

INTERNATIONAL TRADE LAW: *A Comprehensive E-Textbook*

6th Edition, 2025 (Eight Volumes)

VOLUME ONE: INTERDISCIPLINARY FOUNDATIONS

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There are seven sins in the world: Wealth without work, Pleasure without conscience, Knowledge without character, Commerce without morality, Science without humanity, Worship without sacrifice, and Politics without principle.

Mahatma Gandhi (1869-1948)

Dedication

*For Shera and Her Generation,
That They Are Not Scourged by Poverty, Extremism, or a Clash of Civilizations,
But Rather Blessed by Peace through Sustainable Trade and Development.*

And for the Glory of God.

About the Author



Born in Toronto, Rakesh (Raj) Kumar Bhala is a dual Canadian-U.S. citizen. He is the inaugural Leo. S. Brenneisen Distinguished Professor (2017-present) at the University of Kansas School of Law (KU Law), before which he was the Rice Distinguished Professor (2003-2017). Both are university-level chairs. He served as KU Law’s Associate Dean for International and Comparative Law (2011-2017). Raj teaches *International Trade Law*, *Advanced International Trade Law*, *Law and Literature*, and *Islamic Law*. *Ingram’s Business Magazine* designated him as one of “50 Kansans You Should Know” (<https://ingrams.com/article/50-kansas-you-should-know-the-class-of-2020/>).

Before joining KU Law, Raj was the Patricia Roberts Harris Research Professor at The George Washington University School of Law (1998-2003). He began his teaching career at William & Mary Marshall-Wythe School of Law (1993-1998), where he was voted tenure and full professorship. At both, he headed the International Law programs.

Raj has been a Visiting Professor at Duke, Michigan, La Trobe University (Melbourne), Tel Aviv University, University of Auckland (where he was the 2017 New Zealand Legal Research Foundation Visitor), Washington University in Saint Louis, and World Trade Institute (Berne). He has guest lectured around the world, including across India, and held fellowships at the Bank of Japan and University of Hong Kong. An International Bar Association (IBA) member since 1995, Raj has served in officer positions on the Academic and Professional Development and Customs and International Trade Law Committees.

Raj practiced at the Federal Reserve Bank of New York (1989-1993), where he twice won the President’s Award for Excellence thanks to his service as a delegate to the United Nations Conference on International Trade Law (UNCITRAL), along with a Letter of Commendation from the U.S. Department of State. He was Senior Advisor to Dentons U.S. LLP (2017-2023), the world’s largest law firm, focusing on International Trade Law. He is a member of the State Department’s Speaker Program.

Raj is a Harvard Law School graduate (1989, *Cum Laude*), where he wrote his first book – *Perspectives on Risk-Based Capital* (1989) – as a third-year J.D. student. As a Marshall Scholar (1984-1986), Raj earned two Master’s degrees, from the London School of Economics (LSE, 1985) in Economics, and from Oxford (Trinity College, 1986) in Management (Industrial Relations). His undergraduate degree is from Duke (1980-1984, *Summa Cum Laude, Phi Beta Kappa*), where he was an Angier B. Duke Scholar and double-majored in Economics and Sociology. At Harvard and Duke, he served as a Research Assistant (RA), respectively, in International Financial Law to Nomura Professor

Hal S. Scott (1987-1989) and Development Economics to James B. Duke Professor Allen C. Kelley (1981-1984).

Raj is author of 100 scholarly articles published in law journals world-wide, including three trilogies: on *stare decisis* in International Trade Law; the failed Doha Round of multilateral trade negotiations; and India's trade law and policy. He has written 13 books. They include *International Trade Law: A Comprehensive Textbook* (5th edition, 2019, 4 volumes) www.dropbox.com/s/78sagrsm4g30k4g/R%20Bhala%20Book%20Launch.mp4?dl=0), which is one of the world's leading references and has been used at over 100 law schools world-wide, plus the first treatise on GATT in nearly 50 years, *Modern GATT Law* (2nd edition, 2013, 2 volumes). His monographs, *Trade War: Causes, Conduct, and Consequences of Sino-American Confrontation* (2024), and *TPP Objectively: Legal, Economic, and National Security Dimensions of CPTPP* (2nd edition, 2019), were the first interdisciplinary analyses of their subjects by a legal scholar. *Trade, Development, and Social Justice* (2003) was a rare application of Catholic Social Justice Theory to GATT. Raj is the first non-Muslim American scholar to write a textbook on Islamic Law, *Understanding Islamic Law (Sharī'a)* (3rd edition, 2023). That textbook, too, has been widely used, including for 10 years (2010-2019) in his course for U.S. Special Operations Forces at the Command and General Staff College, Fort Leavenworth, Kansas.

Raj's current project is a new book, *Principles of Law, Literature, and Rhetoric: A Shakespearean Approach*. Covering legal interpretative methodologies as well as legal themes in classic works, in both a theoretical and practical sense, this work aims to help organize the subject for use in teaching and research.

In 2022, Raj testified before the U.K. Parliament, House of Commons, International Trade Committee, on trade and human rights. Media world-wide have frequently called upon Raj. He has been quoted in the *Associated Press*, *Bloomberg*, *CNN*, *Financial Times*, *Fortune*, *Frankfurter Allgemeine Sonntagszeitung*, *Hutch Post*, *Los Angeles Times*, *National Law Journal*, *Nikkei Asia*, *Reuters*, *South China Morning Post*, and *The Christian Science Monitor*, *New York Times*, *Washington Post*, and *Weekly Standard*. He has been on radio in America, Bulgaria, and New Zealand, and TV in the EU, India, and Korea. From January 2017-October 2022, across 65 consecutive months, "On Point" was his column on International Law and Economics, which Bloomberg Quint / BQ Prime (Mumbai) published (www.bqprime.com/author/92714/raj-bhala) and distributed to approximately 6.2 million readers globally.

Raj has served on the Executive Board of Directors of the Carriage Club of Kansas City, including as its Treasurer. He also been on the Alumni Association Board of the University School of Milwaukee (USM), his high school *alma mater* (Class of 1980). He is grateful to his USM teachers for a liberal arts education that made all good things possible. Raj loves fitness training, has finished 115 marathons, including the "Big Five" of the "World's Majors" (Boston twice, New York twice, Chicago twice, Berlin, and London). He enjoys studying Shakespeare and (especially since becoming Catholic at Easter Vigil 2001) Theology – and watching baseball.

Summary of Contents for All Eight Volumes

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Preface

Dating to 1993, this *E-Textbook* is based on 32 years of research and teaching around the world. So, it aims to provide students, scholars, and practitioners around the world with a world-class reference – for free. All eight Volumes of the *E-Textbook* are available Open Access.

These Volumes may be used as a set, in sequence, as I do in my *International Trade Law* and *Advanced International Trade Law* courses, covering Volumes 1-4 and 5-8, respectively. Or, one of them may be assigned as a stand-alone Volume for a specialty course or seminar, such as Volume Four for a class on *Trade and National Security*, Volume Seven for a class on *FTAs*, or Volume Eight for a class on *Trade and Development*. Or, any one or more of them may be used for research papers, articles, and books on subjects that implicate multiple Volumes. The only constraint on how the *E-Textbook* is read is the imagination of the reader. As trade negotiators sometimes say, the “geometry is variable.”

The five previous Editions of this work were published by Michie (1st Edition, 1996), LexisNexis (2nd Edition, 2001, 3rd Edition, 2008, and 4th Edition, 2 Volumes, 2015), and Carolina Academic Press (5th Edition, 4 Volumes, 2019). All were available as a hard copy, and eventually as an electronic book, or “e-book.” An earlier Edition was translated into Vietnamese.

The prior Editions, whether print or electronic, became ever-more expensive. Since its 1st Edition, and particularly since its 5th Edition, printing costs increased dramatically. Publishers went out of business or were merged into other publishers. (Sadly, many of my editors, who were my friends, lost their jobs.) Contemporaneously, in a world of curt social media communications, patience for thick books decreased. As the endurance of attention spans diminished, bottom-line answers mattered more than cognitive reasoning processes. Authors were pressured to jam more material into less space, and convey all of it faster.

These trends – adversely affecting both the supply and demand curves for lengthy, conventionally published, law school teaching materials – increasingly impeded access to the previous Editions. That was especially true for students of modest means in America and across the world. The cost of those materials became a non-*de minimis* element in calculating student indebtedness to earn a law degree. Some students could not afford to take my *International Trade Law* and *Advanced International Trade Law* courses. Others cobbled together resources, borrowed or shared the book, or made do with old editions. All the while, good teachers, seeking to be good shepherds, cared about serving their students with instructional materials exceed their teachers.

Thanks to the University of Kansas, School of Law, Wheat Law Library, and its Director, Professor Chris Steadham and Team, the problem of rising supply costs is solved. All eight Volumes of this 6th Edition are published by the Library. Thanks also to Marianne Reed, Digital Publishing and Repository Manager, KU Libraries. Because of her, they may be downloaded from KU ScholarWorks quickly and easily at zero cost. No student, teacher, scholar, or practitioner is left behind for want of eight PDF files.

Likewise, all relevant primary and secondary source documents are freely available on the Library's International Trade Law Research & Study Guide Web page (<https://guides.law.ku.edu/intltrade>). Not one dollar or *dirham*, *riyal* or *rupee* need be spent on paying for a Documents Supplement.

As for demand, no background in the subject matter is presumed. What is required is intellectual curiosity about the subject, an open-hearted willingness to fall ever-more in love with it – and, yes, patience. Learning the subject pays off handsomely, both in professional and personal returns. What also is needed is an appreciation for the reality that the boundaries of the subject continue to widen, its theory and practice continue to deepen. There is a canon, a common core that is the language for a common dialogue. Yet, this canon evolves.

Accordingly, the 1996 single-volume 1st Edition of this work was 1,450 pages. The work has grown with the 30 years' worth of developments in the field, avoiding trade-offs that disrespect its controversies and grandeur. The eight Volumes of this 6th Edition span approximately 6,666 pages. The Volumes are organized thematically into 188 Chapters, thus averaging 36 pages per Chapter.¹ A cursory nutshell (summarizing assorted topics), or a slender work on one aspect of the field (*e.g.*, the WTO), have their place. But they can take a reader only so far. This *E-Textbook* embraces a different challenge: take all readers *further*.

¹ Volume One (Interdisciplinary Foundations), 753 pages, 25 Chapters; Volume Two (Fundamental Multilateral Obligations), 885 pages, 28 Chapters; Volume Three (Customs Law), 440 pages, 16 Chapters; Volume Four (National Security), 1,089 pages, 25 Chapters; Volume Five (Remedies), 1,085 pages, 33 Chapters; Volume Six (Special Sectors), 628 pages, 16 Chapters; Volume Seven (Free Trade Agreements, Labor, and Environment), 1,196 pages, 30 Chapters; and Volume Eight (Growth, Development, and Poverty), 590 pages, 15 Chapters. (Please note page counts are approximate.)

Acknowledgments

A publication of this breadth and depth results from many skilled minds. I am blessed by such minds around me that not only contribute to a better product than possibly could be achieved alone, but also make the research and writing process every bit as fun as quiet contemplation (an equally indispensable activity).

Each Volume of this *E-Textbook* is “Made in the Midwest.” That origination is thanks in part to my Research Assistants (RAs). They came from near and far to the University of Kansas School of Law (KU Law) for their *Juris Doctor* (J.D.) degree, plus earned a Certificate in International Trade in Finance. I asked these talented, cosmopolitan RAs to treat me not as a Professor, but a colleague, and take a “hard look” at the drafts. They worked diligently on hundreds of draft pages. I am grateful for their contributions and personal sacrifices.

Listed alphabetically, my KU Law School RAs on this and previous editions of this work are:

Jacob C. Barefield, J.D. Class of 2023
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Eric Witmer, J.D. Class of 2016
Cody N. Wood, J.D. Class of 2017

It is a joy to see each one of them flourish, professionally and personally, in their extraordinary endeavors across the world.

Hearty thanks also go to Professor Chris Steadham, Director, Wheat Law Library, University of Kansas, School of Law. In every respect, at every step, Chris and his Team – which includes W. Blake Wilson, Assistant Director for Instructional and Faculty Services, and Pamela Crawford, Assistant Director for Public & Technical Services (*Emerita*) – have been efficient, supportive, and responsive. They consistently worked hard to produce, promote, and distribute a product for teaching and research useful around the globe. They are fun professionals with whom to collaborate. Ditto for Marianne Reed, Digital Publishing and Repository Manager, KU Libraries.

This publication is the blessing of a splendid family. The family improves its quality. There is my immediate family: my smart and lovely wife and best friend, **Kara**; and our poised daughter, **Shera**, our little gift who has matured beyond our best dreams into a smiling Dartmouth graduate and Fulbright Scholar with a big heart, world class intellect and *très chic* sense of fashion. And, there is my **Research Assistant** family (above). Thank you all.

I also gratefully acknowledge the law firms of Crowell & Moring LLP, Washington, D.C., and Miller & Company, P.C., Kansas City, Missouri. Their monthly client alerts on International Trade Law are superb. In addition to quoting and citing renowned media sources (especially *Bloomberg*, *Financial Times*, *Nikkei Asia*, Reuters, and *The New York Times*), I have relied on these alerts for valuable explanations and insights on key developments (especially concerning customs classification, AD-CVD, and safeguard cases, and export controls and trade sanctions).

Since the initial version of this work, all previous Editions underwent extensive editing by their publishers: Michie for the 1st Edition, 1996; LexisNexis for the 2nd Edition, 2001, 3rd Edition, 2008, and 4th Edition (Two Volumes), 2015; and, Carolina Academic Press for the 5th Edition (Four Volumes), 2019. Across these Editions, my Research Assistants poured over the manuscript, and my students furnished corrections. Thank you.

Still more scrutiny was applied to this 6th Edition to ensure all Eight Volumes of the *International Trade Law E-Textbook* are as universally user-friendly as possible. Toward this goal, I exercised editorial judgment, though in a light-handed manner that in no way impinged on the meaning of any quoted or excerpted materials. Specifically, I: (1) standardized spelling according to American (not British) English; (2) used international dating (day-month-year); (3) occasionally made minor stylistic (but not substantive) changes (*e.g.*, converting bullet points to numbers, adding an Oxford comma, simplifying ellipses, fonts, and indents, and normalizing “emphasis original” and “emphasis added” notations); and (4) providing full citations (thus avoiding the tyranny of the *Blue Book*).

For over three decades, dating to my research and teaching in 1993, this work has been a joyful passion shaping my career, and more importantly, serving readers globally. No further Editions are anticipated. Any significant updates may be offered through a *Supplement* and/or posted materials, to which the same editorial standards would apply.

Table of Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
AB	WTO Appellate Body
AB InBev	Anheuser-Busch InBev SA/NV
ABA	American Bar Association
ABI	Automated Broker Interface
ACA	<i>America Competes Act of 2022, i.e., America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength Act of 2022, sometimes abbreviated as COMPETES Act (House of Representatives bill)</i>
ACDB	WTO Accession Commitments Data Base
ACFTA (AfCFTA)	<i>African Continental Free Trade Area (entered into force 30 May 2019, operational 7 July 2019, with staged implementation on 1 January 2021 and concluding with full implementation by 2030)</i>
ACFTU	All China Federation of Trade Unions
ACI	Anti-Coercion Instrument (EU)
ACP	African, Caribbean, and Pacific
ACS	Automated Commercial System
ACTRAV	Bureau for Workers' Activities (ILO)
ACWL	Advisory Center on WTO Law
AD	Antidumping
AD Agreement	<i>WTO Antidumping Agreement (Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994)</i>
ADB	Asian Development Bank
<i>Additional Protocol</i>	<i>Model Additional Protocol (associated with NPT, CSA)</i>
ADP	Automatic data processing
ADR	American Depositary Receipt
ADVANCE <i>Democracy Act</i>	<i>2007 Advance Democratic Values, Address Non-democratic Countries and Enhance Democracy Act</i>
AECA	<i>Arms Export Control Act of 1976</i>
AEO	Authorized Economic Operator
AEOI	Atomic Energy Organization of Iran
AES	Automated Export System
AFA	Adverse Facts Available
AfCFTA	<i>African Continental Free Trade Area</i>

(ACFTA)	
AfDB	African Development Bank
AFIP	<i>Administración Federal de Ingresos Públicos</i> (Argentina, Federal Public Revenue Administration)
AFL-CIO	American Federation of Labor-Congress of Industrial Organizations
AFP	<i>Agence France-Presse</i>
AFR	Application for Further Review (U.S. CBP)
AFTA	<i>ASEAN Free Trade Area</i>
AG (1 st meaning)	<i>Aktiengesellschaft</i> (company incorporated in Austria, Germany, or Switzerland, limited by share ownership, the shares of which are tradeable on a stock market)
Ag (2 nd meaning)	Agriculture
AGOA	<i>2000 African Growth and Opportunity Act</i>
AGOA II	included in <i>2002 Trade Act</i>
AGOA III	<i>2004 African Growth and Opportunity Acceleration Act</i>
<i>Agriculture Agreement</i> (<i>Ag Agreement</i>)	<i>WTO Agreement on Agriculture</i>
AI (1 st meaning)	Artificial Intelligence
AI (2 nd meaning)	Avian Influenza
AID	U.S. Agency for International Development
AIG	American Insurance Group
AIIS	American Institute for International Steel
AIKSCC	All India <i>Kisan Sangharsh</i> Coordination Committee
AIM	Aluminum Import Monitoring system (U.S. DOC)
AIO	Aerospace Industries Organization (Iran)
AIOC	Anglo Iranian Oil Company
AIPAC	American Israel Public Affairs Committee
AIS	Automatic Identification System (ship location transponder)
AIT	American Institute in Taiwan
ALADI	Latin American Integration Association (Spanish acronym)
ALBA	Bolivarian Alliance for the Peoples of our America

ALD	atomic layer deposition (production tools)
ALJ	Administrative Law Judge
ALOP	Appropriate Level Of Protection
ALT	Alternate (alternate proposed text)
AMA	American Medical Association
AmCham	American Chamber of Commerce
AMEC	Advanced Micro-Fabrication Equipment Inc. (China)
AMI Credit	Advanced Manufacturing Investment Credit (U.S. 2022 <i>CHIPS Act</i>)
AMIS	Agricultural Market Information System
AMPS	Acrylamido tertiary butyl sulfonic acid
AMS (1 st meaning)	Aggregate Measure of Support
AMS (2 nd meaning)	Agriculture Marketing Services (USDA)
ANAD	National Association of Democratic Lawyers (Mexico)
ANZCERTA	<i>Australia-New Zealand Closer Economic Relations Trade Agreement</i> (<i>CER</i>)
ANZUS (ANZUS Treaty)	1951 <i>Australia, New Zealand, United States Security Treaty</i>
AoA	WTO <i>Agreement on Agriculture</i>
AOG	All Other Goods
AOR	All Others Rate
APA	1946 <i>Administrative Procedure Act</i> (U.S.)
APEC	Asia Pacific Economic Cooperation (forum)
APEP	Assistant to the President for Economic Policy (U.S.)
API	active pharmaceutical ingredient
APMC	Agricultural Produce Marketing Committee (India)
APNSA	Assistant to the President for National Security Affairs (U.S.)
APOC	Anglo Persian Oil Company
APTA	<i>Asia-Pacific Trade Agreement</i>
APV	Annual Purchase Value
AR	Administrative Review
ARI	Additional (United States) Rules of Interpretation

<i>ARP Act of 2000</i>	<i>2000 Agricultural Risk Protection Act</i>
<i>ARRA</i>	<i>2009 American Recovery and Reinvestment Act</i>
<i>ARS</i>	<i>Advance Ruling System</i>
<i>ASA</i> (1 st meaning)	<i>American Securities Association</i>
<i>ASA</i> (2 nd meaning)	<i>American Sugar Alliance</i>
<i>ASCM</i>	<i>WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement)</i>
<i>ASEAN</i>	<i>Association of Southeast Asian Nations</i>
<i>ASL</i> (<i>AFSL</i>)	<i>Anti-Foreign Sanctions Law</i> (June 2021 PRC Law blocking compliance with sanctions against China)
<i>ASM</i>	<i>artisanal small mine</i>
<i>ASML</i> (<i>ASML Holding N.V.</i>)	<i>Advanced Semiconductor Materials Lithography (Netherlands)</i>
<i>ASP</i>	<i>American Selling Price</i>
<i>ASPI</i>	<i>Australian Strategic Policy Institute</i>
<i>ATAP</i>	<i>1996 Agreement Concerning Certain Aspects of Trade in Agricultural Products (1985 U.S.-Israel FTA)</i>
<i>ATC</i>	<i>WTO Agreement on Textiles and Clothing</i>
<i>ATISA</i>	<i>ASEAN Trade In Services Agreement</i>
<i>ATPA</i>	<i>1991 Andean Trade Preferences Act</i>
<i>ATPDEA</i>	<i>2002 Andean Trade Promotion and Drug Eradication Act</i>
<i>ATT</i>	<i>2014 U.N. Arms Trade Treaty</i>
<i>AU\$</i>	<i>Australian Dollar</i>
<i>AUD</i>	<i>Australian Dollar</i>
<i>AUKUS</i>	<i>September 2021 Australia – United Kingdom – United States Security Partnership (Trilateral Security Agreement concerning nuclear submarines and their deployment in Indo-Pacific region)</i>
<i>AUMF</i>	<i>2001 Authorization for Use of Military Force</i>
<i>AUMF</i> (<i>Iraq Resolution</i>)	<i>2002 Authorization for Use of Military Force Against Iraq Resolution</i>
<i>Automotive Appendix</i>	<i>Appendix, Provisions Related to the Product-Specific Rules of Origin for Automotive Goods, to Annex 4-B of USMCA Chapter 4</i>
<i>AUV</i>	<i>Average Unit Value</i>
<i>AV</i>	<i>Audio-Visual</i>
<i>AVE</i>	<i>Ad Valorem Equivalent</i>

AVIC	Aviation Industry Corporation of China
B&H	Brokerage and handling (costs)
B&O	Washington State Business and Occupation Tax Rate Reduction
BA	Bankers Acceptance
BAE	British Aerospace Systems Plc
BAMS-D	Broad Area Maritime Surveillance-Drone (U.S. Navy)
BBC	British Broadcasting Corporation
BBS	Bangladesh Bureau of Statistics
B.C.	British Columbia
BCA	Border Carbon Adjustment (Carbon BTA)
BCI	Business Confidential Information
bcm	billion cubic meters
BCR	Blue Corner Rebate (Thailand)
BDC	Beneficiary Developing Country
BDS	Boycott, Divestment, and Sanctions
<i>BECA</i>	October 2020 <i>Basic Exchange and Cooperation Agreement</i> (U.S.-India)
beIN	beIN Media Group LLC (Qatar)
beoutQ	be out Qatar (Saudi Arabia)
BEPS	tax Base Erosion and Profit Sharing
<i>Berne Convention</i>	1886 (1971) <i>Berne Convention for the Protection of Literary and Artistic Works</i>
<i>BFA</i>	<i>Banana Framework Agreement</i>
Bhd (BHD)	Berhad (publicly limited company, Malaysia)
BIA	Best Information Available (Pre-Uruguay Round U.S. term for Facts Available)
BILA (ILAB)	Bureau of International Labor Affairs (U.S. DOL OTLA)
BIMSTEC	Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand (SAARC minus Afghanistan and Pakistan, plus Myanmar (Burma) and Thailand)
BIS (1 st meaning)	Bank for International Settlements

BIS (2 nd meaning)	Bureau of Industry and Security (U.S. DOC)
<i>bis</i> (3 rd meaning)	second version (of a text), again, repeat
B.I.S.D.	Basic Instruments and Selected Documents
<i>BIT</i>	<i>Bilateral Investment Treaty</i>
<i>BJP</i>	<i>Bharatiya Janata Party</i> (India)
bn (bln)	billion
BNA	Bureau of National Affairs (International Trade Reporter and International Trade Daily)
BNO	British National (Overseas) passport (Hong Kong)
BOJ	Bank of Japan
BOK	Bank of Korea
Bolero	Bills of Lading for Europe
BOP	Balance Of Payments
BOT	Balance Of Trade
BP	British Petroleum
bpd (b/d)	barrels per day
Brexit	British exit, <i>i.e.</i> , withdrawal of the U.K. from EU, effective 31 January 2020, with transition period ended 31 December 2021, following 23 June 2016 U.K.-wide referendum
BRI	Belt and Road Initiative (China)
BRICS	Brazil, Russia, India, China, and South Africa
<i>BRS</i> (<i>BRS Conventions</i>)	<i>Basel, Rotterdam, and Stockholm Conventions</i> (Three MEAs: 1989 <i>Basel Convention on the Control of Transboundary Movements of Hazardous Wastes</i> ; 1998 <i>Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade</i> ; and 2001 <i>Stockholm Convention on Persistent Organic Pollutants</i> .)
BSE (1 st meaning)	Bombay Stock Exchange
BSE (2 nd meaning)	Bovine Spongiform Encephalopathy (Mad Cow Disease)
BSSAC	Beneficiary Sub-Saharan African Country
BSSP	Burmese Socialist Program Party

<i>BTA</i> (1 st meaning)	<i>Bilateral Trade Agreement</i>
<i>BTA</i> (2 nd meaning)	<i>2002 Bio-Terrorism Act</i> <i>(Public Health Security and Bioterrorism Preparedness and Response Act of 2000)</i>
<i>BTA</i> (3 rd meaning)	Border Tax Adjustment
<i>BTB</i>	<i>May 2007 Bipartisan Trade Deal</i>
C-4	Cotton Four Countries (Benin, Burkina Faso, Mali, and Chad)
C&F	cost and freight
CAA	1979 <i>Clean Air Act</i>
CA\$	Canadian Dollar
CAATSA	<i>2017 Countering America's Adversaries Through Sanctions Act</i>
CAC	Cyberspace Administration of China
CAD	Canadian Dollar
CAFC	United States Court of Appeals for the Federal Circuit
<i>CAFTA-DR</i>	<i>Central American Free Trade Agreement – Dominican Republic</i>
<i>CAI</i>	January 2021 EU-China <i>Comprehensive Agreement on Investment</i>
CAIR	Council on American-Islamic Relations
CAN	Community of Andean Nations
<i>CANACAR</i>	<i>Camara Nacional del Autotransporte de Carga</i>
CAOI	Civil Aviation Organization of Iran
CAP (1 st meaning)	Common Agricultural Policy (EU)
CAP (2 nd meaning)	Carolina Academic Press
<i>CAPESES</i>	<i>Centre d'Analyse des Politiques, Economiques et Sociales</i> (Burkina Faso)
CASA	<i>Construcciones Aeronáuticas SA</i> (Spain)
CB	citizens band (radio)
CBA	collective bargaining agreement
CBAM	Carbon Border Adjustment Mechanism
CBC	Canadian Broadcasting Corporation
<i>CBD</i>	<i>U.N. Convention on Biological Diversity</i>
CBE	Commander of the Most Excellent Order of the British Empire
<i>CBERA</i>	<i>1983 Caribbean Basin Economic Recovery Act</i>

<i>CBI</i> (1 st meaning)	<i>Caribbean Basin Initiative</i>
CBI (2 nd meaning)	Central Bank of Iran
CBO	Congressional Budget Office
CBOT	Chicago Board Of Trade
CBP	U.S. Customs and Border Protection ("U.S. Customs Service" until 1 March 2003)
CBSA	Canadian Border Services Agency
<i>CBTPA</i>	<i>Caribbean Basin Trade Partnership Agreement</i>
CC	Cooperative Country (Argentina)
CCB	U.S. Conference of Catholic Bishops
CCC (1 st meaning)	U.S. Commodity Credit Corporation (USDA)
CCC (2 nd meaning)	Customs Cooperation Council (renamed WCO in 1994)
CCC (3 rd meaning)	Commerce Country Chart
CCFRS	Certain cold flat-rolled steel
CCHT	Center for Countering Human Trafficking (U.S. DHS)
CCI (1 st meaning)	Competition Commission of India
CCI (2 nd meaning)	Countervailing Currency Intervention
CCL	Commerce Control List
CCMC	Communist Chinese Military Company
CCP	Chinese Communist Party (or CPC, Communist Party of China)
CCPA	U.S. Court of Customs and Patent Appeals (abolished 1982; transfer to Federal Circuit)
CCS	Carbon Capture and Storage
CDC (1 st meaning)	U.S. Centers for Disease Control and Prevention
CDC (2 nd meaning)	Canadian Dairy Commission
CDC (3 rd meaning)	Chilean Distortions Commission
CDM	Clean Development Mechanism
CDS	credit default swap
<i>CDSOA</i>	<i>2000 Continued Dumping and Subsidy Offset Act</i>

	<i>(Byrd Amendment)</i>
<i>CE</i>	<i>Conformité Européenne</i> (EU)
CEA	Council of Economic Advisors (U.S.)
CEC	Commission for Environmental Cooperation (NAFTA)
CEMAC	<i>Communauté Économique et Monétaire de l'Afrique Centrale</i>
CEMS	Continuous Emission Measurement System (EU CBAM)
CENTCOM	United States Central Command
CEO	Chief Executive Officer
CEP	Constructed Export Price
<i>CEPA</i> (1 st meaning)	<i>India-UAE Comprehensive Economic Partnership Agreement</i>
<i>CEPA</i> (2 nd meaning)	<i>Japan-U.K. Comprehensive Economic Partnership Agreement</i>
CEPR	Center for Economic and Policy Research
<i>CER</i>	<i>Australia-New Zealand Closer Economic Relations Trade Agreement</i> (ANZCERTA)
CET	Common External Tariff
<i>CETA</i>	<i>Comprehensive Economic and Trade Agreement</i>
CFC	Controlled Foreign Corporation
<i>CFCL</i>	Federal Conciliation and Labor Registry Center (Spanish acronym, Mexico)
<i>CFE</i>	<i>Comisión Federal de Electricidad</i> (Mexico)
CFIUS	Committee on Foreign Investment in the United States
CFO	Chief Financial Officer
C.F.R. (1 st meaning)	Code of Federal Regulations
CFR (2 nd meaning)	Council on Foreign Relations
CGE	Computable General Equilibrium
CGLO	Central Government Liaison Office (China)
CGTN	China Global Television Network
CH	Order of the Companions of Honor
<i>CHF</i>	Swiss Francs
CHIP 4 (CHIP 4 Alliance)	U.S., Japan, Korea, and Taiwan (forum concerning semiconductor chips)

CHIPS	Clearing House Interbank Payment System
<i>CHIPS Act</i> (<i>CHIPS for America Act</i>)	2022 <i>Creating Helpful Incentives to Produce Semiconductors Act</i>
CIA	U.S. Central Intelligence Agency
CIC	Citizenship and Immigration Service for Canada
<i>CIDE</i>	Contribution of Intervention in the Economic Domain (Brazil)
CIF (c.i.f)	Cost, Insurance, and Freight
CII	Confederation of Indian Industry
CIP	Chhattisgarh Industrial Program (India)
<i>CISADA</i>	2010 <i>Comprehensive Iran Sanctions, Accountability, and Divestment Act</i>
CISG	Convention on Contracts for the International Sale of Goods (U.N.)
CIT	U.S. Court of International Trade (New York, N.Y.)
CITA	U.S. Committee for Implementation of Textile Agreements
<i>CITES</i>	1973 <i>Convention on International Trade in Endangered Species of Wild Fauna and Flora</i>
CITT	Canadian International Trade Tribunal
CJ	Commodity Jurisdiction
CKD	Complete knock down
cm	centimeter
<i>CMAA</i>	<i>Customs Mutual Assistance Agreement</i>
CME	Chicago Mercantile Exchange
CMI	<i>Comité Maritime International</i> (IMO)
CMIC	Chinese Military Industrial Complex Company
CMM	Conservation Management Measures
CMO	Common Market Organization (EU)
<i>CNCE</i>	<i>Commission Nacional de Comercio Exterior</i> (Argentina)
CNL	Competitive Need Limitation
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
CNY	Chinese <i>Yuan</i>
CO ₂	Carbon Dioxide

CO ₂ e	Carbon Dioxide equivalent
CoA	WTO Committee on Agriculture
CoA-SS	Special Session of WTO Committee on Agriculture
COBRA	<i>Consolidated Omnibus Budget and Reconciliation Act</i> (multiple years)
COCOM	Coordinating Committee on Multilateral Export Controls
COFINS	Civil Service Asset Formation Program Contribution (Brazil)
COFINS-Importation	<i>Contribution to Social Security Financing Applicable to Imports of Goods or Services</i> (Brazil)
COGS	Cost of Goods Sold
COMAC	Commercial Aircraft Corporation of China Ltd.
COMESA	Common Market for Eastern and Southern Africa
CONNUM	Control Number
COO (1 st meaning)	Certificate of Origin
COO (2 nd meaning)	Country of Origin
COO (3 rd meaning)	Chief Operating Officer
COOL	Country of Origin Label
COP (1 st meaning)	Conference of the Parties
COP (2 nd meaning)	Cost of Production
CORE	corrosion-resistant steel
COS	Circumstances of Sale (dumping margin calculation adjustment)
COSCO	Chinese Ocean Shipping Company
COVAX	COVID-19 Vaccines Global Access
COVID-19	Corona Virus Disease (coronavirus)
CPA (1 st meaning)	Certified Public Accountant
CPA (2 nd meaning)	Coalition Provisional Authority (Iraq-U.S.)
CPC (1 st meaning)	Caspian Pipeline Consortium
CPC (2 nd meaning)	U.N. Central Product Classification list
CPC	Communist Party of China

(3 rd meaning)	(or CCP, Chinese Communist Party)
CPEC	China-Pakistan Economic Corridor
CPSC	U.S. Consumer Product Safety Commission
<i>CPTPP</i>	<i>Comprehensive and Progressive Agreement for Trans Pacific Partnership</i> (entered into force 30 December 2018, informally called <i>TPP 11</i>)
CPV	Communist Party of Vietnam (or VCP, Vietnamese Communist Party)
CQE	Certificate of Quota Eligibility
CRO	WTO Committee on Rules of Origin
CROC	Revolutionary Confederation of Laborers and Farmworkers (Mexico, Spanish acronym)
<i>Crop Year 2001 Act</i>	<i>Crop Year 2001 Agricultural Economic Assistance Act</i>
CRPF	Central Reserve Police Force (India)
CRRC	China Railway Rolling Stock Corporation
CRS	Congressional Research Service
CRTC	Canadian Radio-Television and Telecommunications Commission
CSA	<i>Comprehensive Safeguards Agreement</i> (associated with <i>NPT</i>)
CSCL	China Shipping Container Lines
CSI	Container Security Initiative
CSIS	Center for Strategic and International Studies (Washington, D.C.)
CSMS	Cargo Systems Messaging Service (CBP)
CSP (1 st meaning)	Conferences of States Parties
CSP (2 nd meaning)	Certificate of Supplementary Protection (CETA)
CSPV	Crystalline Silicon Photovoltaic cells, modules, laminates, and panels (solar panels)
CSRC	China Securities Regulatory Commission
CTA	Central Tibetan Administration
CTC	Change in Tariff Classification
CTCSC	Customs Tariff Commission of the State Council (China)
CTD	WTO Committee on Trade and Development
CTESS	WTO Committee on Trade and Environment in Special

	Session
CTF	Customs and Trade Facilitation
CTH	Change in Tariff Heading
<i>CTHA</i>	<i>WTO Chemical Tariff Harmonization Agreement</i>
CTIL	Center for Trade and Investment Law (India)
<i>CTPA</i>	<i>United States – Colombia Trade Promotion Agreement</i>
<i>C-TPAT</i> (<i>CTPAT</i>)	<i>Customs – Trade Partnership Against Terrorism</i>
CTSH	Change in Tariff Sub-Heading
CU	Customs Union
<i>Customs Valuation Agreement</i>	<i>WTO Agreement on Customs Valuation (Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994)</i>
<i>CUFTA</i> (<i>CUSFTA</i>)	<i>Canada – United States FTA</i>
<i>CUSMA</i>	<i>Canada – United States – Mexico Agreement</i> (revised FTA based on August 2017-September 2018 renegotiations, called <i>CUSMA</i> in Canada, <i>USMCA</i> in America, called <i>CUSMA</i> in Canada, <i>USMCA</i> in America, and informally called <i>NAFTA 2.0</i> , signed 30 November 2018, signed again after further renegotiations 10 December 2019, and entered into force 1 July 2020)
CV	Constructed Value
CVA	Canadian Value Added
CVD (1 st meaning)	Countervailing Duty
CVD (2 nd meaning)	Chronic Venous Disorder
CVI	Chronic Venous Insufficiency
CVID	Complete, Verifiable, Irreversible Disarmament
CWP (1 st meaning)	Circular Welded carbon quality steel Pipe
CWP (2 nd meaning)	Cooperative Work Program (<i>IPEF</i>)
CY	Calendar Year
DAHD	Department of Animal Husbandry, Dairying, and Fisheries (India)
DARPA	U.S. Defense Advanced Research Projects Agency
DBT	U.K. Department for Business and Trade (established February 2023 via merger of DIT with certain other government functions)

DCIV	Double Cab In Van
DCR	Domestic Content Requirement
DCS	Destination Control Statement
DDA	Doha Development Agenda
DDTC	U.S. Directorate of Defense Trade Controls (Department of State)
<i>DEA</i>	<i>Digital Economy Agreement</i>
DeitY	Department of Electronics and Information Technology (MCIT, India)
<i>DEPA</i> (1 st meaning)	<i>Digital Economic Partnership Agreement</i> (generally)
<i>DEPA</i> (2 nd meaning)	June 2020 <i>Digital Economic Partnership Agreement</i> (Chile, New Zealand, Singapore)
DFFT	Data Free Flow with Trust
DFQF	Duty Free, Quota Free
DG	Director General (Director-General)
DGCFMC	WTO Director General's Consultative Framework Mechanism on the development aspects of Cotton
DGFT	Director General of Foreign Trade (part of Ministry of Commerce, India)
DHS	U.S. Department of Homeland Security
DIPAM	Department of Investment and Public Asset Management (India)
<i>DJAI</i>	<i>Declaración Jurada Anticipada de Importación</i> (Argentina, Advance Sworn Import Declaration)
<i>DIEM</i>	<i>Derechos de Importación Específicos Mínimos</i> (Argentina, Minimum Specific Import Duties)
DIFMER	Difference in Merchandise (dumping margin calculation adjustment)
DIT	Department for International Trade (U.K.)
DIY	Do It Yourself
DM (1 st meaning)	Dumping Margin
<i>DM</i> (2 nd meaning)	<i>Deutsche Marks</i>
<i>DMA</i> (1 st meaning)	2022 EU <i>Digital Markets Act</i>
<i>DMA</i> (2 nd meaning)	Domestic Marketing Assessment
DMZ	De-Militarized Zone

DNA	deoxyribonucleic acid
DNI	Director of National Intelligence (U.S.)
DNR	Donetsk People's Republic
DOC	U.S. Department of Commerce
DOD	U.S. Department of Defense
DOE	U.S. Department of Energy
DOJ	U.S. Department of Justice
DOL	U.S. Department of Labor
<i>DOP</i>	13 September 1993 Israeli-PLO <i>Declaration of Principles on Interim Self-Government Arrangements</i> (<i>Oslo I Accord, Oslo I</i>)
DOS	U.S. Department of State
DOT	U.S. Department of Transportation
DP (DPW)	Dubai Ports Dubai Ports World
<i>DPA</i> (1 st meaning)	1950 <i>Defense Production Act</i> (U.S.)
<i>DPA</i> (2 nd meaning)	Deferred Prosecution Agreement
<i>DPA</i> (3 rd meaning)	Data Protection Authority (India)
<i>DPCIA</i>	1990 <i>Dolphin Protection Consumer Information Act</i>
<i>DPP</i>	<i>Dialogue on Plastic Pollution and Environmentally Sustainable Plastics Trade</i> (WTO)
DPRK	Democratic People's Republic of Korea (North Korea)
DRAM	Dynamic Random-Access Memory
DSM	Dispute Resolution Mechanism (<i>JCPOA</i>)
DRAMS	Dynamic Random-Access Memory Semiconductor
DRC	Democratic Republic of the Congo
DSB	WTO Dispute Settlement Body
DSM	Dispute Settlement Mechanism
DST	Digital Sales Tax, Digital Services Tax
<i>DSU</i>	<i>WTO Dispute Settlement Understanding</i> (<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>)
<i>DTA</i>	<i>Digital Trade Agreement</i>
DUP	Democratic Unionist Party

	(Northern Ireland)
DUV	deep ultraviolet lithography (systems)
DVD	Digital Video Recording
E3	Britain, France, and Germany
EA	Environmental Assessment
EAA	1979 <i>Export Administration Act</i>
EAC (1 st meaning)	East African Community
EAC (2 nd meaning)	East Asian Community
EAC (3 rd meaning)	Environmental Affairs Council (<i>CAFTA-DR, KORUS</i>)
EADS	European Aeronautic Defense and Space Company NV
EaEU (EAEU)	Eurasian Economic Union
EAF	Electric Arc Furnace
<i>EAGLE Act</i>	2021 <i>Ensuring American Global Leadership and Engagement Act</i>
<i>EAPA</i>	2015 <i>Enforce and Protect Act</i> (U.S.)
<i>EAR</i>	<i>Export Administration Regulations</i>
<i>EBA</i>	<i>Everything But Arms</i>
EBOR	Electronic On Board Recorder
EBRD	European Bank for Reconstruction and Development
EC (1 st meaning)	European Commission
EC (2 nd meaning)	European Communities
<i>ECA</i> (1 st meaning)	<i>Economic Cooperation Agreement</i>
<i>ECA</i> (2 nd meaning)	<i>Agreement between the Government of the United States of America and the Government of the Republic of Korea on Environmental Cooperation</i> (<i>KORUS</i>)
<i>ECA</i> (3 rd meaning)	<i>Export Controls Act of 2018</i> (part of 2018 <i>NDAA</i>)
ECAT	Emergency Committee for Foreign Trade
ECB	European Central Bank
ECC (1 st meaning)	Environmental Cooperation Commission (<i>CAFTA-DR</i>)
ECC (2 nd meaning)	Extraordinary Challenge Committee (<i>NAFTA</i>)

ECCAS	Economic Community of Central African States
ECCN	Export Control Classification Number
ECE	Evaluation Committee of Experts (NAFTA)
<i>ECFA</i>	<i>Economic Cooperation Framework Agreement</i>
ECG	electrocardiogram
ECHR	European Court of Human Rights
ECJ	European Court of Justice
ECLAC	Economic Commission for Latin America and the Caribbean
E-Commerce	Electronic Commerce
ECOSOC	U.N. Economic and Social Council
ECOWAS	Economic Community of West African States
<i>ECRA</i>	<i>Export Control Reform Act of 2018</i> (part of <i>John S. McCain National Defense Authorization Act for Fiscal Year 2019, i.e., 2019 NDAA</i>)
ECU	European Currency Unit
ED	Economic Development Administration (of DOC)
EDBI	Export Development Bank of Iran
EDC	Export Development Corporation (Canada)
EDI	Electronic Data Interchange
EEC	European Economic Community
EEU	Eurasian Economic Union
EEZ	Exclusive Economic Zone
EFSA	European Food Safety Authority
<i>EFTA</i>	<i>European Free Trade Association</i>
<i>EGA</i>	<i>WTO Environmental Goods Agreement</i>
EHC	export health certificate (U.K.)
EIB	European Investment Bank
EIF	Enhanced Integrated Framework (formerly “IF,” or “Integrated Framework”)
<i>EIG</i>	<i>équipement d'intérêt general</i> (France)
ELLIE	Electronic Licensing Entry System
ELS	Extra Long Staple (cotton)
EN	Explanatory Note
ENAM	Electronic National Agricultural Market system (India)
<i>ENFORCE Act</i>	<i>2015 Trade Facilitation and Trade Enforcement Act</i>

(TFTEA, TEA)	
EO (E.O.)	<i>Executive Order</i> (U.S.)
EOBR	Electronic On Board Recorder
EP	Export Price
EPA (1 st meaning)	<i>Economic Partnership Agreement</i>
EPA (2 nd meaning)	U.S. Environmental Protection Agency
EPI	Economic Policy Institute
EPZ	Export Processing Zone
ERC	End-Use Review Committee (U.S. DOC BIS, set forth under <i>EAR</i>)
ERP	Effective Rate of Protection
<i>E-SIGN Act</i>	2000 <i>Electronic Signatures in Global and National Commerce Act</i>
ESCS	European Steel and Coal Community
ESG	Environmental, Social, and Governance
ESL	English as a Second Language
ESP	Exporter's Sales Price (Pre-Uruguay Round U.S. term for Constructed Export Price)
ESPO	Eastern Siberia Pacific Ocean
ET (EST)	Eastern Time (Eastern Standard Time)
ETA	Employment and Training Administration (DOL)
ETF	exchange traded fund
<i>ETI Act</i>	2000 <i>Extraterritorial Income Exclusion Act</i>
ETIM	East Turkistan Islamic Movement
ETP	Eastern Tropical Pacific (Ocean)
ETS	Emission(s) Trading Scheme (System)
EU	European Union
EUR	<i>euro</i>
<i>EUSFTA</i>	<i>European Union-Singapore Free Trade Agreement</i>
EUC	End-User Review Committee (U.S.)
EUV	extreme ultraviolet lithography
Eurojust	EU agency for judicial cooperation in criminal matters
Europol	European Union Agency for Law Enforcement Cooperation
EV	Electric Vehicle
Ex-Im Bank	U.S. Export-Import Bank

<i>FACT Act of 1990 (1990 Farm Bill)</i>	1990 <i>Food, Agriculture, Conservation and Trade Act</i>
<i>FAIR Act of 1996 (1996 Farm Bill)</i>	1996 <i>Federal Agricultural Improvement and Reform Act</i>
<i>FAIR Transition and Competition Act</i>	2021 <i>Fair, Affordable, Innovative, and Resilient Transition and Competition Act</i> (proposed BCA legislation)
FAO	Food and Agricultural Organization
FAQ	Frequently Asked Question
FAR	Federal Acquisition Regulation (U.S.)
FAS	Foreign Agricultural Service (of USDA)
FAST	Free And Secure Trade
FATA	Federally Administered Tribal Areas (Pakistan)
FATF	Financial Action Task Force
FBI	U.S. Federal Bureau of Investigation
FCC	Federal Communications Commission (U.S.)
FCF	Fong Chun Formosa Fishery (Taiwan)
FCIC	U.S. Federal Crop Insurance Corporation (USDA)
FCLRC	Federal Conciliation and Labor Registration Center (Mexico)
<i>FCPA</i>	1977 <i>Foreign Corrupt Practices Act</i>
FCSC	Foreign Claims Settlement Commission (U.S.)
FDA	Food and Drug Administration (U.S.)
FDI	Foreign Direct Investment
FDP Rule	Foreign Direct Product Rule (U.S.)
Federal Circuit	U.S. Court of Appeals for the Federal Circuit (Washington, D.C.)
Fed. Reg.	Federal Register
FEMA	Federal Emergency Management Agency (U.S. DHS)
FEP	Fuel Enrichment Plant (e.g., for UF ₆ at Natanz, Iran)
FERC	U.S. Federal Energy Regulatory Commission
<i>FF</i>	<i>French Francs</i>

FFI	foreign financial institution
FFPO	Fines, Penalties and Forfeitures Office(r) (U.S. Ports of Entry)
FFTJ	Fittings, flanges, and tool joints
FGUP	State Research Center of the Russian Federation
FICCI	Federation of Indian Chambers of Commerce and Industry
FIFA	<i>Fédération Internationale de Football Association</i>
Fimea	Finnish Medicines Agency
FinCEN	U.S. Financial Crimes Enforcement Network (Department of the Treasury)
fintech	financial technology
<i>FIRRMA</i>	<i>Foreign Investment Risk Review Modernization Act of 2018</i> (part of 2018 NDAA)
FIT	Feed-in tariff
FLETF	Forced Labor Enforcement Task Force (DHS)
FMCSA	Federal Motor Carrier Safety Administration
<i>FMSA</i>	<i>2011 Food Safety Modernization Act</i>
FMV (1 st meaning)	Foreign Market Value (Pre-Uruguay Round U.S. term for Normal Value)
FMV (2 nd meaning)	Fair Market Value
FMVSS	Federal Motor Vehicle Safety Standards
FN4 Entity	Footnote 4 Entity (entity to which Footnote 4 is added to its entry on Entity List)
FOA	Facts Otherwise Available
FOB (f.o.b.)	Free On Board
FOP	Factors of Production
FOREX	Foreign Exchange
FPA	Foreign Partnership Agreement
FPC	U.S. Federal Power Commission (predecessor of DOE)
FPGA	field programmable gate array integrated circuit
FRAND	Fair, Reasonable, and Non-Discriminatory (terms)
<i>FRCP</i>	<i>U.S. Federal Rules of Civil Procedure</i>
<i>FRCrnP</i>	<i>U.S. Federal Rules of Criminal Procedure</i>
FRE	U.S. Federal Rules of Evidence
FRS	Fellowship of the Royal Society
FRSA	Fellowship of the Royal Society for the Encouragement of Arts, Manufactures, and Commerce

FSA (1 st meaning)	U.S. Farm Services Agency
FSA (2 nd meaning)	Food Safety Agency (EU)
FSB	Federal Security Service (Russia)
FSC	Foreign Sales Corporation
<i>FSIA</i>	<i>Foreign Sovereign Immunities Act of 1976</i>
<i>FSRI Act of 2002</i> (2002 <i>Farm Bill</i>)	2002 <i>Farm Security and Rural Investment Act</i>
FTA	Free Trade Agreement
<i>FTAA</i>	<i>Free Trade Area of the Americas</i>
<i>FTAAP</i>	<i>Free Trade Agreement of the Asia Pacific Region</i>
FTC (1 st meaning)	Free Trade Commission (<i>NAFTA</i>)
FTC (2 nd meaning)	Federal Trade Commission (U.S.)
FTO	Foreign Terrorist Organization
FTSE	Financial Times Stock Exchange Group (“Footsie,” London)
FTZ (1 st meaning)	Foreign Trade Zone
FTZ (2 nd meaning)	Free Trade Zone
FY	Fiscal Year
FX	Foreign Exchange
G7 (G-7)	Group of Seven Industrialized Nations
G8 (G-8)	Group of Eight Industrialized Nations
G20 (G-20)	Group of Twenty Developed Nations
G33 (G-33)	Group of 33 Developing Countries
G&A	General and Administrative expenses
GAAP	Generally Accepted Accounting Principles
Gafa	Google, Apple, Facebook, and Amazon
GAIN	USDA FAS Global Agricultural Information Network
GAO	U.S. Government Accountability Office
<i>GATB</i>	<i>General Agreement on Trade in Bananas</i> (15 December 2009)
<i>GATS</i>	<i>General Agreement on Trade in Services</i>
GATT	General Agreement on Tariffs and Trade (GATT 1947 and/or GATT 1994)
GATT 1947	General Agreement on Tariffs and Trade 1947 and all pertinent legal instruments (Protocols, Certifications,

	Accession Protocols, and Decisions) entered into under it before entry into force of the <i>WTO Agreement</i> (1 January 1995)
GATT 1994	GATT 1947 plus all pertinent legal instruments (1994 Uruguay Round Understandings and Marrakesh Protocol) effective with the <i>WTO Agreement</i> (1 January 1995)
GAVI	Global for Vaccines and Immunizations
GB	Great Britain
GCAM	General Commission for Audiovisual Media (Saudi Arabia)
GCC (1 st meaning)	Global Climate Coalition
GCC (2 nd meaning)	Gulf Cooperation Council
GDP	Gross Domestic Product
GDPR	<i>General Data Protection Regulation</i> (EU 2016/679)
GE	General Electric
<i>Genocide Convention</i>	1948 U.N. <i>Convention on the Prevention and Punishment of the Crime of Genocide</i>
GFCI	Global Financial Centers Index
GI	Geographical Indication
GILTI	Global Intangible Low-Taxed Income
GISAID	Global Initiative on Sharing Avian Influenza Data
GL	General License
<i>GloMag</i>	2016 <i>Global Magnitsky Human Rights Accountability Act</i>
GM	Genetically Modified, Genetic Modification
GMO	Genetically Modified Organism
GMT	Greenwich Mean Time
GNH	Gross National Happiness
GNI	Gross National Income
GNP	Gross National Product
GOI	Government of India
GPA	<i>Government Procurement Agreement</i> (<i>WTO Agreement on Government Procurement</i>)
GPO (1 st meaning)	Government Pharmaceutical Organization (Thailand)
GPO (2 nd meaning)	Group Purchasing Organization (U.S.)
GPS	Global Positioning System
GPT	General Preferential Tariff

GRI	General Rules of Interpretation (of the HS)
GRP	Good Regulatory Practice
GSM	General Sales Manager
<i>GSP</i>	<i>Generalized System of Preferences</i> (U.S.)
<i>GSP+</i>	<i>Generalized System of Preferences Plus</i> (EU)
GTA	Global Trade Atlas
GVWR	Gross Vehicle Weight Rating
GW	gigawatt
H5N1	Avian Flu (virus)
H&M	Hennes & Mauritz AB (Swedish MNC)
HALE	High-Altitude, Long, Endurance unmanned aircraft system (drone) (U.S. Navy)
HALEU	high-assay, low-enriched Uranium
HCTC	Health Care Tax Credit
HDC	Holder in Due Course
HDI	U.N. Human Development Index
HDPE	high-density polyethylene
<i>Helms-Burton Act</i>	<i>1996 Cuban Liberty and Democracy Solidarity (Libertad) Act</i>
<i>HFCAA</i>	<i>2020 Holding Foreign Companies Accountable Act</i>
HFCS	High Fructose Corn Syrup
HHS	U.S. Department of Health and Human Services
HIPC	Highly Indebted Poor Country
HK\$	Hong Kong dollar
HKIAC	Hong Kong International Arbitration Center
HKMA	Hong Kong Monetary Authority
HKSAR	Hong Kong Special Administrative Region
HKSE	Hong Kong Stock Exchange
HKU	Hong Kong University (University of Hong Kong)
HLED	High Level Economic Dialogue (<i>e.g.</i> , U.S.-Mexico)
HM	Her (His) Majesty
HMG	Her (His) Majesty's Government
HMT	Her (His) Majesty's Treasury (U.K.)
HNW	High Net Worth
HOEP	Hourly Ontario Energy Price

<i>Homeland Security Act</i>	<i>2002 Homeland Security Act</i>
HPAE	High Performing Asian Economy
HPAI	High Pathogenic Avian Influenza
HPC	High Performance Computer
HPNAI	High Pathogenic Notifiable Avian Influenza
HQ	Headquarters
HRL	Headquarters Ruling Letter (U.S. Customs Service, CBP)
HS	Harmonized System
HSBC	Hong Kong Shanghai Banking Corporation
HSBI	Highly Sensitive Business Information
HSC	Harmonized System Committee (WCO)
HSI	Homeland Security Investigation (U.S. DHS)
HTS	Harmonized Tariff Schedule
HTSUS	Harmonized Tariff Schedule of the U.S.
HVAC	Heating, Ventilation, and Air Conditioning
IA (1 st meaning)	Import Administration (U.S. DOC)
IA (2 nd meaning)	Information Available
IA (3 rd meaning)	Internal Advice
IAC	Iran Alumina Company (IMIDRO subsidiary)
IADB	Inter-American Development Bank
IAEA	International Atomic Energy Agency
IAR	Internal Advice Response (CBP)
IBRD	International Bank for Reconstruction and Development (The World Bank)
IBT (1 st meaning)	International Brotherhood of Teamsters
IBT (2 nd meaning)	International Business Transactions
IC (1 st meaning)	Indifference Curve
IC (2 nd meaning)	integrated circuit
ICs	Indigenous Communities

	(Inuit and other indigenous communities)
ICAC	International Cotton Advisory Committee
ICAO	International Civil Aviation Organization (U.N.)
ICBM	Intercontinental Ballistic Missile
ICC (1 st meaning)	International Chamber of Commerce
ICC (2 nd meaning)	International Criminal Court
ICE	U.S. Immigration and Customs Enforcement
ICFTU	International Confederation of Free Trade Unions
ICIT	Intergovernmental Commission on International Trade (Ukraine)
ICJ	International Court of Justice
ICOR	Incremental Capital Output Ratio
ICS	Investment Court System
ICSID	International Center for the Settlement of Investment Disputes
ICT	Information and Communications Technology
ICTS	Information and Communications Technology Services
ICTSD	International Center for Trade and Sustainable Development
IDB	Integrated Database
IDF	Israeli Defense Forces
IDP	WTO Informal Dialogue on Plastics Pollution and Environmentally Sustainable Plastics Trade
IE	Information Exchange (MTCR)
IEA	International Energy Agency
IEC (1 st meaning)	International Electrotechnical Commission
IEC (2 nd meaning)	Importer-Exporter Code (India)
<i>IEEPA</i>	<i>1977 International Emergency Economic Powers Act</i>
<i>IFD</i>	<i>WTO Agreement on Investment Facilitation for Development</i>
IFPMA	International Federation of Pharmaceutical Manufacturers and Associations
IFPRI	International Food Policy Research Institute
<i>IFSA</i>	<i>2006 Iran Freedom Support Act</i>
<i>IFTA</i>	<i>1985 United States-Israel Free Trade Implementation Act</i>
<i>IGBA</i>	<i>1970 Illegal Gambling Business Act</i>
<i>IGG</i>	<i>itinéraire à grand gabarit</i> (France)

IHR	International Health Regulations (WHO)
<i>IIA</i>	<i>International Investment Agreement</i>
IIF	Institute of International Finance
IIPA	International Intellectual Property Alliance
IIT	Indian Institute of Technology
ILAB (BILA)	Bureau of International Labor Affairs (U.S. DOL OTLA)
ILC	International Law Commission
ILO	International Labor Organization
ILRF	International Labor Rights Forum
<i>ILSA</i>	<i>1996 Iran and Libya Sanctions Act</i> (called <i>ISA</i> after <i>IFSA</i>)
IMC	Industrial Metal and Commodities
IMF	International Monetary Fund
<i>IMF Articles</i>	<i>Articles of Agreement of the International Monetary Fund</i>
IMIDRO	Iranian Mines and Mining Industries Development and Renovation Organization
IMO	International Maritime Organization (CMI)
IMTDC	iron mechanical transfer drive component
<i>INARA</i>	<i>2015 Iran Nuclear Agreement Review Act</i>
INBAR	International Bamboo and Rattan Organization
Inc.	incorporated (U.S.)
INC	Inter-governmental Negotiation Committee
Incoterms	International Commercial Terms (ICC)
INN	International Non-proprietary Names (WHO)
INOVAR-AUTO	Incentive to the Technological Innovation and Densification of the Automotive Supply Chain (Brazil)
INR (1 st meaning)	Initial Negotiating Right
INR (2 nd meaning)	Indian <i>Rupee</i>
INS	U.S. Immigration and Naturalization Service (reorganized partly into ICE in March 2003)
IO	International Organization
IOR	Importer of Record
IP	Intellectual Property

IPBES	Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Studies
IPCC	U.N. Intergovernmental Panel on Climate Change
<i>IPEF</i>	<i>Indo-Pacific Economic Framework</i>
<i>IPI Tax</i>	Tax on Industrialized Products (Brazil)
<i>IPIC Treaty (Washington Treaty)</i>	1989 <i>Treaty on Intellectual Property in Respect of Integrated Circuits</i>
IPO	initial public offering
IPOA	International Plan Of Action
IPOA-IUU	International Plan Of Action to Prevent, Deter, and Eliminate Illegal, Unreported, and Unregulated Fishing (FAO)
<i>IPPC</i>	1952 <i>International Plant Protection Convention</i>
IPPR	Institute for Public Policy Research
IPR (1 st meaning)	Intellectual Property Right
IPR (2 nd meaning)	International Priority Right
IPTV	Internet Protocol Television
<i>IRA</i> (1 st meaning)	<i>U.S. Inflation Reduction Act of 2022</i>
<i>IRA</i> (2 nd meaning)	Irish Republican Army (Provisional Irish Republican Army)
IRC	U.S. Internal Revenue Code
IRENA	International Renewable Energy Agency
IRG (IRGC)	Iranian Revolutionary Guard Corps (Islamic Revolutionary Guard Corps)
IRGCN	Islamic Revolutionary Guards Corps Navy (Iran)
IRGC-QF	Islamic Revolutionary Guards Corp <i>Quds</i> Forces (Iran)
IRISL	Islamic Republic of Iran Shipping Lines
IRNA	Islamic Republic News Agency (Iran)
IRQ	Individual Reference Quantity
IRS	U.S. Internal Revenue Service
<i>ISA</i>	<i>Iran Sanctions Act of 1996</i> , as amended, <i>i.e.</i> , <i>Iran Sanctions Act of 2012</i> (formerly <i>ILSA</i>)
ISDS	Investor-State Dispute Settlement
ISEAS	Institute of Southeast Asian Studies

	(ISEAS-Yusof Ishak Institute, Singapore)
ISI	Inter-Services Intelligence (Pakistan)
ISIL	Islamic State in the Levant (ISIS)
ISIS	Islamic State in Shams (ISIL)
ISO	International Organization for Standardization
ISTC	International Sugar Trade Coalition
IT	Information Technology
<i>ITA</i> (1 st meaning)	1996 WTO <i>Information Technology Agreement</i>
<i>ITA</i> (2 nd meaning)	U.S. International Trade Administration (DOC)
<i>ITA II</i> (<i>ITA – Exp</i>)	2015 <i>Information Technology Agreement</i> (Expansion of the <i>Information Technology Agreement</i>)
<i>ITAR</i>	<i>International Traffic in Arms Regulations</i>
<i>ITC</i> (1 st meaning)	International Trade Center (joint WTO-U.N. agency)
<i>ITC</i> (U.S.ITC) (2 nd meaning)	U.S. International Trade Commission
ITDS	International Trade Data System (electronic single window for import-export data)
ITO	International Trade Organization
<i>ITO Charter</i> (<i>Havana Charter</i>)	<i>Charter for an International Trade Organization</i>
ITRD	International Trade Reporter Decisions
ITSR	Iranian Transactions and Sanctions Regulations (31 C.F.R. Part 560)
ITT	ITT Corporation
ITT NV	ITT Night Vision
ITU	International Telecommunications Union
IUD	intra-uterine device
IUSCT	Iran – U.S. Claims Tribunal
IUU	illegal, unreported, and unregulated
IWC	International Whaling Commission
<i>JADE Act</i>	2008 <i>Tom Lantos Block Burmese JADE (Junta’s Anti-Democratic Efforts) Act</i>
J&K	Jammu and Kashmir (Indian-Administered Kashmir)
<i>JCPOA</i>	July 2015 <i>Joint Comprehensive Plan of Action</i>

	<i>(Iran Nuclear Deal)</i>
<i>JeM</i>	<i>Jaish-e-Mohammed</i> ("The Army of Muhammad," Pakistan-based terrorist organization)
JFTC	Japan Fair Trade Commission
JIA	Japanese Investigative Authority
JNPT	Jawaharlal Nehru Port Terminals (Mumbai, India)
JPC	Joint Planning Committee (India)
JSC	Joint Stock Company (Russia)
<i>JSI</i>	<i>Joint Statement Initiative</i>
JV	Joint Venture
KAF	Khalid Al Falih (former Saudi Minister of Oil)
KCBT	Kansas City Board of Trade
KDB	Korea Development Bank
KEXIM	Export-Import Bank of Korea
KFC	Kentucky Fried Chicken
<i>KfW</i>	<i>Kreditanstalt für Wiederaufbau</i> (Germany, Credit Agency for Reconstruction)
kg	kilogram
<i>KGB</i>	<i>Komitet Gosudarstvennoy Bezopasnosti</i> ("Committee for State Security," Soviet Union)
<i>KH</i>	<i>Kata'ib Hezbollah</i> (<i>Hezbollah</i> Brigades, Iraq)
km	kilometer
KMA	Kubota Manufacturing of America
<i>KMT</i>	<i>Kuomintang</i>
<i>KORUS</i>	<i>Korea – United States Free Trade Agreement</i>
KPPI	<i>Komite Pengamanan Perdagangan Indonesia</i> (competent international trade authority)
KSA	Kingdom of Saudi Arabia
KU	University of Kansas
kW	kilowatt
kWh	kilowatt hour
L/C	Letter of Credit
LAC	Line of Actual Control (Ladakh-Aksai Chin)

LAN	Local Area Network
LAP	Labor Action Plan (Colombia TPA)
LCA	Large Civil Aircraft
LCD	Liquid Crystal Display
LDBDC	Least Developed Beneficiary Developing Country
LDC (1 st meaning)	Least Developed Country
LDC (2 nd meaning)	Less Developed Country (includes developing and least developed countries)
LDC (3 rd meaning)	Local distribution company
LED	light-emitting diode
LEEM	Licensing and Enforcement Experts Meeting (MTCR)
LegCo	Legislative Council of the Hong Kong Special Administrative Region
LGBTQ+	Lesbian, Gay, Bisexual, Transgender, Queer (or Questioning), and others
LLDC	Landlocked Developing Country
LNG	Liquefied Natural Gas
LNPP	Large Newspaper Printing Press
LNR	Luhansk People's Republic
LOC	Line of Control (Kashmir)
LOT	Level of Trade (dumping margin calculation adjustment)
LPAI	Low Pathogenic Avian Influenza
LPF	level playing field
LPG	Liquefied Petroleum Gas
LPMO	Livestock Products Marketing Organization (Korea)
LPNAI	Low Pathogenic Notifiable Avian Influenza
LPR (1 st meaning)	Labor Force Participation Rate
LPR (2 nd meaning)	Loan Prime Rate (PBOC)
LRW	Large Residential Washer
LTFV	Less Than Fair Value
LVC	Labor Value Content
LVMH	Louis Vuitton Moët Hennessey

LWR	Light-Walled Rectangular pipe and tube
LWS	Laminated Woven Sacks
M&A	mergers and acquisitions
MAD	Mutually Assured Destruction
MAFF	Ministry of Agriculture, Forestry, and Fisheries (Korea)
MAI	Multilateral Agreement on Investment
MAP	Monitoring and Action Plan
<i>Marrakesh Protocol</i>	<i>Marrakesh Protocol</i> to GATT 1994
Maastricht Treaty	1992 Treaty on European Union
MAS	Monetary Authority of Singapore
MBB	<i>Messerschmitt-Bölkow-Blohm GmbH</i> (Germany)
MBS	Mohammed Bin Salman (Crown Prince, Saudi Arabia)
MC (MCX)	WTO Ministerial Conference (MC11 means 11 th Ministerial Conference, MC12 means 12 th Ministerial Conference, MC13 means 13 th Ministerial Conference, and so on)
MCF	military-civil fusion (doctrine) (China)
MCIT	Ministry of Communications and Information Technology (India)
MCL	Munitions Control List
MCTL	Military Critical Technologies List
MDG	Millennium Development Goal
MDL	Military Demarcation Line (DMZ)
MEA	<i>Multilateral Environmental Agreement</i>
MEC	Myanmar Economic Corporation
MEDT	Ministry of Economic Development and Trade (Ukraine)
MEFTA	<i>Middle East Free Trade Agreement</i>
MEHL	Myanmar Economic Holdings Limited
MEK (PMOI)	<i>Mojahedin-e Khalq</i> (<i>People's Mojahedin Organization of Iran, PMOI</i> , exiled Iranian opposition group)
MENA	Middle East North Africa
MEP	Member of the European Parliament
METI	Ministry of Economy, Trade, and Industry (Japan, formerly MITI)
MEU	military end user

<i>MFA</i>	<i>Multi-Fiber Arrangement (1974-2004)</i>
MFN	Most Favored Nation
MGE	Myanmar Gems Enterprise
MHI	Mitsubishi Heavy Industries, Ltd.
<i>MHT</i>	<i>Matra Hautes Technologies</i> (France)
MI5	Military Intelligence, Section 5 (U.K. domestic counter-intelligence and security agency)
MI6	Military Intelligence, Section 6 (U.K. foreign intelligence service)
MIIT	Ministry of Industry and Information Technology (China)
MITI	Ministry of International Trade and Industry (Japan)
MLA	Member of the Legislative Assembly (Stormont, Northern Ireland)
mm	millimeter
MMA	Minimum Market Access (quota)
MMBtu	Million British Thermal Unit
<i>MMPA</i>	<i>1972 Marine Mammal Protection Act</i>
MMT	million metric tons
mn	million
MNC	Multinational Corporation
MNE	Multinational Enterprise
MOCI	Ministry of Commerce and Industry (India, Saudi Arabia)
MOCIE	Ministry of Commerce, Industry, and Energy (Korea)
MOFAT	Ministry of Foreign Affairs and Trade (Korea)
MOFCOM	Ministry of Commerce (China)
MOGE	Myanma Oil and Gas Enterprise (sometimes referred to as Myanmar Oil and Gas Enterprise)
MOI (MOI Test)	Market Oriented Industry
MOTIE	Ministry of Trade, Industry, and Energy (Korea)
MOU	Memorandum of Understanding
MP	Member of Parliament
MPC	Marginal Propensity to Consume
MPF	Merchandise Processing Fee

<i>MPIA</i>	<i>WTO Multi-Party Interim Appeal Arbitration Arrangement</i>
MPS	Marginal Propensity to Save
<i>MRA</i>	<i>Mutual Recognition Agreement</i>
MRE	Meals Ready to Eat
MRI	magnetic resonance imaging
MRL	Maximum Residue Level
MRM	Marine Resource Management
mRNA	messenger ribonucleic acid
MRS	Marginal Rate of Substitution
MRT	Marginal Rate of Transformation
MSCI	Morgan Stanley Capital International
<i>MSF</i>	<i>Médecins Sans Frontières</i>
MSME	Micro, Small, and Medium Sized Enterprise
MSP (1 st meaning)	Minimum Support Price
MSP (2 nd meaning)	Ministry of Social Protection (Colombia)
MSS	Ministry of State Security (China)
MST	Minimum Standard of Treatment
MSY	maximum sustainable yield
mt	metric ton
MTA (1 st meaning)	Managed Trade Agreement
MTA (2 nd meaning)	Metropolitan Transit Authority (New York City)
MTA (3 rd meaning)	Multilateral Trade Agreement
MTB	Miscellaneous Trade Bill (multiple years)
MTCR	Missile Technology Control Regime
MTN	Multilateral Trade Negotiation
MTO	Multilateral Trade Organization
MTOP	Millions of Theoretical Operations per Second
MUFG	Mitsubishi UFJ Financial Group Bank, Ltd. (Japan)
MVTO	Motor Vehicles Tariff Order (Canada)
MWh	Mega Watt hour
MY	Marketing Year
NAD Bank	North American Development Bank

	(<i>NAFTA</i>)
<i>NAAEC</i>	<i>North American Agreement on Environmental Cooperation (NAFTA Environmental Side Agreement)</i>
<i>NAALC</i>	<i>North American Agreement on Labor Cooperation (NAFTA Labor Side Agreement)</i>
<i>NAFTA</i>	<i>North American Free Trade Agreement (NAFTA 1.0 and/or NAFTA 2.0)</i>
<i>NAFTA 1.0</i>	<i>North American Free Trade Agreement (original FTA that entered into force 1 January 1994)</i>
<i>NAFTA 2.0</i>	<i>North American Free Trade Agreement (revised FTA based on August 2017-September 2018 renegotiations, called CUSMA in Canada, USMCA in America, and informally called NAFTA 2.0, signed again after further renegotiations 10 December 2019, and entered into force 1 July 2020)</i>
<i>NAI</i>	Notifiable Avian Influenza
<i>NAM</i> (1 st meaning)	U.S. National Association of Manufacturers
<i>NAM</i> (2 nd meaning)	Non-Aligned Movement
<i>NAMA</i>	Non-Agricultural Market Access
<i>NAND</i>	Not AND flash memory chip technology
<i>NAO</i>	National Administrative Office (<i>NAFTA</i>)
<i>NATO</i>	North Atlantic Treaty Organization
<i>NASA</i>	U.S. National Aeronautics and Space Administration
<i>NASDAQ</i>	National Association of Securities Dealers Automated Quotations exchange (U.S.)
<i>NBA</i>	National Basketball Association
<i>NBP</i>	National Bank of Pakistan
<i>NC</i>	Net Cost
<i>NCC</i> (1 st meaning)	National Chicken Council
<i>NCC</i> (2 nd meaning)	Non-Cooperative Country (Argentina)
<i>NCCDA</i>	<i>National Critical Capabilities Defense Act (part of ACA)</i>
<i>NCM</i>	Non-Conforming Measure
<i>N.C.M.</i>	<i>Nomenclatura Común MERCOSUR (MERCOSUR Common Nomenclature)</i>
<i>NCSC</i>	National Counterintelligence and Security Center

(1 st meaning)	(U.S.)
NCSC (2 nd meaning)	National Cyber Security Center (U.K.)
NCTO	National Council of Textile Organizations
NDA	National Democratic Alliance (India)
<i>NDAA</i>	<i>U.S. National Defense Authorization Act</i> (annual policy bill for DOD and national security since 1962)
NDC	North Drilling Company (Iran)
NdFeB	neodymium-iron-boron permanent magnets (also called neodymium magnets, neo magnets, or rare earth magnets)
NDRC	National Development and Reform Commission (China)
<i>NEA</i>	<i>1976 National Emergencies Act</i>
NEI	National Export Initiative
NEP	New Economic Policy (Malaysia)
nes	not elsewhere specified
NFIDC	Net Food Importing Developing Country
NFTC	National Foreign Trade Council
NG	Natural Gas
NGR	Negotiating Group on Rules (WTO Doha Round)
NHI	National Health Insurance (Korea)
NHS	National Health Service (U.K.)
NHT	National Hand Tools Corporation
NI	Northern Ireland
NIC	Newly Industrialized Country
NICO	Naftiran Intertrade Company
NIDC	National Iranian Drilling Company (NIOC subsidiary)
NIEO	New International Economic Order
NIOC	National Iranian Oil Company
NIST	U.S. National Institute of Standards and Technology
NITC	National Iranian Tanker Company
NJPA	National Juice Products Association
NLC	National Labor Committee (U.S.)

NLCF	National Livestock Cooperatives Federation
NLD	National League for Democracy (Burma)
NLR	No Licence Required (U.S. DOC BIS)
NLRB	National Labor Relations Board (U.S.)
nm	nanometer
NMDC	National Minerals Development Corporation (India)
NME	Non-Market Economy
NMFS	U.S. National Marine Fisheries Service (DOC)
NNSA	U.S. National Nuclear Security Administration (DOE)
NOAA	U.S. National Oceanic and Atmospheric Administration (DOC)
NO _x	Nitrogen oxides
NPA	Non-Prosecution Agreement
NPC (1 st meaning)	National People's Congress (China's legislature)
NPC (2 nd meaning)	National Petrochemical Company (Iran)
NPCSC	National People's Congress Standing Committee (NPC's top-decision making body)
NPF	Non-Privileged Foreign status
NPL	Non-Performing Loan
<i>NPT</i>	<i>1968 Nuclear Non-Proliferation Treaty</i>
NRA	National Rifle Association
NRC	U.S. Nuclear Regulatory Commission
NRI	Non-Resident Indian
NRL	Nuclear Referral List
NSA	U.S. National Security Agency
NSC	National Securities Commission (Argentina)
NS-CMIC List	Non-SDN Chinese Military Industrial Complex Companies List
NSF	U.S. National Science Foundation
NSG	Nuclear Suppliers Group
<i>NSIBR</i>	<i>National Security Industrial Base Regulations</i>
<i>NSL</i>	<i>National Security Law</i> (2020 <i>Law of the PRC on Safeguarding National Security in</i>

	<i>the Hong Kong Special Administrative Region)</i>
NSM	Jawaharlal Nehru National Solar Mission (India)
<i>NSPK</i>	National Payment Card System Joint Stock Company (Russia)
NSPD	National Security Presidential Directive
NSS	WTO SPS National Notification System
NTA	National Textile Association (U.S.)
NTB	Non-Tariff Barrier
NTC	National Trade Council (United States)
<i>NTE</i> (1 st meaning)	<i>National Trade Estimate Report on Foreign Trade Barriers</i> (USTR)
NTE (NTE sector) (2 nd meaning)	Non-Traditional Export (sector)
NTM	Non-Tariff Measure
NTR	Normal Trade Relations
NTSB	National Transportation Safety Board (U.S.)
<i>NV</i> (<i>N.V.</i>) (1 st meaning)	<i>Naamloze Vennootschap</i> (Dutch), a publicly limited liability company, with legal personality, which sells capital that is divided into shares to the public to obtain income.
NV (2 nd meaning)	Normal Value
NVOCC	Non-Vessel Operating Common Carrier
NWFP	North West Frontier Province (Pakistan) (Khyber Pakhtunkhwa)
N.Y. Fed (FRBNY)	Federal Reserve Bank of New York
NYSE	New York Stock Exchange
NYU	New York University
NZ\$	New Zealand Dollar
NZD	New Zealand Dollar
OAS	Organization of American States
OBE	Officer of the Most Excellent Order of the British Empire
<i>OBRA</i>	<i>Omnibus Budget and Reconciliation Act</i> (multiple years)
OCD	Ordinary Customs Duties
OCR	Out of Cycle Review
OCTG	Oil Country Tubular Goods

ODA	Official Development Assistance
ODC	Other Duties and Charges
OECD	Organization for Economic Cooperation and Development
<i>OED</i>	<i>Oxford English Dictionary</i>
OEE	U.S. Office of Export Enforcement (BIS)
OEM	Original Equipment Manufacturer
OFA	Other Forms of Assistance
OFAC	U.S. Office of Foreign Assets Control (Department of the Treasury)
OIC	Organization of Islamic Conference
OIE	World Organization for Animal Health (<i>Office International des Epizooties</i>)
OLI	Ownership, Location, and Internalization (Theory)
OMA	Orderly Marketing Arrangement
OMB	Office of Management and Budget (U.S.)
OMO	Open Market Operation
OOIDA	Owner-Operator Independent Drivers Association
OPA	Ontario Power Authority (Canada)
OPEC	Organization of Petroleum Exporting Countries
OPIC	U.S. Overseas Private Investment Association (U.S. International Development Finance Corporation)
OPZ	Outward Processing Zone (<i>KORUS</i>)
<i>OSINFOR</i>	<i>Organismo de Supervisión de los Recursos Forestales y de Fauna Silvestre</i> (Forestry regulator, Peru)
<i>Oslo I Accord</i> (<i>Oslo I</i>)	13 September 1993 <i>Israeli-PLO Declaration of Principles on Interim Self-Government Arrangements</i> (DOP)
OTC	Over the Counter
<i>OTCA</i> (<i>1988 Act</i>)	<i>Omnibus Trade and Competitiveness Act of 1988</i>
OTCG	Oil Country Tubular Good
OTDS	Overall Trade distorting Domestic Support
OTEXA	Office of Textiles and Apparel (U.S. DOC)
OTLA	Office of Trade and Labor Affairs (in DOL)
OTR	Off-The-Road

P5+1	China, France, Russia, U.K., and U.S. (five permanent U.N. Security Council members), plus Germany
P&I	protection and indemnity (maritime insurance)
PACOM (USINDOPACOM)	United States Indo-Pacific Command
<i>PADIS</i>	Program of Incentives for the Semiconductors Sector (Brazil)
PAP	People's Action Party (Singapore)
PAPS	Pre-Arrival Processing System
<i>Paris Agreement</i>	December 2015 <i>Paris Climate Accord</i> , or <i>Paris Climate Agreement</i> , under <i>UNFCCC</i>
<i>Paris Convention</i>	1883 Paris Convention for the Protection of Industrial Property
PASA	Pre-Authorization Safety Audit
<i>PATVD</i>	Program of Support for the Technological Development of the Industry of Digital TV Equipment (Brazil)
PBC (PBOC)	People's Bank of China
PBS	Price Band System
PBUH	Peace Be Upon Him
Pub. L. No.	Public Law Number (United States)
PC	Personal Computer
PCA (1 st meaning)	Post-Clearance Audit
PCA (2 nd meaning)	Permanent Court of Arbitration (The Hague)
PCAOB	Public Company Accounting Oversight Board (United States)
PCAST	President's Council of Advisors on Science and Technology (United States)
PCB	printed circuit board
PCBA	printed circuit board assembly
PCG (PCG fibers)	polyvinyl alcohol (PVA), cellulose, and glass fibers
PDB	President's Daily Brief
PDR	People's Democratic Republic (Lao PDR)
PDV	Present Discounted Value
<i>PDVSA</i>	<i>Petróleos de Venezuela, S.A.</i>

	(Venezuelan state-owned oil and natural gas company)
<i>PEESA</i>	<i>Protecting Europe's Energy Security Act of 2019</i> , as amended
<i>Pemex</i>	<i>Petróleos Mexicanos</i> (Mexico)
PEO	Permanent Exclusion Order
PETA	People for the Ethical Treatment of Animals
PF	Privileged Foreign status
PFC	Priority Foreign Country
<i>Pharma Agreement</i>	WTO <i>Agreement on Pharmaceutical Products</i> (Uruguay Round plurilateral sectoral agreement)
PhRMA	Pharmaceutical Manufacturers of America
PI	preliminary injunction
<i>PIS/PASEP</i>	<i>Social Integration Program/Civil Service Asset Formation Program Contribution</i> (Brazil)
<i>PIS/PASEP-Importation</i>	<i>Social Integration and Civil Service Asset Formation Programs Contribution Applicable to Imports of Foreign Goods or Services</i> (Brazil)
PJSC	Public Joint Stock Company (Russia)
PLA	People's Liberation Army (China)
Plc	public limited company (U.K.)
PLI	Production-Linked Incentive
PLO	Palestine Liberation Organization
PM	Prime Minister
PMC	Popular Mobilization Committee (Iraq)
PME	Pingtang Marine Enterprise (China)
PNTR	Permanent Normal Trade Relations
PNW	Pine wood nematode
POA	Power of Attorney
POC	Point of Contact (MTCR)
POI	Period of Investigation
POR	Period of Review
POW-MIA	Prisoner of War – Missing in Action
PP	Purchase Price (Pre-Uruguay Round U.S. term for Export Price)

PPA	Power Purchase Agreement
<i>PPB</i>	Basic Productive Process (Brazil)
PPE	personal protective equipment
PPF	Production Possibilities Frontier
PPM (1 st meaning)	parts per million
PPM (2 nd meaning)	process and production method
PPP	Purchasing Power Parity
PPS	Probability-Proportional to Size
PR	public relations
PRC	People's Republic of China
<i>PROEX</i>	<i>Programa de Financiamento às Exportações</i> (Brazil)
<i>PRO-IP Act</i>	<i>2008 Prioritizing Resources and Organization for Intellectual Property Act</i>
PRS	Price Range System
PSA (1 st meaning)	Port of Singapore Authority
PSA (2 nd meaning)	production sharing agreement
PSC	Post-Summary Correction (U.S. CBP)
PSH	Public Stock Holding
PSI	Pre-Shipment Inspection
<i>PSI Agreement</i>	<i>WTO Agreement on Pre-Shipment Inspection</i>
PSRO	Product Specific Rule of Origin
PSU	Public Sector Unit (India)
PTA (1 st meaning)	Preferential Trade Agreement, or Preferential Trading Arrangement
PTA (2 nd meaning)	Payable through account
PTO	U.S. Patent and Trademark Office
PUBG	PlayerUnknown's Battlegrounds (Chinese app)
PV	Photovoltaic
PVA (PVA fibers)	Polyvinyl alcohol fibers
PVC	Polyvinyl chloride
PVLT	passenger vehicle and light truck

PwC	PricewaterhouseCoopers
QAI	Quds Aviation Industries (Iran)
QC	Queen's Counsel
QE	Quantitative Easing
QIZ	Qualified Industrial Zone
QR	Quantitative Restriction
Quad	Quadrilateral Security Dialogue (Australia, India, Japan, and U.S.)
R&D	Research and Development
R&TD	Research and Technological Development measures
RAM	Recently Acceded Member (of WTO)
RAN	Radio Access Network
RBI	Reserve Bank of India
RCC	United States – Canada Regulatory Cooperation Council
RCEP	Regional Comprehensive Economic Partnership
RCMC	Registration-cum-Membership Certificate (India)
RDIF	Russian Direct Investment Fund
rDNA	recombinant deoxyribonucleic acid
REACH	Registration, Evaluation, and Authorization of Chemicals (EU)
REC	Regional Economic Community
REER	Real Effective Exchange Rate
Rep.	Representative
<i>RESTRICT Act</i>	U.S. <i>Restricting the Emergence of Security Threats that Risk Information and Communications Technology (RESTRICT) Act</i>
RFMO	Regional Fisheries Management Organization
RFMO/A	Regional Fisheries Management Organization or Arrangement
RMA (1 st meaning)	Risk Management Association (U.S.)
RMA (2 nd meaning)	Risk Management Authorization
<i>RMB</i>	<i>Ren min bi</i> ("people's money," the Chinese currency)
RMG	Ready Made Garment
RMI (DRM)	Rights Management Information (Digital Rights Management)
RNG	WTO Negotiating Group on Rules

	(Rules Negotiating Group)
RNRC	Russian National Reinsurance Company
ROA	Return on Assets
ROC (R.O.C.)	Republic of China (Taiwan)
<i>Rome Convention</i>	<i>1964 Rome Convention for the Protection of Performer, Producers of Phonograms and Broadcasting Organizations</i>
ROO	Rule Of Origin
ROW	Rest Of World
ROZ	Reconstruction Opportunity Zone
RPC	<i>RCEP</i> Participating Country
RPG	Rocket-propelled grenade
RPL	Relative Price Line
RPOC	Reinforced Point Of Contact (MTCR)
RPT	Reasonable Period of Time
RRM	<i>USMCA</i> Rapid Response Mechanism
Rs.	<i>Rupee</i>
RSS	<i>Rashtriya Swayamsevak Sangh</i> (India)
RTA	Regional Trade Agreement
RTAA	Re-employment Trade Adjustment Assistance
Rusi	Royal United Services Institute (U.K.)
RV	Recreational Vehicle
RVC	Regional Value Content
S&D	Special and Differential
S&ED	Strategic and Economic Dialogue (U.S.-China)
S.A.	<i>Soci�t� Anonyme</i> (French company designation), <i>Sociedad An�nima</i> (Spanish company designation), <i>Sociedade An�nima</i> (Portuguese company designation)
S.A. de C.V.	<i>Sociedad An�nima de Capital Variable</i> (Mexican company designation)
SAA	Statement of Administrative Action
<i>SAARC</i>	<i>South Asia Association for Regional Cooperation</i>
SABIC	Saudi Arabian Basic Industry Corporation (Saudi Arabian Basic Industries Corporation)
SAC	State Administration Council (Burma)
<i>SACU</i>	<i>Southern African Customs Union</i>

SADC	<i>Southern African Development Community</i>
SAF	sustainable aviation fuel (IPEF)
SAFE	State Administration of Foreign Exchange (China)
<i>SAFE Port Act</i>	<i>2006 Security and Accountability for Every Port Act</i>
SAFTA	<i>South Asia Free Trade Agreement</i>
SAGIA	Saudi Arabian General Investment Authority
SAIC	Shanghai Automotive Industry Corporation Motor Corporation Limited (China)
SAM	surface-to-air (missile)
SAMA	Saudi Arabian Monetary Authority
SAP	Structural Adjustment Program
SAPTA	<i>South Asia Preferential Trading Arrangement</i>
SAR (1 st meaning)	Suspicious Activity Report (FinCEN)
SAR (2 nd meaning)	Special Administrative Region (China)
SAR (3 rd meaning)	Saudi Arabian <i>Riyal</i>
SARS	Sudden Acute Respiratory Syndrome
SASAC	State-owned Assets Supervision and Administration Commission of the State Council (China)
SBV	State Bank of Vietnam
SCC	standard contractual clause
Scexit	Exit of Scotland from the U.K.
SCGP	Supplier Credit Guarantee Program
SCI	<i>Secretaría de Comercio Interior</i> (Argentina, Secretary of Domestic Trade)
SCM	Subsidies and Countervailing Measures
<i>SCM Agreement</i>	<i>WTO Agreement on Subsidies and Countervailing Measures</i> (ASCM)
SCP	Sugar Containing Product
SDF	Steel Development Fund (India)
SDG	United Nations Sustainable Development Goal
SDIC	State Development & Investment Corp. (China)
SDLP	Social Democratic and Labor Party (Northern Ireland)

SDN (SDN List)	Specially Designated Nationals and Blocked Persons (List)
Sdn Bhd (SDN BHD)	Sendirian Berhad (privately limited company, Malaysia)
SDR (1 st meaning)	services domestic regulation
SDR (2 nd meaning)	IMF Special Drawing Right
SE	<i>Secretaría de Economía</i> (Secretariat of Economy, Mexico, formerly <i>SECOFI</i>)
SEBI	Securities and Exchange Bureau of India
SEC	U.S. Securities and Exchange Commission
SECOFI	Secretary of Commerce and Industrial Development (<i>Secretario de Comercio y Fomento Industrial</i>), i.e., Ministry of Commerce and Industrial Development (Mexico, renamed SE in December 2000)
SED	Strategic Economic Dialogue (U.S.-China)
SEI	Strategic Emerging Industry (SEI Catalogue – China)
SEIU	Service Employees International Union
Sen.	Senator
SENTRI	Secure Electronic Network for Travelers Rapid Inspection
SEP	Standard Essential Patent
SEZ	Special Economic Zone
SFA	Singapore Food Agency
SFO	Serious Fraud Office
SG&A	Selling, General, and Administrative expenses
SG\$	Singapore Dollar
SGD	Singapore Dollar
SHIG	Shahid Hemmat Industries Group (Iran)
SIDS	Small Island Developing States
<i>SJM</i>	<i>Swadeshi Jagaran Manch</i> (India)
SIE	State Invested Enterprise
SIFI	Systemically Important Financial Institution
SIFMA	Securities Industry and Financial Markets Association
SII	Serum Institute of India
SIL	Special Import License (India)
SIM	<i>Sistema Informático MARIA</i>

	(Argentina, AFIP electronic portal information system)
<i>SIMA</i>	<i>Special Import Measures Act</i> (Canada)
SKD	Semi-knock down
<i>SKM</i>	<i>Samyukta Kisan Morcha</i> (India, umbrella group of approximately 40 farmers unions)
SMART	Secondary Materials and Recycled Textiles Association
SMBC	Sumitomo Mitsui Banking Corporation (Japan)
SME (1 st meaning)	Small and Medium Sized Enterprise
SME (2 nd meaning)	Square Meter Equivalent
SMIC	Semiconductor Manufacturing International Corp. (China)
SMS	Supply Management System (Canada)
SNAP	Supplemental Nutritional Assistance Program
SNAP-R	Simplified Network Application Process - Redesign
SNB	Swiss National Bank
SNITIS	<i>Sindicato Nacional Independiente de Trabajadores de Industrias y de Servicios Movimiento 20/32</i> (independent Mexican labor union)
SNP	Scottish National Party
S.O.	Statutory Order (India)
SOCB	State Owned Commercial Bank (China)
<i>SocGen</i>	<i>Société Générale</i> (France)
SOE	State Owned Enterprise
SOF	Special Operations Forces
SOGI	Sexual Orientation and Gender Identity
SPD	Solar Power Developer
SPI (1 st meaning)	Seven Pillars Institute for Global Finance and Ethics
SPI (2 nd meaning)	Special Program Indicator
<i>SPND</i>	<i>Sazman-e Pazhouheshhaye Novin-e Defa'i</i> (Organization of Defensive Innovation and Research, Iran)
SPS (1 st meaning)	Sanitary and Phytosanitary

SPS (2 nd meaning)	Single Payment Scheme
<i>SPS Agreement</i>	<i>WTO Agreement on Sanitary and Phytosanitary Measures</i>
SPV	Special Purpose Vehicle
SRAM	Static Random Access Memory (chip)
SRO	Special Remission Order (Canada)
SS	Special Session(s)
SSA	Sub-Saharan Africa
SSAC	Sub-Saharan African Country
SSF Guidelines	Voluntary Guidelines for Securing Sustainable Small-Scale Fisheries in the Context of Food Security and Poverty Eradication (FAO)
SSG	Special Safeguard
SSM	Special Safeguard Mechanism
SSN	Resolutions of the National Insurance Supervisory Authority (Argentina)
SST	State Sponsor of Terrorism
Stat.	United States Statutes at Large
Stat. Suf.	Statistical Suffix
STB	set-top box
STDF	WTO Standards and Trade Development Facility
STE	State Trading Enterprise
<i>STIP</i>	<i>U.S.-Kenya Strategic Trade and Investment Partnership</i>
STO	Special Trade Obligation
SUV	Sport utility vehicle
SVE	Small, Vulnerable Economy
SVP	surge voltage protector
SWAT	Strategic Worker Assistance and Training Initiative
SWIFT	Society for Worldwide Interbank Financial Telecommunications
T&A	Textiles and Apparel
TAA (1 st meaning)	Trade Adjustment Assistance
<i>TAA</i> (2 nd meaning)	<i>Trade Agreements Act of 1974, as amended</i>
<i>TAAEA</i>	<i>2011 Trade Adjustment Assistance Extension Act</i>
<i>TAARA</i>	<i>Trade Adjustment Assistance Reauthorization Act of 2015</i>
<i>TAA Reform Act</i>	<i>2002 Trade Adjustment Assistance Reform Act</i>
TABC	Trans-Atlantic Business Council

(TBC)	(also abbreviated TBC)
TABD	Trans-Atlantic Business Dialogue
TAC	Total Allowable Catch
TACB	technical assistance and capacity building (IPEF)
<i>TAIPEI Act</i>	2019 <i>Taiwan Allies and International Protection and Enhancement Initiative Act</i>
TB	tuberculosis
TBEA	Tebian Electric Apparatus Co., Ltd. (China)
TBI	traumatic brain injury
TBT	Technical Barriers to Trade
<i>TBT Agreement</i>	<i>WTO Agreement on Technical Barriers to Trade</i>
TCA	<i>U.K.-EU Trade and Cooperation Agreement</i> (<i>EU-U.K. Trade and Cooperation Agreement</i> , <i>i.e.</i> , Christmas Eve 2020 <i>Brexit Deal</i> , effective 1 January 2020)
TCOM	Total Cost of Manufacturing
TCP (1 st meaning)	Third Country Price
TCP (2 nd meaning)	<i>El Tratado de Comercio entre los Pueblos</i> , ("Trade Treaty for the Peoples")
TCS	Tata Consulting Services
TD	Treasury Decision (U.S.)
<i>TDA</i>	2000 <i>Trade and Development Act</i>
TDDS	trade-distorting domestic support
<i>TDEA</i>	1983 <i>Trade and Development Enhancement Act</i>
TDI	Trade Defense Instrument
TDIC	Tourism Development and Investment Company (Abu Dhabi, UAE)
<i>TEA</i> (1 st meaning)	<i>Trade Expansion Act of 1962</i> , as amended
<i>TEA</i> (2 nd meaning) (<i>TFTEA</i>)	<i>Trade Enforcement Act of 2015</i> , as amended (same as <i>TFTEA</i> , <i>Trade Facilitation and Trade Enforcement Act</i>)
TECRO	Taipei Economic and Cultural Representative Office
TED	Turtle Excluder Device
TEM	Technical Experts Meeting (MTCR)
TEO	Temporary Exclusion Order
<i>ter</i>	third version (of a text)

TESSD	Trade and Environmental Sustainability Structured Discussions (WTO)
TEU	Twenty Foot Equivalent Unit
TFA	WTO <i>Agreement on Trade Facilitation</i> (Trade Facilitation Agreement)
TFAF	Trade Facilitation Agreement Facility
TFP	Total Factor Productivity
TFR	Total Fertility Rate
TGAAA	2009 <i>Trade and Globalization Adjustment Assistance Act</i>
TGL	Temporary General License
THAAD	Terminal High Altitude Area Defense system
TIEA	<i>Tax Information Exchange Agreement</i>
TIES	Threat and Imposition of Economic Sanctions database (University of North Carolina)
TIFA	<i>Trade and Investment Framework Agreement</i>
TIPA	<i>Taiwan Invasion Prevention Act</i>
TIPI	<i>Trade and Investment Partnership Initiative</i>
TISA (TiSA, TSA)	WTO <i>Trade in Services Agreement</i>
TKB	<i>Transkapitalbank</i> (Russia)
TMT	thousand metric tons
TN (1 st meaning)	NAFTA business visa
tn (second meaning)	trillion
TNC	WTO Trade Negotiations Committee
TOT	Terms of Trade
TPA (1 st meaning)	Trade Promotion Agreement
TPA (2 nd meaning)	Trade Promotion Authority (Fast Track)
TPBI	Thai Plastic Bags Industries
TPC	Technology Partnerships Canada
TPEA	2015 <i>Trade Preferences Extension Act</i>
TPF	United States – India Trade Policy Forum
TPL	Tariff Preference Level
TPM (1 st meaning)	Trigger Price Mechanism
TPM	Technological Protection Measure

(2 nd meaning)	
TPP (1 st meaning)	<i>Trans Pacific Partnership</i>
TPP (2 nd meaning)	Tobacco Plain Packaging For example, Australia's (1) <i>Tobacco Plain Packaging Act 2011</i> , (2) <i>Tobacco Plain Packaging Regulations 2011</i> , as amended by the <i>Tobacco Plain Packaging Amendment Regulation 2012</i> (Number 1), and (3) <i>Trade Marks Amendment (Tobacco Plain Packaging) Act 2011</i> .
TPP 11	CPTPP (entered into force 30 December 2018)
TPRB	WTO Trade Policy Review Body
TPRM	WTO Trade Policy Review Mechanism
TPSC	Trade Policy Staff Committee (U.S., interagency led by USTR)
TRA (1 st meaning)	1979 <i>Taiwan Relations Act</i>
TRA (2 nd meaning)	Trade Readjustment Allowance
TRB	Tapered roller bearing
TRIA	<i>Terrorism Risk Insurance Act of 2002</i>
TRIMs	Trade Related Investment Measures
<i>TRIMs Agreement</i>	<i>WTO Agreement on Trade Related Investment Measures</i>
TRIPs	Trade Related Aspects of Intellectual Property Rights
<i>TRIPs Agreement</i>	<i>WTO Agreement on Trade Related Aspects of Intellectual Property Rights</i>
TRO	Temporary Restraining Order
TRQ	Tariff Rate Quota
TSA	U.S. Transportation Security Administration
TSMC	Taiwan Semiconductor Manufacturing Co.
TSUS	Tariff Schedule of the United States (predecessor to HTSUS)
TTC	U.S.-EU Trade and Technology Council
TTF	Dutch Title Transfer Facility
<i>T-TIP</i>	<i>Trans-Atlantic Trade and Investment Partnership</i>
TV (1 st meaning)	Television
TV (2 nd meaning)	Transaction Value
TVE	Town and Village Enterprise
TVPA	2000 <i>Trafficking Victims Protection Act</i>
TWEA	1917 <i>Trading With the Enemy Act</i>

TWN	Third World Network
UAV	Unmanned Aerial Vehicle (drone)
UAW	United Auto Workers
UBC	University of British Columbia
UBS AG	Swiss bank resulting from 1998 merger of Union Bank of Switzerland and Swiss Bank Corporation (founded in 1872 and 1862, respectively)
UCC (1 st meaning)	Uniform Civil Code (India)
U.C.C. (2 nd meaning)	Uniform Commercial Code (U.S.)
UCLA	University of California at Los Angeles
UCP (1 st meaning)	Uniform Customs and Practices
UCP (2 nd meaning)	Unified Cargo Processing
UE	United Electrical, Radio and Machine Workers of America
UEFA	Union of European Football Associations
UES	United Engineering Steel (U.K.)
<i>UETA</i>	<i>1999 Uniform Electronic Transactions Act</i>
UF	Ultra-filtered (milk)
UF ₆	Uranium Hexafluoride
<i>UFLPA</i>	<i>2021 Uyghur Forced Labor Prevention Act</i>
UHRP	Uyghur Human Rights Project
UI	Unemployment Insurance
<i>UIEGA</i>	<i>2006 Unlawful Internet Gambling Enforcement Act</i>
U.K.	United Kingdom
U.K.CA (UKCA)	United Kingdom Conformity Assessed
U.K.CGC	U.K. Carbon & Graphite Company
<i>U.K.SFTA</i> (<i>UKSFTA</i>)	<i>United Kingdom-Singapore Free Trade Agreement</i>
UMR	Usual Marketing Requirement (FAO)
UMTS	Universal Mobile Telecommunications System
UN	United Nations
<i>UNCAC</i>	<i>United Nations Convention Against Corruption</i>
UNCC	United Nations Compensation Commission
UNCDP	United Nations Committee for Development Policy

UNCITRAL	United Nations Commission on International Trade Law
<i>UNCLOS</i>	<i>United Nations Conference on the Law of the Sea Treaty</i>
UNCTAD	United Nations Commission on Trade and Development
UNEP	United Nations Environmental Program
UNESCO	United Nations Educational, Cultural, and Scientific Organization
<i>UNFCCC</i>	<i>United Nations Framework Convention on Climate Change</i>
UNICA	Brazilian Sugarcane Industry Association
UNITA	National Union for the Total Independence of Angola
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
UNODA	United Nations Office of Disarmament Affairs
UNOHCHR (OHCHR)	United Nations Office of the High Commissioner for Human Rights
UPA	United Progressive Alliance (India)
<i>UPOV</i>	<i>International Union for the Protection of New Varieties of Plants,</i> referring to 1961 <i>International Convention for the Protection of New Varieties of Plants</i> (revised 1972, 1978, 1991)
UPS (1 st meaning)	uninterrupted power supply
UPS (2 nd meaning)	United Parcel Service
UPU	Universal Postal Union
<i>URAA</i>	<i>1994 Uruguay Round Agreements Act</i>
U.S.	United States
USAPEEC	USA Poultry and Egg Export Council
USC	United Shipbuilding Corporation (Russia)
U.S.C.	United States Code
USCBC	U.S.-China Business Council
USCCAN	United States Code Congressional and Administrative News
USCCB	United States Conference of Catholic Bishops
USD (1 st meaning)	Union Solidarity and Development Party (Burma)
USD (2 nd meaning)	United States Dollar
USDS	United States Data Security (division)
<i>USICA</i>	<i>U.S. Innovation and Competition Act of 2021</i> (Senate bill)
<i>USJDTA</i>	<i>United States – Japan Digital Trade Agreement</i> (signed 7 October 2019)

<i>USJTA</i>	<i>United States – Japan Trade Agreement</i> (signed 7 October 2019, entered into force 1 January 2020)
<i>USMCA</i>	<i>United States-Mexico-Canada Agreement</i> (revised FTA based on August 2017-September 2018 renegotiations, called <i>CUSMA</i> in Canada, <i>USMCA</i> in America, and informally called <i>NAFTA 2.0</i> , signed 30 November 2018, signed again after further renegotiations 10 December 2019, and entered into force 1 July 2020)
USML	United States Munitions List
USP	United States Price (Pre-Uruguay Round U.S. term encompassing both Purchase Price and Exporter's Sales Price)
U.S.S.	United States Ship (U.S. Navy)
U.S.S.R.	Union of Soviet Socialist Republics
USTR	U.S. Trade Representative
USVSST	United States Victims of State Sponsored Terrorism Fund
USW (1 st meaning)	United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union
USW (2 nd meaning)	United Steel Workers of America
UVL	Unverified List
VAT	Value Added Tax
VC	Venture Capital
VCP	Vietnamese Communist Party (or CPV, Communist Party of Vietnam)
VCR	Video Cassette Recorder
VEO	Violent Extremist Organization
VER	Voluntary Export Restraint
VEU	Validated End User
<i>Vienna Convention</i>	1969 <i>Vienna Convention on the Law of Treaties</i>
VLCC	Very Large Crude Carrier
VND	Vietnamese <i>dong</i>
VNM (VNOM)	Value of Non-Originating Materials
VOC	volatile organic compound
VOD	video on demand
VOM	Value of Originating Materials
VPN	virtual private network
VRA	Voluntary Restraint Agreement
VSD	voluntary self-disclosure

VW	Volkswagen AG
W120	WTO services classification list (based on CPC)
WA	1995 <i>Wassenaar Arrangement</i>
WAML	Wassenaar Arrangement Munitions List
WCF	World Cocoa Foundation
WCO	World Customs Organization (formerly CCC until 1994)
WFOE	Wholly Foreign-Owned Enterprise (China)
WFP	World Food Program
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WIV	Wuhan Institute of Virology
WMD	Weapon of Mass Destruction
WMO	World Meteorological Association
WRO	Withhold Release Order
WTO	World Trade Organization
<i>WTO Agreement</i>	<i>Agreement Establishing the World Trade Organization</i> (including all 4 Annexes)
WWF	World Wildlife Fund
XITIC	Xiamen International Trade and Industrial Company
XPCC	Xinjiang Production and Construction Corps. (China)
XUAR	Xinjiang Uyghur Autonomous Region (China)
YMTC	Yangtze Memory Technologies Co. (China)
YoY	Year on Year
ZAC	<i>zone d'aménagement concertée</i> (France)
ZTE	Zhongxing Telecommunications Corp.
<i>1916 Act</i>	<i>Antidumping Act of 1916</i> , as amended (repealed)
<i>1930 Act</i>	<i>Tariff Act of 1930</i> , as amended
<i>1934 Act</i>	<i>Reciprocal Trade Agreements Act of 1934</i>
<i>1934 FTZ Act</i>	<i>Foreign Trade Zones Act of 1934</i> , as amended
<i>1945 UNPA</i>	<i>United Nations Participation Act of 1945</i>
<i>1974 Act</i>	<i>Trade Act of 1974</i> , as amended
<i>1978 Act</i>	<i>Customs Procedural Reform and Implementation Act</i>
<i>1979 Act</i>	<i>Trade Agreements Act of 1979</i>

<i>1984 Act</i>	<i>International Trade and Investment Act of 1984 (Trade and Tariff Act of 1984)</i>
<i>1988 Act (1st meaning, OTCA)</i>	<i>Omnibus Trade and Competitiveness Act of 1988</i>
<i>1988 Act (2nd meaning)</i>	<i>United States – Canada Free Trade Implementation Act</i>
<i>1990 Act</i>	<i>Customs and Trade Act of 1990</i>
<i>1993 Mod Act</i>	<i>Customs Modernization Act of 1993</i>
<i>1993 NAFTA Implementation Act</i>	<i>North American Free Trade Implementation Act of 1993</i>
<i>2002 Act</i>	<i>Trade Act of 2002</i>
<i>2003 Act</i>	<i>Burmese Freedom and Democracy Act of 2003</i>
<i>2007 Act</i>	<i>Implementing Recommendations of the 9/11 Commission Act of 2007</i>
<i>2010 Act</i>	<i>Omnibus Trade Act of 2010</i>
3D	Three dimensional
3PLs	Third Party Logistics Providers
3Ts (3T Issues)	Taiwan, Tiananmen, and Tibet
4Ts (4T Issues)	Taiwan, Tiananmen, Tibet, and The Party (CCP)

Part One

THEMES

Chapter 1

INTRODUCTION

I. Interdisciplinary and Technical

There are two inherent features to the study of International Trade Law in the post-9/11 world: it is interdisciplinary, and it is technical. These features are ineluctable. “Interdisciplinary” means importantly, but not only, law and economics. To study International Trade Law is to study how and why people and their governments interact, or do not interact. It is to study human behavior in a global framework of law that itself changes, sometimes radically. “Technical” means International Trade Law is not an easy field. There are no masters, only students (including this author) of varying degrees of accomplishment.

One example of this dualism is the Sino-American Trade War.² Each side speaks of the other as a huge threat, or not, seeks to decouple (at least to some degree) from networks linked to the other, or not, and calculates the difficulty of supply chain reconfigurations, or not.³ Their blustery rhetoric, and their critical analyses, are contextualized amidst big-picture concepts like “Cold War” and “Thucydides Trap,” and vital intricacies embodied in mysterious terms “Entity List” and “SDN.” There are countless more examples that illustrate the same point: International Trade Law is formulated, interpreted, applied, and violated in one or more intellectual paradigms amidst practical realities of a global, regional, country-specific, and/or sector-specific nature. To understand this multi-faceted context makes the study of International Trade Law like an advanced Liberal Arts course. The lawyer is called upon to be a Renaissance person in the best sense. (It may even be vouchsafed that the field grew up with and from the Liberal Arts.) The challenge is to think laterally and deeply, or to use the International Trade Law terms, “horizontally” across topics and “vertically” within a topic.

So, it may rightly be asked: Which countries have a keen export or import interest in a particular rule? What economic, political, philosophical, religious, and cultural forces motivate and constrain countries? How does the market for trade in a particular good or service operate? What are the trends in that market? To address these questions is to go far in understanding the rules governing how trade happens.

The answers *per se* do not result in a complete understanding of those rules. To go all the way requires an understanding of the technicalities of rules. What do the rules say? How did they evolve? What justifies them? Where do the uncertainties lie?

² This topic is treated throughout this *E-Textbook*, and a synopsis is offered in a separate Chapter. However, for a full-blown treatment, see Raj Bhala, *Trade War: Causes, Conduct, and Consequences of Sino-American Confrontation* (Durham, North Carolina: Carolina Academic Press, 2023).

³ See Demetri Sevastopulo, *Janet Yellen Warns that U.S. Decoupling from China Would be “Disastrous,”* FINANCIAL TIMES, www.ft.com/content/b38478a6-7a30-47f0-a8f7-6c89dd77d324?shareType=nongift.

Thus, for the reader looking for the proverbial “Law and Ice Cream” course, it is best now to put this *E-Textbook* aside and continue the search. Exercising that option would be at variance with the consistent, if not increasing, pressure on American law schools from the ABA to offer courses that are international and practical in nature. Moreover, to choose the “drop-add” option might be to sacrifice a rare opportunity. In the grandest way, this *E-Textbook*, and courses based on it, aim at “cognitive endurance” and “existential clarity:” readers are invited to press for insights, for longer, more sustained periods, not only about the changing world in which they live, but also about themselves.⁴

So, for the adventurous, this *E-Textbook* might play a sweet (albeit modest) role in understanding issues that fall under the hackneyed term “globalization.” It might broaden and sharpen critical legal analysis of those issues, and even shaping choices about profession and lifestyle. It might also impart knowledge and skills readily applicable in legal positions. Perhaps it might even promote better writing skills, which is another outcome the ABA seeks from the law schools it accredits.

II. Not Geneva-Centric

A logical consequence of the aforementioned two features is that International Trade Law is about far more than the WTO. That was true before 1 January 1995, when the *WTO Agreement* entered into force, and always will be true. For reasons chronicled throughout this *E-Textbook*, what the WTO will look like in the coming decades is unclear. The cover graphic on the 21-27 July 2018 issue of *The Economist* displayed a sinking ship with “The Plan to Save the WTO” emblazoned on its hull. And, with or without the WTO, International Trade Law is about far more than the Western world, the population of which accounts for only 12% of humanity. China and India combined are thrice the size of the West, accounting for 36% of the world’s population: 1.42 and 1.36 billion, respectively, out of 7.71 billion (as of February 2019).⁵ Indonesia, Pakistan, and Bangladesh – the world’s three largest Islamic countries, with populations, respectively, of 268.5, 203.2, and 167.4 million are approaching the size of the West – they sum to 8.3% of humanity. In April 2023, the positions of China and India flipped, and the numbers increased: India at 1.4286 billion, and China at 1.4257 billion, totaling 2.8543 billion, of the roughly 8 billion total world population, or about 35.7 percent of humanity.⁶

Too often, perhaps especially among academics, a Geneva-centric view of the global trading system prevails. The fact is, as Naina Lal Kidwai, President of the Federation

⁴ For examples of undergraduate-level courses with these aims, see Molly Worthen, *Why Universities Should Be More Like Monasteries*, THE NEW YORK TIMES, 25 May 2023, www.nytimes.com/2023/05/25/opinion/college-students-monks-mental-health-smart-phones.html?smid=nytcore-ios-share&referringSource=articleShare.

⁵ See World Population Review, <http://worldpopulationreview.com/>.

⁶ See Y.P. Rajesh, *India’s Population to Overtake China by Mid-2023, U.N. Estimates*, REUTERS, 20 April 2023, www.reuters.com/world/india/india-have-29-mln-more-people-than-china-by-mid-2023-un-estimate-shows-2023-04-19/.

of Indian Chambers of Commerce and Industry (FICCI) put it in January 2013, the multilateral trading system faces an “existential threat.”⁷ Why?

One reason is the increasing appeal to many WTO Members of FTAs. About 75% of cross-border trade occurs under WTO rules (as of February 2024).⁸ But, hence, 25% of all import-export transactions are governed by PTAs, namely, FTAs, CUs, or possibly developing country preference schemes like *GSP*, getting better-than MFN treatment. China is a case in point: ever since its December 2001 WTO accession, it built its network of FTAs with other countries and customs territories, such that (by October 2023) 38% of its exports occurred within this network (with a further 4% and 3%, respectively, shipped to jurisdictions with which China was negotiating or considering FTAs).⁹ The EU also bespeaks the significance of PTAs. As the EU Trade Commissioner wrote (in February 2024), “almost 60 percent of EU trade is done under WTO rules [namely, MFN treatment]” – meaning that over 40%, nearly half, of all EU imports and exports are through FTAs, CUs, and developing country schemes.¹⁰ FTAs and other PTAs thus co-exist with the multilateral system.

FTAs lone pre-date GATT 1947. Indeed, the inefficiencies associated with spreading the production and consumption gains from free trade across the globe through a patchwork of FTAs, and the risks that FTAs become military blocs, helped impel a provision in the August 1941 *Atlantic Charter* calling for a post-Second World War multilateral trade forum. But, with the death of the Doha Round, and more generally the practical frustrations of using the “single undertaking” rule in an ever-larger, more diverse WTO, Members have looked to FTAs as at least a “second best” solution to advance their trade interests.

So, between 1990 and 2010, the number of FTAs and CUs grew from 70 to 300.¹¹ Ironically, that was a relatively good period for the multilateral trading system, as it encompassed the vitally important Uruguay Round (1986-1994). In the first 20 years of the life of the WTO, *i.e.*, since its birth on 1 January 1995 through September 2014, WTO Members had entered into 253 RTAs, which translated into an average of or nearly 13 annually, and notified the Secretariat at a rate of 24 per year.¹² Even before the death of the Doha Round, frustration with it led countries as diverse as America, Chile, Japan, and Singapore to pursue aggressively preferential trading arrangements.

⁷ Quoted in Amrit Dhillon, *Lamy Explains Doha Deadlock as Result of Confusion on Emerging Economies' Role*, 30 *International Trade Reporter* (BNA) 208 (7 February 2013).

⁸ See Emma Farge, Rachna Uppal & Alexander Cornwell, *WTO Meeting Seeks Modest Outcomes, with Global Trade at “Critical Juncture,”* REUTERS, 26 February 2024, www.reuters.com/world/not-dreamland-wto-aims-modest-outcomes-abu-dhabi-meeting-2024-02-26/.

⁹ See James Kyngé & Keith Fray, *China's Plan to Reshape World Trade on its Own Terms*, FINANCIAL TIMES, 26 February 2024, www.ft.com/content/c51622e1-35c6-4ff8-9559-2350bfd2a5c1?shareType=nongift.

¹⁰ Valdis Dombrovskis, *Reform the WTO to Make it Fit for the 21st Century*, FINANCIAL TIMES, 22 February 2024, www.ft.com/content/3357cc3b-8997-4a72-896d-f73f92597dc3?shareType=nongift.

¹¹ See Martin Wolf, *Globalization in a Time of Transition*, FINANCIAL TIMES, 17 July 2013, 7. [Hereinafter, *Globalization*.]

¹² See Bryce Baschuk, *Azevêdo Urges WTO Members to Resolve TFA Impasse; Chides Trade Fragmentation Trend*, 31 *International Trade Reporter* (BNA) 1767 (2 October 2014).

Today, about 50% of the exports of the top 30 exporting countries go to an FTA or CU partner country.¹³ For the U.S., roughly 60% of its trade is on WTO terms (*i.e.*, on an MFN, not preferential, basis), while the other 40% is under an FTA. To be sure, even trade flowing in an FTA or CU framework operates (*i.e.*, is premised) on the legal foundation of the GATT-WTO, particularly GATT Article XXIV. Nonetheless, FTAs and CUs matter ever-more in the world trading system, and their rules are increasingly WTO Plus, and have been ever since the Doha Round failed to yield updated multilateral texts.

Such realities intimate another fact: economies integrated through an FTA or CU share chains of production. Consider *NAFTA* (which, in its first version, *NAFTA 1.0*, entered into force on 1 January 1994, and its second version, *NAFTA 2.0*, *i.e.*, *USMCA*,¹⁴ took effect on 1 July 2020): imports into the U.S. from Mexico, its partner (along with Canada) in *NAFTA* contain an average of 40% American content. The auto sector is especially integrated: the average car part crosses the U.S.-Canada-Mexico borders six times before it is incorporated into a finished vehicle.¹⁵ In contrast, imports into the U.S. from China contain an average of just 4% American content.¹⁶ With the death of that Round, the key function of the WTO, other than dispute settlement, monitoring, and research, is as a “marketplace for different kinds of agreement,” wherein Members attempt “coalitions of the willing to negotiate opening up their own economies without assuming that everyone has to do that or will travel at the same speed.”¹⁷

¹³ See *Globalization*.

¹⁴ The origins of the term “*USMCA*,” which Canada calls *CUSMA*, are said to lie with the insistence by President Donald J. Trump that there be a relationship to the United States Marine Corps: “I want it to be called the *USMCA*, like [the] U.S. Marine Corps.” See Alexander Panetta, *Jared Kushner Memoir Chronicles Frustrations of Negotiating Trade Deal with Canada*, CBC NEWS, 20 August 2022, www.cbc.ca/news/world/kushner-book-usmca-cusma-1.6556647 (quoting *Breaking History* (2022), by Mr. Trump’s son-in-law, Jared Kushner, reporting: “With the deal done, Trump made one final request. ‘I want it to be called the *USMCA*, like [the] U.S. Marine Corps.’ [Canadian Minister of Trade Chrystia] Freeland and the rest of the Canadian government have refused to use that name, continuing to call it ‘the new *NAFTA*,’ or by the acronym *CUSMA*.”). Whether true or apocryphal, there is no obvious connection between *NAFTA 1.0* or *2.0*, and the Marines. Canada calls the trade deal *CUSMA*, and hence it is to be regretted that the rubric “*NAFTA*” – which did not favor any one of the three Parties – was changed on irrelevant, yet nationalistic, even militaristic, grounds.

For discussions of the implementation of *USMCA*, see DAVID A. GANTZ & TONY PAYAN EDS., *THE FUTURE OF TRADE: A NORTH AMERICAN PERSPECTIVE* (Cheltenham, United Kingdom: Edward Elgar, 2023) (especially Chapter 2 at pages 19-46 by David A. Gantz, *Key Issues in USMCA Implementation*, and Chapter 7 at pages 152-173 by Meredith Lilly, *Beyond NAFTA: Canada and USMCA’s Initial Implementation, 2020-2022*).

¹⁵ See B.J. Siekierski, *No U.S.-Only Auto Content Requirement, Canada Says*, 35 *International Trade Reporter* (BNA) 104 (18 January 2018).

¹⁶ See Brian Flood, *Mexican Ambassador Says NAFTA Nations Have Shared Interests in TPP, Other FTAs*, 30 *International Trade Reporter* (BNA) 1458 (19 September 2013).

¹⁷ Ali Qassim, *TTIP, TPP Can Encourage Multilateral Trade Talks, Conference Speakers Say*, 31 *International Trade Reporter* (BNA) 1070 (12 June 2014) (quoting Lord Peter Mandelson, who served as EU Trade Commissioner from 2004-2008, when negotiations collapsed in July 2008 over (*inter alia*) a Special Safeguard Mechanism (SSM) for agricultural product import surges sought by India and other developing countries).

Thus, the fourth of the four Volumes is dedicated to FTAs. To be sure, FTAs are not a panacea for economic growth, development, or revival. A June 2021 ITC study summarized the effects of FTAs on the U.S. economy, which on balance are mixed:¹⁸

Over time, U.S. ... FTAs have expanded in depth and breadth, a trend that is consistent with the expansion of Congress's negotiating priorities in its trade promotion authority (TPA) legislation. Many stakeholders support increasingly detailed and prescriptive FTA requirements, stating that they help level the playing field when other markets are less open than those of the United States; foster a more transparent and rules-based system; and address new challenges as technology and circumstances evolve. Other stakeholders, however, state that U.S. FTAs often serve the interests of multinational corporations at the expense of American workers – for example, by promoting trade liberalization and investor protections while failing to adequately protect worker rights and the environment.

FTA provisions generally focus on expanding and accelerating market access opportunities and reducing tariff and nontariff barriers to trade across all industry sectors. In this report, industry is broken down into six main sectors: agriculture, manufactured goods, natural resources, chemicals, textiles and apparel, and services. Cross-sectoral provisions in FTAs focus on strengthening rules and reducing nontariff barriers. These provisions address issues such as customs administration and trade facilitation, technical barriers to trade, government procurement, investment, electronic commerce and digital trade, intellectual property, labor, environment, regulatory practices, and state-to-state dispute settlement. Evolving approaches to rule of origin (ROO) requirements in FTAs also have played a prominent role in diverse industry sectors, including manufactured goods, textiles and apparel, and chemicals.

Two events mark an important shift in the evolution of FTA provisions. The first is the 2007 *Bipartisan Trade Deal* between Congress and the Executive Branch (also known as the May 10th Agreement), which required modifications to FTAs with Panama, Peru, Colombia, and Korea. Among other things, these changes strengthened labor and environmental provisions and cut back on pharmaceutical intellectual property rights (IPR)

¹⁸ Arguably, the economic effects are even less impressive, given that:

One big trade deal outside the ITC *Report's* scope was the agreement [discussed in a separate Chapter] struck by the United States to pave the way for China to enter the WTO in 2001. Critics of that agreement blame it for contributing to the loss of about 5 million U.S. manufacturing jobs over the following decade, a phenomenon known as the “China shock.”

Doug Palmer, *Decades of Trade Deals Brought Only Slight Benefit to U.S. Economy, Commission Says*, POLITICO, 29 June 2021, www.politico.com/news/2021/06/29/decades-trade-deals-slight-benefit-to-us-economy-itc-497038 (discussing the *Report*.) [Hereinafter, *Decades of Trade Deals*.]

requirements, with the goal of improving access to medicines. The second event was revisions made to the *United States-Mexico-Canada Agreement (USMCA)* in 2019, again resulting from negotiations between Congress and the Executive Branch. Like those of the May 10th Agreement, these modifications reflected more extensive requirements in the areas of labor, environment, and enforcement, while limiting pharmaceutical IPR protections.

... [T]he Commission examined the economy-wide effects of all U.S. trade agreements, effects of specific provisions in U.S. trade agreements on trade in different sectors, and effects of specific U.S. trade agreements on select sectors of the U.S. economy. The Commission’s models rely mostly on econometric techniques to estimate the historical relationship between economic outcomes (including trade in goods and services, investment, and foreign affiliate sales) and the U.S. trade agreements, while controlling for other economic factors.

...

Impacts on the U.S. Economy as a Whole

The Commission estimates that, to the extent quantifiable, the agreements have had a small but positive effect on the U.S. economy. In 2017 (the base year), they led to an estimated increase in U.S. real GDP of \$88.8 billion (0.5 percent) and in aggregate U.S. employment of 485,000 full-time equivalent (FTE) jobs (0.3 percent), based on a model that assumes the economy is at its long-run full employment level. U.S. trade agreements have also had a positive effect on U.S. imports and exports as well, especially with U.S. FTA partners. The Commission also finds, however, that the gains in jobs were not distributed evenly, with the biggest gains in employment estimated for college-educated male workers. ...

Impact of Certain Provisions and Specific U.S. Agreements

In addition to economy-wide estimates, the Commission developed other estimates of certain provisions and specific U.S. agreements:

Services provisions: The Commission finds that reciprocal trade agreements (RTAs) with services provisions that take a “full liberalization approach,” follow the U.S. approach to market access, and cover a full set of other substantive disciplines significantly increase cross-border trade in services for a number of key services sectors.

Extra intellectual property protections: The effects of IPR provisions in RTAs that go beyond the requirements of the WTO’s *Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)* – known as *TRIPs-Plus* provisions – are ambiguous. Although the literature suggests that *TRIPs* has spurred trade in IPR-intensive sectors, the additional effects of

TRIPs-Plus provisions are difficult to disentangle from those of other provisions. RTAs with *TRIPs-Plus* provisions typically include substantial tariff and nontariff commitments. These other commitments may be driving the positive effects of RTAs with *TRIPs-Plus* provisions on trade in IPR-intensive and non-IPR-intensive sectors.

Digital trade provisions and services trade: The Commission estimates the impact of including provisions governing trade in digital products and services in the U.S. trade agreements. The inclusion of these provisions has a positive effect on services trade, and the positive effect increases in sectors that are more digitally intensive.

From preference program to FTA: The Commission examines the impact of transitioning from a unilateral trade preference program to a free trade agreement using U.S. trade with Colombia as an example. The Commission estimates that the United States-Colombia Trade Promotion Agreement increased certainty in trade conditions for Colombian firms, leading to a rise in the number of varieties imported by the United States from Colombia.

U.S. trucking industry and the *KORUS* modification: The Commission estimates the impact of the 2018 modification to the *United States-Korea Free Trade Agreement (KORUS)* on the U.S. light truck industry. In the absence of the modification, light trucks exported from Korea would have gained duty-free access to the U.S. market beginning in 2021. The Commission finds that the modification to *KORUS* led to small increases in the number of U.S. trucks sold to Korea and in the profitability of U.S.-based truck producers.

Review of Economic Literature

The Report's literature review centers on studies that empirically estimate the historical impacts of trade agreements. Although the literature since the Commission's 2016 retrospective Report has been limited, it continues to estimate that *NAFTA* had a large, positive aggregate impact on bilateral trade flows between the United States, Canada, and Mexico. Additionally, literature on the distributional effects of *NAFTA* on different groups is growing. In U.S. localities that had industries which had been protected by tariffs on Mexican goods, findings show that (1) there was lower wage growth for blue-collar workers in those U.S. industries and localities, (2) lower wage growth for blue-collar women than men, (3) a larger increase in unemployment among non-white workers than white workers, and (4) outward migration of workers without a high-school degree from those localities. Literature covering the impacts of agreements other than *NAFTA* is still very limited, and the estimates vary significantly.

Literature on the effects of different types of provisions in U.S. FTAs is also very limited and findings are, generally, specific to the context of agreements and the trading partners involved. For example, labor provisions can raise earnings for workers in middle-income partner countries, but implementation remains challenging in some countries. On IPR provisions, literature suggests the effects vary by type of IPR provision, industry sector, and country development levels. And lastly, environmental provisions in U.S. trade agreements have set new standards for monitoring and reporting environmental impacts in partner countries, and the provisions have led to the adoption of environmental protection laws in some markets.¹⁹

This superb synopsis is premised on the assumption that FTAs are primarily about economics. That is not true, or put differently, that assumption reflects old-fashioned, conventional thinking. In truth, FTAs (as the pertinent Volume explains) are about far more than economics. They are instruments to advance political and national security goals.

Another reason to eschew Geneva-centrism concerns export controls, trade sanctions, and other remedies that go beyond traditional TDIs authorized under GATT and WTO accords. They are important. They will be for as long as Members care about their sovereignty and seek to preserve policy space, not to mention to protect their national security. So, trade remedies make up the other part of Volume Three.

III. Curriculum Revolutions and the Canon

The two features and their implication suggest it is time to revolutionize (again) the way International Trade Law is presented. The 4th edition (2015) aimed to give the field the breadth and depth of coverage it deserves. In that edition, Volume One was dedicated to Fundamental Obligations, and Volume Two to Remedies and Preferences. Those Volumes could be used in a two-semester sequence in International Trade Law. Or, they could be used as separate, stand-alone volumes for individual courses.

Yet in the few years since the 4th edition, International Trade Law has become even broader and deeper than ever before. Many law schools in the U.S. and overseas offer not only a two-semester sequence such as International Trade Law and Advanced International Trade Law, but also a third or even fourth course in the general field of International Trade. Examples of the additional courses include: Customs Law, Trade Remedies, and a variety of “Trade and ...” courses, such as Trade and Labor, Trade and the Environment, and Trade and National Security.

Hence the new revolution embodied in the 5th edition (2019): a four-Volume flexible set that could be used in its entirety, or as stand-alone modules for pertinent courses. There was no (or should not have been a) need for instructors to expend energy

¹⁹ UNITED STATES INTERNATIONAL TRADE COMMISSION, ECONOMIC IMPACT OF TRADE AGREEMENTS IMPLEMENTED UNDER TRADE AUTHORITIES PROCEDURES, 2021 REPORT, Executive Summary, 14-18 (Publication Number 5199, Investigation Number: TPA 105-008, June 2021), www.usitc.gov/publications/332/pub5199.pdf. See also *Decades of Trade Deals* (discussing the Report).

on preparing their own course packs, though certainly they are free to do so. Across these four Volumes, all of them together, or any subset thereof, fulfilled their instructional needs and interests. Toward that end, Volume One included two new Chapters on transactional foundations of free trade. These Chapters reviewed the documentary sale, alleviating the need to supplement the *E-Textbook*, or require as a pre-requisite an International Business Transactions course.

So, too, is it with this 6th Edition. The eight-Volume structure is rationalized and expanded from its four-Volume predecessor. Some Chapters have migrated to a new Volume to make for a cogent organization and alignment with courses and seminars. And, there are new and/or expanded Chapters in each of the Volumes to ensure the entire *E-Textbook* is fully up to date with the myriad of dramatic developments that have occurred since 2019.

Moreover, the eight Volumes should offer instructors and students, plus researchers and practitioners – the “canon” of International Trade Law. Ever since 1 January 1994, when *NAFTA* 1.0 entered into force, and 1 January 1995, when the WTO agreements from the Uruguay Round took effect, a vast canon has developed far beyond what existed from 30 October 1947, when GATT was signed. (That is no less true with *NAFTA* 2.0, which is the same as *NAFTA* 1.0, except for new or amended rules agreed upon on 30 November 2018 and 10 December 2019 concerning auto ROOs, customs, environmental protection, labor rules and dispute settlement, IPRs, ISDS, and a sunset provision.) Scan the Summary Table of Contents, or the Detailed Table of Contents – therein is the outline of that canon. Scan the Table of Abbreviations – there are the acronyms widely used in canonical discourse.

So, to put the point bluntly, quick works will not do for the ambitious. There is stuff – a lot of stuff, important stuff, fascinating stuff – to know about International Trade Law to be able to speak about the subject intelligently and practice it successfully.

IV. Non-Western Orientation

It is well past high time to redeploy intellectual energies to the Non-Western World, and thereby look at the GATT-WTO system and FTAs from the perspectives of the BRICS (Brazil, Russia, India, China, and South Africa), other emerging and developing countries, like Malaysia, and least developed countries, like Bangladesh. By “Non-Western,” I mean Asia, Africa, the Middle East, and Latin America. All authors have their favorites, in terms of topical coverage and comfort level. I am no exception. Mine are India, my heritage, Iran, with which I have been intrigued since the 1979 Hostage Crisis, and Southeast Asia, throughout which I have travelled extensively.

Perhaps these inclinations, which pertain to ex-colonies, may be justified on two grounds. First, to know these countries is to know a good deal about the Non-Western World. India is the largest free market democracy in the world. The dominant player on the Subcontinent, its ethnic, linguistic, and religious diversity makes it an efficient country to visit, despite its decrepit physical infrastructure: the visitor sees all of God’s creation in

one day, and then enjoys its mouth-watering culinary tradition at dinner, along with a robust, domestically brewed lager. The visitor, perhaps while checking email or surfing the internet, also sees India's digital divide: 90% of its population is considered (as of September 2020) digitally illiterate.²⁰ (A separate Chapter treats China's demographic decline.)

Iran, like India, is heir to an ancient civilization, and at the cross-roads of other, grand civilizations. Persians and Indians traded with each other, and others like Arabs and Chinese, long before there was a Western World. Iran is the only *Shī'ite* nation in the world. The erstwhile ally of Iran, the U.S., is a country with which Iran has had a tragic bilateral relationship since the 1978-1979 Islamic Revolution.

Both India and Iran have underperformed economically, albeit for different reasons. They far lag Little Tigers in the Far East, like Malaysia, the country from which my wife hails, and are even further behind the Four Tigers (or Dragons), Hong Kong, Korea, Singapore, and Taiwan. They would be lucky to be in a middle-income trap.

Second, to know these countries is to be able to compare and contrast a large number of other Non-Western countries. How has India performed relative to China? How do Bangladesh, Pakistan, and Sri Lanka differ from India? Why has Malaysia underperformed the Asian Tigers (Hong Kong, Korea, and Singapore, and Taiwan)? Can Malaysia do better yet maintain racial, religious, and ethnic harmony among its Muslim Malay, Buddhist Chinese, and Christian Chinese and Indian communities? As for Iran, what does it need to do to re-enter the world trading system? Can this Persian nation integrate with its Arab and Turkish neighbors?

In sum, it is a sin to train International Trade Lawyers on the premise of a Eurocentric world. Economic, political, military, and perhaps most importantly, demographic facts point to the obvious: for decades to come, the students of today will practice import-export law, trade finance, foreign direct investment, and allied fields in an increasingly Non-Western environment. The U.N. World Population Prospects forecasts, summarized in Table 1-1, show why this point is (or ought to be) obvious. Indeed, the point holds true whether they practice in America, Europe, or elsewhere. Note especially that about 50% of

²⁰ See Sumeysh Srivastava, *International Literacy Day: Bridging India's Digital Divide*, BLOOMBERG QUINT (Mumbai), 8 September 2020, www.bloombergquint.com/technology/international-literacy-day-bridging-indias-digital-divide. Thus:

While India is experiencing a digital revolution that may allow us to move ahead in terms of economic growth and development, we also run the risk of creating a new class of digitally-poor citizens. Digital Poverty has been defined as a new concept of poverty, meaning the inability to access and benefit from information and communications technology services due to a lack of access, and a lack of skills required to access these services.

Id. On the concept of “digital poverty,” see, e.g., United Nations Conference on Trade and Development, *Digital Poverty Needs to be a Development Priority* 3 April 2019, https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2042&Sitemap_x0020_Taxonomy=UNCTAD%20Home.

India's population (1.25 billion as of February 2015) was below 25 years old, and similarly that about half of its population (1.417 billion as of January 2023) was under 30,²¹ and that India had considerable room for "catch up growth:" its PPP GDP *per capita* is U.S. \$5,500 (as of 2013), contrasted with \$11,900 in China and \$15,000 in Brazil.²²

²¹ See Karthikeyan Sundaram, *India's Population Has Already Overtaken China's, Analysts Estimate*, BLOOMBERG, 17 January 2023, www.bloomberg.com/news/articles/2023-01-18/india-s-population-overtakes-china-to-become-world-s-biggest-analysts-estimate?sref=7sxw9Sxl. [Hereinafter, *India's Population Has Already Overtaken*.]

²² *A Chance to Fly*, THE ECONOMIST, 21 February 2015, 11.

Table 1-1:
Global Population and Non-Western World²³

<i>Issue</i>	<i>Answer or Projection</i>			
Global population (billions, with projections based on a medium fertility assumption) in...?	1950	2013	2050	2100
	2.5	7.2	9.55	10.85
European population as a percentage of global population in 1950?	22%, with Britain, Germany, and Italy among the top 10 most populous countries			
Only region in the world to shrink between 2013 and 2050?	Europe, with largest declines in Russia, Bulgaria, and other former Soviet countries			
Sub-Saharan African population as a percentage of global population in 2050?	25% (increased from 16% in 2013), based on increased fertility rates in populous Sub-Saharan African countries such as Nigeria			
Year in which population of China peaks, and size?	2022, at about 1.4 billion (based on fertility rate of 1.6 children per woman)			

²³ See *Population Forecasts*, THE ECONOMIST, 15 August 2015, 31; DANNY DORLING, POPULATION 10 BILLION: THE COMING DEMOGRAPHIC CRISIS AND HOW TO SURVIVE IT (2013); STEPHEN EMMOTT, 10 BILLION (2013); *Faces of the Future*, THE ECONOMIST, 22 June 2013, 64. See also Clive Cookson, *Crowded Planet*, FINANCIAL TIMES, 13-14 July 2013, 11 (reviewing the two books). Note the low fertility assumption model of the U.N. projects population peaking at 8.34 billion in 2050, and then dropping to 6.75 billion in 2100. See *id.* Even if that scenario materializes, the shift to the Non-Western world is likely.

Table 1-1 (continued):

Year in which population of India overtook China, and size, to become most populous country in the world?	<p>Initial projection was 2022, at about 1.4 billion (based on fertility rate of 2.5 children per woman); subsequent forecast was April 2023,²⁴ at over 1.4 billion (with “average fertility of the world’s population ... at 2.3 births per woman over a lifetime, having fallen from about 5 births in 1950,” and “[g]lobal fertility ... projected to decline further to 2.1 births per woman by 2050.”²⁵ In early April 2023, the U.N. confirmed India would overtake China by no later than mid-2023,²⁶ which it did.</p> <p>In January 2023, Chinese demographers disclosed “China’s population fell last year [2021] for the first time in six decades [<i>i.e.</i>, since 1961], a historic turn that is expected to mark the start of a long period of decline in its citizen numbers with profound implications for its economy and the world.”²⁷</p> <p>Also in January 2023, the <i>World Population Review</i> (a U.S.-based, independent demographic research organization) estimated India’s population of 1.417 billion had overtaken China’s population of 1.412 billion.²⁸</p>		
Top 10 most populous countries (in rank order) in...?	1950	2013	2050
	China	China	India

²⁴ See Y.P. Rajesh, *India to Surpass China as World’s Most Populous Country in April, U.N. Says*, REUTERS, 24 April 2023, www.reuters.com/world/india/india-surpass-china-worlds-most-populous-country-april-un-says-2023-04-24/.

²⁵ *India to Surpass China as Most Populous Country in 2023: U.N. Report*, NIKKEI ASIA, 11 July 2022, <https://asia.nikkei.com/Economy/India-to-surpass-China-as-most-populous-country-in-2023-U.N.-report#>.

²⁶ See *India’s Population to Overtake China*.

²⁷ Albee Zhang & Farah Master, *China’s First Population Drop in Six Decades Sounds Alarm on Demographic Crisis*, REUTERS, 17 January 2023, www.reuters.com/world/china/chinas-population-shrinks-first-time-since-1961-2023-01-17/. [Hereinafter, *China’s First Population Drop*.] See also Chris Buckley, Joy Dong & Amy Chang Chien, *A Shrinking, Aging China May Have Backed Itself Into a Corner*, THE NEW YORK TIMES, 18 January 2023 (discussing political and cultural contradictions, such as supporting greater maternity leave but cracking down on feminism, which partly account for the demographic decline and/or make it difficult to reverse).

²⁸ See *India’s Population Has Already Overtaken*.

	India U.S. Russia (excluding rest of former U.S.S.R.) Japan Indonesia Germany Brazil Britain Italy	India U.S. Indonesia Brazil Pakistan Nigeria Bangladesh Russia Japan	China Nigeria U.S. Indonesia Pakistan Brazil Bangladesh Ethiopia Philippines
Number of Non-Western countries (counting Brazil as “Non-Western”) in Top 10 in...?	1950	2013	2050
	5	8	9

V. To Propose, Not Impose

There is, and indeed ought to be, a dramatic tension in any teaching or reference work. At one extreme, a work by an author with strong views risks being idiosyncratic, even a tract. Such a work should not be a vehicle for articulating and defending the views of the author. The appropriate venues for such argumentation are articles and monographs. At the other extreme, no author who earnestly responds to the vocational calling of a teacher writes in an entirely selfless manner. As C.S. Lewis (1898-1963) rightly argued in *The Abolition of Man* (1943), value-free scholarship is a chimera, and to pursue it endangers students. (Textbooks should rise to works of synthetic and innovative scholarship, but that is another matter.). So, inherent and ineluctable in drafting of any teaching materials is the dramatic tension between argumentation and neutrality.

To manage this tension, it is useful to invoke the distinction between imposition and proposition. Never is the object of *International Trade Law: A Comprehensive E-Textbook* to impose a view, least of all my own – assuming it were possible to do so, which it is not. Always, the goal is to propose – that is, to be provocative by setting out ideas for students to ponder and debate. The reader quickly would put down this *E-Textbook* with a thump if it did no more than regurgitate the views of the author from other venues. Rightly so. The reader seeks not indoctrination but enlightenment on theoretical and practical dimensions of a topic.

At the same time, even the least experienced of reader surely appreciates the subject is not algorithmic. Even seemingly slight details sometimes illuminate weighty matters of war and peace, poverty and wealth, injustice and fairness, and chaos and order. The reader needs and deserves guidance, at least to help chalk out an independent course of study and practice. One overture to mitigate the dramatic tension between argumentation and neutrality is to provide cogency to the *E-Textbook* through 10 Propositions (discussed in a separate Chapter). These Propositions concern what International Trade Law is, or ought to be, about. They are woven throughout. They relate to one another, as complements, antagonists, and sometimes both.

VI. TPP, T-TIP, TPA, TISA, and EGA

On 30 December 2018, *CPTPP* entered into force among the *TPP* 11, without the U.S., thanks to America's January 2017 withdrawal from what would have been the largest FTA in human history, covering about 40% of world GDP. (The current *CPTPP* still comprises an impressive 14% of world GDP.) That decision, by President Donald J. Trump (1946-, President, 2017-2021) was monstrously wrongheaded.

My advocacy scholarship in favor of American participation in that deal is *TPP Objectively: Legal, Economic, and National Security Dimensions of CPTPP* (the 2nd Edition of which Carolina Academic Press published in 2019). That scholarship, however, is a distant fourth to three other sources:

- (1) Four former American Secretaries of State, representing both political parties, have endorsed *TPP*: Henry Kissinger (Secretary to Presidents Richard M. Nixon and Gerald R. Ford from 1973-1977); James Baker (Secretary to President George H.W. Bush from 1989-1992); Madeleine Albright (Secretary to President Bill Clinton from 1997-2001); and Colin Powell (Secretary to President George W. Bush from 2001-2005).²⁹ A fifth Secretary of State, John F. Kerry (to President Barack H. Obama from 2005-2009) obviously agreed (as it was the Obama Administration that drove *TPP* negotiations).
- (2) Another distinguished bipartisan group – of eight former Secretaries of Defense – has pressed the argument: Harold Brown (under President Carter from 1977-1981); Frank C. Carlucci (under President Reagan from 1987-1989); William J. Perry (under President Clinton 1994-1997); William S. Cohen (under President Clinton from 1997-2001); Donald H. Rumsfeld (under President Ford from 1975-1977, and President Bush from 2001-2006); Robert M. Gates (under President Bush from 2006-2011); Leon E. Panetta (under President Obama from 2011-2013) and Charles T. Hagel (under President Obama from 2013-2015).
- (3) Six USTRs to four of the five Presidents preceding Mr. Trump, thus representing both political parties, openly said the U.S. should re-engage in *TPP*.³⁰ They are: Ambassadors William Brock (USTR from 1981-1985 under President Reagan); Mickey Kantor (USTR from 1993-1996 under President Clinton); Charlene Barshefsky (USTR from 1997-2001 under President Clinton); Robert Portman (USTR from 2005-2006 under President George W. Bush); Ron Kirk (USTR from 2009-2013 under President Obama); and Michael Froman (USTR from 2013-2019 under President Obama).

It is implausible (actually, ridiculous, arrogant, or both) to think all 18 of them are wrong.

As for *T-TIP*, it is dead. Likewise, though hope remains for episodic (and probably plurilateral) agreements on isolated topics, such as *TISA*, the Doha Round, is dead. The point, in terms of topical coverage in the *E-Textbook*, is this: with respect to which FTAs to devote detailed attention, and which ones to give quicker coverage, generally I endeavor to focus on what the law is, especially with respect to the U.S. That *corpus* is vast and deep enough. This *E-Textbook*, like its predecessors, emphasizes what already is “on the books.”

²⁹ See Cheryl Bolen, *Obama Wins TPP Support from Former Top Officials*, 32 International Trade Reporter (BNA) 1999 (19 November 2015).

³⁰ See Alex Fang, *Ex-U.S. Trade Chiefs Pin High TPP Hopes on Katherine Tai*, NIKKEI ASIA, 18 December 2020, <https://asia.nikkei.com/Politics/International-relations/Biden-s-Asia-policy/Ex-US-trade-chiefs-pin-high-TPP-hopes-on-Katherine-Tai> (also reporting USTR Portman counseled for a bilateral FTA as a starting point to broader Asia-Pacific linkages). As for the USTR to the fifth President, Carla Hills, who served from 1989-1993 under President George H.W. Bush, she indicated her support for TPP at the time it was being negotiated. See, e.g., *Stellar Team of Former U.S. Trade Reps Talk the Big Game on TPP*, NZ.INC., (undated), <https://newzealandinc.com/ustrs-in-unison/>.

Indeed, wholly apart from FTAs, with roughly 20 GATT-WTO agreements, plus another nearly two dozen U.S. FTAs, plus U.S. Customs Law, trade sanctions, and export control rules, there is plenty to learn. I leave it to other works to deal with what the law “was,” “might be,” or “should be.” So, for example, a full account of the evolution and terms of *CPTPP* is in my *TPP Objectively*, and I avoid overlap between that book and this *E-Textbook*.

What the law “is” depends partly on what it “was,” what it “might have been,” and what arguments about what it “should be.” And, who knows what the law might “become”? Like the river of which Herodotus (484-425 B.C.) wrote, International Trade Law flows continuously. Perhaps like that river, some parts are murky, especially the parts that snake through corridors of ideologically-infused, plutocratic power inside the Beltway and in Washington, D.C.? In the monstrously polarized environment inside that Beltway, political statements about contours, details, and timing are as loose pebbles on the riverbed.

In the meantime, teachers must guide their students across the river. To navigate those waters with my students, getting them across to become world-class practitioners and scholars in International Trade Law is my duty, quest, and passion. Among these students are many in the squeezed, indebted middle class – a class that includes single Moms and veterans of the Afghanistan and Iraq Wars, and the class with which I identify and to which I am indebted.

VII. Pedagogy

Is there a single, correct way to teach International Trade Law? Surely not. The *Preface* and *Introduction* articulate why this work is subtitled “A Comprehensive *E-Textbook*,” highlight its interdisciplinary and Non-Western approach, and explain the importance of both grand theory and technical details. Are some ways of teaching this subject better, and others worse? Surely, yes. The better ways are user-friendly – they invite the reader to the subject, drawing the reader to study in a way that makes that study at once both work and play. Toward this end of fostering an experience that is simultaneously productive and fun, this work employs eight strategies.

- **1st: Textbook**

The *E-Textbook* is a *textbook*. It is not a casebook, and thus does not rely heavily on outside excerpts. Rather, it is written from start to finish as a presentation. Excerpts are used only if their substance and style facilitate this presentation. Accordingly, this work aims to avoid disjointedness among readings, and gaps among topics. In other words, it aspires to provide the reader with clear, straightforward coverage of each topic, indeed the entire canon, of the field.

- **2nd: Case Write Ups**

The *E-Textbook* explains and analyzes WTO Appellate Body Reports. It is not that the Appellate Body cannot speak for itself. It is that the Appellate Body does so poorly, with painful prose, endless redundancies, and monstrous length (notwithstanding its boast that in 2017, no decision exceeded 70 pages – pages, it is worth noting, on A4 paper filled with small-font print). The reader needs to know (1) what the rule is, (2) why the rule is what it is, (3) on what facts the rule is based, and (4) why the losing argument was a loser.

So, the *E-Textbook* writes up important Appellate Body precedents emphasizing these factors. Put bluntly, in a world in which English is under assault from certain information technologies like texting, lawyers and their teachers should be guardians of the language of Shakespeare, Gibbon, Churchill, and Orwell. To showcase the writing of the Appellate Body is to assault the language further when training those guardians.

- **3rd: Assumptions**

The *E-Textbook* assumes the reader can “think like a lawyer.” Typically, that cognitive asset is developed in the first year of legal training, though in my experience American law schools do not have a monopoly here. High quality training of diverse vocations such as the Roman Catholic Priesthood and Special Operations Forces nurtures critical analytical and reasoning skills, including a sophisticated ability to make analogies and distinctions, fashion and deconstruct subtle arguments, apply rules to fact patterns, synthesize diverse concepts and sources, and improvise creatively.

What the *E-Textbook* does not assume is that the reader knows anything about International Trade Law. The reader need only be thirsty for knowledge of the breadth and depth of the field. So, the Textbook is not a vehicle for re-hashing first-year legal training, such as extracting a holding or rationale from a judicial opinion. Instead, it is designed to raise the reader to the “next level,” by training her in a specialty.

- **4th: Statutory and Treaty Construction
(Free Online Documents)**

The *E-Textbook* teaches statutory and treaty construction skills. Part of getting to the “next level,” moving from the first year of law school to the upper-class specialty courses and beyond, is developing these skills. While full of multilateral, regional, and domestic cases, treaties, and statutes drive International Trade Law. So, each Chapter identifies the pertinent documents to which the reader should refer. All of them are available freely online on many websites. So, unlike the first three editions, the 4th and subsequent editions are unaccompanied by a *Documents Supplement*.

All Documents referenced in the *E-Textbook*, and many more, are posted *gratis* on the website of the University of Kansas Wheat Law Library. The links are:

General University of Kansas Wheat Law Library:

<http://law.ku.edu/wheat-law-library>

International Trade Law Documents:

<http://guides.law.ku.edu/intltrade>

These documents are freely downloadable, in Word and/or PDF format. I am grateful to my KU Wheat Law Library colleagues, Chris Steadham, Director, Pam Crawford, Assistant Director for Public & Technical Services (*Emerita*), and Blake Wilson, Assistant Director for Instructional & Faculty Services, for their energetic, enthusiastic, and unflagging support.

- **5th: Reality and Possibilities**

Fifth, the *E-Textbook* conveys the reality of change, a sense of urgency, and consequent opportunities. Examples from the Non-Western world adduce the shifts in the global trading system, and perhaps even are a harbinger of reversion to the relative balance of power that prevailed before the Industrial Revolution. Consider the fact that:

Until the late 1990s, only about 30 percent of the developing world (21 of 72 countries) was catching up with the economic frontier (the U.S.), and the rate of catch-up was about 1.5 percent per head per year. Since the late 1990s, nearly three-quarters of the developing world (75 of 103 countries) started catching up, at an accelerated annual pace of about 3.3 percent per head.³¹

This catching up means no practitioner or student can afford to be complacent about, or focus only on, her local legal market. That market already has a Non-Western flavor. That is not a risk. It is an opportunity, “here” and “there.”

- **6th: Restraint**

Politics is one of the disciplines International Trade Law, as an inherently interdisciplinary field, inevitably implicates. Readers should not have to combat the personal political preferences of an author whose aim is to offer a comprehensive, user-friendly *E-Textbook*. Yet the task of remaining non-partisan, and not engaging in *ad hominem* commentary, became increasingly difficult with the Presidential candidacy and November 2016 election of Donald J. Trump (1946-, President, 2017-2021). His style of international trade diplomacy, and that who executed his policies at USTR and DOC, took combativeness to friends and foes alike to new levels. Concomitantly, Republican-Democrat bickering over trade issues boiled to volcanic temperatures.

Across the Trump Presidency, I wrote 65 “On Point” columns for Bloomberg Quint / BQ Prime (Mumbai). My beloved Editor, Mr. Kaushik Vaidya, and I strived to be non-partisan and non-*ad hominem*. I make that same effort in this Textbook. The announcement

³¹ Arvind Subramanian & Martin Kessler, *The Hyperglobalization of Trade and its Future* (2013), quoted in Martin Wolf, *Globalization in a Time of Transition*, FINANCIAL TIMES, 17 July 2013, 7.

in November 2022 of a second Trump Presidential candidacy again posed the challenge of political neutrality to any author having to chronicle and analyze Mr. Trump’s views on international trade. Bluntly put, he and his Republican Party followers are the most challenging figures in modern American history to treat in a purely academic manner. Their substantive views and personal styles are inextricably part of International Trade Law as they would have it. Nevertheless, with an up-front apology for any instance across these Volumes that appears too “political,” I strive for restraint – with one caveat. To be transparent, I agree with the opinion of *The New York Times* Editorial Board, published on 15 November 2022, about the second candidacy.³²

- **7th: Stylistic Conventions**

Readers should not have to fight a text. Rather, the style of the prose they read should be as simple and elegant as possible. When that prose is a law, it should be as clear as possible, except where ambiguity is deliberately intended by the underlying law or policy. To be sure, errors creep into any text, let alone one of major length. Ideally, and through multiple editions, each one entailing corrections to the predecessor, they should be at a minimum.

Toward this end – helping the reader flow with, rather than fight against – this *E-Textbook*, I adhere to the following stylistic conventions. First, in citations, I rebel against the *Blue Book*. Instead of slavishly following that aspect of American legal culture, I use consistent, common-sense references that describe all the information (including, where applicable, websites) the reader needs to appreciate and access source materials. Likewise, I avoid excessive citation, and provide a general (and heart-felt) acknowledgment in the Front Material to Volume One.

Second, I rely heavily on the use of abbreviations that are used across the discourse of International Trade Law. Each abbreviation is defined in the Table of Abbreviation, which appears in the Front Material of each Volume. Along with the text itself, this Table explains each term. In turn, knowing those terms and the short-hand notations for them are ingredients for success in study, scholarship, and practice.

Third, with respect to excerpted materials, and on occasion and where appropriate, I make minor stylistic edits. Such edits make no impact on the substance of the passages (which would be inappropriate). Rather, they are designed to be user-friendly, to enhance the reader’s focus on substance by avoiding distractions caused by odd or incongruous style. So, for instance, I correct minor typos, capitalize certain common terms, format margins and headings, convert British to American English spelling, use numbered instead of bullet-point or dash lists, standardize all dates according to the traditional international convention of day-month-year, and normalize certain fonts.

- **8th: Hints for Exams**

³² The Editorial Board, *America Deserves Better Than Donald Trump*, THE NEW YORK TIMES, www.nytimes.com/2022/11/15/opinion/trump-2024-announcement.html?smid=nytcore-ios-share&referringSource=articleShare.

There is no short cut to excellence in International Trade Law. The sequence for success is an old fashioned one: read the assigned portions of the *E-Textbook* conscientiously; formulate notes and outlines while reading; go to and engage actively (at least intellectually, if not verbally) in class (which, if priced hourly, costs a lot); sit near the front of the class, and do not multi-task while in class (the texts, emails, and web surfing can wait); take copious class notes; recopy those notes and synthesize them with notes from the readings; re-read relevant portions of the *E-Textbook*; and ask questions of the teacher (whose salary, or a portion thereof, the student pays). Following this sequence is vital, whether preparing for an end-of-semester exam or a major research paper.

There are some additional hints. One is to review the Table of Contents. Perusing this Table will bring to mind the structure of the material, its organization, and key concepts and cases. Another one is to use the Table of Abbreviations. Like flash cards, the items in that Table identify or link to virtually every key concept in the *E-Textbook*. A third hint is sleep. Peaceful, quiet, sleep. Lawyers make mistakes (or more of them), and are less polite, when tired.

VII. Sources

The increased availability of information about the subject of this *E-Textbook*, made possible thanks to the Internet, does not ease its preparation. To the contrary, it is ever more difficult. There are two problems: quantity and quality.

First, the sheer amount of data available is overwhelming. From blogs and media coverage to law review articles and think-tank studies, there is an assault of materials.

Second, of the material available, much of it is of low, zero, or even negative marginal value. That is especially true of official government pronouncements. In November 2014, Lori Wallach, Director of Global Trade Watch, which is part of the NGO, Public Citizen, lambasted a White House statement that claimed, in respect of *TPP* negotiations, negotiators had “narrowed the remaining gaps,” the conclusion was “coming into focus,” and finishing the talks “as soon as possible” was “a top priority.”³³ Ms. Wallach called the statement the “same sort of *vague cheerleading*” about “progress and a path to an imminent deal” made since 2011.³⁴ Her characterization was apt, even polite. More than a few officials trumpet little or no progress as momentous. A realist might say that is because there is so little genuine progress in the polarized political atmosphere in many governments and international economic relations that any step looks like a leap. A cynic might say they do so because progress, real or not, on their watch helps them get better, higher paying positions in the private sector when they rotate out of what is supposed to be public service.

³³ Quoted in Leslie A. Pappas, *Ministerial Meeting Doesn't Yield Consensus But Leaders in Talks Say Gaps More Narrow*, 31 *International Trade Reporter* (BNA) 1990 (13 November 2014). [Hereinafter, Pappas.]

³⁴ Quoted in Pappas. (Emphasis added.)

So, to prepare each edition of this *E-Textbook*, across all Volumes, I sift through a prodigious volume of sources with a skeptical eye. I need filtering devices. Three of them are the *International Trade Reporter*, *Economist*, and *Financial Times*. These publications have on staff the finest international trade journalists in the English language. Their stories help keep my students and me current. It is neither possible nor desirable to cite each story used.

Yet, special mention deservedly should be made for many pieces by Toshio Aritake, Bryce Baschuk, Nayanima Basu, Ryan Beene, Len Bracken, Rossella Brevetti, Lucien O. Chauvin, Connor Cislo, Stephanie Cohen, Gabrielle Coppola, Joe Deaux, Amrit Dhillon, Tony Dutra, Brian Flood, Tom Gilroy, Stephen Gardner, Jennifer Jacobs, Llewellyn Hinkes-Jones, Alexis Kramer, Joe Kirwin, Jenny Leonard, Bengt, Ljung, Eric Martin, Andrew Mayeda, Peter Menyasz, Rick Mitchell, Mark Niquette, Toluse Olorunnipa, Chris Opfer, Leslie A. Pappas, Daniel Pruzin, Elaine Ramirez, Jorgelina do Rosario, B.J. Siekierski, Madhur Singh, Justin Sink, Amy Tsui, Justin Villamil, Josh Wingrove, and Gary G. Yerkey in the *International Trade Reporter*, which Bloomberg BNA publishes, and by Alan Beattie, Shawn Donnan, Guy de Jonquières, Simon Mundy, David Pilling, Victor Mallet, Gillian Tett, Frances Williams, and Martin Wolf in the *Financial Times*. (*The Economist* does not identify author bylines.) With apologies to them and their colleagues, this new Edition would be nothing but a multi-volume citation list, were I not to adopt a simple policy: a footnote appears to accompany a direct quote, or extensive use of key data. In brief, may I express my deepest thanks and respect for these publications and their staff?

May I also express gratitude to the BBC, Bloomberg (U.S.), Bloomberg Quint (Mumbai), and Reuters for their exceptional coverage of international trade law and policy developments? Thanks also are due to *Al Jazeera*, *Khaleej Times*, *Gulf News*, and *The Gulf Today*, for their coverage of developments concerning trade and the Islamic world. Lawyers operate based on facts as well as law, but whence the hard, reliable facts to exercise good legal judgments? Well-educated, unfettered journalists are one vital source.

Similarly, several Chapters herein benefit from a large number of official publications of the U.N., World Bank, and WTO, and from some U.S. and foreign government bodies. None of them bears a copyright, and almost all of them are available on the official websites of these entities. Citing them all would load this work down in footnotes. Yet, it is worth remarking that among them, my lodestar has been the *Overview and Compilation of U.S. Trade Statutes* (111th Congress, 2nd Session, 2010). Prepared periodically by the Committee on Ways and Means of the U.S. House of Representatives, this Committee Print is the clearest and most concise summary of American foreign trade law contained in any official publication.

What I learned from legal sources referenced in earlier *International Trade Law* Editions resonates in the present Edition. Space does not permit a full list of the thousands of books, book chapters, and articles I have examined since 1993, when I began to prepare the 1st edition that appeared in 1996. That list grows weekly. The same policy applies to

legal sources: a footnote accompanies a direct quote or great dependence; otherwise, a friendly expression here of indebtedness.

There are core texts on international and development topics on which I draw to prepare material (including graphs). It is only right to acknowledge them explicitly:³⁵

- P.T. Bauer, *Dissent on Development* (1976)
- Jagdish Bhagwati & Arvind Panagariya eds., *The Economics of Preferential Trade Agreements* (1996)
- Robert J. Carbaugh, *International Economics* (7th ed. 1999)
- Richard E. Caves, Jeffrey A. Frankel & Ronald W. Jones, *World Trade and Payments: An Introduction* (6th ed. 1993)
- Robert M. Dunn, Jr. & John H. Mutti, *International Economics* (5th ed. 2000)
- Malcolm Gillis et al., *Economics of Development* (4th ed. 1996)
- Robert Gilpin, *The Political Economy of International Relations* (1987)
- Steven Husted & Michael Melvin, *International Economics* (4th ed. 1998)
- Melvyn Krauss, *The New Protectionism* (1978)
- Melvyn Krauss, *How Nations Grow Rich* (1997)
- Paul Krugman, *The Age of Diminished Expectations* (1990)
- Paul R. Krugman & Maurice Obstfeld, *International Economics: Theory and Policy* (4th ed. 1997)
- V.I. Lenin, *Imperialism: The Highest State of Capitalism* (1916, Junius Publications Ltd. ed. 1996)
- Stuart R. Lynn, *Economic Development: Theory and Practice for a Divided World* (2003)
- W. Charles Sawyer & Richard L. Sprinkle, *International Economics* (2003)
- Amartya Sen, *Development as Freedom* (1999)
- Dudley Seers ed., *Dependency Theory – A Critical Reassessment* (1981)
- T.N. Srinivasan, *Eight Lectures on India's Economic Reforms* (2000)
- Robert C. Tucker ed., *The Marx-Engels Reader* (2nd ed. 1978)
- Immanuel Wallerstein, *The Essential Wallerstein* (2000)

In addition, certain parts of this *E-Textbook* draw on my other books.

On GATT topics, it is only natural to peek at my treatise, *Modern GATT Law*, originally published in 2005 and expanded to two-volume 2nd edition in 2013, by Thomson Reuters Sweet & Maxwell in London. Eleanor Norton and Andrew Moroney, the Publishing Editors on the 1st and 2nd Editions, respectively, and more recently Lydia Manch, kindly understood my desire to avoid “re-inventing the wheel.” I draw on Chapters and used sections from the treatise, with appropriate substantive and stylistic changes. To a lesser degree, I draw on *Trade, Development, and Social Justice* (Carolina Academic Press 2003), and a treatise with Professor Kevin Kennedy of Michigan State, *World Trade Law* (Lexis Publishing 1998, with 1999 *Supplement*). Dr. Keith Sipe, President of Carolina

³⁵ The online *Teacher's Manual* for the 5th Edition (available at Carolina Academic Press) sets out a longer list of consulted works, particularly in the fields of international and development economics.

Academic Press, and Ms. Adriana Sciortino, Lexis Publishing, indulged my efforts to economize on my efforts.

Similarly, I rely on previous articles, some of which are not cited in, or subsequent to, the *Modern GATT Law* treatise. Material on GATT Article XX(a) and Islamic countries comes from *Diversity within Unity: Import Laws of Islamic Countries on Ḥarām (Forbidden) Products*, 47 *THE INTERNATIONAL LAWYER* 343-406 (2014, with Shannon B. Keating). The discussion of trade preferences for Africa uses *The Limits of American Generosity*, 29 *FORDHAM INTERNATIONAL LAW JOURNAL* 299-385 (January 2006), and some discussion of FTAs is based on *Competitive Liberalization, Competitive Imperialism, and Intellectual Property*, 28 *LIVERPOOL LAW REVIEW* issue 1 (2007). The trade sanctions analysis is informed by *MRS. WATU and International Trade Sanctions*, 33 *THE INTERNATIONAL LAWYER* 1-26 (spring 1999). The review of the EU CAP draws on *Empathizing with France and Pakistan on Agricultural Subsidy Issues in the Doha Round*, 40 *Vanderbilt Journal of Transnational Law* 949-985 (2007). The annual *WTO Case Review*, published by the *Arizona Journal of International and Comparative Law* (co-authored with my dear friend, University of Arizona Professor David Gantz, and also in its later years with Shannon Keating, Bruno Simões, Eric Witmer, and Cody Wood, assists in many spots.

Confessedly, it is not easy to set aside my views, and in any event, value-free scholarship is impossible. Besides, who wants teaching or research materials replete with bland regurgitation, but no provocative analysis to ponder? A work without personality is unnatural and insufferable. So, regarding WTO dispute settlement, my views on precedent are evident in the coverage of the *DSU* (and *The Stare Decisis Trilogy* is cited in the pertinent Chapter). Likewise, my views in *The Doha Round Trilogy* (cited in the Chapter on that Round) are evident in various discussions. To all the journals in which the *Trilogies* and other articles on which I have drawn, thank you.

VIII. Invitation to Chat

Every Edition of *International Trade Law* has included an invitation premised on what Friedrich Nietzsche (1844-1900) wrote in 1888 in his last book, *Ecce Homo* (published in 1908): that which does not kill you makes you stronger. Future Editions, or Supplements to the present Edition, can be better than this Edition with the help of the most important target audience: students. Scarcely is there a finer moment in teaching than when the teacher learns from the student. So, please communicate your criticisms to me.

Or, call just to chat about trade for fun. After all, too many lawyers, and too many law professors, are dour. Practitioners and teachers who have the most fun usually provide the best service – to their faith, health, families, and clients – and live a good life.

Chapter 2

10 PROPOSITIONS³⁶

I. **Proposition 1: Promote Growth, Alleviate Poverty, and Advance Liberal Capitalist Values**

International Trade Law ought to promote economic growth and poverty alleviation. Arguably, it ought also to advance liberal Capitalist values. Recall the wisdom of Professor Ernst-Ulrich Petersmann (a student of 1974 Nobel Economics Prize winner F.A. Hayek, 1899-1992): “The common starting point of the neoliberal economic theory is the insight that in any well-functioning market economy, the ‘invisible hand’ of market competition must by necessity be complemented by the ‘visible hand’ of the law.”³⁷ Simply put, law is about values. And yet, countries and regions have different ones. From surveillance Capitalism to concepts of corporate power, values and the laws that enforce them will increasingly shape markets.

If International Trade Law does not achieve these fundamental and oft-repeated goals, then it cannot be justified in the paradigm in which it most frequently is evaluated, namely, a Utilitarian calculus of economic efficiency. As among these goals, if and to the extent there is a trade-off, the second is especially important – simply because the poor lack resources. Catholic Social Justice Theory is one religious and philosophical paradigm proposing that a preferential option ought to be given to the poor. International Trade Law ought not to make the deprived even more so, and if it does, then its rules are not sustainable. Continued negotiation, drafting, implementation, and enforcement of those rules will be rejected – God forbid, through violent social unrest.

A previous WTO Director General, Pascal Lamy (1947-, Director General, 2005-2013), got it wrong in a January 2013 speech to the Federation of Indian Chambers of Commerce and Industry (FICCI) in New Delhi, India, when he blamed the deadlock in the Doha Round on confusion about the role of emerging economies. He asked:

Are emerging countries rich countries that happen to have sizeable numbers of poor people, or are they poor countries that happen to have large numbers of rich people? If it’s the first, then the main principle guiding them in trade talks will be reciprocity with a little flexibility. If the second, then it would be flexibility with a little reciprocity.³⁸

³⁶ The statistics mentioned in these Propositions are derived from a variety of sources, including *Lamy Calls on Decision-Makers to Move the WTO Negotiations Forward*, WTO NEWS: SPEECHES (21 September 2012), www.wto.org; *Lamy Suggests “Essential Principles” for Reform of Global Governance*, WTO NEWS: SPEECHES (21 September 2012), www.wto.org.

³⁷ Quoted in Rana Foroohar, *My Guide to a Deglobalizing World*, FINANCIAL TIMES, 22 October 2022, www.ft.com/content/80aea0bf-2d05-4292-8542-e07929fc663b?shareType=nongift. [Hereinafter, *My Guide to a Deglobalizing Word*.]

³⁸ Quoted in Amrit Dhillon, *Lamy Explains Doha Deadlock as Result of Confusion on Emerging Economies’ Role*, 30 International Trade Reporter (BNA) 208 (7 February 2013).

That is not even a question. The Trump Administration USTR, Robert E. Lighthizer (1947-), made the similar mistake of forcing a false binary choice.

In January 2021, Ambassador Lightizer slammed the leading candidate for the WTO Director General position, Dr. Ngozi Okonjo-Iweala, the former Finance Minister of Nigeria, a former World Bank Managing Director, and Chair of the Board of Gavi (a public-private alliance to develop vaccines for poor countries). In opposing 66-year-old Dr. Okonjo-Iweala, who holds a doctorate in Economics and dual U.S.-Nigerian citizenship,³⁹ and thus blocking a WTO consensus in her favor for the WTO's top job, the USTR said she had "no experience in trade at all."⁴⁰ Ambassador Lighthizer added:

"We need a person who actually knows trade, not somebody from the World Bank who does development." ...

"We need a trade person with real trade experience." ... "And there are very few areas where you would say, 'here's an organization in very bad shape, let's get someone who knows nothing about its core mission.'"⁴¹

Therein was the false conflict (regrettably posited with quintessential American arrogance and rudeness), that trade is trade, development is development, and they are mutually exclusive. *Au contraire!* Trade is development, and development is trade, *i.e.*, trade should result in development, and development should stimulate trade. Fortunately, President Joseph R. Biden (1942-, President, 2021-) removed the Trump Administration objection and joined every other Member in support of Dr. Okonjo-Iweala.⁴²

In its first public statement under the Biden Administration, the U.S. Trade Representative's office said the U.S. was "pleased to express its strong support for the candidacy of Dr Ngozi Okonjo-Iweala as the next Director General of the WTO."

³⁹ See World Trade Organization, *History is Made: Ngozi Okonjo-Iweala Chosen as Director-General* (15 February 2021), www.wto.org/english/news_e/news21_e/dgno_15feb21_e.htm; Bryce Baschuk, *U.S. Backs Nigerian for WTO, Now Set for First Female Chief*, BLOOMBERG, 5 February 2021. [Hereinafter, *U.S. Backs Nigerian*.]

⁴⁰ Quoted in Aime Williams, *Outgoing U.S. Trade Chief Says Leading WTO Candidate Lacks Experience*, FINANCIAL TIMES, 19 January 2021, www.ft.com/content/baca66bb-5987-47e1-861d-3375a6f6d01b?shareType=nongift. [Hereinafter, *Outgoing U.S. Trade Chief*.]

⁴¹ Quoted in *Outgoing U.S. Trade Chief*.

⁴² *Biden Ends Deadlock Over First African and First Woman to Lead WTO*, BBC NEWS, 6 February 2021, www.bbc.com/news/business-55958682 (also reporting the Trump Administration-backed nominee, South Korea's Minister of Trade, Yoo Myung-hee, withdrew her candidacy, and that President Trump had called the WTO "horrible," as well as biased in favor of China); *U.S. Backs Nigerian* (also reporting: "The Biden Administration's decision to support Okonjo-Iweala's campaign will be viewed in Geneva as a welcome shift in U.S. support for the multilateral trading system following four years of salvos against an organization that former President Donald Trump previously called the worst trade deal the U.S. ever signed.").

“Dr. Okonjo-Iweala brings a wealth of knowledge in economics and international diplomacy from her 25 years with the World Bank and two terms as Nigerian finance minister,” USTR said in a statement. “She is widely respected for her effective leadership and has proven experience managing a large international organisation with a diverse membership.”⁴³

Via a virtual meeting on 15 February 2021, the WTO General Council confirmed her selection as the first African and first woman to serve as Director General (with a four-year term that commenced on 1 March 2021, and possible four-year renewal after this term ended on 31 August 2025).⁴⁴

It is true developing countries account (as of 2014) for 48% of global trade output (on PPP terms), and their share of global agricultural trade increased (between 2000-2014) from 27% to 36%.⁴⁵ Emerging countries are in the latter camp. To have roughly 600-700 million of 1.2 billion people desperately poor, or about 700-800 million rural poor of 1.3 billion people, as do India and China, respectively, does not make a country “rich,” and to say they “happen to have sizeable numbers of poor people” nearly trivializes both the scale and plight of the poor. As for LDCs, their average *per capita* income is just 4% of that of developed countries.⁴⁶ (The term “LDC,” meaning least developed country, arose on 18 November 1971, pursuant to U.N. Resolution 2768 (XXVI), *Identification of the Least Developed among Developing Countries*.⁴⁷ The first list of LDCs comprised 25 countries; as of May 2022, 46 countries are classified as “LDCs” – and 20 of them were on the original 1971 list.) Concomitantly, the share of LDCs in world trade is sadly small: LDCs account for 0.94% of world exports of goods and commercial services in (2018, barely up from 0.92% in 2017).⁴⁸

Accordingly, is it emerging countries that are confused about their role in the global economy? Or, is it some of the rich countries that try to foist an identity onto them that they are not ready, willing, or able to assume? Unless global trade rules clearly “work” in respect of boosting growth and stimulating poverty, emerging countries rightly will look at those rules, and rule reforms proposed by rich countries, with suspicion.

⁴³ Edward White, Song Jung-a, Aime William & Alan Beattie, *U.S. Backing Paves Way for Nigeria’s Okonjo-Iweala to Lead WTO*, FINANCIAL TIMES, 5 February 2021, www.ft.com/content/5c50d594-0df3-4204-8325-0882303631bc?shareType=nongift (also reporting Dr. Okonjo-Iweala had “battled corruption in her country.”).

⁴⁴ See World Trade Organization, *WTO General Council to Consider Appointment of Next Director-General*, 9 February 2021, www.wto.org/english/news_e/news21_e/gc_09feb21_e.htm.

⁴⁵ See WORLD TRADE ORGANIZATION, 2014 WORLD TRADE REPORT 2014 (20 October 2014), www.wto.org.

⁴⁶ See World Trade Organization, *WTO Helps Developing Countries Adjust to Major Shifts in Trading Environment* (opening remarks of WTO Director General Roberto Azevêdo), 20 October 2014, www.wto.org.

⁴⁷ See *Identification of the Least Developed Among the Developing Countries*, UN. General Assembly (26th Session, 1971), <https://digitallibrary.un.org/record/192021?ln=en>.

⁴⁸ See World Trade Organization, *WTO Members Continue Efforts to Facilitate LDCs’ Exports*, 6 November 2019, www.wto.org/english/news_e/news19_e/devel_06nov19_e.htm.

That is true despite professions by rich countries that trade liberalization demonstrably has alleviated poverty. American Secretary of State John Kerry made just such a pronouncement in November 2013. In an address to the OAS, he claimed FTAs such as the *NAFTA*, *CAFTA-DR*, and FTAs between the U.S. and Chile, Columbia, Panama, and Peru, had raised over 73 million people in Latin America out of poverty in the previous decade (2002-2012).⁴⁹ That trade liberalization boosts economic growth, narrowly defined as gains in *per capita* GDP, was generally agreed, and backed by robust economic research. That this growth alleviates poverty, rather than exacerbate socioeconomic stratifications, was not.

The consensus among economists is globalization – defined as increased cross-border flows of trade, investment, finance, and IP – has increased income inequality.⁵⁰ Not surprisingly, therefore, there is a vast corpus of literature challenging globalization in general, and free trade in particular. Among the leading works are *Has Globalization Gone Too Far?* (1997) and *Straight Talk on Trade* (2018), both by Dani Rodrik (1957-), and *Globalization and its Discontents* (2002), *Fair Trade for All* (2005), *Making Globalization Work* (2004), and *The Great Divide: Unequal Societies and What We Can Do About Them* (2015), all by Joseph Stiglitz (1943-), World Bank Chief Economist (1997-2000), and 2001 Nobel Economics Prize winner. Professor Rodrik further argued (in 2011) that: “Democracy, national sovereignty, and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full.”⁵¹

To this (dare it be said) pessimism, there also is an impressive counter-literature. The leading works include those by Jagdish Bhagwati (1934-) – *The Wind of the Hundred Days: How Washington Mismanaged Globalization* (2002), *Free Trade Today* (2003), *In Defense of Globalization* (2007), *Termites in the Trading System: How Preferential Agreements Undermine Free Trade* (2008), and *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries* (2013, with Arvind Panagariya) – plus *Why Globalization Works* (2004), by Martin Wolf, CBE (1946-). Likewise, it is argued: “Rather than too much free trade, the United States has too little: U.S. companies have preferential access to less than ten percent of the world’s consumers. Mexico and Canada, in contrast, maintain such access to over 50 percent of global markets.”⁵² Each publication is to be taken seriously, especially by law students, legal scholars, and practicing lawyers. So, also, must be taken seriously the authors who are not lawyers, which makes their analysis of the world trading system for which lawyers write and apply rules all the more important.

⁴⁹ See John F. Kerry, *Remarks on U.S. Policy in the Western Hemisphere*, Speech to Organization of American States, Washington, D.C. (18 November 2013), www.state.gov/secretary/remarks/2013/11/217680.htm.

⁵⁰ See David J. Lynch, *Obama’s Goals Clash as Allies Say Trade Push Widens Income Gap*, 31 *International Trade Reporter* (BNA) 245 (6 February 2014) (also reporting the above-mentioned statistics).

⁵¹ Quoted in *My Guide to a Deglobalizing World*.

⁵² Shannon K. O’Neil, *Protection Without Protectionism – Getting Industrial Policy Right*, 100 *FOREIGN AFFAIRS* Number 1 150-160, 157.

Summarizing much less synthesizing the literature in the debate about globalization and trade liberalization is fraught with peril. That said, there is no doubt inequality is severe and worsening. Likewise, there is no doubt that, as Angus Deaton (1945-), winner of the 2015 Nobel Economics Prize, put it “inequality may pose a threat not just to *capitalism* but also to our *democratic system*.”⁵³ Indeed, Oxford University historian Timothy Garton Ash observed in his December 2020 essay, *The Future of Liberalism*, that “[f]or the first time this century, among countries with more than one million people, there are now fewer democracies than there are non-democratic regimes.”⁵⁴ The reason is linked to economics, as Martin Wolf of the *Financial Times* rightly observes:

To understand what is happening, one must connect politics to economics. Branko Milanovic, an expert on inequality, did this in *Capitalism Alone*, published last year [2019]. Capitalism has triumphed, he argues. He is right: the market economy is indeed triumphant. But, he adds, capitalist economies go with two distinct political systems in leading economies: the “liberal” model of the U.S. and its allies, which is the concern of Messrs Garton Ash ..., and China’s “political” model.

Mr. Milanovic argues correctly that liberal democracy is a good in itself and also allows peaceful self-correction. People do desire freedom and U.S. voters have disposed of Donald Trump. The Chinese cannot do the same with Premier Xi Jinping. The argument for “political capitalism” is instrumental: it works. The rise of China has indeed been extraordinary. ...

Mr. Milanovic’s dichotomy is useful but simplistic. A third political version of capitalism exists: demagogic authoritarian capitalism. This can arise out of collapsed communism, as in today’s Russia, or out of enfeebled democracy, as in Brazil or Turkey. Demagogic authoritarian capitalism is a hybrid. As in the Chinese system of bureaucratic authoritarian capitalism,

⁵³ Quoted in Jill Ward, *Britain Risks “Crisis of Capitalism” Due to Rising Inequality*, BLOOMBERG, 13 May 2019, www.bloomberg.com/news/articles/2019-05-13/britain-risks-crisis-of-capitalism-due-to-rising-inequality. (Emphasis added.) See also Chris Giles, *The Left is Winning the Battle of Idea*, FINANCIAL TIMES, 29 April 2021, www.ft.com/content/d3c1c5c5-e601-4c46-8d3a-187e1d9a6b87?shareType=nongift (observing: “As rich countries begin to emerge from the [COVID-19] pandemic, it is time to ask what lessons it provides for the way we run our economic systems. Many people have already made up their minds. ... [P]ressure groups, business organizations and politicians [are] recommending exactly the same policies as they have always advocated and merely adding that Covid-19 increases the necessity of those changes. But a notable exception is a survey conducted by the Pew Research Center, which sought to find out what the public wanted from the economic system rather than telling them what they should get. ... [L]arge majorities in the four countries [surveyed] are unhappy with the economic system. In the U.S., U.K. and Germany, half of all those questioned said it requires ‘major changes’ or ‘needs to be completely reformed.’ That share rose to 70 per cent in France. Only a very small proportion, the highest was 12 per cent in the U.S., thought the economic system did not need to be changed.”). The late fall 2020 Pew survey is discussed in detail in Kat Devlin, Shannon Schumacher & J.J. Moncus, *Many in Western Europe and U.S. Want Economic Changes as Pandemic Continues*, Pew Research Center, 22 April 2021, www.pewresearch.org/global/2021/04/22/many-in-western-europe-and-u-s-want-economic-changes-as-pandemic-continues/.

⁵⁴ Timothy Garton Ash, *The Future of Liberalism*, PROSPECT, 9 December 2020, (January-February 2021), www.prospectmagazine.co.uk/magazine/the-future-of-liberalism-brexit-trump-philosophy.

the ruler is above the law and democratically unaccountable – elections are a sham. But power is personal, not institutionalized. This is corrupt gangster politics. It rests on the personal loyalty of sycophants and cronies. Often the core consists of the family members, viewed as most trustworthy of all. This is the political system Mr. Trump wished to install in the U.S.

Such rulers are like wasp larvae that eat the spider from within. They manage to win an election and then erode the institutional and political bulwarks against indefinite personal rule. Mr. Trump has all the relevant characteristics: the truth is what he says it is; a fair election is one he wins; and a good official is one who is loyal. He wants to be an autocrat. This is distinct from saying that he wants to govern. Nero was not very interested in governing either. But he definitely was tyrannical.

...

Liberal democracy does have one big advantage: its main opponent. ... China's approval rating in Gallup polling is a median of 32 per cent among over 130 countries. It has hardly budged in 10 years. People respect China, but do not like it. China also confronts the challenge of sustaining economic dynamism without a credible rule of law.⁵⁵

Among the principal supporters of such tyranny are “pluto-populists,” that is, the privileged plutocratic class that benefits from “tax cuts and deregulation,” and persuades “a large proportion of the population to vote against its economic interests by focusing on culture and identity.”⁵⁶

Accordingly, a key aspect of the debate about globalization, and its consequences for liberal capitalism, political capitalism, and demagogic authoritarian capitalism, is about the relevant causal factors (*i.e.*, is globalization and free trade to blame for inequality?) and policy prescriptions (*i.e.*, is more or less globalization, and freer trade, the way to lessen socioeconomic stratifications and alleviate poverty)?⁵⁷ But, as to the problem of inequality

⁵⁵ Martin Wolf, *The Fading Light of Liberal Democracy*, FINANCIAL TIMES, 22 December 2020, www.ft.com/content/47144c85-519a-4e25-9035-c5f8977cf6fd?shareType=nongift. [Hereinafter, *The Fading Light*.]

⁵⁶ *The Fading Light*.

⁵⁷ One notable policy shift came in August 2018, when the New Zealand's Labor government, led by Prime Minister Jacinda Ardern (1980, PM, 2017-) banned all foreigners from buying existing homes in the country (except for Australians and Singaporeans, because of FTA commitments, and foreigners with residency status). Average home prices in New Zealand had risen over 60%, and in Auckland had doubled, in the previous decade (2008-2017). The law, the *Overseas Investment Amendment Bill*, which passed Parliament on a 63-57 vote, was designed to eliminate demand from wealthy foreigners (particularly Mainland Chinese), but also increase the supply of affordable housing, by allowing them to make limited investments in new apartments in large developments – in other words, to cause an inward shift in the demand curve, and an outward shift in the supply curve, in the New Zealand property market. See *New Zealand Bans Sale of Homes to Foreigners*, BBC NEWS, 15 August 2018, www.bbc.co.uk/news/world-asia-45199034. As New Zealand's Minister of Trade and Economic Development, David Parker (1960-), said:

This government believes that New Zealanders should not be outbid by wealthier foreign buyers. Whether it's a beautiful lakeside or ocean-front estate, or a modest suburban house,

per se, the evidence is clear. One percent of the world’s population owns 50% of the world’s wealth (as of 2016), a clear increase from 44% in 2009 and 48% in 2014, and headed toward 54% (by 2020).⁵⁸ The top 80 billionaires hold as much wealth (\$1.9 trillion) as the bottom 50% of the rest of the world, an increase of 50% (\$600 billion) in just four years (2011-2014). Conversely, the material wealth (such as it was) of the poorest 50% of the world during those years tumbled (by \$750 billion).

America is a case in point. The richest 10% of Americans account for over 50% of annual national income, whereas in the 1970s they claimed one-third of it. That is the most skewed distribution since 1917. Between 1993 and 2012, the top 1% of Americans (families with an income in 2012 of \$394,000 or more) received more than two-thirds of the nation’s growth in income. And, in 2015, the top 1% of American families (those with gross incomes of at least \$421,926) made over 26.3 times more than the bottom 99% of families (those with gross incomes of no more than \$50,107).⁵⁹

During the 2009-2018 economic expansion, the top 5% of American households (defined as those with an average income of \$451,122 or more as of 2019) saw their incomes rise 28% (adjusted for inflation). But their gain “helped push inequality to the widest in decades.”⁶⁰ That is because it “compare[d] with a mere 11% rise for the bottom 20%, whose income rose to about \$15,290 from roughly \$13,800 a decade ago,” and similarly “[t]hose in the middle groups – who made between \$40,600 and \$111,100 last year (2019) – saw their incomes rise between 16% to 18%.”⁶¹ This growing divide is a nationwide phenomenon: from 2009 to 2015, the family income gap between the top 1% and bottom 99% increased in 43 States and the District of Columbia. In contrast, between 1928 and 1973, the share of income held by America’s top 1% declined in nearly every State. Simply put, income growth for the bottom 99% has been sluggish, but for the top 1% has been breath taking, for nearly 50 years.

A skewed distribution also characterizes wealth in America.⁶² In 2018, the richest 10% of American households held 70% of all wealth in the U.S. They held 60% in 1989.

this law ensures that the market for our homes is set in New Zealand, not on the international market.

Quoted in id.

⁵⁸ See *Richest 1% To Own More than Rest of World, Oxfam Says*, BBC NEWS, 19 January 2015, www.bbc.com/news/business-30875633 (reporting results of an Oxfam study).

⁵⁹ See Estelle Sommeiler & Mark Price, *The New Gilded Age: Income Inequality in the U.S. by State, Metropolitan Area, and County*, Economic Policy Institute 19 July 2018, www.epi.org/publication/the-new-gilded-age-income-inequality-in-the-u-s-by-state-metropolitan-area-and-county/; Carmen Reinicke, *U.S. Income Inequality Continues to Grow*, CNBC, 19 July 2018, www.cnbc.com/2018/07/19/income-inequality-continues-to-grow-in-the-united-states.html.

⁶⁰ Katia Dmitrieva, *Richest Americans Got Richer in Past Decade, Far Outpacing Poor*, BLOOMBERG, 15 September 2020, www.bloomberg.com/news/articles/2020-09-15/richest-americans-got-richer-in-past-decade-far-outpacing-poor?sref=7sxx9Sxl (relying on U.S. Census data). [Hereinafter, *Richest Americans Got Richer*.]

⁶¹ *Richest Americans Got Richer*.

⁶² See Michael Batty, Jesse Bricker, Joseph Briggs, Elizabeth Holmquist, Susan McIntosh, Kevin Moore, Eric Nielsen, Sarah Reber, Molly Shatto, Kamila Sommer, Tom Sweeney & Alice Henriques Volz,

At the top, the picture is the same: in 2018, the richest 1% of American households held 32% of the country's wealth. That was up from 23% in 1989. At the very top, the highest 0.1% (which translates to 170,000 American families) command 20% of the wealth – the highest for that cohort since 1929.⁶³ In contrast, the bottom 90% of American households control just 26% of the wealth, and the combined net worth of the bottom half of U.S. households is negative. By November 2019, the wealth held by the richest 1% of Americans nearly surpassed that of the entire middle class: “the very richest had assets of about \$35.4 trillion in the second quarter, or just shy of the \$36.9 trillion held by the tens of millions of people who make up the 50th percentile to the 90th percentile of Americans – much of the middle and upper-middle classes.”⁶⁴

Wealth is a broader measure of economic well-being than income, because it takes account of the accumulated stock of assets, as distinct from earnings flows. The extreme inequality in wealth distribution suggests America is becoming ever-more aristocratic and plutocratic. So breath taking are the figures that it may be said there is a new – and global – socioeconomic class, the *über-rich*. That 82% of the world's wealth was held, as of January 2018, by 1% of the world's population, and that the poorest half of the world's population got no increase in money generated, are shocking testaments to the widening top-bottom gap.⁶⁵ So, too, was the fact that just 42 people in 2018 had as much wealth as the poorest half of the world's population – meaning greater concentration of wealth, as the figure was 61 in 2017.

This skewed distribution of wealth continued to worsen:

The share of wealth owned by the world's richest people soared during the Covid pandemic....

Introducing the Distributional Financial Accounts of the United States, Finance and Economics Discussion Series 2019-017, Board of Governors of the Federal Reserve System (March 2019); www.federalreserve.gov/econres/feds/files/2019017pap.pdf; Mark Decambre, *The Richest 10% of Households Now Represent 70% of All U.S. Wealth*, MARKETWATCH, 31 May 2019, www.marketwatch.com/story/the-richest-10-of-households-now-represent-70-of-all-us-wealth-2019-05-24.

⁶³ See Ben Steverman, *The Wealth Detective Who Finds the Hidden Money of the Super Rich*, Bloomberg Businessweek, 23 May 2019, www.bloomberg.com/news/features/2019-05-23/the-wealth-detective-who-finds-the-hidden-money-of-the-super-rich.

⁶⁴ See Alexandre Tanzi & Michael Sasso, *Richest 1% of Americans Close to Surpassing Wealth of Middle Class*, BLOOMBERG, 9 November 2019, www.bloomberg.com/news/articles/2019-11-09/one-percenters-close-to-surpassing-wealth-of-u-s-middle-class (also reporting, based on Federal Reserve data, that as for “the bottom 50% of Americans,” “[t]hose households have 35.7% of liabilities in the U.S. and just 6.1% of assets”).

⁶⁵ See Katie Hope, “World's Richest 1% Get 82% of the Wealth,” Says Oxfam, BBC NEWS, 22 January 2018, www.bbc.com/news/business-42745853.

Oxfam's analysis relies on the *Credit Suisse Global Wealth Report*, www.credit-suisse.com/corporate/en/research/research-institute/global-wealth-report.html. This *Report* measures the net worth of an individual's assets, *i.e.*, the total value of real and personal property she owns, minus her indebtedness. Thus excluded are wages or income, which for millions in developing countries such as India and Vietnam have risen. And, indebted persons who may have a high-future income earning potential (*e.g.*, students), are cast as poor. Nevertheless, if the combined wealth of the world's poorest half is adjusted to exclude net indebted persons, the wealth of that poorest half sums to that of the 128 (rather than 42) of the richest people – still a highly skewed distribution.

The *World Inequality Report* said that 2020 saw the steepest increase in billionaires' wealth on record.

Meanwhile, 100 million people sank into extreme poverty, the *Report* from the Paris-based World Inequality Lab said.

The richest 10% of the population now takes 52% of global income and the poorest half just 8%....

The 228-page *Report*, whose authors are part of a group founded by renowned economist Thomas Piketty, also said that since 1995, billionaires' wealth had risen from 1% to 3%.

“This increase was exacerbated during the Covid pandemic. In fact, 2020 marked the steepest increase in global billionaires' share of wealth on record,” the *Report* said.

The world's richest 1% has taken more than a third of all additional wealth accumulated since 1995, while the bottom 50% captured just 2%.

“After more than 18 months of Covid-19, the world is even more polarized,” Lucas Chancel, Co-Director of the World Inequality Lab, based at the Paris School of Economics, ...[said].

“While the wealth of billionaires rose by more than € 3.6 tn ..., 100 million more people joined the ranks of extreme poverty,” said Mr Chancel, noting that extreme poverty had been previously falling for 25 years.

The *Report* concluded that:

- An average adult individual earned € 16,700 per year in 2021 and the average adult owns € 72,900.
- On average, an individual from the top 10% of the global income distribution earns €87,200 per year.
- An individual from the poorest half of the global income distribution makes just €2,800.
- The poorest half of the global population barely owns any wealth, possessing just 2% of the total.
- The richest 10% of the global population own 76% of all wealth.

The researchers found that the world's 52 richest individuals saw the value of their wealth grow by 9.2% per year for the past 25 years, well above less wealthy social groups.⁶⁶

The disparities in wealth distribution were apparent by gender and region:

Women's share of total global income from work was less than 35%, up from near 30% in 1990 but still short of parity with men.

...

Europe was the world's most equal region, with the richest 10% taking 36% of the income share. The Middle East and North Africa was the most unequal, with the wealthiest 10% taking 58% of income.⁶⁷

Thus, understandably, Oxfam speaks of "political capture:" the wealthy translate their net worth into economic power to ensure rules are bent to favor them, "often to the detriment of everyone else," resulting in an "erosion of democratic governance, the pulling apart of social cohesion, and the vanishing of equal opportunities for all."⁶⁸ The cycle of worsened economic inequality and increased political power is a mutually enforcing one that reifies the positions of rich and poor alike. While hardly alone to blame, the rules some of them, that privileged, work to bend include those of the GATT-WTO and FTA regimes.

Regrettably, the COVID-19 pandemic neither broke the cycle nor lessened the skewed wealth distributions. In January 2022, Oxfam published *Inequality Kills*, "based on [survey] data from the *Forbes* Billionaires List," which "uses the value of an individual's assets, mainly property and land, minus debts, to determine what he or she 'owns,'" and "excludes wages or income" [because the focus is on wealth as distinct from income inequality], as well as data from "the annual Credit Suisse Global Wealth report, which gives the distribution of global wealth going back to 2000," and data from the World Bank.⁶⁹ Oxfam's key findings were:

The pandemic has made the world's wealthiest far richer but has led to more people living in poverty....

⁶⁶ *Super-rich Increase their Share of World's Income*, BBC NEWS, 13 December 2021, www.bbc.com/news/business-59565690. [Hereinafter, *Super-rich Increase*.] The summary and full study are at Lucas Chancel (Lead author), Thomas Piketty, Emmanuel Saez & Gabriel Zucman, World Inequality Lab, *World Inequality Report 2022* (December 2021) <https://wir2022.wid.world>.

⁶⁷ *Super-rich Increase*.

⁶⁸ Oxfam, *Working for the Few: Political Capture and Economic Inequality*, Briefing Paper 178 (20 January 2014), www.oxfam.org/sites/www.oxfam.org/files/bp-working-for-few-political-capture-economic-inequality-200114-en.pdf.

⁶⁹ *Wealth of World's 10 Richest Men Doubled in Pandemic, Oxfam Says*, BBC NEWS, 17 January 2022, www.bbc.com/news/business-60015294. [Hereinafter, *Wealth of World's 10 Richest Men*.] The Report is Oxfam, *Inequality Kills – The Unparalleled Action Needed to Combat Unprecedented Inequality in the Wake of COVID-19* (January 2022), <https://oxfamilibrary.openrepository.com/bitstream/handle/10546/621341/bp-inequality-kills-170122-en.pdf?sequence=9>. Oxfam publishes its wealth distribution annually in advance of the World Economic Forum meeting in Davos, Switzerland.

Lower incomes for the world's poorest contributed to the death of 21,000 people each day....

But the world's 10 richest men have more than doubled their collective fortunes since March 2020....

...

"This year, what's happening is off the scale," he [Danny Sriskandarajah, Oxfam Great Britain's Chief Executive] said. ...

"There's been a new billionaire created almost every day during this pandemic, meanwhile 99% of the world's population are worse off because of lockdowns, lower international trade, less international tourism, and as a result of that, 160 million more people have been pushed into poverty."

"Something is deeply flawed with our economic system," he added.

... [T]he world's 10 richest men are: Elon Musk, Jeff Bezos, Bernard Arnault and family, Bill Gates, Larry Ellison, Larry Page, Sergey Brin, Mark Zuckerberg, Steve Ballmer. and Warren Buffet.

While collectively their wealth grew from \$700bn to \$1.5tn between March 2020 and November 2021, there is significant variation between them, with Mr Musk's fortune growing by more than 1,000%, while Mr Gates' rose by a more modest 30%.

...

Oxfam's Report ... said a lack of access to healthcare, hunger, gender-based violence and climate breakdown contributed to one death every four seconds.

It said 160 million more people were living on less than \$5.50 (£4.02) a day than would have been without the impact of the Covid pandemic.

The World Bank uses \$5.50 a day as a measure of poverty in upper-middle-income countries.

The *Report* also sa[id]:

- The pandemic is forcing developing countries to slash social spending as national debts rise.
- Gender equality has been set back, with 13 million fewer women in work now than in 2019 and over 20 million girls at risk of never returning to school.
- Ethnic minority groups have been hardest hit by Covid, including U.K. Bangladeshis and the U.S.'s black population.

“Even during a global crisis our unfair economic systems manage to deliver eye-watering windfalls for the wealthiest but fail to protect the poorest,” Mr Sriskandarajah said.⁷⁰

Unsurprisingly, the patterns were evident in major developed countries. India, home to 25% of the world’s undernourished people, “added [in 2021] 40 billionaires to 142 last year [2020], when a second wave of infections overwhelmed its health infrastructure, and pushed crematoriums and burial grounds to breaking point,” and those 40 had “almost \$720 billion in combined fortune, more than the poorest 40% of the population.”⁷¹

Inequality has a worrying negative psychological externality: stress. Research by Richard Wilkinson (1943-) and Kate Pickett (1965-), FRSA, British social epidemiologists at the University of York, presented in their 2019 book, *The Inner Level: How More Equal Societies Reduce Stress, Restore Sanity and Improve Everyone’s Well-being*, which builds on their 2009 book, *The Spirit Level: Why More Equal Societies Almost Always Do Better*, helps explain why “[t]he world’s richest large country [America], the city on a hill, sometimes seems to be coming apart.” Their books, in turn, advance the work of German-American social psychologist Erich Fromm (1900-1980), who in *The Sane Society* (1955), chronicled the strains American put on themselves by working long hours to afford and accumulate ever-more consumer goods.

Professors Wilkinson and Pickett point out mental illness is higher in less equal societies – one in 10 Germans and Japanese, versus one in five Australians and Britishers, versus one in four Americans. Their explanation for the connection between mental health and inequality is “status anxiety,” that is:

stress related to fears about individuals’ places in social hierarchies. Anxiety declines as incomes rise, ... but is higher at all levels in more unequal countries – to the extent that the richest 10% of people in high-inequality countries are more socially anxious than all but the bottom 10% in low-inequality countries. ... [In essence,] it is a person’s relative position rather than absolute income that matters most. ... It is not enough to lift all boats ... if the poshest vessels are always buoyed up more than the humblest.

...

[A]s inequality rises, differences in status become harder to ignore. There is more to be gained or lost by moving from one rung on the ladder to another. ... The steeper the income gradient, the less secure everyone

⁷⁰ *Wealth of World’s 10 Richest Men* (also noting: “Oxfam’s decision to measure the growth from the start of the pandemic, when global share prices plummeted, also skews the findings slightly. The wealth of the world’s richest is typically tied up in their stock holdings, which fell sharply in March 2020, meaning the subsequent growth was from this lower base. If Oxfam had measured from just before the pandemic began, the growth would have been less pronounced.”).

⁷¹ Archana Chaudhary, *India’s Richest More Than Double Their Fortunes During Covid Crisis*, *Oxfam Says*, BLOOMBERG QUINT (Mumbai), 17 January 2022, www.bloomberquint.com/business/tax-the-rich-in-country-with-biggest-poverty-surge-oxfam-says. [Hereinafter, *India’s Richest Men More Than Double*.]

becomes, in both their self-respect and their sense of the community's esteem.⁷²

The specific mental ills are well-known: depression, narcissism, and schizophrenia. Americans compensate by:

tak[ing] pills, to steel their nerves or dull the pain. Some cut themselves. Some adopt a more submissive posture, avoiding contact with others. ...

Others respond in the opposite way, by behaving more aggressively and egotistically. [Indeed,] ... narcissistic tendencies showed a steep increase between 1982 and 2006 ...: 30% more Americans displayed narcissistic characteristics at the end of the period than at the beginning. ...

Domineering responses to anxiety are associated with loss of empathy and delusions of grandeur. ... [T]he rich are generally less empathetic and more likely to think they deserve special treatment than others.⁷³

Is free trade to blame for all the economic and psychological dysfunctions?

Of course not. At least, trade liberalization is not the sole cause, nor even a major one. For example, Oxfam did not blame trade for the shocking rise in India's billionaires during the pandemic. Rather:

State policies including the abolition of a wealth tax in 2016, steep cuts in corporate levies, and an increase in indirect taxation are among the factors that helped make the rich richer, while the national minimum wage has remained at 178 *rupees* (\$ 2.4) a day since 2020. ... Reduced federal funding to local administrations amid growing privatizations in the health and education sectors have further boosted inequalities.⁷⁴

Indeed, given the global rise in protectionism and slump in trade, it would be illogical to target blame on imports and exports for the negative externalities trending before, and accelerating with, the pandemic. Manifestly, there are many intervening variables between laws that free up trade, on the one hand, and socioeconomic status and mental states, on the other hand.

Yet, free trade is part of the American *laissez-faire* Capitalist ethic, and “[m]odern Capitalism ... selects for assertiveness, for a lack of sentimentality in business and comfort in sacking underlings, and for showy displays of strength.”⁷⁵ For most of the post-Second

⁷² *The Crack-Up*, THE ECONOMIST, 71-72, 16 June 2018 (reviewing *The Inner Level*). [Hereinafter, *The Crack-Up*.]

⁷³ *The Crack-Up*.

⁷⁴ *India's Richest Men More Than Double*.

⁷⁵ *The Crack-Up*.

World War era, America evangelized about free trade, for good reason. Trade liberalization can have salubrious psychological externalities, opening up a world of opportunities to realize dreams unimaginable under autarky, and fostering a joyful cosmopolitan demeanor appreciative global interdependence. What America did not do is confess the reality that trade liberalization also can produce some nasty, insecure characters.

Corresponding with the rise in inequality and mental illness, America signed blockbuster trade agreements – *NAFTA* 1.0, which entered into force on 1 January 1994, and the Uruguay Round, by which the WTO was born on 1 January 1995. Since *NAFTA*, the share of trade that makes up the American GDP doubled to 28% (as of 2013). And, between 1990 and 2007, Chinese imports into the U.S. surged, leading to increased unemployment, lower wages, higher disability claims, and lower labor force participation. To be sure, when *NAFTA* entered into force in 1994, international trade supported one out of every 10 American jobs.⁷⁶ Two decades later, roughly spanning the period between the 1st and 4th editions of this Textbook, trade accounted for one out of every five jobs. Yet, for understandable reasons, the bedrock of American society, its middle and working classes, do not champion aggressive trade liberalization.

Chinese import competition is blamed for 20%-25% of manufacturing job losses, with low-skilled workers especially injured. Richard Trumka (1949-2021), President of the AFL-CIO pointed out in a March 2014 speech to the Center for American Progress:

NAFTA put corporations in charge of America's economic strategy, with the goal of shipping jobs offshore to lower labor costs. [Post-*NAFTA* trade deals] have used *NAFTA* as a starting blueprint.

[Despite] many changes in the trade template since *NAFTA* [including stronger worker rights provisions, the modified *NAFTA* template] failed to evolve with our complex and dynamic global economy.

[The consequence has been the closure of tens of thousands of American manufacturing facilities,] as major companies created more jobs offshore than at home, and imports outstripped exports year after year. [America imports electronics from China, but what it exports in return is] basically trash, like scrap metal and waste paper.

We pursued the strategy that led to structural trade deficits on purpose, because it pitted the workers of our trading partners against our own, and against each other. For their part, our trading partners short-changed their domestic markets in favor of supplying for America, so they too pushed weak unions, low wages, artificially cheap currency, and subsidies for foreign investment like tax-free export zones.

...

⁷⁶ See Len Bracken, *Ryan Says TPA Is Top Priority, Outlines Extensive Trade Agenda*, 32 International Trade Reporter (BNA) 334 (12 February 2015) (quoting Representative Paul Ryan (Republican-Wisconsin), Chairman, House Ways and Means Committee).

NAFTA worked too well. It's still keeping wages low. It's still subverting the rule of law.

...[P]roponents of these outdated agreements no longer say they're good for everyone, or even most of us. Instead, they say we don't have a choice, we have to do these agreements.

[But,] there is a better way... We need new policies to spark a virtuous cycle where rising wages fuel demand, not flimsy debt-driven demand but healthy demand, which would in turn spark business investment and more jobs and higher wages in a strong cycle of global growth that works for all our families, for the environment and our communities.

...

[We also need] strong labor rights protections so that every worker in every country can exercise fundamental human rights on the job, without fear.⁷⁷

Mr. Trumpka had empirical support for his position: 72% of Mexico's exports went to the U.S. (as of 2017).⁷⁸ That fact bespeaks not only Mexico's dependence on the American market (which, amidst difficult *NAFTA* renegotiations, it sought to reduce by boosting trade with Asia, the EU, and South America), but also the extent to which Mexican imports penetrated the American market (and thus could be blamed for U.S. job losses and wage declines). Asked succinctly, then, ever since *NAFTA*, has American trade policy been "corporatized," resulting in growth and poverty?

Again, free (or freer) trade is not necessarily the most important cause of these woes, or a cause of all of them. Technology, education, and English literacy play a significant role. An inability to utilize modern technology, which is linked to poor schooling and dreadful English, are hallmarks of the poverty trap. Indian parents know as much: even urban slums and rural huts are dotted with satellite dishes, so that kids can study online and gain fluency in the world's business language. So, too, is an inability to adapt to ineluctable automation. Human capital enhancement is essential.

American parents should know its importance, too. For the first time in U.S. history (by 2022), more manufacturing positions – jobs on factory lines as diverse as aerospace components, agricultural equipment, EVs, motorcycles, plastics, and T&A merchandise – are obtained by college (including technical school) graduates than by workers with only a high-school diploma or less, because those jobs require complex, problem-solving industrial-engineering skills, such as managing technologies and coding computer software for robots.⁷⁹ In 1991, just 22% of manufacturing workers had a college degree; in 2019,

⁷⁷ Quoted in Michael Rose, *Trumpka Outlines AFL-CIO Priorities For Future Trade Agreements Including TPP*, 31 *International Trade Reporter* (BNA) 620 (3 April 2014).

⁷⁸ See Eric Martin & Toluse Olorunnipa, *Mexico Wants August NAFTA Deal as Trump Vows "Dramatic" Action*, 35 *International Trade Reporter* (BNA) 106 (26 July 2018).

⁷⁹ See Austen Hufford, *American Factories Demand White-Collar Education for Blue-Collar Work*, *THE WALL STREET JOURNAL*, 9 December 2019, www.wsj.com/articles/american-factories-demand-white-collar-education-for-blue-collar-work-11575907185 (citing U.S. DOL Bureau of Labor Statistics data, and observing that "[i]mprovements in manufacturing have made American factories more productive than ever

that figure was over 40%.⁸⁰ Tellingly, in 2019, a Japanese robot to perform one of the few remaining T&A industry tasks for which workers had been needed:

There was only one job that robots could not do when Fast Retailing, the owner of Uniqlo, replaced 90 per cent of its workers with robots at its flagship warehouse in Tokyo last year [2018].

But now, with the help of a Japanese start-up [founded in 2011] called Mujin, the world's third-largest retailer says it has cracked the final barrier to full automation, a priority for Uniqlo as Japan's ageing population creates labor shortages. The two companies have invented a robot with two arms that can pick up soft T-shirts and place them neatly in boxes to be shipped to customers.

While it sounds easy, the ability to lift soft textiles has been a challenge for clumsy robotic arms. Add to this the need to sort through constantly changing seasonal clothes, in shades that are hard to distinguish and wrapped in various forms of packaging, and humans have always come out on top.⁸¹

Robots trump humans not only to solve a problem common in Japan, Korea, and China (labor shortages due to an aging population), but also to address a need in countries, like the U.S., which do not face an inverted demographic pyramid.⁸² That need is based on the

and ... require a third fewer workers than the nearly 20 million employed in 1979, the industry's labor peak.".) [Hereinafter, *American Factories Demand*.]

⁸⁰ See *American Factories Demand*.

⁸¹ See Kana Inagaki, *Packing T-Shirts? There's A Uniqlo Robot For That*, FINANCIAL TIMES, 24 December 2019, www.ft.com/content/79434838-2142-11ea-b8a1-584213ee7b2b?shareType=nongift.

⁸² Contrary to the conventional stereotype, India, too, ultimately faces the challenge of an aging population and inverted demographic pyramid:

By the middle of this century, India will have 1.6 billion people. That's when the country's population will finally start to decline, ending up at perhaps a billion by 2100. While that is still around 250 million more people than China will have then, every time India's population is projected, its peak seems to come earlier and crest lower. While India will be a young country for decades yet, it is aging faster than expected.

... The average Indian woman is now likely to have only two children. That's below the "replacement rate" of 2.1, at which the population would exactly replace itself over generations.

A few decades ago, this would have been considered miraculous in a country dismissed as a Malthusian nightmare. As modern health care became increasingly available after independence in 1947, population growth exploded – rising from 1.26% annually in the 1940s to 2% in the 1960s. Twenty years after independence, the demographer Sripati Chandrashekhkar became India's Health Minister and warned that "the greatest obstacle in the path of overall economic development is the alarming rate of population growth." ...

microeconomic theory of a firm competing in a Capitalist market: minimization of manufacturing costs by substituting physical capital for un- and low-skilled labor.

Simply put, automation and the enhanced human capital it demands, not merely competition from low-wage countries, contributes to the decline in manufacturing jobs. Amidst the inexorable, long-term march of technology, efforts to re-write ROOs in FTAs (as was the case with *NAFTA 2.0*), or to impose trade remedies (such as Section 232 of the *1962 Act*, and Section 301 of the *1974 Act*), to repatriate jobs are (at best) short-term palliative measures to help low- and semi-skilled workers, and (at worst) cynical ploys to win their votes.

II. Proposition 2: Stabilize New Fragile Middle Class

n the end, increasing prosperity, decreases in infant mortality and – crucially – female education and empowerment achieved more than government propaganda ever could. In urban India, the fertility rate is now 1.6, equivalent to the U.S.

This is good news. But unalloyed good news is rare in India, and this is no exception. The unexpected speed of the demographic transition has forced India to confront a new problem.

China-watchers have long debated whether that country will grow old before it gets rich. India now has to answer that same question, with far fewer resources at its disposal.

Draconian though China's one-child policy was, those born under it received unprecedented attention from their families: Average education levels rose sharply, as did the quality of their nutrition. ... [I]n the five years after 2015-16, acute undernourishment actually worsened for children in most parts of India.

... India's education system is clearly failing. Indian companies are already reporting a shortage of skilled manpower. That isn't because schools aren't turning out enough graduates: In fact, ... the unemployment rate for college graduates is 19.3%, almost three times higher than the national average. Universities just aren't producing the kind of workers that companies feel they can employ. ... [E]mployers have said that less than half the college graduates entering the workforce have the cutting-edge skills they need or the ability to pick them up in the workplace.

Moreover, too few of these young people are trying to get into the workplace at all. Two-thirds of working-age Chinese are currently either employed or looking for a job.... ... (The global average [Labor Force Participation Rate, or LPR] is close to 60%.) In India, by contrast, ... the country's LPR stands at a mere 43%...

One big reason: Just one in five Indian women work, which the World Bank has argued is linked to the social stigma of holding jobs outside the home.

Forget about growing rich: An India in which less than half of the working-age population is even looking for a job is not one that will be able to escape poverty before it grows old.

Mihir Sharma, *India Has a People Problem*, BLOOMBERG QUINT (Mumbai), 15 December 2021, www.bloombergquint.com/gadfly/india-will-likely-get-old-before-it-grows-rich.

Arguably the most remarkable but scariest shift in the global economy since the November 1989 fall of the Berlin Wall is the rise of the new fragile middle class.⁸³ More of humanity – 3 billion people, or almost half the world’s population – is in this cohort. These souls are just above the line of absolute poverty of U.S. \$1.25 per day. (In October 2015, the World Bank updated the definition of “extreme poverty” to approximately \$1.90 per day, thus adding 148 million to its ranks, with 136 million of the increase in Asia and 8 million in Africa.⁸⁴) But, they lack the hallmark of the middle class: financial security. The Asian Development Bank defines “middle class” as a *per capita* GDP of between \$2.00-20.00 per day, whereas the fragile subset manages on \$2.00-10.00 per day.

That there is a fragile middle class is remarkable, because of whence it came: from poverty. It is thanks to globalization, market capitalism, open trade and investment, better governance, and the rule of law that so many people have been lifted out of abject poverty. In 1981, 58% of the world’s population lived on less than \$2.00 per day, while just 20% (then 930 million people) were in the fragile middle class. By 1990, 1.9 billion people – far less than 58% of humanity – lived on less than \$1.25 per day. By 2010, 1.2 billion people – less than 20% of the global population – earned below \$1.25 per day.

To where did the erstwhile impoverished go during the Reagan-Thatcher Privatization Revolution of the 1980s and after the fall of the Berlin Wall in November 1989? Into the middle class: its growth has been exponential in direct relation to the inchoate victory over poverty. The largest Muslim country in the world, Indonesia, is a case in point. In 2010, of its 240 million people, 111 million lived on less than \$2.00 per day, but 125 million lived on between \$2.00-\$10.00 per day. Indonesia crossed the inflection point.

Who these people are is familiar to any traveler in the Non-Western World. They are street vendors selling fruit in Tunisia or fresh coconut juice in Sri Lanka. They are noodle stand hawkers in Malaysia and samosa vendors in India. They are office cleaners working in gleaming skyscrapers in Bangkok and microenterprise entrepreneurs in Dhaka. They are wheat farmers in Punjab and tea planters in Assam, and they grow dates in Saudi Arabia and apples in China. They design t-shirts in Mumbai once conceived in Paris. They

⁸³ The statistics cited below are from Gillian Tett, *Bad News for Western Jobs as Ideas Are Also Made in China*, FINANCIAL TIMES, 2 May 2014, 7; Shawn Donnan, Ben Bland & John Burn-Murdoch, *A Slippery Ladder*, FINANCIAL TIMES, 14 April 2014, 7. Many of the points, and more, are treated in Thomas Piketty’s best-seller, *Capital in the Twenty-First Century* (2014).

⁸⁴ See Shawn Donnan, *Rise in World Bank Poverty Threshold Set to Push Millions More Below the Line*, FINANCIAL TIMES, 24 September 2015, 1. The World Bank inaugurated the dollar-a-day metric in 1990, and was criticized for statistical arbitrariness in settling on a figure.

However, the Bank also said extreme poverty, meaning those below the new \$1.90 per day figure, had fallen from 12.8% in 2012 to 9.6% at year-end 2015 (and from 37.1% in 1990 and 29% in 1999 of the world’s population). The drop was due to progress in East Asia and the Pacific (with a decline in that region from 7.2% to 4.1% of its population, and from 60% in 1990). The worst afflicted regions were Sub-Saharan Africa, areas dependent on commodity exports, and conflict zones. See *World Bank: Extreme Poverty “To Fall Below 10%,”* BBC NEWS, 5 October 2015, www.bbc.com/news/world-34440567.

edit legal documents in Bangalore once checked by attorneys in New York. In all these examples are women and religious and ethnic minorities.⁸⁵

What these people want also is familiar to any traveler – and to any astute International Trade Lawyer. They want a bank account, smart phones, high-speed Internet access, and affordable pharmaceuticals. They want to enjoy a beer and snacks after a long workday in front of a flat-screen television while they watch on satellite TV the latest Bollywood movies or cricket test matches. They want to learn English and send their kids to private schools. They might even want to keep a small pet, say a cat, buy a small car like the Tata Nano, and take a short vacation to a nearby beach or a hill station.

Simply put, from an American perspective, our suppliers and our customers are the new fragile middle class, and *vice versa*. Therein lies a powerful beauty of the world trading system: interdependence. We need them for what they offer to us at a cheaper cost and better quality (and, typically with a smile) than we can provide. They need us to enjoy a better life than their recent squalor.

That there is fragile middle class is scary, because of where it might go: back to poverty. Will they continue to be the greatest beneficiaries of globalization, free markets, and free trade? Will governance and the rule of law help reinforce and boost their socioeconomic status? Nothing in the logic of capitalist free trade compels an affirmative answer. That logic is about net gains to a society from unilateral dismantling of trade barriers, not about how those gains are distributed within a society. Seldom do the avatars of free trade – the titans of multinational corporations and their affiliates in political

⁸⁵ One of the important yet under-researched areas of International Trade Law is the status of women and LGBTQ+ persons in the world trading system, even though two FTAs – *TPP* (Chapter 23) and *USMCA* (Chapter 23) – contain provisions on this topic. See Raj Bhala & Cody N. Wood, *Two Dimensional Hard-Soft Law Theory and the Advancement of Women's and LGBTQ + Rights through Free Trade Agreements*, 47 *GEORGIA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW* issue 2, 299-366 (2019), <https://digitalcommons.law.uga.edu/gjicl/> (with Cody N. Wood). Notably:

International trade is a male monopoly. According to the International Trade Center [a joint WTO-U.N. agency in Geneva], 99 per cent of trade and 99 per cent of procurement contracts, whether from governments or companies, are controlled by men. International data sets show economic gender inequality is visible in every country and in every domain of the economy. Uniquely gendered structural mechanisms enforce the disparities across the whole world system. A mushrooming number of studies – large-scale statistical analyses and rigorous scientific investigations – further show that this lop-sidedness reduces GDP significantly, while perpetuating poverty, hunger, slavery, and violence of all kinds, as well as geopolitical and economic instability.

Linda Scott, *It's Time to End the Male Monopoly in International Trade*, *FINANCIAL TIMES*, 20 September 2020, www.ft.com/content/054847da-3e24-43af-91bc-b15f8fc00c3a?shareType=nongift. The referenced study is International Trade Center, *Empowering Women Through Public Procurement* (2014), www.intracen.org/uploadedFiles/intracenorg/Content/Publications/Women%20procurement%20guide-final-web.pdf. See also Susan Harris Rimmer, *Gender-Smart Procurement – Policies for Driving Change*, Chatham House Research Paper (December 2017), www.chathamhouse.org/sites/default/files/publications/research/Gender-smart%20Procurement%20-%2020.12.2017.pdf (observing: “Public procurement accounts for around one-fifth of global ... GDP [, yet] [i]t is estimated that women entrepreneurs supply only 1 per cent of this market”).

officialdom – champion *sua sponte* or selflessly the cause of the fragile middle class, much less the poor. Often self-interested opportunity, or threat to self-interest, stirs them.

III. Proposition 3: Focus on Non-Western Future

The Asia-Pacific region could descend into conflict over long-standing territorial disputes, resource competition, or any other number of miscalculated reasons. Despite accounting for just 17% of world population, rich countries – including those of Europe – generate (as of April 2014) 50% of world GDP.⁸⁶ But, assuming cooler heads prevail in the Non-Western World, then heed should be paid to certain facts and projections.

First, as of 2011, the value of exports in South-South trade exceeds that of South-North trade. That is, in 2011, the value of exports from developing countries (the South) to other developing countries surpassed the value of exports from developing to developed countries (the North). In 2002, developing countries purchased 40% of total developing country exports, while developed countries bought the other 60%. In 2010, the split was 50-50. In 2011, the split crossed the 50-50 threshold. Simply put, poor countries are a more important market for other poor countries than are rich countries.

Another way to appreciate this point is in terms of the center of gravity of trade: it is moving back to the Non-Western World. This center shifted from Northern India 1,000 years ago, to the North Atlantic in the 1900s, and now is moving eastward towards China and the Far East.⁸⁷ This shift is evident from statistics on bilateral trade. In 2009, 62% of all bilateral trade was between rich, western countries, particularly Canada, the EU, and

⁸⁶ See Chris Giles, *China to Overtake U.S. As Top Economic Power This Year*, FINANCIAL TIMES, 30 April 2014, 1. [Hereinafter, *China to Overtake*.] As to whether and when China would overtake America as the world's largest economy, see Ruchir Sharma, *China's Economy Will Not Overtake the U.S. Until 2060, If Ever*, FINANCIAL TIMES, 23 October 2022, www.ft.com/content/cff42bc4-f9e3-4f51-985a-86518934afbe?shareType=nongift (arguing: "As he embarks on a third term [as President], Xi Jinping's goal is to make China a mid-level developed country in the next decade, which implies that the economy will need to expand at a rate of around 5 per cent. But underlying trends – bad demographics, heavy debt, and declining productivity growth – suggest the country's overall growth potential is about half that rate. The implications of China growing at 2.5 per cent have yet to be fully digested... [A]ssuming that the U.S. grows at 1.5 per cent, with similar rates of inflation and a stable exchange rate, China would not overtake America as the world's largest economy until 2060, if ever. Growth in the long term depends on more workers using more capital, and using it more efficiently (productivity). China, with a shrinking population and declining productivity growth, has been growing by injecting more capital into the economy at an unsustainable rate. ... China is an outlier. It would be the first large middle-income country to sustain 2.5 per cent gross domestic product growth despite working-age population decline, which began in 2015. And in China this decline is precipitous, on track to contract at an annual rate of nearly 0.5 per cent in the coming decades. Then there's the debt [which is 275% of GDP]. In the 19 countries that sustained 2.5 per cent growth after reaching China's current income level, debt (including government, households, and businesses) averaged 170 per cent of GDP. None had debts nearly as high as China's. ... Though capital – largely property investment – helped pump up GDP growth, productivity growth fell by half to 0.7 per cent last decade. The efficiency of capital collapsed. China now has to invest \$8 to generate \$1 of GDP growth, twice the level a decade ago, and the worst of any major economy.").

⁸⁷ See Andre Tartar & Cedric Sam, *How the Rise of Developing Countries Has Disrupted Global Trade*, REUTERS, 6 May 2019, www.bloomberg.com/graphics/2019-bloomberg-new-economy/global-trade-developing-nations/?srnd=premium. The statistics above are from this source.

U.S. By 2019, that share dropped to 47%, because bilateral trade between developing countries increased. In this 20-year period (2009-2018), the value of trade between emerging countries increased 10-fold. And, between 1997 and 2019, the percentage of bilateral trade in which at least one emerging country is the importer or exporter rose from 38% to 53%. The share of total bilateral trade in which both countries are developing is 14% (as of 2017) and is forecast to cross the 50% threshold by 2100. Moreover, the number of countries that count the majority of their trade with emerging markets has risen from 19 in 2009 to 64 in 2019.

Second, the share of poor countries in global trade has risen markedly since 1991. In that year, they accounted for 16% of world trade. Over the next 20 years, their share rose an average 0.8%. So, by 2011, developing countries accounted for 32% of world trade. In contrast, exports from traditional powers like the EU and Japan grew relatively less robustly, and even fell. So, *The Economist* observed:

As rich economies falter, middle-income ones grab more of their export markets. As middle-income countries move up the chain, poor ones occupy the less-crowded space of low-wage manufacturing.⁸⁸

This move-up-the-chain phenomenon is unsurprising to International Trade Lawyers and Development Economists who know Stages of Growth Theory. (This Theory, presented in 1960 by W.W. Rostow in *The Stages of Economic Growth: A Non-Communist Manifesto*, is covered in the *E-Textbook*.)

Third, still another telling statistic is the differential rates of growth of exports between poor versus between rich countries. Between 2001 and 2011, exports from rich to poor countries rose at an annual average clip of 11%. In contrast, exports between rich countries rose 7% a year. So, as *The Economist* rightly put it: Not only is the South more important to the poor; it is more important to the rich, too.”⁸⁹

That is true for imports as well as exports: not only are poor countries increasingly important export markets for rich countries, but also they are prominent sources of imports into rich countries. For instance, in 2013, over 54% of U.S. imports came from developing countries.⁹⁰ The increasing reliance of developed countries on export market access and import sourcing from developing countries should not be surprising: as a consumption location for exports from developed countries, developing countries are where the vast new middle class with a voracious appetite is; and as a production location for imports into developed countries, developing countries boast both a large supply of cheap labor and significant human capital. Simply put, demographics are a key determinant of trade patterns and trends.

⁸⁸ *O for a Beaker Full of the Warm South*, THE ECONOMIST, 19 January 2013, 72. [Hereinafter, *Beaker*.]

⁸⁹ *Beaker*.

⁹⁰ See Ye Xie, *Made-in-America Revival Signals Emerging Trouble: Currencies*, 31 International Trade Reporter (BNA) 932 (22 May 2014).

Fourth, in *Global Trends 2030*, published in 2012, the U.S. National Intelligence Council (NIC) acknowledged that:

With the rapid rise of other countries, the “unipolar moment” is over, and “*Pax Americana*” – the era of American ascendancy in international politics that began in 1945 [with the end of the Second World War] is fast winding down.⁹¹

This quadrennial report, reflecting the views of all 16 intelligence agencies, unmistakably identified Europe, Russia, and Japan as powers in relative decline, and Asia as the ascendant region.⁹² The U.S. “will retain its central role, because it will remain the only country able to mobilize coalitions to address global challenges.”⁹³

Hence, as the NCI put it, America in 2030 still will be “first among equals.”⁹⁴ As for China, subject to constraints of an ageing population, environmental degradation, gross income inequalities, and socio-political unrest, it may challenge America economically, technologically, politically, and militarily. But, hostility from its neighbors near and far create support for the U.S. as a bulwark against China.

IV. Proposition 4: Watch Europe

“Never mind Europe, focus on the Non-Western World” might be one, albeit undiplomatic, bit of advice for even those planning on a career in the EU. That would be bad advice. Much of their business and legal affairs will be with Asia, regardless of whether their base is Brussels or Boston. Some in the American law professoriate have an enduring endearment with Europe justified by comfort zones but not facts or forecasts, with

⁹¹ Quoted in Geoff Dyer, *Rise in Asian Power to Hasten Demise of “Pax Americana,”* FINANCIAL TIMES, 11 December 2012, 4.

⁹² In this respect, consider who is likely to test with increasing frequency International Trade Law, and how and why. International Trade Law is tested not only by traditional hegemonic powers like America and the EU, but also by emerging leaders like the BRICS, Islamic countries like the Kingdom of Saudi Arabia, and tiny countries like Antigua. That is no surprise.

In 1990, the share of world trade accounted for by advanced economies was 75%. By 2012, that share had fallen to slightly above 50%, meaning that developing and some least developed countries are rising in prominence, partly because of relatively more robust economic and export growth. China is the most obvious example: its share of world economic output (measured in current dollar terms) rose from less than 2% in 1992 to 10% in 2012.

Similar statistics exist with respect to FDI. In 2000, the U.S. held 37% of the worldwide inward stock of FDI. By 2012, that share was just 17% share. See James Politi, *Obama Push on Inward Investment,* FINANCIAL TIMES, 28 October 2013, 1. To where did that stock of investment migrate? Emerging markets, which tested the historical advantage of the U.S.: a large consumer market with high purchasing power, certainty and predictability in the rule of law, modern infrastructure, and good governance. In all these areas, America suffered varying degrees of dysfunction, while the challengers, many of which were in the Non-Western World, had “upped their game.”

⁹³ Geoff Dyer, *Rise in Asian Power to Hasten Demise of “Pax Americana,”* FINANCIAL TIMES, 11 December 2012, 4.

⁹⁴ Quoted in Geoff Dyer, *Rise in Asian Power to Hasten Demise of “Pax Americana,”* FINANCIAL TIMES, 11 December 2012, 4.

consequent Euro-centrism in books and course materials. It would be uncharitable and probably erroneous to condemn Europe and its uneasy Union to irrelevance in the global trading order. But, are Europe's best centuries behind it?

Hopefully not. True, some signs suggest Europe is haggard: demographics (Europe is full of grey hair), finances (some countries in Europe are effectively bankrupt), vigor (much of Europe seems, well, tired), secularism (Europe denies its roots), Brexit (Europe lost its second largest economy on 29 March 2019), and chaos (for example, over refugee and asylum policy). No less than the first non-European Pope in 1,300 years, Francis (1936-), said as much in November 2014 in a speech to the European Parliament (the legislature for the then pre-Brexit 28-state EU) in Strasbourg:

In many quarters we encounter a general impression of *weariness and aging*, of a Europe which is now a “grandmother,” *no longer fertile and vibrant* [In too many cases, the Judeo-Christian values and the humanist ideals that inspired European continental unity seem to have been supplanted by] the *bureaucratic technicalities of its institutions*. ...

...

Europe seems to give the impression of being somewhat *elderly and haggard*, feeling less and less a protagonist in a world which frequently regards it with aloofness, mistrust and even, at times, suspicion. ...

...

[New life for the European project] depends on the recovery of the vital connection [among transcendental values and the talents and needs of Europeans]. A Europe that is no longer open to the *transcendent dimension of life* is a Europe which risks slowly *losing its own soul* and that “humanistic spirit” which it still loves and defends. ...

...

[While EU discussions frequently reference human rights, they lack attention to correlative duties.] As a result, the rights of the individual are upheld, without regard for the fact that each human being is part of a social context wherein his or her rights and duties are bound up with those of others and with the *common good* of society itself.⁹⁵

⁹⁵ *Pope Calls European Parliament to Rejuvenate “Grandmother” of Europe*, CATHOLIC NEWS SERVICE, 25 November 2014, www.catholicnews.com/data/stories/cns/1404908.htm. (Emphasis added.)

For a superb study of Vatican diplomacy and how Pope Francis transformed it, see Victor Gaetan, *God's Diplomats: Pope Francis, Vatican Diplomacy and America's Armageddon* (London, England: Rowman and Littlefield, 2021). Indeed:

Vatican diplomacy has diverged sharply from U.S. foreign policy under Pope Francis, according to a new book, which details examples to illustrate the widening divide. “While Francis has continued the pragmatism of his two predecessors, he’s also a skilled administrator, who’s mobilized the whole diplomatic corps with its interlocking assets to implement a culture of encounter,” said author Victor Gaetan.

...

It [the book] maintains the Pope’s diplomacy has worked better than the “militarized approach” of recent U.S. policy and demonstrates advances achieved by the Vatican as a mediator and reconciler, even with countries once considered hostile.

These realities, not to mention the feeling in the cities, towns, villages, marketplaces, factories, and farms, are different in countries from India, Indonesia, and Malaysia, to Singapore, South Africa, and Vietnam.

This and the previous Proposition connote a *E-Textbook* designed to prepare readers for the next half century should not be monochromatic, focusing on Europe along with America. Rather, it should enhance familiarity with the Non-Western World (with Latin America included in that term) to which their business increasingly gravitates. And yet, neither should readers downplay the historic and potential future importance of Europe.

...

He [Mr. Gaetan] added that veteran U.S. officials viewed Rome's "*Ostpolitik*" toward Eastern Europe as "the jewel of Vatican diplomacy" and said many foreign policy shapers had praised the "professionalism and deep knowledge" of Vatican diplomats.

...

As examples of divergent Vatican-U.S. approaches, growing since St. John Paul II's "deep opposition" to the 2003 invasion of Iraq, the book cites the Vatican's refusal to demonize Russia, cultivating it instead as a "valued Christian ally," and encouragement of Christian leaders in Syria who rallied around President Bashar Assad.

...

Pope Francis defied harsh U.S. criticisms with a renewed 2020 Vatican agreement with China, recognizing a joint process for selecting Bishops while giving the Pope the final say.

He added that Pope Francis, who has visited 52 countries since his March 2013 election, wielded power as a "moral authority," but also exercised "broad and deep control" over the Vatican's diplomatic apparatus.

"The Holy See under Pope Francis no longer has a Western European outlook," Gaetan said.

"He's deeply frustrated with Western powers, especially the U.S., as arms merchants fomenting conflict, and he sees little difference between the imperial pretensions of the U.S., Russia or China," he added.

...

Although "smaller than the Pentagon and its parking lot," the Vatican can draw on a school of diplomacy founded by Pope Clement VI in 1701, Gaetan said, noting that diplomacy emphasizes impartiality, dialogue and "showing faith through charity."

The Holy See has full diplomatic ties with 181 states and a permanent presence in around 40 international organizations, from the United Nations and its agencies to the Council of Europe and Arab League.

... Gaetan said Popes had shown "power of prediction" by opposing the 1919 *Treaty of Versailles*, which "punished Germany too harshly" after World War I, and by resisting U.S. pressure to approve the Korean War in the 1950s and curb dialogue with Soviet ruler Nikita Khrushchev in the 1960s.

Jonathan Luxmoore, *Author Says Pope Has Mobilized Diplomats to Create Culture of Encounter*, CATHOLIC NEWS SERVICE (28 July 2021), www.catholicnews.com/author-says-pope-has-mobilized-diplomats-to-create-culture-of-encounter/#noredirect.

**V. Proposition 5:
Advance Social Justice**

If the rules by which nations trade do not advance the common good through higher levels of production, employment, and wages, and through better distribution of consumption and employment opportunities, and income, then those rules are unjust. Utilitarian-based economic efficiency ought not alone to be the benchmark for evaluating International Trade Law. Rather, Social Justice also should be considered.

Social Justice calls for more than an examination of the free trade–fair trade dichotomy, which itself is a distinction that is often used for political gain, but rarely defined with precision, and subject to shifting perceptions. (For example, in 1993, 51% of Democrats said the EU was a “fair” trading partner of the U.S., and 27% said so of Japan.⁹⁶ In 2018, those figures rose to 70% and 65%, respectively.) Social Justice demands an examination of the effect of International Trade Law on human dignity. Each person is unique, unrepeatable, and of inestimable value. It calls for emphasis on the common good. Calculating winners and losers, and moving forward based on cost-benefit, is less satisfactory than advancing the interests of all. To analogize to the economic concept of Pareto improvements, why not seek changes that advance the interests of all parties, or at least and make no single party worse off?

International Trade Law, if it is socially just, should promote subsidiarity. Decision-making should be decentralized to the furthest extent possible. Doing so, not only promotes human dignity, but also builds and respects communities. The WTO ought not to be the precursor to global trade governance, for to make it so would ride rough shod over people and localities. Finally, Social Justice in trade rules also means that if choices must be made, a preferential option should be given to the poor.

Few contemporary figures on the world stage have spoken with a more poignant combination of candor and theology more candidly about the application of these principles as the Holy Father, Pope Francis. Consider his statement to the 2014 annual gathering of the world’s elite in Davos, Switzerland:

Ours is a time of notable changes and significant progress in different areas which have important consequences for the life of humanity. In fact, “we must praise the steps being taken to improve people’s welfare in areas such as health care, education and communications” ([Apostolic Exhortation,] *Evangelii Gaudium* [*Joy of the Gospel*], 52 [24 November 2013]), in addition to many other areas of human activity, and we must recognize the fundamental role that modern business activity has had in bringing about these changes, by stimulating and developing the immense resources of human intelligence.

⁹⁶ See Jenny Leonard, *How Democrats Could Help or Hurt Trump’s Next Trade Policy Moves*, 35 *International Trade Reporter* (BNA) 1459 (15 November 2018) (citing Gallup surveys).

Nonetheless, the successes which have been achieved, even if they have reduced poverty for a great number of people, often have led to a widespread social exclusion. Indeed, the majority of the men and women of our time still continue to experience daily insecurity, often with dramatic consequences. ... I wish to emphasize the importance that the various political and economic sectors have in promoting an inclusive approach which takes into consideration the dignity of every human person and the common good. I am referring to a concern that ought to shape every political and economic decision, but which at times seems to be little more than an afterthought. Those working in these sectors have a precise responsibility towards others, particularly those who are most frail, weak and vulnerable. It is intolerable that thousands of people continue to die every day from hunger, even though substantial quantities of food are available, and often simply wasted. Likewise, we cannot but be moved by the many refugees seeking minimally dignified living conditions, who not only fail to find hospitality, but often, tragically, perish in moving from place to place.⁹⁷

Surely such remarks at least compliment the work of secular NGOs against marginalization and exclusion in the global economy.

Social Justice is one species of justice. Another type pertinent to International Trade Law is Distributive Justice. Here, inequalities are justifiable only if they work to the advantage of the least well off. Query whether, and to what extent, trade agreements are negotiated, drafted, and executed from behind that Rawlsian veil of ignorance.

VI. Proposition 6 Understand Schisms

International Trade Law is inherently divisive, both among countries and within countries. Moreover, there are no long-term alliances, across borders or within borders, among trading nations. President Donald J. Trump (1946-, President, 2017-) put it well at a February 2020 Prayer Breakfast:

We have allies. We have enemies. Sometimes the allies are enemies, but we just don't know it.⁹⁸

The harsh reality is systemic stability, in the sense of equilibrium across all rules, is not enduring.

There is, for example, constant pressure to change or get exemptions from rules – so called “differentiated” treatment, whether for “developing” countries or for “sensitive”

⁹⁷ *Message of Pope Francis to the World Economic Forum in Davos*, 17 January 2014, www.news.va/en/news/message-of-pope-francis-to-the-world-economic-foru.

⁹⁸ *Quoted in Andrea Shalal & David Lawder, As Trump Takes Aim at EU Trade, European Officials Brace for Fight*, REUTERS, 11 February 2020, www.reuters.com/article/us-usa-trade-europe-analysis/as-trump-takes-aim-at-eu-trade-european-officials-brace-for-fight-idUSKBN2051AK.

sectors. That partly is a result of the rise of global supply chains and shifting patterns of trade within those chains. Globalization not only has de-nationalized consumption, allowing consumers to opt for an array of goods from multiple countries, but also it has de-nationalized production. Production of goods and services involves value added chains that ignore borders, a phenomenon possible partly by information technology. The chains are constructed, creatively destroyed, and reconstructed elsewhere based on interdisciplinary variables, not the least of which are economic and political. Thus, interdependence through an alliance of producers-suppliers-exporters-importers-consumers one day can shift another day.

Schisms in International Trade Law also result from politics. Consider Dubai, a commercial *entrepôt* with the political aspiration of rivaling Singapore as one of the world's greatest low-cost import-export centers. In working toward this goal, Dubai has navigated another political reality: American sanctions against Iran, Dubai's "traditional commercial partner."⁹⁹ The replacement for Iran is Africa, and Chinese companies are particularly prominent in funneling imports and exports to Africa via Dubai. Therein lies a third political reality: the increased attention of China on Africa's natural resources to fuel China's energy needs in competition with those of India and the U.S.

An illustration both marvelous and flummoxing of the schismatic challenges posed by de-nationalized production came in January 2014. The mighty Tokyo-headquartered auto company, Honda, announced that exports of its cars from its factories in America exceeded its imports of cars into the U.S.¹⁰⁰ It thus became the first Japanese car manufacturer to become a net exporter of cars from the U.S., which is the second largest car market in the world. It opened its first American plant in 1982. Between 2011-2013, Honda invested \$3 billion to increase production capacity at its four plants in Alabama, Indiana, and Ohio. As America's fifth largest car company (measured by sales in 2013), Honda had good reason for localizing production: avoid currency risks (*e.g.*, dollar depreciation relative to the *yen*); take advantage of FTA networks, like *NAFTA* (indeed, Mexico was the destination for most of its American output); minimize shipping and distributions costs; and, of course, jump over tariffs and NTBs.

What does this fact mean for International Trade Law? Does it mean the Laws of Absolute and Comparative Advantage, developed by Adam Smith (1723-1790) and David Ricardo (1772-1823) are wrong, insofar as they presume producer-exporters are domestic citizens? Or, do those Laws operate regardless of the nationality of producer-exporters? Does it mean trade remedy laws are outdated, because imposing an AD duty, CVD, or safeguard on imports might hurt American companies manufacturing abroad and shipping home to the U.S. – the classic pattern (before the decoupling associated with the Sino-American Trade War) with China as their export platform? Simply put, when actors in cross-border trade find geography irrelevant, what happens to the rules that govern them, which are based on geography, and underlying it, sovereign spaces? As for America, what

⁹⁹ Simeon Kerr, *Dubai Optimism Fails to Mask Concerns on Overheating Risk*, FINANCIAL TIMES, 28-29 December 2013, 4.

¹⁰⁰ See Jennifer Thompson & Henry Foy, *Honda's U.S. Exports Overtake Imports*, FINANCIAL TIMES, 29 January 2014, 11.

does it mean for its international trade policy? Should it be suspicious of FTAs, the critics of which charge accelerate the decline of American industry? Or, should it take note that FTAs might be contributing to the “steady hollowing out” of the Japanese industrial base?¹⁰¹

Another intriguing point about schisms is that sometimes they are not allowed to appear too openly. Theoretically, WTO Members are equal. They should work out disagreements through patient, persistent negotiation, resulting in consensus decision-making. Thus, only once in the history of the WTO has there been a vote. That happened in 1995, shortly after its birth: there was a show of hands to approve the accession of Ecuador.¹⁰² The reality, however, is rather different. The U.S. strongly opposes voting in the WTO. Why? Voting is a “nuclear option,” and (unlike the International Monetary Fund and World Bank), it is not weighted among Members by their budgetary contributions to the Organization. So, the U.S. would be reduced to one country, one vote, as in the U.N. The act of voting could be an adverse precedent for America, which results in precedents in terms of substantive decisions that are adverse to American interests. In other words, voting could expose schisms between the U.S. and much of the rest of the world, with determinations in favor of the latter.

VII. Proposition 7: See Dichotomies

International Trade Law is divisive in respect of the relationship between multilateral and RTAs. There are (based on notifications to the WTO as of 31 July 2013) “574 RTAs, of which 379 are in force.”¹⁰³ On average, each WTO Member belongs to 13 different FTAs or CUs. Thus, the average Member must administer 14 different regimes of International Trade Law – the texts of the GATT and associated WTO agreements, plus 13 other FTAs or CUs. This dichotomy creates technical difficulties (while good work for lawyers). They are evident (*inter alia*) in relation to ROOs.

The dichotomy between multilateral and FTA regimes creates tensions. First, while trade liberalization via FTAs may catalyze efforts to reduce barriers at the GATT-WTO level, FTAs also can sap multilateralism of its vitality. If a country secures market access for most of its exports through a web of FTAs, why pursue multilateral talks? Indeed, Jagdish Bhagwati dubs all trade agreements, save for multilateral ones, as “termites in the trading system.”¹⁰⁴ They are sub-optimal, not first-best solutions for free trade, but second best, partial ones.

¹⁰¹ Ben McLannahan & Shawn Donnan, *Twin Forces Lead to Japan’s Worst Trade Deficit*, FINANCIAL TIMES, 28 January 2014, 4.

¹⁰² See Daniel Pruzin, *WTO Bali Package in Limbo; Cuba, Latin American Allies Block Deal*, 30 International Trade Reporter (BNA) 1920 (12 December 2013).

¹⁰³ See Daniel Pruzin, *G-20 Leaders to Call for Greater Transparency in Regional Free Trade Talks*, 30 International Trade Reporter (BNA) 1339 (5 September 2013).

¹⁰⁴ See JAGDISH BHAGWATI, *TERMITES IN THE TRADING SYSTEM: HOW PREFERENTIAL AGREEMENTS UNDERMINE FREE TRADE* (2008).

Interestingly, the converse problem also exists. Attention to multilateral talks may make it difficult to focus on regional ones. Indeed, the USTR, Ambassador Carla Hills, “was initially cool to the idea” of *NAFTA*, because she and her fellow negotiators were focused on the Uruguay Round.¹⁰⁵ Signed in December 1992, *NAFTA* discussions began in 1986; that Round was launched in September 1986 and finished in December 1993.

Second, there are diminishing returns to the value of preferences under FTAs and CUs. Each new such deal erodes the distinctiveness of the preference of prior deals. Some countries in an earlier-in-time arrangement may feel economically disadvantaged relative to parties to a later-in-time deal. This erosion helps explain the appeal of “mega-regionalism,” that is, FTAs involving a large number of countries across one or more regions, such as the *CPTPP*, involving 11 countries, and a long-sought after FTA, such as *T-TIP*, between America and Europe. With multiple countries as parties to a single deal, erosion of one smaller deal between two countries by one of them entering another smaller deal with a third country is less a concern – all such countries are in the megadeal.

Further, countries not included in one or another FTA or CU may feel excluded not only in an economic sense, but also in a geopolitical one. That is especially true for poor countries relying on the *GSP* for market access into rich countries: as the latter sign ever-more and ever-deeper FTAs, and include some developing countries in those FTAs, the value of *GSP* treatment for the excluded ones is reduced. And, smaller countries excluded from FTAs with the likes of the U.S. may feel their concerns – such as placing disciplines on farm or fisheries subsidies – cannot be addressed by an FTA, because (like climate change) the problem is global, demanding a multilateral solution.¹⁰⁶

¹⁰⁵ Shawn Donnan, *World Faces Up to the Era of Regional Agreements*, FINANCIAL TIMES SPECIAL REPORT – THE FUTURE OF NAFTA, 3 December 2013, 1 (quoting Robert Zoellick).

¹⁰⁶ At any given juncture, Schisms (Proposition 6) and Dichotomies (Proposition 7) are manifest in a few key economic sectors. Their legal problems sometimes shape International Trade Law. Most obviously, agriculture (particularly food commodities or valuable natural resources), industry (particularly steel and T&A), services (particularly banking, finance, insurance, and telecommunications), and IP (particularly patented pharmaceuticals), drive many trade negotiations. Yet another example is government procurement, which accounts for 20% of the GDP of the EU, and indeed about that amount for the world. To ignore the fact some sectors are strategic, and some are sensitive, is to study International Trade Law at too abstract a level.

Consider the vital importance of services in trade negotiations. Frustrated by the lack of progress in the Doha Round, starting in 2012, the U.S. pursued a plurilateral *Trade in Services Agreement* (*TISA*, or *TSA*), and sought to liberalize service trade via a major FTA, the *TPP*. That made strategic sense for two reasons: roughly 80% of America’s GDP and labor force is engaged in services, and foreign trade barriers to American service imports often are worse than tariffs on American goods. China and Mexico are cases in point. The average Chinese and Mexican levies on all American goods (as of December 2013) are 8% and 5%, respectively. When Chinese and Mexican barriers to American services are converted to a tariff equivalent metric, the equivalent tariffs are 66 and 44%, respectively. Similarly, in India, the equivalent tariff barrier is about 70%. See Edward Luce, *Obama Cannot Lead from Behind on Trade*, FINANCIAL TIMES, 9 December 2013, 11 (citing research by Edward Allen, Council on Foreign Relations); Edward Alden, *Obama: Building Trade to Build Growth*, REUTERS, 5 December 2013; <http://blogs.reuters.com/great-debate/2013/12/05/obama-building-trade-to-build-growth/>.

Simply put, there is considerable room for the U.S. to negotiate reductions by foreign countries in their barriers to the sector of greatest importance to the American economy. That also is true for other developed countries, even with respect to advanced developing countries like Mexico. Mexico (as of March 2017) has an average MFN tariff on manufactured goods of 8%, and 20% on agricultural goods.

VIII. Proposition 8: Link National Security and Public Health to Trade

International Trade Law is an instrument of national power. In discussing FTA negotiations such as *TPP* amidst the collapse of multilateralism with the death of the Doha Round, the *Financial Times* observed:

Stop counting carrier fleets, fighter jets, and cruise missiles. America's wars in Iraq and Afghanistan showed the limits of military might. Today's great games revolve around another dimension of power. Geopolitics is making way for geoeconomics.¹⁰⁷

Market access through a network of FTAs projects commercial power in the way an aircraft carrier projects air power. If military power can protect market access, by safeguarding shipping channels, then so much the better. Of all world trade, 90% is conducted across oceans, and a vital element in American national security strategy is keeping shipping lanes safe from pirates, terrorists, or other threats to commerce.

What, then, has changed from previous centuries of colonialism backed by gunboat diplomacy? One answer concerns the broadening and deepening of cross-border supply chains. Consider the November 2019 admonition about the fragility of the Pentagon's supply chain for warships, because "many contractors were reliant on single suppliers for certain high-tech and high-precision parts, increasing the likelihood they would have to be procured from geostrategic rivals."

Mr. Spencer said [to the *Financial Times*] the U.S. was engaged in "great power competition" with other global rivals and that several of them – "primarily Russia and China" – were "all of a sudden in your supply chain, [which is] not to the best interests of what you're doing" through military procurement. He said he was particularly concerned about China, saying he believed Beijing was trying to "weaponize capital" through its Belt and Road Initiative. He accused Beijing of offering developing countries "loan to own" debt that they could not pay back in order to gain leverage over critical assets. "You go to a country in need, you fill that need which they are grateful for, but at some point do they turn around and go: 'You know

In turn, providing better quality services to a broader number of people can help alleviate poverty. Consider health care. In the developed world, 80% of children diagnosed with cancer survive, whereas in many parts of the developing world, the rate is just 10%. It is higher in some developing countries, but not by much: in Rangoon, Burma, it is 30%. See Shawn Donnan, *Bringing First-World Care to Developing Nations*, FINANCIAL TIMES, 25 November 2013, 8. The availability of advanced health care research, diagnostic, and treatment services in rich countries is the key factor that explains why a cancer diagnosis is not a death sentence in them, but tends to be one in poor countries. Reducing barriers to trade in medical and nursing services, allowing greater access of First World providers into the Third World, can change the reality that 94% of childhood cancer deaths occur in low- and middle-income countries.

¹⁰⁷ Philip Stephens, *Trade Trumps Missiles in Today's Global Power Plays*, FINANCIAL TIMES, 22 November 2013, 9.

what, everybody out, we're going to use this now ... the keys are mine'?" Mr Spencer said. "There's nothing that prevents that."¹⁰⁸

Simply put, national security is enhanced or imperiled, respectively, to the extent friends or foes make up the value-added chains for goods or services used for military or dual military-civilian purposes.

Another answer is that International Trade Law can be an instrument of national power deployed for the common good. It can (indeed, ought to) advance the cause of "peace through trade," reduce fear and anxiety, and thereby enhance national security. In the 21st century, America lacks the resources, and perhaps the will, to police all of the world's oceans all of the time. So, it must forge and nurture friendships, and rely on them, as it did in 2009 to form a coalition of over 80 countries named the "Contract Group on Piracy off the Coast of Somalia." The game is not a zero-sum one of mercantilism and empire, but of a win-win mutually beneficial open trading environment. After all, a trading relationship characterized by domination is not sustainable. Sooner or later, the exploited will revolt against the exploiter.

To be sure, the causal direction between peace through trade is much in doubt. Consider this September 2022 *Financial Times* viewpoint:

"The story of the human race is war," said Winston Churchill. "Except for brief and precarious interludes, there has never been peace in the world; and before history began, murderous strife was universal and unending."

In recent decades, policymakers and business leaders who attended gatherings at Davos and had the ears of western leaders were inclined to think otherwise. After the fall of the Berlin Wall in 1989, a near-consensus prevailed among them that peace was the natural condition of the developed world, and that globalization was immune from geopolitical risk.

This confidence extended to a belief that generating prosperity through trade was conducive to democracy in developing countries – a notion that played an important part in the west's decision to welcome China into the global economy and grant it membership of the World Trade Organization in 2001. There is, of course, a superficial plausibility in a logic that echoes Shakespeare's Julius Caesar, who declared "Let me have men about me that are fat" because he feared the "lean and hungry look" of the murderous Cassius.

The extraordinary post-Cold War climate of optimistic liberal internationalism was accompanied by notable complacency among central bankers and mainstream economists, who trumpeted a decline in

¹⁰⁸ Peter Spiegel & Andrew Edgecliffe-Johnson, *U.S. Navy Secretary Warns of "Fragile" Supply Chain*, FINANCIAL TIMES, 4 November 2019, www.ft.com/content/b9260d54-fcf4-11e9-98fd-4d6c20050229?shareType=nongift.

macroeconomic volatility that they dubbed the “Great Moderation.” There followed the great financial crisis of 2007-09.

Now war in Ukraine and strategic competition over Taiwan with an enduringly undemocratic China have given a new edge to Churchill’s Hobbesian observation – all the more so since Vladimir Putin’s announcement ... partial mobilization of reserves, together with hints that Russia might now deploy nuclear weapons. And then there is the possibility that Xi Jinping’s increasingly assertive China could inflict further damage on western industrialists and investors. The question is: how did the developed world sleepwalk into this mercantile trap?

John Maynard Keynes famously remarked, in his *General Theory of Employment, Interest and Money*: “The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else.” The big idea behind western capitalism’s growing economic interdependence with authoritarian, nuclear-armed bedfellows is one usually attributed to the French enlightenment thinker Montesquieu, best known for his advocacy of the separation of powers incorporated in the US constitution. In *De l’Esprit des Lois*, published in 1748, he claimed: “The natural effect of commerce is to bring peace. Two nations that negotiate between themselves become reciprocally dependent, if one has an interest in buying and the other in selling.”

This economic brand of liberal internationalism, which was shared by such thinkers as Adam Smith, Voltaire, and Spinoza, reached its apogee in the first great period of globalization that lasted from the 19th into the early 20th century. John Stuart Mill believed commerce was making war obsolete, while the pacifist and anti-imperialist Richard Cobden, campaigner for the repeal of the Corn Laws, declared: “I see in the free-trade principle that which shall act on the moral world as the principle of gravitation in the universe – drawing men together, thrusting aside the antagonism of race and creed and language, and uniting us in the bonds of eternal peace.”

The seminal text of this idealist, liberal tendency was a book published in 1910 called *The Great Illusion*, by the British journalist and politician Norman Angell. Its theme was the futility of war in conditions of economic interdependence. Angell argued that the gains of victory were always outweighed by the costs. Then came the assassination in 1914 of Archduke Franz Ferdinand of Austria by the Bosnian Serb student Gavrilo Princip. This and the ensuing great war dealt a catastrophic blow to liberal economic internationalism. It demonstrated precisely that nationalism and tribal instinct can trump economic interest.

...

The curious thing is that the devastation wrought in two world wars did not prove fatal for Montesquieu's nostrum. In proposing the establishment of the European Coal and Steel Community in 1950, French Foreign Minister Robert Schuman declared that he wanted a process of European economic integration to "make war not only unthinkable but materially impossible." That process, aimed at preventing further war between France and Germany and cementing a broader peace across Europe, paved the way for the EU.

...

... [W]ealth in modern economies, which relates more to people than natural endowments, is much harder to steal through force than was the case with agricultural and early industrial societies. The decline in the value of disputed territory relative to technological innovation means that the proceeds of resource theft via conquest are increasingly threadbare – a point indicating that Angell's thinking was not entirely without substance, even if its predictive power was nugatory. It also highlights that hacking government computer systems and stealing corporate intellectual property are low-cost alternatives to warfare.

Indeed, globalization itself may have reduced the spoils of territorial conquest by making it easier to acquire resources via markets rather than the use of force. Had there been a global energy market in 1941, Japan might not have felt a need to attack Pearl Harbor in a preventive action designed to secure access to energy and natural resources in the Pacific region.

...

Europe remains a continent in which it can be convenient to believe in commerce as a substitute for foreign policy, particularly in the case of Germany. The country makes a striking case study on the trade and peace thesis, given its chronic export dependency and extensive overseas investments. Understandably, in the light of history, post-war German politicians have not wished to play a foreign policy role commensurate with Germany's size in the world economy. They have cloaked themselves in the mantle of the EU.

Under chancellors Gerhard Schröder and Angela Merkel, the country pursued a policy of *Wandel durch Handel*, or "change through trade." This led to extreme energy dependence on Russia. It was, in effect, an outgrowth of *Ostpolitik*, the policy of engagement with the Soviet Union pursued by chancellor Willy Brandt in the 1960s and 1970s.

The snag is that trade brought the wrong sort of change. By waving a green flag to the Nord Stream 2 Russia-to-Germany gas pipeline after Russia's annexation of Crimea in 2014, Germany sent a signal to Putin that he could probably invade Ukraine with impunity. It pursued a similar "change through trade" policy towards China, sharing the U.S. assumption that integrating China into the global economy would make it more politically liberal. Yet China failed to oblige western expectations.

The two states now find themselves at odds over Hong Kong, Taiwan, and the South China Sea. This sits uncomfortably with German industry's huge investment in China, especially in the motor industry. More than a third of total sales of Volkswagen, BMW, and Mercedes-Benz take place there. VW is estimated to rely on the country for at least half of its annual net profits.

This entails a marked geopolitical vulnerability. And as VW's recently fired Chief Executive, Herbert Diess, remarked last year: "China probably doesn't need VW, but VW needs China a lot."

Rafał Ulatowski, a foreign policy specialist at the University of Warsaw, argues that Germany's Indo-Pacific strategy in recent years shows that economic ties do not determine the behavior of states. While in the short term, close economic relationships may have a moderating effect on a state's behavior, he adds, in the long run strategic interests prevail.

Another point overlooked by liberal internationalists is one made by Keynes in the interwar period as he retreated from his earlier liberalism. He worried that economic interdependence could increase the scope for friction between countries, even to the point of provoking war. Interestingly, economic relations within the eurozone often resemble war by other means.

...

...

What was striking about the second great period of globalization [after the 1939-1945 Second World War] was its much greater intensity than in the first episode before 1914 [and the 1914-1918 First World War]. This was reflected in the larger number of countries participating in the global trading system, very complex cross-border industrial supply chains and the frenetic internationalization of finance.

It was all hugely successful in increasing global welfare. ... [T]he IMF's Kristalina Georgieva, Gita Gopinath, and Ceyla Pazarbasioglu say the forces of integration "boosted productivity and living standards, tripling the size of the global economy and lifting 1.3 bn people out of extreme poverty."

But these successes, they add, came at the cost of widening inequalities and social dislocation in many countries. By creating losers as well as winners, globalization thus made for a backlash. Populist politicians, most notably Donald Trump, sought an answer in welfare-reducing trade wars with China, among others.

The second great globalization also tended to confirm Keynes's misgivings about trade because its sheer intensity increased the potential for weaponizing trade and financial relations. The western sanctions [discussed

in a separate Chapter] in response to Putin’s invasion of Ukraine were unprecedented in their ferocity, covering not only companies, banks, and Putin’s crony oligarchs, but also squeezing Russia out of the dollar-based global financial system. This was done by freezing much of Russia’s war chest of \$600 bn of reserves. Several Russian commercial banks have been excluded from the SWIFT messaging system for cross-border payments.

...

What is clear is that the high tide of the second great globalization has passed. While the prospect might not be quite as bleak as in Churchill’s Hobbesian vision, the world is undoubtedly a more dangerous place than it was before the confluence of calamities. There can be no denying that economically liberal internationalism has, at least in aggregate, enhanced global welfare. But it has once again delivered a very disappointing political outcome.¹⁰⁹

That clarity is obvious on the Indian Subcontinent.

In other words, warring parties are unlikely to drop their weapons and start commerce in the hopes of building peace, particularly if they have not agreed on an international political boundary between them. This unlikelihood seems a near certainty in respect of India and Pakistan (with respect to the disputed Kashmir boundary) and Israel and Palestine (with respect to the disputed boundary of the two states). But, at least as among countries with mutually recognized boundaries, such as Iran and the U.S., there is no *a priori* reason to rule out the possibility trade could yield a mutually beneficial and respectful interdependence. And, where boundaries are unsettled, hope fueled by a positive provision lives on.

In underscoring the inextricable link between trade and national security, *i.e.*, stating that trade policy is (a component of) national security policy, it is vital to appreciate the breadth of what “national security” means. Yes, “national security” obviously is about military equipment and securing a supply chain for ordnance. Yes, it is about maintaining strong agricultural, industrial, and service bases in strategic areas to ensure a country has the economic means it needs to defend itself from invasion and unwanted foreign influence. But, national security also is about public health, that is, protecting citizens from diseases and disease-bearing pests that threaten their lives, and thus their ability to contribute to GDP and national defense.

In an unprecedented way, the late 2019-mid-2020 COVID-10 pandemic undermined faith in globalization as a means to protect vulnerable populations. Consider the April 2020 evaluation and prediction of John Gray, the lead Book Reviewer for Britain’s *New Statesman*:

¹⁰⁹ John Plender, *Why Trade Couldn’t Buy Peace*, FINANCIAL TIMES, 22 September 2022, www.ft.com/content/a3c224d1-c604-4393-9c32-922f634ab36a?shareType=nongift

This [pandemic] is not a temporary rupture in an otherwise stable equilibrium: the crisis through which we are living is a turning point in history.

The era of peak globalization is over. An economic system that relied on worldwide production and long supply chains is morphing into one that will be less interconnected. A way of life driven by unceasing mobility is shuddering to a stop. Our lives are going to be more physically constrained and more virtual than they were. A more fragmented world is coming into being that in some ways may be more resilient.

...

In the view of the future to which progressive thinkers cling, the future is an embellished version of the recent past. No doubt this helps them preserve some semblance of sanity. It also undermines what is now our most vital attribute: the ability to adapt and fashion different ways of life. The task ahead is to build economies and societies that are more durable, and more humanly habitable, than those that were exposed to the anarchy of the global market.

This does not mean a shift to small-scale localism. Human numbers are too large for local self-sufficiency to be viable, and most of humankind is not willing to return to the small, closed communities of a more distant past. But the hyper-globalization of the last few decades is not coming back either. The virus has exposed fatal weaknesses in the economic system that was patched up after the 2008 financial crisis. *Liberal capitalism is bust.*

With all its talk of freedom and choice, liberalism was in practice the experiment of dissolving traditional sources of social cohesion and political legitimacy and replacing them with the promise of rising material living standards. This experiment has now run its course. Suppressing the virus necessitates an economic shutdown that can only be temporary, but when the economy restarts, it will be in a world where governments act to curb the global market.

A situation in which so many of the world's essential medical supplies originate in China – or any other single country – will not be tolerated. Production in these and other sensitive areas will be re-shored as a matter of national security. The notion that a country such as Britain could phase out farming and depend on imports for food will be dismissed as the nonsense it always has been. The airline industry will shrink as people travel less. Harder borders are going to be an enduring feature of the global landscape. A narrow goal of economic efficiency will no longer be practicable for governments.

The question is, what will replace rising material living standards as the basis of society? One answer green thinkers have given is what John Stuart

Mill in his *Principles of Political Economy* (1848) called a “stationary-state economy.” Expanding production and consumption would no longer be an overriding goal, and the increase in human numbers curbed. Unlike most liberals today, Mill recognized the danger of overpopulation. A world filled with human beings, he wrote, would be one without “flowery wastes” and wildlife. He also understood the dangers of central planning. The stationary state would be a market economy in which competition is encouraged. Technological innovation would continue, along with improvements in the art of living.

In many ways this is an appealing vision, but it is also unreal. There is no world authority to enforce an end to growth, just as there is none to fight the virus. ...

Of course, economic expansion is not indefinitely sustainable. For one thing, it can only worsen climate change and turn the planet into a garbage dump. But with highly uneven living standards, still rising human numbers and intensifying geopolitical rivalries, zero growth is also unsustainable. If the limits of growth are eventually accepted, it will be because governments make the protection of their citizens their most important objective. Whether democratic or authoritarian, states that do not meet this Hobbesian test will fail.

...

The texture of everyday life is already altered. A sense of fragility is everywhere. It is not only society that feels shaky. So does the human position in the world. Viral images reveal human absence in different ways. Wild boars are roaming in the towns of northern Italy, while in Lopburi in Thailand gangs of monkeys no longer fed by tourists are fighting in the streets. Inhuman beauty and a fierce struggle for life have sprung up in cities emptied by the virus.

...

Technology will help us adapt in our present extremity. Physical mobility can be reduced by shifting many of our activities into cyberspace. Offices, schools, universities, GP [General Practice] surgeries and other work centers are likely to change permanently.

...

What the virus is telling us is not only that progress is reversible – a fact even progressives seem to have grasped – but that it can be self-undermining. To take the most obvious example, globalization produced some major benefits – millions have been lifted out of poverty. This achievement is now under threat. *Globalization begat the de-globalization that is now under way.*¹¹⁰

¹¹⁰ John Gray, *Why This Crisis is a Turning Point*, NEW STATESMAN, 1 April 2020, www.newstatesman.com/international/2020/04/why-crisis-turning-point-history. (Emphasis added.)

Thus (as chronicled in a separate Chapter), in March-April 2020, amidst the coronavirus crisis, several countries enacted export bans to protect domestic supply chains of pharmaceuticals and medical devices they deemed essential to fight the coronavirus, and which they feared would be in short supply if they relied on international markets for procurement. Simply put, trade policy not only is (a component of) national security policy, but also health policy. In turn, there should be no surprises to see military generals and public health scientists at a trade negotiating table.

IX. Proposition 9: Pay Special Attention to India and China

Across all Propositions, India and China are a common denominator. But, that denominator is not always of the same value. India and China are similar and different.

They have achieved impressive economic growth. They combat gross income disparities and argue they need the special dispensations in international trade rules that come with developing country status (Propositions 1 through 4). They side with each other, or with different countries, in international trade negotiations, depending on the issue, and some of their trade measures are the subject of dispute, being criticized for contributing to gross trade imbalances (Propositions 5 and 6). Such measures often involve raw materials, T&A, the steel industry, or the banking, insurance, or telecommunications sectors (Proposition 6). By no means is it certain their Membership in the WTO (particularly the accession of China on 11 December 2001) has resulted in reduced political or military tensions with their Asian neighbors (including not only Taiwan *vis-à-vis* China, but China and India themselves), or the U.S. (Proposition 7). And, China's much ballyhooed accession has not yielded the widespread civil liberties and human rights freedoms everyday Indians have enjoyed since Independence from Britain on 15 August 1947.¹¹¹ China, since the CCP took power by force on 1 January 1949, remains an authoritarian, officially atheistic state; modern India is a secular democracy struggling to adhere to the principles of its "*Bapu*" (Father), Mohandas K. (Mahatma) Gandhi (1869-1948).

India boasts the third largest economy in the world, following China and America.¹¹² Measuring its GDP in PPP terms, India jumped from Number 10 in 2005 to Number 3 in 2014. The Indian economy doubled, from 19% of the size of America's in

¹¹¹ Similarly, the extent to which the human rights climate in Vietnam improves following its 11 January 2007 WTO accession and participation in FTA negotiations, such as the *TPP*, is unclear. There was speculation the Communist government would free dissidents, and loosen restrictions on freedom of speech, as the Communist government sought to build trust with its western trading partners. The extent to which it does so, and whether it does so in a sustained manner (*i.e.*, it avoids regressive crack downs), is uncertain. See John Boudreau, *U.S.-Vietnam Ties, Trade Negotiations May Free More Critics, Freed Blogger Says*, 31 International Trade Reporter (BNA) 1975 (6 November 2014) (discussing the views of Vietnamese blogger Nguyen Van Hai, also known as Dieu Cay, who was sentenced in 2012 to 12 years imprisonment for spreading anti-government propaganda, but released in October 2014 and re-settled in Los Angeles, as a goodwill gesture amidst FTA negotiations with the U.S. and EU).

¹¹² See *China to Overtake*.

As discussed in a separate Chapter, PPP corrects for exchange rate and inflation differences by measuring the value of the same basket of goods and services (*e.g.*, an apple, a laptop computer, a haircut, and a medical checkup) in real terms in different countries.

2005 to 37% in 2011. India is of considerable importance to America: with the world's third largest middle-class consumer market, it is (as of 2013) America's 18th largest export market.¹¹³ Boasting a diverse array of products, from precious stones and rice to pharmaceuticals and textiles, India is the 10th largest origin of America's imports. A flagship company, Tata Consulting Services (TCS), sponsors the world's largest marathon, New York, dropping the troubled European bank, ING, in 2014.¹¹⁴ Similarly, American law firms outsource to Indian lawyers an array of tasks.

For all its promise, Indian reforms launched in 1991, have yet to be thorough in their ambition or implementation. From Srinagar to Trivandrum, and Amritsar to Calcutta, India has nothing close to a 21st century infrastructure. India requires an investment of roughly \$1 trillion to modernize its roads, ports, telecommunications network, and other features required for any economy to realize its comparative advantages in the world trading system. Further, until India grapples with its monstrous and pervasive corruption, the small person will stay small. These problems lie at the central and sub-central government levels. Special note should be taken of the latter, for two reasons. First, GATT-WTO obligations generally apply to sub-central governments as much as they do to central governments. Second, state – not central – governments are the cause of delay for 80% (as of May 2014) of large infrastructure projects vital to India's progress.¹¹⁵

But, as any traveler to India knows, there is serenity in the world's largest free market democracy. It is ancient civilization that is the most religiously pluralistic nation in human history. Somehow, India survives, and moves forward, if at times at an elephant's pace referred to as the "Hindu rate of growth" of around 5% that allows the nation to keep pace, or barely outpace, population growth. For all the suffering of the poor and fragile middle class, there is a joy on the streets and in the villages of India matched in China by a widespread (but by no means universal) morose anxiety enveloped in an oppressive climate.

Whether this atmosphere will be sustained with the resurgence of *Hindutva* – Hindu-ness, or loosely, Hindu nationalism – stoked by authoritarian political leadership operating closely with favored business interests is uncertain. India cannot continue the claim to the moniker "world's largest free market, secular democracy" if its tolerance of freedom of conscience and thought narrows. Also uncertain is whether India can address three other challenges, in addition to its infrastructure, if it is to match, let alone overtake, China in growth and development: continued urbanization and industrialization, without their negative labor and environmental externalities, and human capital enhancement, *i.e.*,

¹¹³ See Stephanie Cohen, *Obama, Modi Agree to High-Level IP Working Group, Financing, Infrastructure Initiative*, 31 International Trade Reporter (BNA) 1748 (2 October 2014).

¹¹⁴ Your *E-Textbook* author ran the last ING sponsored New York Marathon on a crisp autumn day in November 2013, finishing in 3:37:34, with his wife and daughter greeting him at the finish line. (He now runs shorter distances instead.)

¹¹⁵ See Victor Mallet, *Faith in Modi's Free Market Credentials is Misguided*, FINANCIAL TIMES, 5 May 2014, 2.

talent upskilling, through an education that does better than churn out at students at poor functional literacy levels.¹¹⁶

Put differently, there also is a race to get rich before India ages out, a race with which China is familiar. China competes by presents itself as offering to the world an alternative to Western-style economic growth and development, and thereby to the largely Western-influenced pattern India has followed:

“The East is rising; the West is declining,” goes a saying that has gained popularity in Beijing this year [2021, particularly in connection with the 1 July centenary of the CCP], reflecting a country brimming with confidence, if not hubris.

In the past decade, China and the Party have prospered in the face of the global financial crisis as Western nations struggled. They have seen off former U.S. President Donald Trump and the instability he spawned. In just the last year, after the bungling of the outbreak of COVID-19 in Wuhan, Chinese growth has rebounded faster than any other major economy.

In modern times, China’s people have never been richer, its industries more advanced and its military stronger.

Most strikingly of all, the Party has pulled this off while adhering to and nurturing steadfast loyalty to Marxist-Leninism, a credo and philosophy discarded, derided and occasionally outlawed in the high councils of government in developed nations.

...

However modern China’s economy might be, the political system is traditionally Communist. Every leader of any influence and standing is a CCP member. There are no opposition parties, and no open competition is allowed for high office.

“The consistent argument that the Party makes for its systems of institutions includes the case that socialism is better at marshaling collective effort for development, a claim [Chinese President] Xi [Jinping] frequently evokes today,” said Daniel Tobin, of the National Intelligence University.

To be sure, this is Socialism with Chinese characteristics, Deng Xiaoping’s flexible formula that allowed the CCP to strengthen single-Party rule even as it liberalized the economy and made room for a vibrant entrepreneurial sector.

...

¹¹⁶ See Vrishiti Beniwal, Shruti Mahajan, Eltaf Najafizada & Ruchi Bhatia, *India Races to Get Rich Before It Gets Old as Population Passes China*, 20 April 2023, www.bloomberg.com/news/articles/2023-04-19/india-races-to-get-rich-before-it-gets-old-as-population-passes-china?leadSource=verify%20wall&sref=7sxw9Sxl.

The Party's Leninist organizational framework has been strengthened under his [Xi's] leadership. So too has the Marxist notion that the Party is both an instrument and vehicle of history for China to regain its place as a global superpower.

In editions of *Qiushi*, the CCP's flagship ideological journal whose title translates as *Seeking Truth*, Xi's articles in the lead-up to the anniversary have focused on collections of his quotes on history.

"Through the learning of history, it is not difficult to find that without the leadership of the CCP, the country and the Chinese nation could not have made today's achievements and could not have obtained today's international status," Xi wrote in an article in June [2021].

Anyone who questions the Party's word on history and the revisions that have gathered pace under Xi runs the risk of going to jail. Querying Party history and the official pantheon of Party heroes embedded within it amounts to the crime of "historical nihilism."

...

Like Hu Jintao and Jiang Zemin, who preceded him as Party General Secretary, Xi has ordered rank-and-file members to study the demise of the Soviet Union as an abject lesson of the fate that awaits a weak party.

But for all its attention to learning lessons from the wreckage of other communist states, the CCP is increasingly focused on the road ahead rather than the rear-view mirror. Once, it was content with building and defending socialism within its own borders. Now, the CCP sees a global playing field for its endeavors.

"[China] offers a new option for other countries and nations who want to speed up their development while preserving their independence," Xi said in his address to the 19th Party Congress." And it offers Chinese wisdom and a Chinese approach to solving the problems facing mankind."

Xi's statement, little-noticed when it was made in 2017, has blossomed into a small cottage industry. Spearheaded by the Belt and Road Initiative and multiple efforts to take over the leadership of international organizations, Beijing's promotion of its model as an alternative form of governance has gone mainstream.

"For most of the world's developing and less developed countries, China's major moves in development have made them eschew Western models," said Wang Wen, a prominent state ideologue, on the eve of the anniversary.

Wang points out that about 100 countries have gained independence since World War II, but only a handful of economies, including South Korea and

Taiwan, have reached middle-income status. “If it happens,” he said, “China, as a country with a population more than 20 times bigger than South Korea, will have a greater effect and play a more important pilot role in reaching the high-income stage.”¹¹⁷

In world trade, the role China plays is one India does not. India is the biggest of the 100 countries stuck below middle-income status. (Of course, repeatedly on multiple occasions, the negative external effects of the CCP’s behavior have been challenged at the WTO, as, for example, in September 2021. In the context of a 206-page *Trade Policy Review* of China’s since 2018, Australia, Canada, EU, Japan, U.K., and U.S. criticized Chinese for its (1) failure to reform its economy consistent with market-based principles as required by China’s 2001 *WTO Accession Protocol*, (2) forced labor practices, (3) national security restrictions on trade, and (5) lack of transparency in notifying the WTO of its subsidy programs.¹¹⁸)

Growth in China has exceeded that “Hindu rate.” In 1979, when reforms spearheaded by Deng Xiaoping were launched, the *per capita* income of China was U.S. \$180. Over the next three decades, Chinese GDP grew by an historically unprecedented annual average of 10%. By 2013, Chinese *per capita* GDP was about \$8,000. Between 1990 and 2012, China leaped from having just 2% of world trade in tangible goods to 12%.

Yet, China was – and still is – both a developing and developed country.¹¹⁹ China is developing in that its *per capita* GDP ranks 100 in the world.

China is developed in that, as of 2013, it was the second largest economy in the world, measured by GDP, following the U.S. and surpassing Japan. In 2014, the World Bank announced China became the world’s largest economy, measured in PPP terms, displacing the U.S. from the top spot, which America held since 1872 when it overtook the United Kingdom.¹²⁰ Whereas India sometimes disappoints expectations, China often exceeds them: it was not projected to beat America until 2019. The pace of its growth, even discounting for inaccuracies and falsehoods in official CCP statistics, is breath taking. In 2005, its GDP in PPP terms was 43% of that of the U.S.; by 2011, it was 87%. Between 2011 and 2014, the Chinese economy expanded by 24%, whereas the American economy grew by just 7.6%.

¹¹⁷ Richard McGregor, *The Lives of the Party: The Chinese Communist Party Turns 100*, NIKKEI ASIA, 30 June 2021, <https://asia.nikkei.com/Spotlight/The-Big-Story/The-lives-of-the-party-The-Chinese-Communist-Party-turns-100>. For the text of President Xi’s CCP centenary speech, see *Full Text of Xi Jinping’s Speech on the CCP’s 100th Anniversary*, NIKKEI ASIA, 1 July 2021, <https://asia.nikkei.com/Politics/Full-text-of-Xi-Jinping-s-speech-on-the-CCP-s-100th-anniversary>.

¹¹⁸ See World Trade Organization, Trade Policy Review Body, *Trade Policy Review, Report By The Secretariat, China*, Summary, 10-15, WT/TPR/S/415, (15 September 2021), www.wto.org/english/tratop_e/tpr_e/s415_e.pdf.

¹¹⁹ See *China Should be More Active in Global Economic Governance, Lamy Tells Beijing Forum*, World Trade Organization (Speech of Pascal Lamy to China Development Forum), 24 March 2013, www.wto.org.

¹²⁰ See *China to Overtake*.

Concomitantly, China is the largest holder of U.S. Treasury securities, and second only to Canada as America's largest trading partner. China is the largest source of American imports (thus being the second largest market for Chinese exports), and the third largest market for U.S. exports. At least that all was true before the Sino-American Trade War, which began in March 2018. Like it or not, America and China were, and to a notable degree still are, broadly and deeply interdependent. In 2013, the U.S. and China ranked first and second as the top destinations for FDI.

They also compete with one another on non-military fronts. And they clash, a lot, increasingly on military fronts amidst claims of nefarious behavior that undermines the rules-based global political economy and recriminations of containment. America and China thus are locked in what (at present) seems to be a forever trade war that has spilled over into trade-related matters. Their conflict touches on multiple Chapters in all eight Volumes of this *E-Textbook*. But it is so vast and deep I cover it in *Trade War: Causes, Conduct, and Consequences of Sino-American Confrontation*.¹²¹ That book may be regarded as a *de facto* Volume 9 to this *E-Textbook*, or as a separate, stand-alone work.

Notwithstanding the Sino-American Trade War (indeed, before it erupted), thanks to its export-oriented growth success that contrasted with India's traditional inward-looking growth strategies, the Chinese Communist Party pulled hundreds of millions of Chinese citizens out of poverty, the greatest poverty reduction in human history:

In 1990 there were more than 750 million people in China living below the international poverty line – about two-thirds of the population.

By 2012, that had fallen to fewer than 90 million, and by 2016 ... it had fallen to 7.2 million people (0.5% of the population).

So clearly, even in 2016 China was well on the way to reaching its target.

This suggests that overall, 745 million fewer people were living in extreme poverty in China than were 30 years ago [*i.e.*, 1990 versus 2020].¹²²

In March 2021, President Xi Jinping (1953-, President, 2013-), said the CCP met a goal he set when he became President to raise 100 million Chinese out of absolute poverty.¹²³ In 2010, China defined a person to be in “poverty” if that person lived in a rural area and earned less U.S. \$2.30 per day (adjusted for inflation). (China supplemented this threshold of income poverty with metrics for education, healthcare, and living conditions.) That figure is higher than the World Bank's line for extreme poverty, which is \$1.90 per day.¹²⁴

¹²¹ Published by Carolina Academic Press, Durham, North Carolina, 1st edition, 2023.

¹²² Jack Goodman, *Has China Lifted 100 Million People Out of Poverty?*, BBC NEWS, 28 February 2021, www.bbc.com/news/56213271 . [*Has China Lifted?*]

¹²³ *Has China Lifted?*

¹²⁴ However, the official CCP number for extreme “poverty” reportedly was lower than that of the World Bank:

India still is indisputably poor. Indeed, “India, had 22% of its population living below the international poverty line in 2011”¹²⁵ – and the fact 2011 data were the most recent available itself is an indictment of Indian governance. By contrast, as of March 2021, Vietnam had made China-like progress on absolute poverty, and Brazil, a country that shared with India a proclivity to import substitution, had “4.4% of its people earning less than \$1.90 a day.”¹²⁶

To be sure, the human rights costs China paid India would never incur: (1) assaults on human dignity, such as female infanticides, forced abortions, and a one-child policy, all of which led to the deaths of upwards of 100 million Chinese girls; (2) the destruction of two civilizations, Tibetan Buddhist and Uyghur Muslim, and (3) assaults on human freedom, thanks to endless efforts, some extraterritorial, by the CCP to repress freedom of speech, association, and conscience. Moreover, more credit should be given to the Chinese people, as distinct from the CCP, for successes in the war against poverty: As David Rennie of *The Economist* put it, “Chinese people, by working extremely hard, lifted themselves out of poverty – in part because some of the stupidest economic policies ever created, by Chairman Mao, were abandoned in favor of versions of Capitalism.”¹²⁷

Chinese President Xi Jinping says his country has achieved the “miracle” of eradicating extreme poverty.

His government says that over an eight-year period, nearly 100 million people have been lifted out of poverty.

... Mr Xi said it was a “complete victory” that would “go down in history.”

But some experts have questioned the way this has been measured. In China, extreme poverty is defined as earning less than \$620 (£440) a year.

...

“According to the current criteria, all 98.99 million poor rural population have been taken out of poverty, and 832 poverty-stricken counties as well as 128,000 villages have been removed from the poverty list,” he said.

...

But some experts say that China has set a low bar in its definition of poverty, and that ongoing investment is needed in its poorest areas.

The threshold set by China to define extreme poverty amounts to \$1.69 a day at current exchange rates, compared to the World Bank’s global threshold of \$1.90....

Wide income inequalities also continue to exist in the country.

China’s Xi Declares Victory in Ending Extreme Poverty, BBC NEWS, 25 February 2021, www.bbc.com/news/world-asia-china-56194622.

¹²⁵ *Has China Lifted?*

¹²⁶ *Has China Lifted?*

¹²⁷ *Quoted in Has China Lifted?* (also noting: “Mao Zedong, who founded the People’s Republic of China in 1949, oversaw attempts to industrialize the country’s peasant economy in the 1950s. His disastrous

Great Leap Forward, which began in 1958, forced farmers into communes, leading to mass starvation in the countryside.”). The Chinese people knew well when the Party went too far, as it did in December 2021 when it tried to mandate a three-child policy:

Chinese Communist Party members were asked to personally implement China’s “three-child” policy in a commentary that went viral before being deleted, the [Hong-based] *South China Morning Post* reported.

Screenshots of the article, originally published on a state-affiliated website, sparked heated discussion on China’s Twitter-like Weibo, where users expressed outrage and shock at its instructions.

“Those who do not have three children should be expelled from the Party and those who did not have three children should not be allowed to join the party. Is it 2021 now? Did I travel in time?” asked one user. “When going on blind dates in the future, people will no longer ask how many apartments you have, they will ask: are you a party member. If yes, then can say goodbye,” joked another.

...
The number of children born in China has plummeted in recent years, despite government efforts to encourage births. Earlier this year [2021] the government allowed all couples to have three children [as discussed in a separate Chapter], but early signs indicate that the number of newborns continued to decline this year.

It’s unclear what the government can do to reverse the trend of falling birth rates, which is a phenomenon seen in most developed nations across the world. It may also be too early to see much effect of any “third-child policy” – after decades of enforcing a “one-child policy,” most families don’t even have a second child.

Call For China Cadres to Have Three Kids Sparks Outrage, BLOOMBERG, 9 December 2021, www.bloomberg.com/news/articles/2021-12-10/call-for-china-cadres-to-have-three-kids-sparks-outrage-deleted?sref=7sxxw9Sxl. One month later, more data confirmed the coldness of the demographic winter China faced:

China announced ... [in January 2022] its birthrate plummeted for a fifth straight year in 2021, moving the world’s most populous country closer to the potentially seismic moment when its population will begin to shrink, and hastening a demographic crisis that could undermine its economy and even its political stability.

The falling birthrate, coupled with the increased life expectancy that has accompanied China’s economic transformation over the last four decades, means the number of people of working age, relative to the growing number of people too old to work, has continued to decline. That could result in labor shortages, which could hamper economic growth, and reduce the tax revenue needed to support an aging society.

The situation is creating a huge political problem for Beijing, which is already facing economic headwinds. Along with the demographic data, the country reported ... in the last quarter of the year [2021] slowed to 4 percent.

China’s ruling Communist Party has taken steps to address the birthrate decline, by relaxing its notorious “one child” policy, first allowing two children in 2016 and as many as three since last year [2021]. It is also offering incentives to young families and promising improvement in workplace rules and early education.

None have been able to reverse a stark fact: An increasing number of Chinese women don’t want children.

“China is facing a demographic crisis that is beyond the imagination of the Chinese authorities and the international community,” said Yi Fuxian, a Professor at the University of Wisconsin-Madison, who has long argued that China’s Communist Party leaders were underreporting population figures.

The number of births fell to 10.6 million in 2021, compared with 12 million the year before, according to figures reported ... by the National Bureau of Statistics. That was fewer even than the number in 1961, when the Great Leap Forward, Mao Zedong’s economic policy, resulted in widespread famine and death.

For the first time since the Great Leap Forward, China’s population could soon begin to contract. The number of people who died in 2021 – 10.1 million – approached the number of those born.... Some demographers say the peak may already have occurred.

“The year 2021 will go down in Chinese history as the year that China last saw population growth in its long history,” said Wang Feng, a Professor of Sociology at the University of California, Irvine, adding that the 2021 birth rate was lower than the most pessimistic estimates.

...

“I don’t really want to spend my savings on kids,” said Wang Mingkun, 28, who lives in Beijing and teaches Korean language. “I actually don’t hate kids,” she went on. “I actually like them, but I don’t want to raise any.”

Steven Lee Myers & Alexandra Stevenson, *China’s Births Hit Historic Low, a Political Problem for Beijing*, THE NEW YORK TIMES, 17 January 2022, www.nytimes.com/2022/01/17/world/asia/china-births-demographic-crisis.html?referringSource=articleShare. [Hereinafter, *China’s Births Hit Historic Low*.] See also *China’s Population Flatlines With Fewest Births Since 1950*, BLOOMBERG, 16 January 2022, www.bloomberg.com/news/articles/2022-01-17/china-s-population-flatlines-with-fewest-births-since-1950?sref=7sxxw9Sx1 (reporting: “There were 1.41 billion Chinese people in Mainland China at the end of last year [2021], a 480,000 increase from the level at the end of 2020. Of those, 62.5% were of working-age, which China defines as people aged 16 to 59, down from more than 70% a decade ago, highlighting the challenges the country faces as its population ages [(Emphasis added.)].”).

The authoritarian impulse of the CCP – censoring proposals to mitigate the demographic decline – retarded the Party’s ability to address the problem:

Because the “one child” rule was a pillar of Communist Party policy for decades, questions about its consequences have become politically fraught. When a prominent economist wrote ... [in January 2022] that the way to solve China’s declining birth rate was to print trillions of bank notes, he was promptly censored online.

Ren Zeping, the economist, wrote in a research paper ... that if Beijing set aside the equivalent of \$313 billion to help pay for incentives such as cash rewards, tax breaks for couples and more government child-care facilities, it would fix the problem. “China will have 50 million more babies in 10 years,” he explained in a research paper he posted on his social media account.

When his suggestion provoked a fierce debate online, his social media account on *Weibo* was suspended for “violation of relevant laws.”

China’s Births Hit Historic Low.

Notably, in January 2023, provincial officials – in Sichuan – took matters into their own hands. They eliminated all restrictions on the number of children a couple could have, and most tellingly, eliminated the requirement that a couple be married to register and gain the benefits for, their child. Simply put, a single Mother and her child were legally cognizable under Sichuan’s rules. See Megan Fisher, *Sichuan: Couples in*

Indeed, thanks to the inverted demographic pyramid characterizing China, “domestic demographers ... lament[ed] that China will get old before it gets rich, slowing the economy as revenues drop and government debt increases due to soaring health and welfare costs.”¹²⁸

So, China not only is the greatest opportunity for energetic exporters and importers around the world, but also the greatest threat to the multilateral trading system (and, perhaps, the CCP to human dignity). Fear of competition from China on an MFN basis is a causal factor in the failure of WTO Members to conclude successfully the Doha Round. China, while implementing some of the WTO decisions against it, flagrantly violates many of the foundational principles, or pillars, of the GATT. It failed to liberalize its markets for services and FDI in the manner it pledged when it acceded to the WTO, and since 2006, it reneged on some of its liberalization reforms in trade in goods. China stands accused of manipulating its currency for at least a decade, deliberately under-valuing it to boost exports.

Whether the government of China embodies the values appropriate for full, honest participation in the world trading system is in question. Indeed, the long-term stranglehold of the CCP on power cannot be presumed.¹²⁹ Unthinkable in India except for the briefest

Chinese Province Allowed to Have Unlimited Children, BBC News, 30 January 2023, www.bbc.com/news/world-asia-china-64457367 (reporting: “For decades, the country had a one-child policy - increased nationally for married couples to three in 2021. As part of the policy change in Sichuan, unmarried individuals will also now be able to raise children. Previously there was a ban on single women registering a birth. ... Now, there will be no limit on the number of children people can have in Sichuan, a province of 80 million people in the southwest of the country.”). See also *China’s Sichuan Frees Unmarried People to Legally Have Children*, Reuters, 30 January 2023, www.reuters.com/world/china/chinas-sichuan-frees-unmarried-people-legally-have-children-2023-01-30/ (reporting: “Health authorities in China’s southwestern province of Sichuan will allow unmarried individuals to raise a family and enjoy benefits reserved for married couples, in the latest effort to bolster a falling birth rate.”).

All official efforts seemed to fail. In January 2023, China announced its population had fallen for the second straight year. See Farah Master, *China’s Population Drops for Second Year, with Record Low Birth Rate*, REUTERS, 17 January 2024, www.reuters.com/world/china/chinas-population-drops-2nd-year-raises-long-term-growth-concerns-2024-01-17/ (reporting: “The National Bureau of Statistics said the total number of people in China dropped by 2.08 million, or 0.15%, to 1.409 billion in 2023. That was well above the population decline of 850,000 in 2022, which had been the first since 1961 during the Great Famine of the Mao Zedong era. ... Long-term, U.N. experts see China’s population shrinking by 109 million by 2050, more than triple the decline of their previous forecast in 2019.”); *China Population Extends Record Drop on Covid Deaths, Low Births*, BLOOMBERG, 16 January 2024, www.bloomberg.com/news/articles/2024-01-17/china-population-extends-historic-decline-as-covid-deaths-surged?sref=7sww9Sxl (“China’s population declined at a faster pace in 2023 as births fell to a record low, accelerating a demographic shift that poses long-term challenges to a government already contending with deflation pressures and a property crisis. ... For China, a rapidly aging society would bring further headwinds to its flagging economy, in part by hurting long-term demand for housing. The government may also struggle to pay for its underfunded national pension system. ... One in five of the mainland’s 1.4 billion people were 60 or older at the end of 2022 — with the ratio set to exceed 30% in a decade....”).

¹²⁸ *China’s First Population Drop*.

¹²⁹ For contrasting views offered in May 2020, amidst the coronavirus pandemic and China’s controversial response to it in late 2019, alongside America’s blundering one in early 2020, see, e.g.:

(1) Jamil Anderlini, *China’s Communist Party Will Survive COVID-19*, FINANCIAL TIMES, 21 May 2020, www.ft.com/content/6075d728-99ae-11ea-8b5b-63f7c5c86bef?shareType=nongift (arguing

of periods (the 1974-1976 Emergency Period under Prime Minister Indira Gandhi, who promptly was voted out of office at the next general election), the CCP is cited repeatedly for complicity in human rights atrocities, the 4 June 1989 Tiananmen Square incident being a pre-eminent illustration. In its paranoid efforts to retain its grip on power, the CCP systematically represses any group or person it perceives as a challenge to the authority of the Party. That is manifest not only in its treatment of Tibetan Buddhists, but also in its ordination of Catholic bishops who do not have approval from the Holy See (Vatican). Marking the end of 2016, senior CCP leader Yu Zhengsheng intoned:

Chinese Catholics must run their church independently, implying at arm's length from the Vatican, and guide believers on a "Sinicization path"....

...

Catholics should "run their church independently and better integrate it into society"....

"The church should adhere to the principles of self-administration, run religious affairs independently and guide believers to adhere to the Sinicization path of the religion"....

...

-
- “[b]y embracing capitalism, the Communist Party was able to meet its end of the [post-June 1989 Tiananmen Square “massacre”] bargain [*i.e.*, “stay away from politics in exchange for ever-rising prosperity”],” [because] the CCP “achieved high levels of ‘output legitimacy’ by improving people’s daily lives despite the nearly total absence of ‘input legitimacy’ in the form of popular participation in deciding who governs and how,” admitting “behind closed doors, Chinese leaders have worried for decades that their legitimacy rests too much on rapid growth and wondered what will happen when the expansion comes to an end,” but concluding that “[s]ince February [2020], the Communist Party’s image at home has been helped immeasurably by the disastrous virus response from other major countries, especially the U.S. and U.K., “[s]hrill rhetoric from U.S. President Donald Trump’s regime, blaming China for the pandemic, has helped Beijing build solidarity and nationalism,” thus “[t]hrough some in the west wish China was on the cusp of open rebellion, they are likely to be disappointed”); versus,
- (2) Rosalind Mathieson, *China Blew a Chance at Global Leadership Responding to Covid-19*, BLOOMBERG QUINT, (Mumbai), 21 May 2020, www.bloombergquint.com/businessweek/china-blew-opportunity-to-lead-during-coronavirus-crisis (contending that “[r]ather than seizing the chance to bring countries further into its orbit, China ... sent the message that it sees its rise to global primacy as inexorable – and that other nations should simply bow to that fact ... [because] China was a cornerstone of supply chains worldwide,” [i]t had splashed enormous sums of money on infrastructure projects in the developing world and bought into key companies everywhere,” and [i]ts military reach is growing,” so “[i]t didn’t need to win over others,” and observing that “[e]quality among nations is not a natural concept for them,” sa[id] William Reinsch, Scholl Chair in International Business at the Center for Strategic and International Studies (CSIS) and a U.S. Department of Commerce official in the Clinton Administration,” thus “[t]hey [*i.e.*, the CCP] are busy telling the world that their model of a heavily state-directed economy and a repressive undemocratic political system works better than the Western system and is the wave of the future,” and concluding “[f]oreigners may not be the audience for this display of [Chinese] nationalistic ire,” [because while] [s]triking a patriotic tone is standard fare for China’s leaders in times of domestic challenge,” “[t]he Communist Party’s No. 1 concern is mitigating the risk of social unrest, an obsession heightened by the economic devastation wrought by Covid-19,” [so] Beijing may not set a numerical target for gross domestic product growth this year [2020],” and “[o]ne way to minimize domestic political damage is to rally people behind the idea that China is under attack overseas,” an accusation which foreign audiences see through – and reject).

The Sinicization of religion is likely a reference to bringing religion under Chinese influence.

Chinese Catholics must “unify patriotism with affection for the Church” and “unite all believers to contribute to construction of the socialism with Chinese characteristics”¹³⁰

“Sinicization” is an Orwellian term.

“Sinicization” means religion should be “under Chinese influence,” which in turn means the faithful should put their faith not first in God, but in the CCP.¹³¹ As Chinese President Xi Jinping intoned in August 2020, China “must build an ‘impregnable fortress’ to maintain stability in Tibet, protect national unity and educate the masses in the struggle against ‘splittism,’ [and] build a ‘united, prosperous, civilized, harmonious and beautiful new, modern, socialist Tibet.’”¹³² These goals require “strengthen[ing] the role of the Communist Party in the territory and better integrat[ing] its ethnic groups,” and “Tibetan Buddhism also need[s] to adapt to Socialism and to Chinese conditions.”¹³³ (China seized control of Tibet in 1950, an occurrence it describes as “peaceful liberation.”¹³⁴)

So, “Sinicization” (sometimes called “Sinofication”¹³⁵) is anything but separation of Church and state; rather, it is the subordination of Church to state. It is not about rendering unto Caesar the things that are Caesar’s, and unto God the things that are God’s (Christ’s teaching sourced in all three synoptic Gospels – *Matthew* 22:15-22, *Mark* 12:13-17, and *Luke* 20:20-26); rather it is about rendering everything to Caesar, and unto God leftovers Caesar discards. Whereas some Indian leaders might bathe in the Ganges at Varanasi to cleanse themselves of their bad *karmas* (deeds), almost laughably, the CCP

¹³⁰ *Catholics in China Should Integrate into Socialist Society – Senior Party Official*, REUTERS, 30 December 2016, <http://mobile.reuters.com/article/worldNews/idUSKBN14J16I>. [Hereinafter, *Catholics in China*.] Yu Zhengsheng, who leads a body associated with the parliament to represent Chinese of different faiths, was speaking at the government-approved Chinese Patriotic Catholic Association and Bishops Conference of Catholic Church of China. *See id.*

¹³¹ *Catholics in China*.

¹³² *Quoted in Xi Says China to Step Up Efforts to Fight “Splittism” in Tibet*, NIKKEI ASIAN REVIEW, 30 August 2020, <https://asia.nikkei.com/Politics/Xi-says-China-to-step-up-efforts-to-fight-splittism-in-Tibet>. [Hereinafter, *Xi Says China*.]

¹³³ *Xi Says China*.

¹³⁴ *Xi Says China*.

¹³⁵ See, e.g., *Xi Affirms China’s Control with Visit to Tibet*, Business Day (South Africa), 23 July 2021, www.businesslive.co.za/bd/world/asia/2021-07-23-xi-affirms-chinas-control-with-visit-to-tibet/ (reporting: “China has been criticized for its policies in Tibet, which has been subject to intense social, security and religious controls, much like its northern neighbor Xinjiang. In May [2021], Wu Yingjie, the Communist Party chief of mostly Buddhist Tibet, lauded the progress Beijing has made developing the region, saying that ‘religion has been increasingly compatible with a socialist society.’ [Chinese President] Xi [Jinping] told officials at a meeting on Tibet issues in August last year [2020] to ‘actively guide Tibetan Buddhism to adapt to socialist society, and promote the *Sinofication of Tibetan Buddhism*.’ ‘To govern a country, it’s necessary to govern the border,’ Xi said at the symposium, where the Party discussed policies for developing the region. ‘To govern the border [in this case, with India], it’s required to stabilize Tibet first.’”). (Emphasis added.)

tries to control the reincarnation of the 14th Dalai Lama, Tenzin Gyatso (1935-) (because only one approved by the CCP is authorized):

... The choice of his [the 14th Dalai Lama's] successor is shaping up to be a struggle between India and the U.S. on the one hand and China on the other.

The Dalai Lama is believed to be a living Buddha who is reincarnated after his death. Traditionally a search for a child reincarnation is conducted, and once a boy is confirmed, he studies to prepare for his role. The current Dalai Lama was identified at the age of 2. There's no single method of choosing a Dalai Lama, and the process can be long and complicated.

... India hosts the Tibetan government-in-exile in the city of Dharamsala and only recognized Tibet as part of China in 2003. [Mao's PLA invaded Tibet in October 1950, annexing it in 1951 in what the CCP called a "Peaceful Liberation," essentially annexing it following the October 1951 *Seventeen Point Agreement*.] ...

From January through March, along its Himalayan border with China, India convened five separate assemblies of senior monks from various sects and schools in the region – the first time such gatherings have taken place in more than 2,000 years. The government hopes that this group will grant international legitimacy to the current Dalai Lama's successor and help fill a power vacuum, as it could take two decades or longer for a reincarnation to be identified and to come of age.

In 1959, U.S. intelligence agents helped smuggle Tenzin Gyatso out of Tibet and into northern India to avoid being captured by Chinese security forces. He hasn't laid out a clear succession plan. A decade ago, he issued a statement saying he'd consult with other Tibetan Buddhist leaders when he's about 90 on whether the more than 600-year-old institution of the Dalai Lama should continue after he dies.

Samdhong Rinpoche, who is part of the Dalai Lama's personal office, the Gaden Phodrang, which will help decide the succession, says that if Tibet "remains occupied" by China, "His Holiness the Dalai Lama has said he will be reincarnated outside Tibet and most likely in India." China may appoint its own Dalai Lama, but its choice "will have no legitimacy."

In 2007, China issued an order that requires authorities in Beijing to oversee the next Dalai Lama's selection without the interference "of any foreign organization or individual." It calls for potential successors to be chosen by picking lots from the golden urn in Jokhang Temple in Lhasa, Tibet's capital. When installed, the Dalai Lama must then get a "living

Buddha permit” from the Chinese government. Chinese officials say there’s precedent for Beijing to be involved in picking the Dalai Lama, as the current one ascended to the position in 1939 after being approved by Chiang Kai-shek, who was President of the Republic of China before the Communist Party took power in 1949.

The Dalai Lama has called that a “lie” and says the golden urn method was used to pick only two of the 14 Dalai Lamas since the first one was born in 1391. (The Dalai Lama said a different procedure, the “dough-ball method,” could be used if there were multiple candidates; this entails writing the names on a piece of paper, encasing them in dough balls, placing these in a bowl before a sacred object for three weeks, and then publicly rolling them around in the bowl until one falls out.)

Last year, former President Donald Trump signed the *Tibetan Policy and Support Act of 2020* [Senate Bill 2539 and its companion, House Resolution 4331, which reauthorized and modified the 2002 *Tibetan Policy Act*, and which was incorporated into the 2021 FY omnibus spending bill, *Consolidated Appropriations Act, 2021*, House Resolution 133, Public Law 116-260, 116th Congress, 2d Session (27 December 2020)], which reiterates the U.S. stand that the current Dalai Lama is the final authority on his reincarnation, and in November 2020, the head of Tibet’s exiled government visited the White House for the first time. The Biden administration is maintaining Trump’s policy: “We believe that the Chinese government should have no role in the succession process of the Dalai Lama,” State Department spokesman Ned Price told reporters in March. Rinpoche says the U.S. policy is well-intentioned, but “the reincarnation of the Dalai Lama is entirely a spiritual matter for the people of Tibet.”

...

While the current Dalai Lama has advocated only autonomy for Tibet, not independence, Beijing still sees that as a threat. Wu Yingjie, the Communist Party’s top official overseeing Tibet, wrote in an official publication last October that China should “go deep in exposing the counter-revolutionary nature of Dalai Lama and the Dalai Clique” and guide the Tibetan people to “take a rational approach to religion.”

A similar power struggle played out with the Panchen Lama, the second-most prominent figure in Tibetan Buddhism. After the death of the 10th Panchen Lama in 1989, both the Chinese government and the Dalai Lama identified reincarnations. The man selected by Beijing is now a senior adviser to China’s parliament. The Dalai Lama’s choice hasn’t been seen in two decades, and his followers say he was abducted at the age of 6.

“The reincarnation of Dalai and Panchen is rightly China’s internal affair” and “allows no interference of external forces,” China’s Foreign Ministry said in a statement.¹³⁶

¹³⁶ Sudhi Ranjan Sen, *U.S., India Step Up Fight With China Over The Next Dalai Lama*, BLOOMBERG, 14 April 2021, www.bloomberg.com/news/articles/2021-04-14/who-will-be-the-next-dalai-lama-u-s-india-china-try-to-control-process?sref=7sxw9Sxl. In a June 2021 telling, if not Orwellian, account of a CCP-sponsored trip to Tibet for foreign journalists, Reuters observed:

Under clear blue skies, rugged peaks and the spectacular Potala Palace, one image is ubiquitous in Tibet’s capital city Lhasa: portraits of Chinese President Xi Jinping and fellow leaders.

In a rare and tightly chaperoned government tour of the region . . . , a Reuters journalist saw the portraits in classrooms, streets, religious institutions, houses, and the bedroom of a Buddhist Monk.

...
Chinese officials say the campaign is key to the future of Tibet, a region which makes up over 12% of China’s land mass but is home to just 3.5 million people, mostly ethnic Tibetans.

Civilians and religious figures who the government arranged to be interviewed on the five-day trip pledged loyalty to the Communist Party and Xi.

Asked who his spiritual leader was, a monk at Lhasa’s historic Jokhang temple named Xi.

“I’m not drunk . . . I speak freely to you,” said the monk named Lhakpa, speaking from a courtyard overlooked by security cameras and government observers.

The portraits of Xi were visible at almost all sites visited by Reuters during the trip to Tibet, where journalists are banned from entering outside of such tours. It was not clear when the posters and flags were put up.

“The posters coincide with a massive political education programme which is called ‘feeling gratitude to the party’ education,” said Robert Barnett, a Tibetan studies veteran scholar at the University of London’s School of Oriental and African Studies.

China’s Foreign Ministry said: “Tibet’s economy and society has made great achievements under the care of China’s central government and the strong support of every Chinese person.

“The right to religious freedom of all ethnic groups in Tibet are protected by the Constitution and the law.”

...
Beijing says it “peacefully liberated” Tibet in 1951, after Chinese troops entered the then-country and took over its administration.

The Dalai Lama, the spiritual leader of Tibetan Buddhism, fled Tibet in 1959 after a failed uprising against Chinese rule, and has since established a government in exile based in Dharamsala, India.

Beijing has labeled him a dangerous separatist and has said when he passes away the government will select its own successor.

The Foreign Ministry statement is doubly oxymoronic: reincarnation transcends geopolitical boundaries, and should be of no concern to an officially atheist Communist Party. Nevertheless, with no less arrogance, the CCP intervenes in the Apostolic succession dating back over 2,000 years to the Chair of Saint Peter, instituted by Christ, by ordaining bishops without a Papal mandate.¹³⁷

Indian or Non-Resident Indians (NRIs) have won Nobel Prizes in several disciplines, making India proud. Surely China is in the rare position of having the honor of being home to two Nobel Peace Prize winners – the Dalai Lama (1989) and Liu Xiaobo (2011) – but persecuting them both. Many WTO Members would subscribe to the

Reuters did not see any images of the Dalai Lama, previously common in homes throughout Tibet, on the trip from May 31 to June 5 [, 2021].

Photos of the spiritual leader are now strictly banned, according to rights groups and Tibetans who have since left the region.

The Foreign Ministry repeated China's position that the Dalai Lama was “attempting to separate Tibet from China.”

“Since Dalai defected, he has not done anything good for the Tibetan people,” said Fan Chunwen, the Secretary for Tibet’s Department of Education.

In Tibet’s College of Buddhism, a major religious training school on the outskirts of Lhasa, Chinese flags flew atop temples and images of Xi featured prominently in every dorm and classroom visited by Reuters.

“We are under the leadership of the Communist Party now, of course, we must learn about politics,” said Kelsang Wandui, Vice Director of the college.

Around 40% of the school’s study program was dedicated to political and cultural education, Wandui said, adding the monks will celebrate the upcoming 100th anniversary of the Communist Party on July 1 [, 2021].

The Central Tibetan Administration (CTA), the name of the exiled Tibetan government which oversees up to 150,000 Tibetans in exile, said the “political re-education campaign has been reinvigorated to Sinicize Tibet.”

...

In a Lhasa high school political ideology class visited by Reuters, a teacher preached the benefits of China’s policy in Tibet and led them in chants of agreement.

“Our young people must cherish the Party, listen to the Party and be guided by the Party and be loyal to our beautiful new Tibet,” said Wang Zhen, Director of the Department of Education in Tibet.

Martin Pollard, “*Xi Jinping is My Spiritual Leader:*” *China’s Education Drive in Tibet*, REUTERS, 11 June 2021, www.reuters.com/world/asia-pacific/xi-jinping-is-my-spiritual-leader-chinas-education-drive-tibet-2021-06-11/.

¹³⁷ See, e.g., John Thavis, *Vatican Condemns Illegitimate Ordination of Bishop in China*, CATHOLIC NEWS SERVICE, 5 July 2011, www.catholicnews.com (reporting on the case of Paul Lei Shiyin, who was ordained by the Chinese Catholic Patriotic Association, which is supported by the CCP).

principles in Charter '08, authored by Liu Xiaobo (1955-2017).¹³⁸ India not only would do so, but also might wish its secular constitution, which embodies all of those principles, but which is the longest in the world, would be shorter. Following the dramatic Arab Spring of 2011, the list includes former leaders of autocratically-governed Arab countries. But, it does not include the CCP.

Now the CCP faces the unprecedented challenge of resolving a Sino-American Trade War catalyzed by the Section 232 and 301 actions brought by the Administration of President Donald J. Trump, but caused in part by fundamental ideological and structural problems in China. Ideologically, can the CCP lead the economy to an advanced, post-industrial state the sources of growth of which are technology, IP, and innovation, when nothing in Marxist-Leninist theory tells it how to move beyond industrialization? Structurally, can the CCP loosen its grip over nearly all aspects of Chinese life to breathe life into the economy to propel it to that state, anticipating that it also will have to embrace political reforms and champion inalienable liberties as they are properly understood in International Human Rights Law?

**X. Proposition 10:
Be Happy**

International Trade Law is (or should be) the architecture for cross-border importation and exportation that leads to greater wealth and less poverty. To use a different metaphor, it is (or should be) the rule-of-law scaffolding that allows for trade, and that trade should better the lives of people, both in terms of expanded production and consumption opportunities, and the quality of those opportunities.

If International Trade Law plays (or ought to play) this happy role, then why are many practitioners and professors in the field so unhappy? Why are some of them downright miserable, mean, or both? Why do some obsess endlessly about fame and fortune, and die at their desks in the office (literally) as their children fall into drug abuse and their spouses divorce them? Surely knowing the grand purpose of their field should lead them to a joyful approach to it, to think of their work as a vocation, not merely an occupation? And yet, rarely do they mention “fun.”

Consider these grim facts revealed in 2015:¹³⁹

¹³⁸ On the first official visit by a Chinese diplomat to a Scandinavian country in 15 years, Foreign Minister Wang Yi warned Norway not to award the Nobel Peace Prize to advocates of democracy in Hong Kong, which China would regard as “politicizing” the Prize and “interfer[ing] in ... its internal affairs.” *Quoted in China Warns Norway Against Peace Prize for Hong Kong Protesters*, BLOOMBERG, 27 August 2020, www.bloomberg.com/news/articles/2020-08-28/china-warns-norway-against-peace-prize-for-hong-kong-protesters?sref=7sxxw9Sxl (also reporting: “Relations between Oslo and Beijing have been turbulent following a 2010 decision to award the Peace Prize to then-jailed – and now deceased – Chinese democracy advocate Liu Xiaobo. Though the Norwegian government doesn’t have any say in who is awarded the Prize, China responded by suspending ties and freezing free-trade talks. It took six years before the two countries agreed to normalize relations in 2016.”).

¹³⁹ See Brian S. Clarke, *Coming Out in the Classroom: Law Professors, Law Students and Depression*, 64 JOURNAL OF LEGAL EDUCATION 403, 405 (February 2015).

- (1) American law students enter law school with the same rate of depression as the general public, namely, 8%. By the spring semester of their 1L year, 32% of them are clinically depressed. By the time they graduate from law school, 40% of them are clinically depressed. (The figure drops to 17% two years after graduation, but that still is double the average.)
- (2) Suicide is the third leading cause of death among lawyers in the U.S. and Canada. It accounts for 10.8% of their deaths. Suicide among lawyers is 6 times the suicide rate in the general population (69.3 per 100,000, versus 10-14 per 100,000).

More recent data, from a 2018-2019 survey of depression, anxiety, and stress among First-Year students all ABA-accredited law schools, confirm and amplify these findings:¹⁴⁰

- (1) 57% of 1Ls report some form of depression, with 10% in the “severe,” and 15% in the “extremely severe,” category. These figures far exceed those of the general U.S. population: annually, 16% of Americans qualify under the clinical standards for depression.
- (2) When Second- and Third-Year (2L and 3L) student survey results are aggregated with those of 1Ls, depression is significantly higher at so-called “Tier One” schools as ranked by *U.S. News and World Report*. Law students at Tier One law schools also felt less supported, had a lower perception of learning, lower academic self-perception, and lower social self-perception, than those at lower Tier institutions.
- (3) 10% of 1Ls say they suffer from “severe” anxiety, and 26% of them say they suffer from “extremely severe” anxiety. Here, too, these figures well exceed results from the general U.S. population: 18% suffer from some form of anxiety each year.
- (4) 20% of 1Ls state they are under “severe” stress, and 10% under “extremely severe” stress. The four most significant sources of stress are: ineffective teaching (*e.g.*, heavy workloads, use of the Socratic method, lack of feedback from faculty before exams, disrespectful faculty, that is, professors who are nasty in class, and a need to self-educate owing to a lack of teaching); competition and isolation (*i.e.*, competition among students that results in a sense of alienation); ineffective assessments (*e.g.*, application of a curve, use of class rank, and final exams); and, institutional

¹⁴⁰ See Amanda Carey, J.D., Ed.D., *The Fog of Blackacre: Exploring Depression, Anxiety, and Stress of the American Law Student*, Doctoral Dissertation, Northern Illinois University (Executive Summary) (2020), ProQuest Dissertation Publications, <https://search.proquest.com/openview/9e6c077b911ea455e784f082852f5557/1?pq-origsite=gscholar&cbl=18750&diss=y> (also observing a 2014 Yale Mental Health Alliance study indicated as many as 70% of law school students experience mental health distress, and the WHO reported over 300 million people globally suffer from depression).

construction of success and failure (*i.e.*, how a law school defines success and failure for students and attorneys, and the link between its definitions and grades and class rank).

Notably, these figures are from surveys before the COVID-19 pandemic, which assuredly caused greater depression, anxiety, and stress.

A joint WHO-ILO study of 194 countries, reported in May 2021 (based on 2000-2016 data), revealed that “[l]ong working hours are killing hundreds of thousands of people a year.”¹⁴¹ In 2016, 745,000 persons died from heart disease or stroke caused by long working hours. Among the most prone to such hours were workers in the Western Pacific (including China, Japan, and Korea) and Southeast Asia. All those aspiring to work in Big Law, beware:

The research found that working 55 hours or more a week was associated with a 35% higher risk of stroke and a 17% higher risk of dying from heart disease, compared with a working week of 35 to 40 hours.

...

The report said working long hours was estimated to be responsible for about a third of all work-related disease, making it the largest occupational disease burden.

The researchers said that there were two ways longer working hours led to poor health outcomes: firstly, through direct physiological responses to

¹⁴¹ *Long Working Hours Killing 745,000 People a Year, Study Finds*, BBC NEWS, 17 May 2021, www-bbc-co-uk.cdn.ampproject.org/c/s/www.bbc.co.uk/news/business-57139434.amp. [Hereinafter, *Long Working Hours Killing*.] The full study is Frank Pega, Bálint Náfrádi, Natalie C. Momen, Yuka Ujita, Kai N. Streicher, Anette M. Prüss-Üstün, Technical Advisory Group, Alexis Descatha, Tim Dricoll, Frida M. Fisher, Lode Godderis, Hanna M. Kiiver, Jian Li, Linda L. Magnusson Hanson, Reiner Rugulies, Katharine Sørensen & Tracey J. Woodruff, *Global, Regional, and National Burdens of Ischemic Heart Disease and Stroke Attributable to Exposure to Long Working Hours for 194 Countries, 2000-2016: A Systematic Analysis from the WHO/ILO Joint Estimates of the Work-related Burden of Disease and Injury*, 154 *Environment International* (September 2021), [www.sciencedirect.com/science/article/pii/S0160-4120\(21\)00220-8](http://www.sciencedirect.com/science/article/pii/S0160-4120(21)00220-8). See also World Health Organization, *Long Working Hours Increasing Deaths from Heart Disease and Stroke: WHO, ILO, Joint News Release*, 17 May 2021, www.who.int/news/item/17-05-2021-long-working-hours-increasing-deaths-from-heart-disease-and-stroke-who-ilo (summarizing the key findings of the study: “In a first global analysis of the loss of life and health associated with working long hours, WHO and ILO estimate that, in 2016, 398 000 people died from stroke and 347 000 from heart disease as a result of having worked at least 55 hours a week. Between 2000 and 2016, the number of deaths from heart disease due to working long hours increased by 42%, and from stroke by 19%. This work-related disease burden is particularly significant in men (72% of deaths occurred among males), people living in the Western Pacific and South-East Asia regions, and middle-aged or older workers. Most of the deaths recorded were among people dying aged 60-79 years, who had worked for 55 hours or more per week between the ages of 45 and 74 years. With working long hours now known to be responsible for about one-third of the total estimated work-related burden of disease, it is established as the risk factor with the largest occupational disease burden. This shifts thinking towards a relatively new and more psychosocial occupational risk factor to human health. The study concludes that working 55 or more hours per week is associated with an estimated 35% higher risk of a stroke and a 17% higher risk of dying from ischemic heart disease, compared to working 35-40 hours a week. Further, the number of people working long hours is increasing, and currently stands at 9% of the total population globally. This trend puts even more people at risk of work-related disability and early death.”).

stress, and secondly, because longer hours meant workers were more likely to adopt health-harming behaviors such as tobacco and alcohol use, less sleep and exercise, and an unhealthy diet.¹⁴²

To be clear: it is difficult to meet a minimum annual billable target of 2,000 hours with a 55-hour work week, which in any case entails inhuman 11-hour days across a five-day work week. Remember, (1) many large law firms allow an equally inhuman maximum of two weeks of paid vacation, and (2) an attorney cannot bill every hour worked (typically, based on anecdotal evidence, a large law firm associate needs to work about 10% more daily than the number of hours that can be billed to a client). And, men, take note: “three quarters of those that died as a result of working long hours were middle-aged or older men.”¹⁴³ As for the effects of the pandemic and national lockdowns on work hours, the WHO-ILO said those hours had increased 10%.¹⁴⁴

Economically, the grim facts bespeak a terrible waste of human capital. Morally, it is tragic that students pay good money (plus incur an opportunity cost) for the salaries of law professors, yet then go to law school only to become depressed (or worse), and thereafter join a profession that puts them at disproportionate risk of suicide. Morally, law professors who, through their acts or omissions, cause or contribute to the problem need to rethink the way they do business. Regrettably, nowhere in the process of faculty hiring, promotion, or tenure is account taken of the mental health of teachers; rather, dysfunctions typically are dealt with by cover up, excuse, or neglect. Faculty can avoid faculty, but students cannot avoid faculty. So, students pay the price.

Thanks to the COVID-19 pandemic, the figures have worsened:

Of the coronavirus’s many side effects, perhaps the least appreciated are psychological. Those who’ve had a bad case and survived, like people who’ve been in war or accidents, may suffer post-traumatic stress for years. And even people in the as-yet-healthy majority are hurting. Young adults, in particular, are getting more depressed and anxious as SARS-CoV-2 uproots whatever budding life plans they’d been nursing.

It’s long been clear that Covid-19, like any major disaster, is causing an increase in mental-health disorders and their accompanying evils. Those range from alcoholism and drug addiction to wife beating and child abuse. In the Americas, the world’s most afflicted region with hotspots from the U.S. to Brazil, this psycho-social crisis has become its own epidemic....

In the U.S., the national rate of anxiety tripled in the second quarter [April-June 2020] compared to the same period in 2019 (from 8.1% to 25.5%), and depression almost quadrupled (from 6.5% to 24.3%). In Britain, which has

¹⁴² *Long Working Hours Killing.*

¹⁴³ *Long Working Hours Killing.*

¹⁴⁴ *Long Working Hours Killing.*

also had a severe outbreak and a long lockdown, depression has roughly doubled, from 9.7% of adults before the pandemic to 19.2% in June [2020].

...

[O]lder adults had already built their lives before the pandemic – with routines, structures, careers and relationships to fall back on. The young had not, and were just embarking on that adventure when Covid-19 struck. And what a mess it has made of all those hopes. Even in good times, adolescents and young adults aren't exactly paragons of emotional stability. Many are unhappy with their own bodies or confused about their professional paths, their sexual options, and their friendships.

But in 2020 all these bugbears have grown. ...

[R]eplacing in-person, tactile and pheromonal interactions with screens and apps just doesn't cut it. Biologically, we're still like other primates, who need to groom and be groomed to lower cortisol levels and feel well. One result, especially for the hormonal young, is isolation and loneliness, which can lead to listlessness and despair: in short, depression.¹⁴⁵

Fortunately, an Australian Nurse, Bronnie Ware, offers wise counsel in her book, *The Top Five Regrets of the Dying* (2013).¹⁴⁶

Having served for many years in palliative care for patients in the last 12 weeks of their lives, Ms. Ware explains these patients gain clarity of vision at the end of their lives. Their top five regrets are:

- (1) I wish I had had the courage to live a life true to myself, not the life others expected of me.
- (2) I wish I had not worked so hard.
- (3) I wish I had had the courage to express my feelings.
- (4) I wish I had stayed in touch with my friends.
- (5) I wish I had let myself be happier.

The inference is obvious.

Before their last 12 weeks, International Trade Lawyers can learn from the wisdom of Ms. Ware's patients. They need not wait until the end of life to be true to themselves, to realize they work too hard, to express their feelings courageously, to stay in touch with their friends, and to let themselves be happier. If their present position leave their dreams unfulfilled (*e.g.*, working for MNCs instead of LDCs), keeps them on a treadmill (*e.g.*, billing over 2,000 hours annually), suppresses their true capabilities (*e.g.*, does not involve

¹⁴⁵ Andreas Kluth, *An Epidemic of Depression and Anxiety Among Young Adults*, BLOOMBERG QUINT (Mumbai), 22 August 2020, www.bloombergquint.com/gadfly/coronavirus-millennials-are-suffering-an-epidemic-of-depression.

¹⁴⁶ See Susie Steiner, *Top Five Regrets of the Dying*, THE GUARDIAN, 1 February 2013, www.guardian.co.uk/lifeandstyle/2012/feb/01/top-five-regrets-of-the-dying/print.

client contact or field work), corrodes their friendships (*e.g.*, by leaving no time for spontaneous gatherings at the local pub), and is merely satisfactory (*e.g.*, because it is a familiar routine), then they should move on, perhaps set up their own enterprise. International Trade Law is a large and growing field. This life is finite.¹⁴⁷

Manifestly, these Propositions go beyond conventional Neo-Classical economic analysis and traditional doctrinal analysis of International Trade Law. These analytical paradigms are plentiful herein. But, so too are perspectives from other disciplines, notably history, philosophy, politics, and religion. Most importantly, these Propositions are just that. Lest there be doubt, as a student of the field, my own views of them hardly remain static.

¹⁴⁷ For a revealing and thought-provoking analysis of the causes in American legal education of psychological distress of law students, and mental health problems in the legal profession associated with habits of the legal mind (*e.g.*, perfectionism, hyper-competitiveness, adversarial thinking, and negativity), see Esperanza Franco, Esq., *Emotionally Intelligent Lawyers: How to Navigate the Psychological Implications of Becoming a Lawyer* (Esperanza Franco Jiménez, 2023).

Part Two

MORAL FOUNDATIONS

Chapter 3

PHILOSOPHICAL AND RELIGIOUS THEORIES¹⁴⁸

I. Why Trade? Plutarch versus Horace

International Trade Law predates 30 October 1947, though that day, when GATT was signed, is the birthdate of the modern multilateral trade law regime. Trade economics did not begin with Adam Smith (1723-1790) and David Ricardo (1772-1823), and their respective Laws of Absolute and Comparative Advantage. Indeed, the discipline of economics dates to the 1200s:

Some form of economic theory has been taught continuously at the highest university levels since the mid-thirteenth century, when Thomas Aquinas first fully integrated it within the scholastic theory of Natural Law. ... [To be sure,] the logical and mathematical structures of scholastic economics differ fundamentally from Adam Smith’s so-called classical economics and today’s “neoclassical” economics. [However,] [f]ew economists today are aware of the scholastic version of economics, in large measure because American university economics departments, led by the University of Chicago in 1972, abolished the requirement that students of economics master its history before granting a degree.¹⁴⁹

The elimination of the “History of Economic Thought” requirement from mainstream curricula is incongruous with the history or the international economy. Trade itself did not commence after the Second World War (1939-1945). The roots of the study and praxis of trade are ancient and interdisciplinary. The presumption trade ought to be free remains highly controversial.

Embedded in these roots, but sometimes buried by modern, muddle-headed, jargon-filled, and occasionally Pharisaic legal and economic scholarship, is an integral link between trade, and economic activity generally, and morality:

What is economics about? Jesus once noted – apart from any claims about Divine revelation ... – that since the days of Noah and Lot, people have been doing four kinds of things: planting and building, buying and selling, marrying and being given in marriage, and eating and drinking (Luke 17:26-28). In other words, we humans spend most of our time producing,

¹⁴⁸ Documents References:

- (1) *Havana Charter Preamble*
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

¹⁴⁹ John D. Mueller, *The Scholastic Origins of the Social Sciences*, 41 FELLOWSHIP OF CATHOLIC SCHOLARS QUARTERLY, number 1, 5-15 (April 2018). [Hereinafter, *The Scholastic Origins*.]

exchanging, giving (or sometimes taking), and using (or consuming) our human and non-human goods.¹⁵⁰

The proposition, then, is that international trade, the legal regime that governs it, and the policy considerations that suffuse it, always have been about not only economics, but also morality.

In the first Chapter of his splendid account, *Against the Tide* (1996), Douglas A. Irwin explores the dichotomous views in Ancient and Medieval times of foreign commerce. Plutarch of Delphi (46-127 A.D.) and the Roman lyric poet Horace (65-08 B.C.) embody the extremes. In *Moralia* (specifically, the essay *On Whether Water or Fire is More Useful*), Plutarch argues:

God created the sea to promote interaction and to facilitate commerce between the various peoples of the earth. ... Without the exchanges made possible by the sea, ... man would be “savage and destitute.”¹⁵¹

Horace, instead, in *Odes*, proffers:

[t]he sea brought contact with strangers who could disrupt domestic life by exposing citizens to the bad manners and corrupt morals of barbarians.¹⁵²

Is trade an opportunity for peaceful intercourse to advance prosperity? Or, is it a threat to moral fiber and civic security? The dichotomy remains to the present, resonating in contemporary debates about globalization.

Consider the reasons French lawyer and Prime Minister François Fillon (1954-present, Prime Minister from 2007-2012) offered in February 2011 to support his argument that access to the market of the EU must be contingent on the environmental, labor, and counterfeiting policies of foreign exporting countries: “It’s an economic necessity *but also a moral necessity*.”¹⁵³

II. Are Traders Immoral? Plato, Cicero, and Early Christian Fathers

For Ancient thinkers, traders themselves were part of the problem. In Plato’s (428/427-348/347 B.C.) division of labor, retail trade was an occupation beneath the dignity of a Greek citizen. It was best left to an inferior person – preferably a segregated foreign resident in a Greek city-state – incompetent at other activities. In the *Republic*, Plato acknowledged the need to import a good only if a city-state cannot supply itself, and

¹⁵⁰ *The Scholastic Origins*, 78.

¹⁵¹ DOUGLAS A. IRWIN, *AGAINST THE TIDE* 11 (1996). [Hereinafter, IRWIN.] The discussion draws on pages 11-21.

¹⁵² IRWIN, 12.

¹⁵³ Quoted in Rick Mitchell, *France to Back Ambitious Doha Pact if EU Farm Interests Preserves*, *Says Fillon*, 28 *International Trade Reporter* (BNA) 304 (24 February 2011). (Emphasis added.)

to do so only if the good is a necessity, paying for it by shipping abroad an exportable surplus. Aristotle (384-322 B.C.) in *Politics*, looked askance at traders and dependency on foreign trade. A port facility is necessary only to import necessities that cannot be obtained elsewhere, and that facility should be physically separate from a city, and closely monitored by authorities, to ensure no vices are brought in with merchandise. Surely merchants and their loyalties cannot be trusted, added Xenophon (431-355 B.C.). In *Oeconomicus*, he urged “all men naturally love whatever they think will bring them profit.” How vulgar it is, added Ancient Romans like Cicero (106-43 B.C.) in *De Officiis*, to buy merchandise at one price, and sell it at a higher price, unless the exchange brings great benefit or enhances the intelligence of Romans.

Early Christian Fathers, too, viewed commerce as ethically unseemly, an occasion for many of the Seven Deadly Sins – anger, covetousness, envy, greed, lust, pride, and sloth. They recalled the Gospel account of Christ throwing merchants from the Temple. Indeed:

Money is a big part of the story of the Bible. When you read God’s Word, you realize it suggests a very different approach to money than most of the world takes. *Jesus had a lot to say about money: About 15% of his recorded words were about the topic* – even more than he spoke about Heaven or hell, marriage and family, more than he spoke about the Church.

Jesus explained that money doesn’t belong to us, it belongs to God and we must accept the responsibility of being his steward. (“The Parable of the Dishonest Steward,” Luke 16: 1-13 and “The Parable of the Talents,” Matthew 25, 14-30).¹⁵⁴

Saint Augustine (354-430 A.D.) intoned in *Exposition on the Book of Psalms*, “Let Christians amend themselves, let them not trade.” Given the risks of foreign commerce, coupled with an ethnocentric sense of superiority, the trade policy – if it be called that – of many Ancient philosophers and theologians was to ban imports of non-necessities and forbid exports of necessities. Self-sufficiency was preferred, and so much the better if it could be achieved through autarky.

III. Doctrine of Universal Economy

The tide began to turn in favor of free, or freer, trade with the Doctrine of the Universal Economy. This Doctrine was espoused by philosophers and theologians, notably Seneca the Younger (4 B.C.-65 A.D.) in *Naturale Quaestiones*, Philo of Alexandria (20 B.C.-50 A.D.), in *On the Cherubim*, Origen (185-254 A.D.) in *Contra Celsum*, Libanius (314-394 A.D.) in *Orations (III)*, Saint Basil the Great (329-379) in *Exegetic Homilies* (specifically, *On Hexameron, Homily 4*), Saint John Chrysostom (349-407 A.D.) in

¹⁵⁴ Father Michael White & Tom Corcoran, *Commentary: Why You Need to Give to Your Parish*, CATHOLIC NEWS SERVICE, 11 July 2020, <https://cnstopstories.com/2020/07/11/commentary-why-you-need-to-give-to-your-parish/#noredirect>.

Discours Sur La Componction (2), and Saint Theoderet of Cyrrhus (393-457 A.D.) in *On Divine Providence*. This Doctrine states:

... trade between regions should be accepted as beneficial and even be permitted to run its course free from interference. ... Providence deliberately scattered resources and goods around the world unequally to promote commerce between different regions. According to [noted economist] Jacob Viner [who identifies the Doctrine as the oldest, longest lived economic precept, and a forerunner of the factor endowments theory of trade, such as the Hecksher-Ohlin Theorem], [there are] four distinct elements [in the Doctrine]. First, it embraces the stoic-cosmopolitan belief in the universal brotherhood of man. Second, it describes the benefits to mankind arising from the trade and exchange of goods. Third, it embodies the notion that economic resources are distributed unequally around the world. Finally, it attributes this entire arrangement to the Divine intervention of a God who acted with the deliberate intention of promoting commerce and peaceful cooperation among men.¹⁵⁵

The Doctrine entered into Natural Law theory. In brief, “Natural Law”:

... presumes that “Law exists prior to jurists and legal philosophers.” ... Natural Law philosophy holds that through the senses, which are in contact with reality, the intellect comes to discern universal truths which are immutable. Furthermore, Saint Paul posits that the Natural Law is “inscribed in the heart,” which affirms by intuition a certain order of being. These truths provide the foundation for inalienable human rights – life, liberty, property, justice, the pursuit of happiness – which cannot be taken away by any state.

Because human reason is flawed, due to original sin, but not completely obliterated by the Fall [of Adam and Eve from Paradise], Divine revelation aids us in our quest for truth ([see Saint Thomas] Aquinas, 1265-1274, [*Summa Theologica*,] I, Q.I, A.I). Supernatural revelation highlights and completes the natural knowledge discerned by reason.¹⁵⁶

¹⁵⁵ IRWIN, 15.

¹⁵⁶ Rev. Michael P. Orsi, Ave Maria School of Law, *Maintaining Equilibrium at The Catholic Law School*, 34 FELLOWSHIP OF CATHOLIC SCHOLARS QUARTERLY number 4, 35-38 (winter 2011) (quoting H.A. ROMMEN, *THE NATURAL LAW: A STUDY IN LEGAL AND SOCIAL HISTORY AND PHILOSOPHY* (Indianapolis, Indiana: Liberty Fund, Inc. 1946, 1998 ed.)). As Rev. Orsi rightly points out, to appreciate more fully the Natural Law tradition and the establishment of a just society, the questions of “Who is man?,” “How should he act?,” and “What is his final end?” are indispensable. As he points out, among the helpful documents to consult are Papal Encyclicals such as *Dignitatis Humanae* (1965) (discussing the inviolable rights of each person, particularly religious freedom), *Fides et Ratio* (1998) (explaining how reason and faith complement one another towards knowledge of the truth), *Veritatis Splendor* (1993) (concerning morality), *Evangelium Vitae* (1995) (defending human life).

By the Medieval Scholastic era (1100-1500 A.D.), the paradigm moved further – albeit slowly and with opposition – in favor of trade and traders. Trade routes were paths for evangelization, and small, impoverished traders were worthy of sympathy. Merchandise itself is not merely an object of arbitrage, but a chance to express human creativity by enhancing the value of that object.

St. Thomas Aquinas (1225-1274) had much to do with this shift. In *Summa Theologica*, he delineates three kinds of useful economic activity (*i.e.*, engagements with a value added to society): storing goods, importing necessity goods, and transporting goods to regions of scarcity. Pecuniary gain from these activities, says Saint Thomas, is not inherently sinful. To be sure, domestic production is more dignified than trade. But, conducted in moderation – and, critically, with the proper motives – trade could be a morally virtuous activity. Later, Martin Luther (1483-1546) did not take such a positive view in *To the Christian Nobility of the German Nation* (1520). Still, subsequent theologians – including John Calvin (1509-1564) in *Commentary on the Book of the Prophet Isaiah* – generally continued the tradition of synthesizing the Doctrine of the Universal Economy with moral precepts. That tradition is ecumenical. For example, various *ayat* (verses) in the Holy *Qur’ān* address interaction among peoples and upright conduct among merchants.

In sum, scholarship about trade is neither new nor the province of one discipline. Contemplation about trade and morality, not just calculations about trade and economics, has long roots. Those roots spread into international law through jurists like Francisco de Vitoria (1480/83-1546) in *De Indis De Jure Bell* (*circa* 1532), Francisco Suarez (1548-1617) in *De Legibus, Ac Deo Legislatore* (1612), Alberico Gentili (1552-1608) in *The Three Books on the Law of War* (1612), and Hugo Grotius (1583-1645) in *The Law of War and Peace* (1625). They urged the right of countries to trade, and presumption of free trade, exists in the Law of Nations (*jus gentium*), not just Natural Law. Today, is the paradigm in which International Trade Law operates reverting from free trade to protectionism? How is a paradigmatic shift gauged? What factors cause a shift? Is the dichotomy between “free trade” and “protectionism” false, *i.e.*, is there such a thing as “free” trade? As a matter of law, is trade invariably restricted by encumbrances and contingencies? Does the *de jure* scheme lawyers created result, to one degree or another, in *de facto* managed trade?

IV. Peace Through Trade or Trade After Peace? Bastiat, Montesquieu, Cobden and Hull versus Keynes, History, and Expectations

There is little doubt that peace can stimulate trade. That is, an environment of non-violence around settled boundaries promotes imports, exports, and FDI.

Trade and peace are closely linked. History has many examples of the need to create peace in order to have trade. Plutarch, writing around 100 A.D. [in *Life of Pericles*], tells us that Pericles [c. 495-429 B.C.] in the 5th century B.C. took a fleet into the Black Sea to demonstrate Athenian power and secure the grain route from the Crimean Peninsula. He then called

together all Greeks, in Europe and in Asia, to a general assembly to discuss recovery from war and “the navigation of the sea, that they might henceforward pass to and from and trade securely and be at peace among themselves.”

Peace enables trade. If we needed a lesson on this, we received it in February of this year, when Russia invaded Ukraine. We in the developed world had grown unused to war between nation-states. The Russia-Ukraine war is the first between WTO Members, or for that matter GATT Contracting Parties. ... Trade did not cause this war; nor did trade prevent it. Territorial ambitions of a large state adjacent to a smaller state started the conflict, not for the purpose of seizing productive assets – as was the case in the August 2, 1990, Iraqi invasion of Kuwait, an invasion which gave Iraq 20% of the world’s oil reserves.

Ukraine accounts for merely 3% of Russia’s exports and would not have been a significant factor in Russia’s decision to invade. However, the implications for global trade are profound, felt far beyond the borders of the Black Sea. The Allies (led by the United States and the EU) have limited imports from and exports to Russia as sanctions seek to halt the conflict or at least weaken Russia’s resolve. The Black Sea becoming a war zone has blocked food and fertilizer exports from both Ukraine and Russia, with serious adverse consequences particularly for a number of countries in Africa, with the possibility of reducing domestic peace in the region if hunger is widespread. Russia has limited its gas exports to Europe, a substantial disruption of the EU’s consumption of energy. Trade is clearly both a weapon of this war as well as a casualty of it.¹⁵⁷

Conversely (as suggested above), war is an impediment to lawful trade – though a boon to smuggling and other illicit transactions. But what about the opposite directional relationship, *i.e.*, does (or can) trade cause peace?

Classic liberal theorists believe that democracy and free trade can prevent the occurrence of war between countries that subscribe to liberal political and economic systems. The logic of “liberal peace” is based on the premise that economic interdependence raises the stakes of conflict, disincentivizing war because war would be to the detriment of all parties’ economic benefit. It is also argued that trade facilitates communication and the exchange of goods and ideas, bringing societies closer together and improving their economies.

This conclusion does not go unchallenged.¹⁵⁸

¹⁵⁷ *Trade for Peace*, Remarks of Alan Wm. Wolff, Distinguished Visiting Fellow, Peterson Institute for International Economics (PIIE) (Graduate Institute Geneva, 28 September 2022), www.piie.com/sites/default/files/2022-09/2022-09-28wolff.pdf. [Hereinafter, Wolff, *Trade for Peace*.]

¹⁵⁸ Wolff, *Trade for Peace*.

Consider, then, the debate through the ages about the peace-through-trade conclusion.

- **Bastiat:
Soldiers Will Cross Borders If Goods Do Not**

Frédéric Bastiat (1801-1850), a French classical liberal political economist, opined that: “When goods do not cross borders, soldiers will.” His view addresses a key question: Does peace occur through international trade? Or, does trade follow and reinforce peace?

Bastiat thought economic interdependence was essential to the prevention of armed hostilities. If nations relied on one another for mutually beneficial trade, then they would not war with each other. Why commit armed robbery against one’s neighbor to get a cup of sugar, when one can trade with the neighbor for a cup of sugar? But, might nations fear interdependence, and prefer self-sufficiency to the extent they can achieve it, if necessary, by force? Why not occupy the neighbor and its entire sugar supply?

- **Montesquieu:
“Natural Effect of Commerce is Peace”**

In this view, Bastiat had intellectually powerful company: The French Enlightenment philosopher, Montesquieu (1689-1755) wrote in *De L’esprit des Lois* (*The Spirit of Laws*, 1748): “the natural effect of commerce is to lead to peace.” Montesquieu had faith that business could accomplish what religion and moral philosophy had failed to do: restrain the destructive passions of man.¹⁵⁹ If man could harness those passions positively in pursuit of his own self-interest toward trade, investment, and finance, then he would not fight with his neighbor.

- **Cobden and Anti-Corn Law League:
With Free Trade, No Need for Empires or Militaries**

Across the Channel from France, Richard Cobden (1804-1865), a British manufacturer and statesman influenced by Bastiat and Adam Smith (1723-1790), championed this reasoning. Indeed, he advanced it: surely if nations pursued free trade with each other, then they would not need to raise armies and navies, and fight for empires against each other. They might join together in a “benign global government.”¹⁶⁰ Cobden was influential in the Anti-Corn Law League, and in establishing the *Cobden-Chevalier Treaty*. The League sought repeal of protectionist, mercantilist legislation, the *Corn Laws*, which had protected through high tariffs British and Irish cereal producers from foreign competition since 1815 under the *Importation Act* of that year. Without foreign competitive pressures, British and Irish landowners benefited from steep prices for their grains. Yet, the working class spent unnecessarily high percentages of their limited budgets on bread, and even suffered famines.

¹⁵⁹ See John Plender, *China and the Fallacy That Trade Will Always Lead to Peace*, FINANCIAL TIMES, 30 April 2013, 9. [Hereinafter, *China and the Fallacy*.]

¹⁶⁰ *China and the Fallacy*.

Thanks to the efforts of Cobden and his cohorts, merchants in the major trading cities of London, Manchester, and Glasgow, successfully petitioned the House of Commons to abolish all duties. Parliament repealed the *Navigation Laws* (protectionist legislation from the 17th century) in the 1820s, and via the 1846 *Importation Act*, the *Corn Laws*.¹⁶¹ With this unilateral shift to free trade, grain imports increased, and domestic bread prices fell.¹⁶² League members like Cobden also lobbied for free trade, again for its salubrious effects like a greater availability of consumption items at cheaper prices, and a finer division of labor and production specialization based on comparative advantage. Under the 1860 *Cobden-Chevalier Treaty* between Britain and France, France capped at 30% its tariffs on most British industrial goods, while Britain slashed its duties on French brandy and wine. Bilateral exports in both directions more than doubled in the 1860s.¹⁶³

- **Keynes:
Free Trade Creates Strains and Enmities**

John Maynard Keynes (1883-1946) was not as optimistic as Montesquieu, Bastiat, or Cobden. Lord Keynes argued in 1933 that free trade plus capital mobility “set[s] up strains and enmities’ that were more likely to provoke war than inhibit warmongers.”¹⁶⁴ Subsequent events seemed to prove Keynes right.

In the late 1800s and first few decades of the 1900s, European nations, Japan, and the U.S. built, protected, and extended empires with armies and navies employing new technologies that could kill with ghastly efficiency. Kill they did from 1914-1918, in the First World War, as famed British military historian John Keegan (1934-2012) brilliantly

¹⁶¹ See World Trade Organization, *Azêvedo: Our Aim Now Should Be Nothing Less Than To Complete The Round and Do It Quickly*, 8 April 2014 (speech to the International Chamber of Commerce U.K. and TheCityUK, London), www.wto.org.

¹⁶² See *Corn Laws*, WIKIPEDIA, http://en.wikipedia.org/wiki/Corn_Laws. That is not to say Cobden was altruistic:

The economic issue, in essence, was food prices; the price of grain was central to the price of the most important food staple, bread, and the working man spent much of his wages on bread.

The political issue was a dispute between landowners (a long-established class, who were heavily represented in Parliament) and the new class of manufacturers and industrialists (who were not): the former desired to maximize their profits from agriculture, by keeping the price at which they could sell their grain high; the latter wished to maximize their profits from manufacture, by reducing the wages they paid to their factory workers – the difficulty being that men could not work in the factories if a factory wage was not enough to feed them and their families; hence, in practice, high grain prices kept factory wages high also.

Id.

¹⁶³ See *Cobden-Chevalier Treaty*, WIKIPEDIA, http://en.wikipedia.org/wiki/Cobden-Chevalier_Treaty. France ended the Treaty in 1892 and imposed the Méline Tariff. See *id.*

¹⁶⁴ Quoted in John Plender, *China and the Fallacy That Trade Will Always Lead to Peace*, FINANCIAL TIMES, 30 April 2013, 9. [Hereinafter, *China and the Fallacy*.]

chronicles in his 1998 book of that title. With even greater monstrosity, kill they did again from 1939-1945 in the Second World War. That is the title of the six-volume masterpiece by Sir Winston Churchill (1874-1965) he completed between 1948 and 1953, for which in part he earned the 1953 Nobel Prize for Literature. In the first volume, Churchill himself summarized the “moral of the work:” “In War: Resolution, In Defeat: Defiance, In Victory: Magnanimity, In Peace: Goodwill.”

Manifestly, in the late 19th and early 20th centuries, the natural effect of commerce among nations was not peace. Rather, commerce seemed to encourage conquest to gain economic, political, and military advantages, and avoid dependence on foreign powers. Perhaps that realization helped motivate President Woodrow Wilson’s liberal internationalist “attempt to put the trade for peace policy into practice:”

Wilson was in foreign affairs a utopian. He sought a just peace, without humiliation and without severe penalties. The other primary allies, France and Britain, wished to see repayment for the war, and not through earnings from German manufactures. Wilson’s utopian vision for organizing the world was specified in his Fourteen Points, which he presented at the Paris Peace Conference in 1919 with his proposed League of Nations.

Point III of Wilson’s Fourteen Points provided:

- III. The removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the peace and associating themselves for its maintenance.¹⁶⁵

And yet, consider the above-quoted synopsis from the greatest of British Prime Ministers: whither trade?

A realist, Sir Winston gave trade no explicit role in enhancing peace. Stretching matters, perhaps “magnanimity” might include generous trade concessions by victorious powers, and “goodwill” might be extended through special and differential trade treatment to poor countries. But, while Churchill co-authored the 1941 *Atlantic Charter*, surely he would have regarded the proposition that trade liberalization causes peace as naïve.

Might China be an historical example for the Keynesian position? Since the economic reforms ushered by Deng Xiaoping in 1979, and its 2001 accession to the WTO, China has become increasingly integrated into the global economy. It is more dependent on trade for national income than is the U.S. Between 2009 and 2011, international trade accounted for 28% of American GDP, but 53% of Chinese GDP.¹⁶⁶ Chinese interdependence is coupled with Communist Party rhetoric about a “peaceful rise” in the world. Yet, it is embroiled in nationalist territorial disputes with India, Japan, Vietnam, Malaysia, and the Philippines, leading those countries to partner increasingly closely with

¹⁶⁵ Wolff, *Trade for Peace*.

¹⁶⁶ *China and the Fallacy*.

the U.S.

Indeed, China might be an historical counter-example, as the BBC pointed out following the August 2022 visit by U.S. House of Representatives Speaker Nancy Pelosi (Democrat-California) to Taiwan:

The consensus, just a few years ago, was that as an established superpower [e.g., U.S.] should build strong trade and investment ties with a newly emerging one [e.g., China]. The ideological differences would then fade away.

Instead, while China has indeed become the factory of the world, deeply integrated into global supply chains, it has grown more authoritarian at home and more assertive abroad.

A 1997 trip to Taiwan by then U.S. House Speaker Newt Gingrich (Republican-Georgia), for example, was met with little opposition.

The Nancy Pelosi visit has been met with [Chinese ballistic] missiles – flown directly over a democracy [Taiwan] and the heads of its 24 million people – whose appetite, by the way, for China’s vision for unification dwindles ever further the more authoritarian it becomes.

And now, any American citizen worried about the impact of Chinese precursor chemicals – sold into Mexico and then turned into the fentanyl that is fueling thousands of U.S. deaths – will also feel the impact of these shifting geopolitical plates.

The Chinese statement [following Speaker Pelosi’s visit] suspends counter-narcotics co-operation.

China’s “shared future for mankind” messaging on climate change is similarly put on ice, now seemingly held hostage to the precondition that its claims to Taiwan be recognized.

Nancy Pelosi may have given China the pretext. But this is a shift that was already well under way. The battle over values is front and center stage once again, and the profound challenges it presents for the existing global order are likely only to increase.¹⁶⁷

Put bluntly, is “peace through trade” a realistic vision when two sides have disparate cultural, political, and social values, historical narratives, and one side, at least, controls all media to ensure its population is exposed to its perspectives?

¹⁶⁷ Sam Cabral, *Taiwan Tensions: China Halts Co-operation with U.S. on Key Issues*, BBC NEWS, 5 August 2022, www.bbc.com/news/world-asia-china-62438262 (John Sudworth, Analysis, *A New Low in Relations*).

- **Hull and Depression Era**

It was the longest-serving Secretary of State in American history, Cordell Hull (1871-1955), who took up the Bastiat-Montesquieu-Cobden mantle in the Depression Era (1929-1941). Serving from 1933-1945 in the Administration of President Franklin Delano Roosevelt (1882-1945), Secretary Hull saw trade liberalization as a useful tool to promote peaceful intercourse among nations that otherwise had retreated behind protectionist walls. He championed the *Reciprocal Trade Agreements Act of 1934*, and used that Act to reduce on a bilateral basis the high tariffs set under the *Smoot-Hawley Tariff Act*, which was part of the *Tariff Act of 1930*. For his work in establishing the U.N., he was awarded the 1945 Nobel Peace Prize.

- **Realistic Expectations**

Whether the thematic influence of GATT, of heralding peace through trade, continues in the post-9/11 world perhaps is more in doubt than at any time since President Roosevelt and Prime Minister Churchill drew up the *Atlantic Charter*. Does the historical record suggest the vision itself is not “peace through trade,” but rather “trade follows peace and reinforces that peace”? After all, countries that fought each other in the First and Second World Wars, and thereafter in the Korean War (1950-1953), Vietnam War (1965-1973), and countless other undeclared conflicts, did not start trading and then stop fighting. Rather, they first laid down their arms, and later started trading, and their commercial intercourse broadened, deepened, and stabilized their relationships.

Thus, for example, is it realistic to expect Israel and certain Arab countries to start trading, before they have reached a peace agreement covering the Occupied Territories? Is it realistic to expect India and Pakistan to boost significantly their trade ties before resolving their dispute over Kashmir? Similarly, is trade an effective weapon against terrorism? That is, does trade hold the promise of alleviating poverty and injustice, and thus lessening the number of people susceptible to violent, extremist ideologies?

- **Free Trade and Naval Power**

In considering the link between peace and trade, consider the importance of military power. Does military power to secure freedom of navigation and open trade enhance peace? Or, does dominance by a single power (or small allied group of them) engender rivalries? For instance, are some countries grateful for, or resentful of, the dominance of sea lanes by a single country? On the one hand, the dominant power may use its naval prowess to behave like an umpire: it ensures a level commercial playing field for all law-abiding trading nations (including itself)? On the hand, the dominant power may advantage itself relative to other trading nations, behaving like a player, leveraging its navy to channel commercial benefits to its companies. What does history teach? What does the future hold?

Ninety percent of all merchandise traded between continents, and two-thirds of all petroleum supplies, travel by sea. Keeping international shipping lanes open, free, and secure requires the U.S. Navy, just as the Royal Navy played this role in the 18th, 19th, and

early 20th centuries of the British Empire. In the 1980s, under President Ronald Reagan, the Navy had 600 warships. That figure fell to 350 after the 1989 collapse of the Berlin Wall, and by 2012, to 284.¹⁶⁸ Future warship numbers likely will fluctuate between 250 and 313, depending partly on budgetary matters and the willingness and ability of other countries, such as Australia and India, to make the seas safe for free trade.

- **Lessons from European Project**

In reflecting on the peace-trade link, consider the significance of the European project. It originated as the European Coal and Steel Community (ECSC), “specifically aimed to bind France and Germany so close[ly] as,” in the words of the French Foreign Minister Robert Schuman who proposed it in 1950, to make war “not only unthinkable but materially impossible.”¹⁶⁹ Via the 1951 *Treaty of Paris*, six nations at the heart of the Continent – Belgium, Italy, France Netherlands, Luxembourg, and West Germany – formed the first of European supranational organizations. Never again would these former warring countries take up arms against each other if they shared the same sources – a common market – for the indispensable ingredients of ordinance: coal and steel.

So, they bound themselves under the ECSC High Authority. Though Europe lost its international comparative advantage in coal and steel, its supranational unification project advanced: via the 1957 *Treaty of Rome*, the European Economic Community (EEC), which under the 1965 *Merger Treaty* became the European Communities (EC), renamed the European Community (EC) by the 1993 *Maastricht Treaty*, and which (the EC) took over all ECSC functions in 2002, when the *Treaty of Paris* expired, and ultimately under the 2009 *Treaty of Lisbon* the European Union (EU).

Is this Union a model for regional integration in other parts of the world with a view to facilitating peace? What lessons might be drawn from the 1992-1995 Bosnian War? The 2010-2013 Eurozone sovereign debt crisis?

V. Contemporary Doubts about Peace through Trade

- **Anger and Resentment**

In his September 2005 address to the U.N., George W. Bush (1946-, President 2001-2009) intoned:

In this young century, the far corners of the world are linked more closely than ever before, and no nation can remain isolated and indifferent to the struggles of others. When a country or a region is *filled with despair and resentment and vulnerable to violent and aggressive ideologies*, the

¹⁶⁸ See ROBERT KAPLAN, *MONSOON: THE INDIAN OCEAN AND THE FUTURE OF AMERICAN POWER* (2010); Robert Kaplan, *The U.S. Navy Fostered Globalization: We Still Need It*, FINANCIAL TIMES, 30 November 2011, 9.

¹⁶⁹ *China and the Fallacy*.

threat passes easily across oceans and borders and could threaten the security of any peaceful country.

Terrorism fed by anger and despair has come to Tunisia, to Indonesia, to Kenya, to Tanzania, to Morocco, to Israel, to Saudi Arabia, to the United States, to Turkey, to Spain, to Russia, to Egypt, to Iraq, and the United Kingdom. And those who have not seen attacks on their own soil have still shared in the sorrow, from Australians killed in Bali to Italians killed in Egypt, to the citizens of dozens of nations who were killed on September the 11th, 2001....*The lesson is clear: There can be no safety in looking away or seeking the quiet life by ignoring the hardship and oppression of others. Either hope will spread, or violence will spread, and we must take the side of hope.*

...

We will fight to lift the burden of poverty from places of suffering, not just for the moment but permanently. And the surest path to greater wealth is greater trade. ... The [U.N.] Secretary-General said ... we ... need to reduce trade barriers and subsidies that are holding developing countries back. I agree with the Secretary-General: The Doha round is “the most promising way” to achieve this goal.

A successful Doha Round will reduce and eliminate tariffs and other barriers on farm and industrial goods. It will end unfair agricultural subsidies. It will open up global markets for services. Under Doha, every nation will gain, and the developing world stands to gain the most. Historically, developing nations that open themselves up to trade grow at several times the rate of other countries. The elimination of trade barriers could lift hundreds of millions of people out of poverty over the next 15 years. The stakes are high. The lives and futures of millions of the world’s poorest citizens hang in the balance, and so we must bring the Doha trade talks to a successful conclusion.

Doha is an important step toward a larger goal. We must tear down the walls that separate the developed and developing worlds. We need to give the citizens of the poorest nations the same ability to access the world economy that the people of wealthy nations have, so they can offer their goods and talents on the world market alongside everyone else. We need to ensure that they have the same opportunities to pursue their dreams, provide for their families, and live lives of dignity and self-reliance.

And the greatest obstacles to achieving these goals are the tariffs and subsidies and barriers that isolate people of developing nations from the great opportunities of the 21st century. Today, I reiterate the challenge I have made before: We must work together in the Doha negotiations to eliminate agricultural subsidies that distort trade and stunt development and to eliminate tariffs and other barriers to open markets for farmers around

the world. Today I broaden the challenge by making this pledge: The United States is ready to eliminate all tariffs, subsidies, and other barriers to free flow of goods and services as other nations do the same. This is key to overcoming poverty in the world's poorest nations. It's essential we promote prosperity and opportunity for all nations.

By expanding trade, we spread hope and opportunity to the corners of the world, *and we strike a blow against the terrorists who feed on anger and resentment. Our agenda for freer trade is part of our agenda for a freer world, where people can live and worship and raise their children as they choose.* In the long run, the best way to protect the religious freedom and the rights of women and minorities is through institutions of self-rule, which allow people to assert and defend their own rights. All who stand for human rights must also stand for human freedom.¹⁷⁰

However, in the post-9-11 era, there are plenty of reasons to doubt, and plenty of doubters, in respect of this “peace through trade” theory. And, of course, the Doha Round became the first and only Round in the history of MTNs to fail.

- **Competing Beliefs and Globalization as Sources of Conflict**

About 10 years after the President’s speech, the prominent economic journalist Robert J. Samuelson (1945-) offered these reflections:¹⁷¹

What we are witnessing in the spreading turmoil around the world – in Iraq, in Ukraine, in Gaza – is the silent rejection of a central tenet of U.S. post-World War II foreign policy: that global prosperity would foster peace and stability. *Countries would rather trade than fight.* Promoting economic growth would suppress the divisive forces of nationalism, ideology, religion and culture. So we thought.

It’s an idea with a long pedigree in American thinking, going back to at least Thomas Jefferson [(1743, 1826, President 1801-1809)]. The purpose of free trade, he and his followers believed, “was not merely to promote commercial prosperity everywhere but to promote peace everywhere,” writes historian Gordon Wood [(1933-)]. Free trade “would tie nations together peacefully and change the way international politics had traditionally been conducted.”

¹⁷⁰ Address to the United Nations General Assembly by President George W. Bush, 14 September 2005, www.state.gov/p/io/potusunga/207566.htm. (Emphasis added.)

¹⁷¹ *Prosperity Won't Cure All Global Ills*, REAL CLEAR MARKETS, 18 August 2014, www.realclearmarkets.com/articles/2014/08/18/prosperity_wont_cure_all_global_ills_101232.html. (Emphasis added.) [Hereinafter, *Prosperity Won't Cure*.]

Samuelson accepts that peace through trade worked during the decades immediately following the post-Second World War, through the Cold War, unifying Europe and re-integrating Japan into the world order.

But, the famously (or infamously) titled book by Francis Fukayama, *The End of History*, was prematurely triumphant. After the November 1989 fall of the Berlin Wall:

There was also a lot of sloppy support for “the McDonald’s theory of international relations,” which held ... that two countries with McDonald’s would never fight, because both were integrated into the world economy and wouldn’t jeopardize the benefits. As Russia with more than 400 McDonald’s and Ukraine with more than 70 face off, writes [fellow columnist Anne] Applebaum [(1964-)], “*we can finally declare the McPeace theory officially null and void.*”

The leaders of large expanses of humanity *never bought into the idea that achieving prosperity was life’s central purpose* or what fundamentally defined them. They had *other competing beliefs, traditions and ambitions that qualified and limited the power of economic growth*. This applies to Iraq and Afghanistan, much of the Middle East and – including the influence of nationalism – China and much of Asia.

...

Globalization amazes and disappoints.

...

It is not just that we overestimated globalization’s power to subdue traditional sources of mayhem. We also failed to see that it could breed conflict and upheaval in its own right. In some circumstances, *it can encourage countries to resort to force*: They assume that their trading partners will not retaliate for fear of harming their own economic interests.¹⁷²

Simply put, despite the broad, deep, and sophisticated rule of law architecture of GATT-WTO legal agreements, metastasis of trade agreements, and growing values and volumes of world trade, countries have not shuttered their weapons’ factories, locked up their ordnance, resolved remaining boundary disputes, and marched toward free trade and liberal democracy. Why not?

Consider what those “competing beliefs” are. Do they necessarily lead to violence? Are they authentic understandings of the non-economic dimensions of life? Or, are they flawed, even manipulative, misinterpretations of religious texts? Consider, too, what the alternatives to globalization are: Isolationism? Managed Trade? What are their costs and benefits?

V. More Doubts: Russia’s February 2022 Invasion of Ukraine and EU Energy

¹⁷² *Prosperity Won’t Cure.* (Emphasis added.)

Doubts about whether economic interdependence would reduce tensions and disincentivize conflict, and thereby bolster national security, were quite literally energized by the 24 February 2022 invasion by Russia against Ukraine. The war – which Russian President Vladimir Putin insisted on misleadingly labeling a “special military operation” – triggered nearly world-wide condemnation (China and India being notable exceptions, and Belarus being a predictable one), and multiple waves of sanctions against Russia (imposed by the U.S., U.K., EU, and G-20). (The war and these legal measures in response are discussed in a separate Chapter.) On the eve of the invasion, and even thereafter, the EU was heavily dependent on Russian crude oil and NG – 27% and 41%, respectively, of EU imports were sourced from Russia.¹⁷³ (So, too, was 47% of the EU’s solid fuel, mostly coal – it came from Russia).¹⁷⁴ Conversely, the EU was “the single largest consumer of crude and fuel from Russia.”¹⁷⁵

Germany was particularly reliant on Russian energy, and had long pursued a strategy of inter-dependence in the hopes of locking in peace with Russia, and thereby avoiding the horrors of the German-Soviet conflict in the Second World War. This policy was associated with German Chancellor Gerhard Schröder (1998-2005), and manifest in the construction of pipelines to carry Russian hydrocarbons to Germany. Long before the war in Ukraine, America consistently opposed the strategy, arguing German and other EU reliance on Russia would split the NATO alliance, and that in any event, Russia was not to be trusted. The February 2014 Russian invasion and subsequent annexation of Ukraine’s Crimean Peninsula fueled America’s concerns.

Then came Russia’s full-scale assault on Ukraine, and Mr. Schröder’s advocacy of peace-through-trade was called into question:

On the evening of Dec. 9, 2005, 17 days after Gerhard Schröder left office as Chancellor of Germany, he got a call on his cellphone. It was his friend, President Vladimir V. Putin of Russia.

Mr. Putin was pressing Mr. Schröder to accept an offer to lead the Shareholder Committee of Nord Stream, the Russian-controlled company in charge of building the first undersea gas pipeline directly connecting Russia and Germany.

¹⁷³ *From Where Do We Import Our Energy?*, EUROSTAT, <https://ec.europa.eu/eurostat/cache/infographs/energy/bloc-2c.html> (reporting: “Russia is the main EU supplier of crude oil, natural gas and solid fossil fuels,” and: “In 2019, almost two thirds of the extra-EU’s crude oil imports came from Russia (27%), Iraq (9%), Nigeria and Saudi Arabia (both 8%) and Kazakhstan and Norway (both 7 %). A similar analysis shows that almost three quarters of the EU’s imports of natural gas came from Russia (41%), Norway (16%), Algeria (8%) and Qatar (5%), while over three quarters of solid fuel (mostly coal) imports originated from Russia (47%), the United States (18%) and Australia (14%).”). [Hereinafter, *From Where Do We Import*].

¹⁷⁴ *From Where Do We Import*.

¹⁷⁵ Alberto Nardelli & Nikos Chrysoloras, *EU to Propose Phasing Out Russian Oil by the End of the Year*, BLOOMBERG, 30 April 2022, www.bloomberg.com/news/articles/2022-04-30/eu-to-propose-phasing-out-russian-oil-by-the-end-of-the-year?sref=7sxxw9Sxl. [Hereinafter, *EU to Propose Phasing Out*.]

...

Seventeen years later, the former Chancellor, who recounted the events himself in a pair of rare interviews, remains as defiant as ever.

“I don’t do *mea culpa*,” Mr. Schröder said, sitting in his sprawling light- and art-filled office in the center of his home city, Hanover, in northwestern Germany. “It’s not my thing.”

With Mr. Putin now waging a brutal war in Ukraine, all of Germany is reconsidering the ties with Russia that – despite years of warnings from the United States and Eastern European allies – have left Germany deeply reliant on Russian gas, giving Mr. Putin coercive leverage over Europe while filling the Kremlin’s war chest.

That dependency grew out of a German belief – embraced by a long succession of chancellors, industry leaders, journalists, and the public – that a Russia bound in trade would have too much to risk in conflict with Europe, making Germany more secure while also profiting its economy.

...

In the interviews, Mr. Schröder, now 78, spoke with undiminished swagger, cracking jokes but arguing in essence that, well, if he got rich, then so did his country. When it came to Russian gas, everyone was on board, he pointed out, mocking his detractors over copious amounts of white wine.

“They all went along with it for the last 30 years,” he said. “But suddenly everyone knows better.”

...

Distancing himself now [from Mr. Putin or Russian energy companies], Mr. Schröder said, would lose him the trust of the one man who can end the war: Mr. Putin. Even so, after all of his years of close relations with Mr. Putin, he walked away with nothing during his one brief interlude trying to mediate in the Ukraine conflict.

...

Germany’s reliance on Russian gas surged to 55 percent before Russia’s attack on Ukraine began in February, from 39 percent in 2011, amounting to 200 million *euros*, or about \$220 million, in energy payments every day to Russia.

It has helped make Mr. Putin perhaps one of the world’s richest men, has buoyed his otherwise feeble economy, and has enabled and emboldened him to pursue his aggression in Ukraine.

...

“I think this war was a mistake, and I’ve always said so,” Mr. Schröder said. “What we have to do now is to create peace as quickly as possible.”

“I have always served German interests,” he added. “I do what I can do. At least one side trusts me.”

That side is not the German side.

Since Russia’s attack on Ukraine began, the entire staff of Mr. Schröder’s Parliamentary office resigned in protest....

He relinquished his honorary citizenship in Hanover before his home city could strip it from him – something it last did, posthumously, to Adolf Hitler. ...

...

But Mr. Schröder is undaunted. He remains Chairman of the Shareholder Committee of Nord Stream, reportedly earning about \$270,000 a year, and served as Head of the Supervisory Board of Nord Stream 2, which built a second pipeline connecting Russia to Germany under the Baltic Sea, until it was shuttered before the war.

Three weeks before Russia launched its attack on Ukraine, *Gazprom* – the Soviet Energy Ministry turned Russian state-controlled gas company, which owns 51 percent of Nord Stream and all of Nord Stream 2 – announced that Mr. Schröder would join its board, too. (Mr. Schröder would not say whether he would accept the nomination.)

Since 2017, he has also presided over the board of the Russian oil company Rosneft, earning another \$600,000 a year, according to public records, on top of his monthly \$9,000 government stipend as former chancellor.

...

... [E]ven his fiercest critics acknowledge that Mr. Schröder’s close and lucrative dealings with Russia are also emblematic of his country’s decades-old approach of engagement with Russia. Lobbied aggressively by Germany’s export industry and cheered on by labor unions, successive chancellors, including Ms. Merkel, collectively engineered Germany’s dependency on Russian energy.

...

Mr. Schröder was born in 1944, a year before World War II ended, and never met his father, who fought for the Nazis and was killed on the eastern front when the future Chancellor was only 6 months old. The horrors that the Nazis inflicted on the Soviet Union, where some 27 million people died, weighed heavily on his youth, he said.

...

... [In 1969], when Mr. Schröder was 25, Willy Brandt [1913-1992] became post-war Germany’s first Social Democratic Chancellor [from 1969-1974], *ushering in a new policy of engagement with the Soviet Union that became known as Ostpolitik.*

The guiding rationale of Ostpolitik was “Wandel durch Handel,” or “change through trade,” and would become a defining pillar of successive Social Democratic-led administrations, including Mr. Schröder’s two decades later.

... Mr. Schröder’s two children were both adopted from Russia.

“All of these things influenced my relationship with Russia very early on, and as Chancellor, I actually tried to continue it that way,” he said.

When it came to pipelines, Mr. Schröder was not the first. They were being built between Germany and Russia even during the Cold War. Under Brandt, Germany signed a major pipeline project with Moscow, in 1970.

His successor, Helmut Schmidt, Chancellor for the rest of the 1970s and the early 1980s, oversaw an expansion of the pipelines, including another big project known as the West Siberia Pipeline.

While that pipeline was uncontroversial in Germany, it was not without critics abroad – namely, the United States. The Soviets had already invaded Afghanistan [in December 1979] and would soon [in 1980-1981] push the Polish government to quash anti-Communist protests and impose martial law.

“Basically, since the 1960s, cooperation with the Soviet Union and later with Russia has been a constant,” Mr. Schröder said.

“They got the money and they delivered the gas,” Mr. Schröder said of the Russians. “Even in the toughest times of the Cold War, there were never any problems.”

After the fall of the Berlin Wall in 1989 and the collapse of the Soviet Union, cheap Russian energy was seen more than ever as an earned peace dividend.

It was also Germany’s geostrategic North Star. For a country that had abandoned a military dimension to its foreign policy after World War II, economic interests were its security interests.

Germany is energy-poor, and as its coal resources diminished in the late 1990s, it needed affordable fuel to power its export-oriented economy, one of the world’s top five. Once the Russian pipelines were established, they fed German industry with a steady supply of gas through long-term contracts that led Germany to stop looking for other providers.

“This story, among other things – the early gas pipeline business with the Soviet Union, the attempt to find a compromise with the Soviet Union – was the basis for the Russians being able to say, ‘O.K., with this Germany we can risk reunification,’” Mr. Schröder said.

During his own time in office, from 1998 to 2005, Mr. Schröder shepherded through Germany’s next pipeline project, Nord Stream 1.

But his pipeline differed from his predecessors’ in important ways. It bypassed Ukraine and Poland, for the first time connecting Russia and Germany directly under the Baltic Sea.

... [T]he Russian President he was dealing with was Vladimir V. Putin.

...

In 2001, Mr. Putin addressed German lawmakers, the first Russian President to do so. Speaking in German, he described Russia as “a friendly European nation” whose goal was “stable peace on the continent” and got a standing ovation. Among those applauding that day was Ms. Merkel, Mr. Schröder’s successor.

Mr. Schröder recalled the mood in those early years of the 21st century. “It felt like a new era: the European House from Vladivostok to Lisbon,” he said.

Nord Stream 1 was a corporate project, initiated by Gazprom and a Finnish energy company before Mr. Schröder and Mr. Putin took office, and eventually comprised German, French and Dutch companies.

The idea was to secure German and European gas supply at a time when quarrels between Russia and Ukraine over transit fees and Kyiv’s siphoning off of gas raised concerns about supply disruptions.

...

When Mr. Putin called Mr. Schröder on his cellphone the night of Dec. 9, 2005, he accepted the offer.

Many in Germany were appalled. No Chancellor before him had taken a job in a company controlled by a foreign country, let alone one that had benefited from their support in office.

But the pipeline project itself remained uncontroversial.

“The next government continued with it seamlessly,” Mr. Schröder recalled. “Nobody in the first Merkel government said a word against it. No one!”

...

“This gas pipeline will make Europe’s energy supply significantly more secure,” Mr. Schröder said then.

...

Earlier in 2011, Ms. Merkel had stunned the world, including her own country, by announcing that Germany would be phasing out nuclear power after the disaster at the Japanese nuclear plant in Fukushima. Under pressure from German industry to identify alternative sources of energy, she was open to Nord Stream 2.

“They said we need a transitional technology – we won’t be able to do it with renewables alone, at least not at a price that doesn’t get us into financial difficulties,” Mr. Schröder said. “The transition technology was gas.”

But Mr. Putin’s invasion of Ukraine in February 2014, and then his annexation of Crimea the following month, raised questions about the viability of Nord Stream 2, as the West put the first sanctions against Russia into place.

...

The revolving door of contacts worried some lawmakers enough to ask the government to disclose a list of meetings between politicians and representatives of Nord Stream 2.

...

Matthias Warnig, the Chief Executive of Nord Stream 2, who took part in 19 of the [62] meetings..., has acknowledged having been a former spy of the *Stasi*, the former secret police of Communist East Germany. *Stasi* records show that, in February 1988, both he and Mr. Putin, when he was stationed in Dresden as a K.G.B. officer, were awarded medals for their service. But Mr. Warnig has denied reports that he had recruited spies for Mr. Putin in their old days.

...

Nord Stream 2 was approved in June 2015, the same year that *Gazprom* was also allowed under the Merkel government to buy Germany’s biggest strategic gas-storage facility, where it has kept levels of gas conspicuously low for the past year in what may have been preparation for providing leverage for Mr. Putin in his war.

But Mr. Schröder said he was unbothered by the growing dependency, or by American and Eastern European warnings about Mr. Putin weaponizing energy supplies.

The Russians, he argued, had always been reliable when it came to delivering oil and gas.

“Why should we have been distrustful? It always worked,” Mr. Schröder said. “*For us, dependency meant double dependency. The so-called energy weapon is ambiguous. They need oil and gas to pay for their budget. And we need oil and gas to heat and to keep the economy going.*”

...

What if Russia turns off the tap?

“It won’t happen,” Mr. Schröder said. But if it did, “then I would resign.”¹⁷⁶

But, on 23 April 2022, that is exactly what happened.

Russia turned off the tap of oil and NG exports to Poland and Bulgaria. Russia did so because it demanded payment in *roubles*, which Poland and Bulgaria said violated the pertinent supply contracts, which called for payment in euros. (As discussed in a separate Chapter, Russia made that demand to prop up its failing currency amidst waves of sanctions that sent the *rouble* into freefall, including denial of access to the SWIFT payment messaging system and cancellation of final approvals for Nord Stream 2.) The idea of “double dependency” – that Russia would not behave in a hostile manner toward the EU, a major export market for its prized commodities, and likewise the EU would not take outright adversarial positions toward Russia, a key source of those resources – was dead. Pulitzer Prize winning author of *The Prize* (1992), Daniel Yergin, put it well:

For half a century, Russia has trumpeted its brand as a reliable supplier – no matter the political tensions, its energy would flow to Europe without interruption. The war has pulverized that brand. Europe doesn’t trust Russian energy any more and doesn’t want it.¹⁷⁷

Now, Russia had warred against Ukraine, an EU partner, and the EU was fighting a proxy war against Russia by supplying arms to Ukraine. The EU vowed to phase out Russian oil imports by year-end 2022.¹⁷⁸

VI. Relationship Between Political Freedom and Free Markets

Can political and economic freedoms be segregated, so that authoritarian governance and open markets operate in tandem? 1976 Nobel-Prize winning economist Milton Friedman (1912-2006) suggested “yes,” in his 1962 classic, *Capitalism and Freedom*. Or, are political freedoms and the freedom from state control of pricing and output decisions indispensable jointly and mutually reinforcing? India’s Founding Fathers, including Mohandas K. (Mahatma) Gandhi (1869-1948) steadfastly refused to sacrifice basic human and civil rights in the interests of economic growth and development, and thus distinguished themselves and their country from the CCP and China. Hong Kong under British Colonial rule seems to support the Friedman thesis, while America and Britain are among the functioning democracies pointing to a “no” answer.

¹⁷⁶ Katrin Bennhold, *The Former Chancellor Who Became Putin’s Man in Germany*, THE NEW YORK TIMES, 23 April 2022, www.nytimes.com/2022/04/23/world/europe/schroder-germany-russia-gas-ukraine-war-energy.html?referringSource=articleShare. (Emphasis added.)

¹⁷⁷ David Yergin, *Europe No Longer Trusts Moscow’s Energy Brand*, FINANCIAL TIMES, 29 April 2022, www.ft.com/content/ca41d977-210c-467a-8744-addba04ffb32?shareType=nongift.

¹⁷⁸ See *EU to Propose Phasing Out*.

Amidst the Sino-American Trade War (discussed in a separate Chapter), China again has been the focus of attention in this debate as to whether the prerequisite for a successful open economy is an open political system:

Many people in the West have long assumed that liberal democracy provides the ideal conditions for building economic prosperity and that authoritarian rule stifles it. The contemporary Chinese Communist model, and even the softer Singaporean version, would appear to contradict this. Most Chinese citizens have become incomparably more prosperous than they were even a few decades ago. If you compare modern Chinese trains or airports with those in the United States, you might think that Americans are now living in what used to be called the Third World and China is by far the more developed country.

Perhaps [China's President] Xi [Jinping] is right that Hong Kong can continue to prosper even if the city is stripped of its free press, democratic politicians and pluralist intellectual culture, all of which were promised in 1997. In terms of infrastructure – a terrific airport, a clean subway system that runs on time, superb hotels and slick shopping malls – this is even likely. No wonder, then, that the glossy “China Model,” unlike the old Soviet model, which was always rather shabby, is appealing to many autocrats around the world.

Still, while the idea that democracy is the only route to prosperity, or that greater prosperity naturally leads to democracy, may have been debunked, there are good reasons to doubt that citizens will be better off following the China Model.

First of all, for a society to prosper, its brightest citizens must be encouraged to do their best work in a free spirit. Fine engineers might still do well in an autocracy such as China. But the talents of legal experts, artists, writers, political thinkers, economists, journalists and even businessmen who defy strict party lines will be wasted. Many will leave for more hospitable places. Hong Kong is already suffering a significant brain drain.

Also, the argument in favor of free speech and intellectual freedom advanced by the Indian economist Amartya Sen remains persuasive. He wondered why India suffered devastating famines during British colonial rule but not after independence. He famously answered, “Famines are easy to prevent if there is a serious effort to do so and a democratic government, facing elections and criticisms from opposition parties and independent newspapers, cannot help but make such an effort.”

All governments, even the most democratic ones, make bad mistakes. When left unchecked by public scrutiny and critical opinion, bad mistakes can easily become catastrophic.

The way China is dealing with the Covid-19 pandemic would seem to confirm Sen's dictum. Xi decided on a Zero-Covid policy, shutting China's biggest cities down, locking citizens up in unsanitary camps and seriously damaging the Chinese economy, not to mention those of many other countries.

If anything is diminishing China's prosperity, it is Xi's policy. Many Chinese are unhappy about it. Chinese overseas have criticized it. China's Prime Minister Li Keqiang has worried about it. Large foreign corporations, such as Apple Inc., are moving some production out of China in response.

And yet Xi will not tolerate any criticism. People who might come up with more sensible solutions are silenced or even arrested for their impertinence. Thus, a policy which could lead to disaster persists, unchecked by constructive criticism or better ideas.

Defenders of the China Model often claim that autocratic rule and an absolute obedience to public authorities belong to an ancient cultural tradition that distinguishes the Chinese world from the supposedly more individualistic West. Supporters of what Singaporean spokesmen [such as its founding leader, Lee Kuan Yew, and his acolyte minions, such as Kishore Mahbubani] used to call "Asian values" [discussed in a separate Chapter] said much the same thing.

And it's true that a recent history of war and revolutionary turmoil has made Chinese fear disorder more than anything. This helps explain why the expanding class of educated and urbanized citizens of China have accepted a lack of political freedom as the price of leading a secure and comfortable life.

At the same time, Taiwanese, Japanese, and South Koreans, whose cultures are rooted in the same traditions, refuse to conform to the China Model. The cultural claim is wrong anyhow. An important element in Confucian philosophy is the duty of scholar-officials to criticize corrupt rulers. The right to rebel is part of the Chinese tradition, too.¹⁷⁹

The debate is destined to continue: what is the right mix of political and economic freedom, and what how is "right" to be defined? Indeed, is not this debate an iteration of that between Plutarch and Horace (discussed earlier)?

¹⁷⁹ Ian Buruma, *Can China Prosper Without Freedom? Maybe Not*, BLOOMBERG, 6 July 2022, www.bloomberg.com/opinion/articles/2022-07-06/china-s-economy-will-suffer-without-more-political-freedoms?sref=7sxn9Sxl.

Chapter 4

FOUR TYPES OF JUSTICE¹⁸⁰

I. General Definition

Though widely used in debates about globalization and free trade, the term “social justice” rarely is defined. It connotes “justice in society in general,” which is to say it “is concerned with the common good.”¹⁸¹ Specifically, “social justice” concerns rights and duties at a societal level, that is, the obligations owed by individuals and groups in their design and operation of societal frameworks (such as the legal system, the economy, and the political system) in which these individuals and groups interact. Social justice should not be confused with the other three types of justice.

II. Commutative Justice

Commutative justice covers the obligations arising from relationships between and among individuals, and involves respect for the rights of another person, including for the property of that person. Commutative justice “binds individual to individual in the sphere of private transactions.”¹⁸² A classic example is a contractual relationship between two parties, whereby rights and obligations are established, whether the subject matter be goods, services (including labor in exchange for a wage), or property. As Saint Thomas Aquinas explains in *Summa Theologica*,

Commutative justice is concerned with the mutual dealings between two people.... In commutations something is paid to an individual chiefly in buying and selling. Hence it is necessary to equalize thing with thing – equality in *arithmetic* proportion.¹⁸³

Commutative justice demands “economic justice in exchange of goods by barter or selling,” which means “there must be exact equivalence between what is agreed and what is paid.”¹⁸⁴ Indeed, this type of justice “commands that exchange be of equal value ... [and because it] operates by the standard of strict equality,” it is “violated by theft, fraud, and unjust damage.”¹⁸⁵ For example, commutative justice would entail a right of restitution for payment of funds already made in the event of non-performance of a duty.

¹⁸⁰ Documents References:

- (1) *Havana Charter Preamble*
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

¹⁸¹ RODGER CHARLES, S.J., AN INTRODUCTION TO CATHOLIC SOCIAL TEACHING 27 (Ignatius Press, San Francisco, California: 1999). [Hereinafter, CHARLES.]

¹⁸² MONSIGNOR DAVID BOHR, CATHOLIC MORAL TRADITION 337 (revised edition, 1999). [Hereinafter, BOHR.]

¹⁸³ SAINT THOMAS AQUINAS, SUMMA THEOLOGICA, II^a II^{ae} Q. 61 Art. 1, Art. 2 (*quoted in* CHARLES, 28 (Emphasis original.)).

¹⁸⁴ CHARLES, 27.

¹⁸⁵ BOHR, 337-338.

III. Distributive Justice

Distributive justice concerns the obligations of a community or government to the individual members of the community or citizens of the polity, particularly as regards the allocation of public social goods. In *Summa Theologica*, Saint Thomas Aquinas states:

[D]istributive justice distributes common goods proportionately. ... In distributive justice we find equality in *geometric* proportion; a person's station is considered.¹⁸⁶

The benefits and burdens of membership in a community, or of citizenship in a country, are regulated by the governing authority of that community or country. How that authority distributes these benefits and burdens is a question of distributive justice.

In brief, this type of justice pertains to “the distribution of the goods and honors of the State among its citizens according to their contribution to the commonweal.”¹⁸⁷ As a criterion for distributive justice, the allocation ought to be in some relation to the needs and contributions of the members of the community or polity. A progressive tax system, implying payment based on ability to pay, coupled with the expenditure of tax revenues on the housing, food, education, and health needs of the poor, is an example. In contrast, “[p]erversions” of distributive justice “include all kinds of corruption, favoritism toward individuals or groups, all kinds of oppression, [and] all unrelieved poverty.”¹⁸⁸

IV. Legal Justice

Legal justice refers to the obligations of a person to a community, or of a citizen to a government. Commutative justice, as well as distributive justice, is a species of “particular” justice. But, “legal” justice also is called “general” justice. This appellation is based on coverage. “Legal” or “general” justice “pertains both to the bearers *and* subjects of authority who practice it by passing and furthering legislation favorable to the common welfare.”¹⁸⁹

In other words, legal justice is about what an individual owes to a collective body (whereas distributive justice is the converse). The individual could be an ordinary one, or one who is a leader in political society. A classic example is the duty of an individual to pay his fair share of taxes, where this share is calculated according to a criterion of general justice, such as the ability to pay.

V. Social Justice

¹⁸⁶ SAINT THOMAS AQUINAS, *SUMMA THEOLOGICA*, II^a II^{ae} Q. 61 Art. 1, Art. 2 (*quoted in* CHARLES, 28 (Emphasis original.)).

¹⁸⁷ CHARLES, 27.

¹⁸⁸ BOHR, 338.

¹⁸⁹ BOHR, 338. (Emphasis added.)

Social justice concerns arise in International Trade Law in many contexts, from agricultural subsidies and cultural protection to service market liberalization and special and differential treatment.

What distinguishes “social justice” from other types of justice is its use of moral reasoning to take “into account the fact that relationships between persons have an *institutional or structural dimension*.”¹⁹⁰ In Catholic Christian terms, social justice is:

the obligation of all parties to apply the Gospel to the structures, systems, and institutions of society which are the framework in which all human relationships take place.¹⁹¹

Social justice demands that individuals and groups empowered to create and implement these frameworks “take an active interest in necessary social and economic reform.”¹⁹² In doing so, they serve God, as Saint Thomas Aquinas points out in *Summa Theologica*:

Justice is a habit whereby a man renders to each one his due by constant and perpetual will. *Just as love of God includes love of neighbor, so too the service of God includes rendering to each one his due.*¹⁹³

Interestingly, while the philosophical and theological roots of the concept of “social justice” are ancient, the term itself is relatively new. In *Quadragesimo Anno*, Pope Pius XI uses the term “social justice” eight times.¹⁹⁴ This 1931 *Encyclical* may be one of the first instances in which the term appears, at least in Roman Catholic social teaching.

VI. Five Pillars of Catholic Social Justice Theory

In any political and economic society, five moral problems arise:

- 1st: What should the relationship of the individual to a society be?
- 2nd: What should be the principle guiding the public behavior (*i.e.*, the official acts) of the leaders of a society?
- 3rd: What should a society do about a distinct sub-group, namely, individuals who, by some measure relative to a societal average or standard, are less well off?
- 4th: Where should decision-making authority lie?

¹⁹⁰ BOHR, 337. (Emphasis added.)

¹⁹¹ RICHARD P. MCBRIEN, *CATHOLICISM* 946 (new ed. 1994). [Hereinafter, MCBRIEN.]

¹⁹² MCBRIEN, 946.

¹⁹³ SAINT THOMAS AQUINAS, *SUMMA THEOLOGICA*, II^a II^{ae} Q. 58 Art. 1 ad 6 (*quoted in* CHARLES, 26). (Emphasis added.)

¹⁹⁴ *See* BOHR, 337.

5th: For whom are goods destined?

Catholic Social Teaching offers answers to the problems, respectively: respect human dignity; pursue the common good; give preference to the poor; structure decision-making at the most decentralized level possible; and goods are for all.

All five principles are encapsulated in the 40,000-word Encyclical of Pope Francis (1936-, Pope 2013-), *Fratelli Tutti, On Fraternity and Social Friendship* (“Brothers and Sisters All,” or “All Brothers and Sisters”), published on 4 October 2020 amidst the COVID-19 pandemic:

The Encyclical takes its title from St. Francis of Assisi and is inspired by his “fraternal openness,” which ... calls on people “to acknowledge, appreciate and love each person, regardless of physical proximity, regardless of where he or she was born or lives.”

The title, which literally means “all brothers and sisters” or “all brothers,” are the words with which St. Francis “addressed his brothers and sisters and proposed to them a way of life marked by the flavor of the Gospel”

That flavor, explained throughout the document, involves welcoming the stranger, feeding the hungry, listening to and giving a hand up to the poor, defending the rights of all and ensuring that each person, at every stage of life, is valued and invited to contribute to the community.... It also means supporting public policies that do so on a larger scale.¹⁹⁵

¹⁹⁵ Cindy Wooden, *Belief in God as Creator of All Has Practical Consequences, Pope Says*, CATHOLIC NEWS SERVICE, 4 October 2020, www.catholicnews.com/belief-in-god-as-creator-of-all-has-practical-consequences-pope-says/#noredirect (quoting FRATELLI TUTTI, ¶ 1). [Hereinafter, *Belief in God*.] The full *Encyclical* is ENCYCLICAL LETTER, FRATELLI TUTTI, OF THE HOLY FATHER FRANCIS, ON FRATERNITY AND SOCIAL FRIENDSHIP, 3 October 2020, www.vatican.va/content/francesco/en/encyclicals/documents/papa-francesco_20201003_enciclica-fratelli-tutti.html. [Hereinafter, FRATELLI TUTTI.]

Likewise, in an April 2021 address to the IMF and World Bank, the Holy Father applied principles of equal human dignity, the common good, and preferential option for the poor to point the way to a more socially just international economic order in the twin context of the Third World debt crisis and unequal access to COVID-19 vaccines:

Poor countries cannot be expected to recover from the current financial crisis if the world returns to an economic model in which a small minority of people owns half of the world’s wealth, Pope Francis said.

... [T]he Pope said that despite “our deeply held convictions that all men and women are created equal, many of our brothers and sisters in the human family, especially those at the margins of society, are effectively excluded from the financial world.”

“If we are to come out of this situation as a better, more humane and solidary world, new and creative forms of social, political and economic participation must be devised, sensitive to the voice of the poor and committed to including them in the building of our common future,” he said.

Although countries are formulating their own recovery plans, ... there is a need for a global plan to create new institutions to advance “the integral human development of all peoples.”

Poor nations, the pope said, not only must have “an effective share in decision-making and facilitating access to the international market” but also a significant reduction in their debt.

“Relieving the burden of debt of so many countries and communities today is a profoundly human gesture that can help people to develop, to have access to vaccines, health, education and jobs,” he said.

...

Pope Francis also said financial markets must be regulated and geared toward serving the common good during the current health crisis.

Calling “a justly financed vaccine solidarity,” the pope said governments cannot allow “the law of the marketplace to take precedence over the law of love and the health of all.”

Quoted in Junno Arocho Esteves, Solidarity Needed to Reduce Debt of Poor nations, Pope Tells World Bank, CATHOLIC NEWS SERVICE, 8 April 2021, www.catholicnews.com/solidarity-needed-to-reduce-debt-of-poor-nations-pope-tells-world-bank/.

In Siblings All, Sign of the Times: The Social Teaching of Pope Francis (Maryknoll, New York: Orbis Books, 2022) Canadian Cardinal Michael Czerny and Father Christian Barone, an Italian theologian discuss and analyze “[t]he Christian mission of proclaiming the Gospel of salvation and defending the God-given dignity of every human person,” which “has led popes over the past 130 years to build a body of theological reflection known as Catholic Social Teaching or Social Doctrine,” and point out this “teaching has expanded and deepened over the years, challenging an idea that somehow Church teaching never changes.” Cindy Wood, *Living the Faith in the World: Book Explores Pope Francis’ Social Teaching*, CATHOLIC NEWS SERVICE, 1 October 2021, www.catholicnews.com/living-the-faith-in-the-world-book-explores-pope-francis-social-teaching/#noredirect. After all: “While human sin is constant, it can and does take new forms in the world. And while Gospel values are constant, there can be and have been changes in the church’s understanding of how to live those values more fully to ensure a life that is good, just and peaceful for all God’s children in a changing world.” *Id.* So, “[f]rom the pontificate of Pope Leo XIII to that of Pope Benedict XVI, some Catholics reacted with skepticism each time an official pronouncement was made on social issues, from workers’ rights to nuclear weapons and from the problems with unbridled capitalism to the need for a strong “world political authority” to coordinate responses to global challenges.” *Id.* As the authors put it: “Pope Francis insists on ‘the close link between proclamation and social commitment, between faith and justice, joy and solidarity,’ which shows “how the essence of Christianity is summed up in charity. We can proclaim to the world the greatest truths about God, but without that love which becomes a closeness and a gift of self to the ‘wounded’ other, in the manner of the good Samaritan, faith stops at a merely theoretical level....” Quoted in *id.* Moreover: “While Saint [Pope] John Paul II is rightly credited with firmly establishing Catholic social teaching as an important discipline in Catholic theology, Father Barone ... [said], ‘some of his arguments often remain tied to subjective choices, falling into the realm of personal ethics. Francis has had the strength to say that it is not enough to be ‘better’ people as individuals, but it is necessary to make ethical choices that involve the least ones and thus change the common direction of humanity. *What is always striking about Pope Francis is his ability to look at problems in a global way, his vision of the whole,*’ the Priest said. ‘*In his social teaching, one senses this habit of inclusiveness, of placing himself on the side of the disadvantaged, of reflecting on reality by placing himself ‘ex parte pauperum’ (on the side of the poor).*’ In short, Father Barone said, ‘One cannot act in the direction of a more just world if one does not start by listening to those who live in injustice.’ ‘Early in one’s Christian life – and later on, too – comes the question, ‘How do I live this beautiful and demanding faith in Jesus during the week, Monday to Friday?’ Cardinal Czerny ... [said]. ‘The question gets answered with the help of Catholic Social Teaching, which sheds the light of the Gospel, the message of Jesus, onto the questions which trouble us and which we really do need to take responsibility for both as citizens and as Christians: economic inequality, environmental degradation, racism and xenophobia, abuse and violence against women and children and so on. ‘*Catholic Social Teaching,*’ he said, ‘*is about living the Christian faith in the marketplace, in the agora or the commons of life.*’” *Quoted in id.* (Emphasis added.)

Fratelli Tutti synthesizes and applies to contemporary challenges “the social, political and economic obligations that flow from a belief that all people are children of God and therefore brothers and sisters to one another,” namely, “human fraternity, the equal dignity of all people, the preferential option for the poor, the universal destination of goods, and the obligation of solidarity,” as well as “[c]are for the environment and the virtue of peace making.”¹⁹⁶

- **First Pillar: Human Dignity**

Society ought to relate to the individuals in it in a manner that respects the dignity of each individual. As Pope Francis writes in *Fratelli Tutti*: “Human beings have the same inviolable dignity in every age of history and no one can consider himself or herself authorized by particular situations to deny this conviction or to act against it.”¹⁹⁷ Respect for human dignity is a logical extension of the Catholic precept that the dignity of a human being lies in his ability to choose freely good from evil.

[M]an is given [by God] intelligence and free will so that he can choose the good, the good made known through the objective law of God. For those who do not know the one true God, this good is known through the natural law. For those who do know God, the good is known by Revelation and the Church which interprets it.¹⁹⁸

Of course, the ability to choose good from evil presumes each person has both political and economic freedom. That is, when people organize themselves into a group – be it civic, political, or economic in nature – the society must respect the dignity of each constituent individual.¹⁹⁹

Indeed, individuals must be free to organize themselves into such groups in the first place. As John XXIII says in his 1963 Encyclical, *Pacem in Terris*:

¹⁹⁶ Cindy Wooden, *Pope Will Sign New Encyclical in Assisi Oct. 3*, CATHOLIC NEWS SERVICE, 5 September 2020, www.catholicnews.com/pope-will-sign-new-encyclical-in-assisi-oct-3/#noredirect.

¹⁹⁷ *Belief in God* (quoting FRATELLI TUTTI, ¶ 213).

For a complimentary argument that international human rights law “occupies a uniquely important role in international law due to its intrinsic connection with the main constitutive value of the modern public world order: human dignity,” hence (given its “central role”), human rights law is “in a hierarchically superior position relative to other fields of international law and policy,” but that international practice, including international development, has failed to integrate fully human rights law to the detriment of human dignity, so greater convergence between (or integration of) human rights law and other areas of international law are needed as a “precondition for good governance,” see Siobhán McInerney-Lankford & Aaron Fellmeth, *International Human Rights Law, Normative Hierarchy, and Development Policy*, 54 NEW YORK UNIVERSITY JOURNAL OF INTERNATIONAL LAW AND POLITICS number 2, 311-377 (winter 2022).

¹⁹⁸ CHARLES, 29.

¹⁹⁹ See CHARLES, 61 (stating “[t]he structures and mechanisms of economic society must respect the dignity of the man who works, and his spiritual, moral and intellectual needs as well as his material needs”).

Men have the right to form associations and give them the form which they consider most suitable for their objectives. Such organizations safeguard man's personal freedom and dignity.²⁰⁰

The declarative tone and language are not too strong in the present context. Individuals form a society to serve their interests, not the other way around, and submit to the authority of a society insofar as the society operates to their benefit. The dignity of each human being is not a gift from the society of which he is a part, and hence it is not for the society to withdraw or curtail. Respect for human dignity is not justified by sentimentality (*i.e.*, that it is “nice” to do so), nor by secular democratic theory (which champions individual rights).

Rather, that dignity is a consequence of being made in the image of God – in effect, a gift from the Creator. The reason is human beings are “made in God’s image and likeness.”²⁰¹ Pope Leo XIII (1810-1903, Pope, 1878-1903) put the point forcefully in the 1891 Encyclical, *Rerum Novarum*, which heralded modern Catholic social justice theory by responding to the challenges of free-wheeling capitalism:

All men have the same Father who is God the Creator, the same benefits of nature and gifts of divine grace belong in common to the whole human race: “we are children, we are heirs as well; heirs of God and co-heirs with Christ.”²⁰²

The arrow of causation starts with God, who in making us does so in a particular way. By respecting that way, we respect God. Or, to put the point another way, respect for human dignity is an inalienable human right. The failure of a society to respect this dignity is a key indicator that the society has become oppressive. Political and economic societies are particularly susceptible to this vice. In turn, oppression is a legitimate reason for individuals to cease with their responsibilities toward the society, to rescind their fidelity to that society, and in serious instances, to revolt against the society.²⁰³

But, there is more to the rationale that individuals “must” be free to associate than a social contract-type bargain between individuals and society. Catholic Social Theory reminds us that the stakes are as high as ever could be imagined – the eternal destiny of each person in a society. If an individual is unduly constrained in the political and/or economic arenas, then he cannot exercise his free will to choose his eternal destiny. Why not? Simply because he is not free to choose right from wrong, and thus cannot work toward a spiritual end.

[M]an is born into freedom and for freedom. Made in God’s image and likeness, he must be able to obey God’s law in freedom. In this way he can

²⁰⁰ JOHN XXIII, ENCYCLICAL LETTER, PACEM IN TERRIS (“Peace on Earth”) ¶¶ 23-24 (11 April 1963) (*quoted in* CHARLES, 24). [Hereinafter, PACEM IN TERRIS.]

²⁰¹ CHARLES, 29.

²⁰² LEO XIII, ENCYCLICAL LETTER, RERUM NOVARUM (“On the Condition of the Working Classes”) ¶ 24 (15 May 1891) (*quoted in* CHARLES, 34). [Hereinafter, RERUM NOVARUM.]

²⁰³ See CHARLES, 14.

be happy in this life and, when life is over, receive the reward of eternal life. *He must therefore have political and economic freedom, because only through them can he make the free choices in his life which will enable him to serve God worthily.*²⁰⁴

Put succinctly, “[m]an is the purpose and end of every society, and the State (and any social organization) exists to serve him. He does not exist to serve them.”²⁰⁵

Human dignity and its specific manifestations are put into practice through law and policy, hence the importance of political life. On the occasion of the issuance of *Fratelli Tutti*, Catholic News Service pointed out that “[p]eople who think politics is sinking to new lows may find comfort in knowing Pope Francis also is concerned about the debasement of what Church teaching has described as a ‘lofty vocation.’”²⁰⁶ Thus, in this Encyclical, the Holy Father recognizes:

Political life no longer has to do with healthy debates about long-term plans to improve people’s lives and to advance the common good, but only with slick marketing techniques primarily aimed at discrediting others. In this craven exchange of charges and countercharges, debate degenerates into a permanent state of disagreement and confrontation....

Today, in many countries, hyperbole, extremism and polarization have become political tools.... Employing a strategy of ridicule, suspicion and relentless criticism, in a variety of ways, one denies the right of others to exist or to have an opinion.²⁰⁷

Regrettably, this “‘social aggression’ often found on social media has spilled over into mainstream political discourse.”²⁰⁸ In fact, “[t]hings that until a few years ago could not be said by anyone without risking the loss of universal respect can now be said with impunity, and in the crudest of terms, even by some political figures”²⁰⁹

Nevertheless, as Archbishop Jose H. Gomez of Los Angeles, President of the U.S. Conference of Catholic Bishops (USCCB), put it:

[I]n analyzing conditions in the world today, the Holy Father provides us with a powerful and urgent vision for the moral renewal of politics and political and economic institutions from the local level to the global level,

²⁰⁴ CHARLES, 16. (Emphasis added.)

²⁰⁵ CHARLES, 13. *See also id.* at 35 (stating as “principles which a healthy civil society must foster,” first, that “the citizen has rights which the state cannot take away from him, and [second] that man is the end and purpose of every social organization”).

²⁰⁶ Cindy Wooden, *Pope Calls for Politics to Rediscover its Vocation to Work for Common Good*, CATHOLIC NEWS SERVICE, 4 October 2020, www.catholicnews.com/pope-calls-for-politics-to-rediscover-its-vocation-to-work-for-common-good/#noredirect. [Hereinafter, *Pope Calls for Politics*.]

²⁰⁷ *Pope Calls for Politics* (quoting FRATELLI TUTTI).

²⁰⁸ *Pope Calls for Politics* (quoting FRATELLI TUTTI).

²⁰⁹ *Pope Calls for Politics* (quoting FRATELLI TUTTI).

calling us to build a common future that truly serves the good of the human person.

For the Church, ... the Pope is challenging us to overcome the individualism in our culture and to serve our neighbors in love, seeing Jesus Christ in every person, and seeking a society of justice and mercy, compassion and mutual concern.²¹⁰

To be sure, it is tempting to avoid the unpleasantness of politics by “bowing out of political engagement.”²¹¹ But, the correct response is to remain engaged “and build relationships of trust and assistance and support politicians and political platforms that promote the common good,” which is the second moral pillar of Catholic Social Justice Teaching.²¹²

- **Second Pillar: Common Good**

Leaders of any society ought to pursue the common good. *Fratelli Tutti* “urges Christians and all people of goodwill to recognize the equal dignity of all people and to work together to build a world where people love and care for one another as brothers and sisters.”²¹³ To do so “requires encounter and dialogue, processes that allow people to speak from their experience and culture, to listen to one another, learn from one another and find ways to work together for the common good.”²¹⁴ Here, then, is a “moral compass” that Pope Francis proposes for development in impoverished regions of the world, which requires attention to both the common good and a preferential option for the poor:

Globalization has a profoundly moral dimension, said Pope Francis, adding that development requires a moral compass to guide discussions that shape the future of the international community.

He invited businesses and states to work together to promote “far-sighted and ethically sound models of globalization.”

Development, said the Pope, “must entail subordinating the pursuit of power and individual gain, be it political or economic, to the common good of our human family, giving priority to the poor, the needy, and those in the most vulnerable situations.”²¹⁵

Further, as Latin American Bishops emphasized at their conference in 1968 in Medellín, Colombia when discussing Liberation Theology, leaders ought to make decisions “on the

²¹⁰ Quoted in *Pope Calls for Politics*.

²¹¹ *Pope Calls for Politics*.

²¹² *Pope Calls for Politics*.

²¹³ *Pope Calls for Politics*.

²¹⁴ *Pope Calls for Politics*.

²¹⁵ Devin Watkins, *Pope to Davos Economic Forum: Development Needs a Moral Compass*, VATICAN NEWS, 17 January 2024, www.vaticannews.va/en/pope/news/2024-01/pope-francis-message-davos-world-economic-forum.html.

basis of the common good *rather than on the good of privileged persons.*²¹⁶ That basis is as important for International Trade Law as any other field, as Professor Thompson observes:

An inegalitarian power structure can turn either an export-oriented policy or an import substitution strategy toward more inequality. *It is not only trade policy that is important, but whose interests the policy is intended to serve.*²¹⁷

These considerations matter also to resolve specific problems.

For example, respecting both human dignity and the common good also are essential to resolving the human trafficking, as Pope Francis noted in linking this evil to economic behavior:

For economic policies and systems to promote an end to human trafficking, they must care about people, their dignity and working conditions, and they must be regulated in ways that promote social justice, not special interests, Pope Francis said.

An economy without human trafficking will require “the courage of patient construction, of planning that does not look always and only at the very short-term gains, but at the medium- and long-term fruits and, above all, at people,” he said ... marking the International Day of Prayer and Awareness against Human Trafficking [8 February].

When it comes to creating an economy without human trafficking, Pope Francis said it would have to be an “economy of care,” meaning, it takes care of people and nature, and offers products and services aimed at fostering the common good.

It would be an economy that creates employment opportunities “that do not exploit workers through degrading working conditions and grueling hours,” but upholds solidarity to weave a more secure and sound social fabric.

“An economy without human trafficking is an economy with market rules that promote justice, not exclusive special interests”....

“Human trafficking finds fertile ground in the setting of neo-liberal capitalism, in the deregulation of markets aimed at maximizing profits

²¹⁶ BOHR, 355. (Emphasis added.) Two meetings of the Latin American Episcopal Conference – at Medellín in 1968, and at Puebla, Mexico, in 1979 – produced seminal documents in Liberation Theology. These documents are summarized in Peter J. Henriot, S.J. *et al.*, eds. *Catholic Social Teaching – Our Best Kept Secret* 134-143 (3rd ed. 1992).

²¹⁷ J. MILBURN THOMPSON, JUSTICE & PEACE – A CHRISTIAN PRIMER 48 (1997). (Emphasis added.)

without ethical limits, without social limits, without environmental limits,” he said.

A deregulated market only follows the logic of calculating pros and cons, he said, where “choices are not made on the basis of ethical criteria, but by pandering to dominant interests, often cleverly obscured by a humanitarian or ecological veneer. Choices are not made by looking at people: people are numbers, to be exploited.”

He said there needs to be a “courageous economy” that has “the courage to combine legitimate profit with the promotion of employment and decent working conditions.”

...

...Pope Francis asked people to make an effort in supporting an economy that does not treat human beings like “a commodity, an object.” The aim of work is to serve people, “not use them like merchandise.”²¹⁸

So, overall, by focusing on the common good, the cause of social justice will be advanced.

Why? Because in a loose sense “social justice” refers to “justice in society in general,” *i.e.*, it “is concerned with the common good.”²¹⁹ In his 1937 Encyclical, *Divini Redemptoris*, Pius XI linked social justice as the desired outcome from pursuit of the common good.

*It is of the essence of social justice to demand from each individual all that is necessary for the common good. But just as in the living organism it is impossible to provide for the good of the whole unless each single part and each individual member is given what it needs for the exercise of its proper functions, so it is impossible to care for the social organism and the good of society as a unit unless each single part and each individual member ... is supplied with all that is necessary for the exercise of his social functions.*²²⁰

This linkage begets an important practical question: who is responsible for it? That is, who is in charge of pursuing the common good, and thereby promoting social justice?

Saint Thomas Aquinas provides the answer in *Summa Theologica*. He identifies leaders (“the sovereign”) as precisely the figures “principally” responsible for the common good.²²¹ Leaders of a political society ought to be devoted to the common good. Leaders of an economic society ought to share this devotion, and in particular appreciate that

²¹⁸ Quoted in Carol Glatz, *Pope: Markets Need Regulation to Promote Justice, Not Special Interests*, CATHOLIC NEWS SERVICE, 8 February 2021, www.catholicnews.com/pope-markets-need-regulation-to-promote-justice-not-special-interests/#noredirect.

²¹⁹ CHARLES, 27.

²²⁰ PIUS XI, ENCYCLICAL LETTER, DIVINI REDEMPTORIS (1937) (quoted in BOHR, 338).

²²¹ ST. THOMAS AQUINAS, SUMMA THEOLOGICA II^o II^{ae} Q. 58 Art. 6 (quoted in CHARLES, 27).

ownership of private property has a “social character” implying respect in the use of property not only for individual interests, but also for the common good.²²²

That property, of course, includes profits from import-export transactions, as well as real estate or personal assets. As Saint John Paul II (1920-2005, Pope, 1978-2005) makes clear in *Sollicitudo Rei Socialis* (1987), awareness of interdependence among individuals and nations ought to create a moral attitude of solidarity with one another. This awareness, which arises out of international trade and the myriad of other daily cross-border events:

is not a feeling of vague compassion or shallow distress at the misfortunes of so many people, both near and far. On the contrary, it is *a firm and persevering determination* to commit oneself to the *common good*; that is to say, to the good of all and of each individual, because we are *all* really responsible *for all*. This determination is based on the *solid* conviction that what is hindering full development is that desire for profit and that thirst for power.... These attitudes and “structures of sin” are only conquered – presupposing the help of divine grace – by a *diametrically opposed attitude*: a commitment to the good of one’s neighbor with the readiness, in the gospel sense, to “lose oneself” for the sake of the other instead of exploiting him, and to “serve him” instead of oppressing him for one’s own advantage (*cf.* Mt. 10:40-42; 20:25; Mk 10:42-45; Lk 22:25-27).²²³

The obvious next inquiry is to define the “common good.”

It means “the good of the whole people, and of each person, under just law,”²²⁴ as Leo XIII suggests in *Rerum Novarum* when identifying elements of proper governance:

Statesmanship consists in making the structure and administrative functioning of the State conduce to *public and private prosperity*: sound morals, family life, regard for religion and justice, moderate taxes equitably levied, growing industry and trade, a flourishing agriculture, *the greater well-being and happiness of the citizens*.²²⁵

The italicized phrases are particularly noteworthy. The “common” good does not mean just the “collective good,” nor does it connote stopping after completion of a utilitarian-type calculation of the most sizeable benefit for the largest number of people.

²²² PIUS XI, ENCYCLICAL LETTER, QUADRAGESIMO ANNO (“After Forty Years”) ¶ 49 (15 May 1931). [Hereinafter, QUADRAGESIMO ANNO.]

²²³ JOHN PAUL II, ENCYCLICAL LETTER, SOLLICITUDO REI SOCIALIS (“On Social Concern”) ¶ 38 (30 December 1987). (Emphasis original.) [Hereinafter, SOLLICITUDO REI SOCIALIS.]

²²⁴ CHARLES, 15. *See also* JOHN XXIII, ENCYCLICAL LETTER, MATER ET MAGISTRA ¶¶ 65-67 (15 May 1961) (explaining that privately-established associations like corporate enterprises “collaborate in the pursuit of their own specific interests *and* those of the common good.”) (Emphasis added.)

²²⁵ LEO XIII, ENCYCLICAL LETTER, RERUM NOVARUM ¶ 33 (15 May 1891) (*quoted in* CHARLES, 39-40). [Hereinafter, RERUM NOVARUM.]

Rather, “common” encompasses the good of each individual, and of the association of which he is a part. As Father Charles puts it: “[p]olitical society emerges for that very purpose: to secure the common good, *the good of each and the good of all.*”²²⁶ Leaders pursue the common good, according to Catholic social justice theory, in large measure by keeping in mind the response to the first moral problem. That is, leaders ought to respect human dignity, which in a practical sense means ensuring for each individual the maximum freedom consistent with the good of all individuals.²²⁷

There are tensions between the levels. All societies face the challenge of resolving them in a manner consistent with respect for human dignity. But, the difficulty of that resolution is exaggerated whenever the basis for human solidarity is forgotten.

What is that basis? The typical answer is that solidarity in a political or economic society emanates from a shared political or economic ideology. That response assumes solidarity to be a human product, of the intellect, of experience, or of both. It is not, and history is littered with ideologies (“-isms”) that failed to link all individuals in a society together in a respectful and enduring manner. The folly lies in believing political or economic leaders can create solidarity:

States and political philosophies and parties have the duty to encourage solidarity, but they cannot of themselves create it. It must be the product of a vision of life which transcends that important sphere of secular life with which the state is concerned. It must be the product of a culture, of a philosophy or a theology which the state cannot control.²²⁸

If neither political nor economic ideology can engender a lasting and comprehensive solidarity, then what kind of metaphysics can produce a transcendent vision?

One response, given in the 1965 Second Vatican Council document *Gaudium et Spes*, is to look to the purpose of forming a society in the first place. That purpose is the achievement of a fuller development than is possible by a person acting alone.

Men, families and the various groups which make up the civil community are aware that they cannot achieve a truly human life by their own unaided efforts. They see the need for a wider community, within which each one makes his specific contribution every day toward an ever-broader realization of the common good. For this purpose, they set up a political community according to various forms. The political community exists, consequently, for the sake of the *common good*, in which it finds its full justification and significance, and the source of its inherent legitimacy. Indeed, the common good embraces the *sum of those conditions of the social*

²²⁶ CHARLES, 42. (Emphasis added.) See also MASSARO, 121 (stating “[t]o speak of the common good is to recognize that there are numerous rightful goals in life beyond our own private benefits”).

²²⁷ See CHARLES, 42.

²²⁸ CHARLES, 41.

*life whereby men, families and associations more adequately and readily may attain their own perfection.*²²⁹

Through solidarity, “we recognize human interdependence not only as a necessary fact but also as a positive value in our lives.”²³⁰ It is such, because the full potential and dignity of a person is realized through a life in shared with others, one of cooperation with others on projects for a mutual benefit.²³¹

The consequence is a transformation from an inner attitude about solidarity, not manifested in action, to the engagement in external activities “that demonstrate our commitment to the well-being of others.”²³² It is a commitment to the common good. This approach to the “common good” expressly links society with complete and efficacious fulfillment of individuals and organizations in the society. The legitimacy of the society depends on its promotion of that fulfillment, and solidarity among its constituents is enhanced by their efforts at doing so.

A second response to understanding the concept of the “common good” can be inferred from a principle known as “the universal destination of goods.” This principle is derived from the Old Testament Book of Genesis, cited by Saint John Paul II in his explanation of the principle:

The original source of all that is good is the very act of God, who created both the earth and man, and who gave the earth to man, so that he might have dominion over it by his work and enjoy its fruits (Gen. 1:28). God gave the earth to the whole human race for the sustenance of all its members, without excluding or favoring anyone. This is the foundation of the universal destination of the earth’s goods.²³³

This principle complements the institution of private property, essentially reminding property owners they are custodians too, on behalf of others (particularly those with less or no property), and their assets are to be used in a socially constructive way.

In turn, a sense of the collective implications of private ownership leads to consideration of the collective implications of work performed on, or using, property owned privately. Saint John Paul II explains in *Centesimus Annus* (1991) that:

a person’s work is naturally interrelated with the work of others. More than ever, work is *work with others* and *work for others*: it is a matter of doing something for someone else. Work becomes ever more fruitful and productive to the extent that people become more knowledgeable of the

²²⁹ SECOND VATICAN COUNCIL, GAUDIUM ET SPES ¶ 74 (1965). (Emphasis added.)

²³⁰ MASSARO, 120.

²³¹ See MASSARO, 120.

²³² MASSARO, 121.

²³³ JOHN PAUL II, ENCYCLICAL LETTER, CENTESIMUS ANNUS (“On The Hundredth Anniversary of *Rerum Novarum*”) ¶ 31 (1 May 1991). (Emphasis original.) [Hereinafter, CENTESIMUS ANNUS.]

productive potentialities of the earth and more profoundly cognizant of the needs of those for whom their work is done.²³⁴

To think about the universal destination of goods, and the “social mortgage” on private property, but not to think about the work done on or with the property to produce goods, would be an inchoate thought – unless, of course, the property is idle.²³⁵

Thus, one way to define “common good” is to consider the fulfillment individuals seek when they form societies, and a second way is to consider the links between the work done by people in societies. Both ways connote engagement in activities for oneself and for those around oneself. However, neither approach gets at the profound basis for human solidarity. What is it that gives each individual in a political or economic society a sense of connectedness to all others in not only that society, but in all other societies?

The theological answer is not surprising (though forgotten, suppressed, or rejected in a frightening number of daily transactions in the global economy). The deepest-of-all foundation is the common Creator:

[T]he soundest basis for such solidarity is the truth that the whole human race is made in God’s image and likeness, and that all men and women are therefore entitled to be treated accordingly, to be given their rights and be expected to accept their responsibilities as sons and daughters of God.²³⁶

Why is this basis – acceptance of a transcendent power common to and above all human beings – the “soundest” for human solidarity? Because (as indicated earlier) to pursue the common good, tensions among competing interests must be resolved. A just resolution of the competition, or the insight to appreciate the interests are not in direct competition, or at least not severely so, may require some check, or self-restraint, on the part of the interested parties. That is, some limit restraint on the relentless pursuit of selfishness may be necessary.

This answer is not singularly Catholic, or even uniquely Christian. “[I]t is an insight which the Stoic philosophers arrived at, as have many of the non-Christian religions of the world.”²³⁷ Catholics and non-Catholics may disagree “on how they should work in society to see this truth become a reality.”²³⁸ But, such disagreement does not vitiate a truth:

²³⁴ CENTESIMUS ANNUS ¶ 31. (Emphasis original.)

For an argument that the classical period of Catholic Social Justice Theory, which began with Pope Leo XII’s 1891 *Rerum Novarum* Encyclical ended with Saint John Paul II’s 1991 *Centesimus Annus* Encyclical, and thereafter with social documents issued during the Pontificates of Benedict XVI and Francis, has not “stood above ideological posturing and partisanship” because it has lost its anchor in “stable, permanent” principles that “challenge ... all forms of secular reasoning about polity, economy, society, and culture,” see George Weigel, *The Uncertain Future of Catholic Social Doctrine*, 41 FELLOWSHIP OF CATHOLIC SCHOLARS QUARTERLY number 1, 5-15 (April 2018).

²³⁵ Saint John Paul II uses the term “social mortgage” in his *Encyclical, Sollicitudo Rei Socialis* (“On Social Concern”) ¶ 42 (30 December 1987), to convey the social function of private property.

²³⁶ CHARLES, 25.

²³⁷ CHARLES, 25.

²³⁸ CHARLES, 25.

political leadership (whether democratic or dictatorial), public policy logic (however compelling), and economic rationality (however profitable) are neither adamant nor enduring bases for human solidarity. Only belief in a supreme transcendent power can lead to peaceful acceptance of restraints on self-aggrandizing behavior when needed in the pursuit of the veritable common good.²³⁹

- **Third Pillar: Preferential Option for Poor**

The first pillar is to respect human dignity. Degradations of that dignity must be fought. “Poverty and deprivation” are, says Saint John Paul II in *Centesimus Annus* (1991), “unworthy of the human person.”²⁴⁰ In the battle against degradation, preferences enshrined in law are a weapon. The second pillar identifies human solidarity as a basis to the common good. In *Sollicitudo Rei Socialis* (1987), Saint John Paul II explains the link between human solidarity, on the one hand, and assistance for the poor, on the other hand:

The exercise of solidarity *within each society* is valid when its members recognize one another as persons. Those who are more influential, because they have a greater share of goods and common services should feel *responsible* for the weaker and be ready to share with them all they possess.

...

...

The same criterion is applied by analogy in international relationships. Interdependence must be transformed into *solidarity*, based upon the principle that the goods of creation *are meant for all*. That which human industry produces through the processing of raw materials, with the contribution of work, must serve equally for the good of all.²⁴¹

The analogy to preferences in International Trade Law is clear: they are a product of solidarity. Rules on S&D treatment constitute a legalized preference borne of solidarity among WTO Members and, in particular, of rich Members with poor Members.

Similarly, there can be a healthy overlap between Social Justice Theory and industrial policy. The U.S. 2022 *IRA* and 2022 *CHIPS Act* (discussed in separate Chapters) are an example:

U.S. President Joe Biden, facing Congressional resistance to his proposals, will announce more than 50 executive actions ... aimed at advancing free preschool and expanding care for children, older Americans and those with disabilities.

...

Ai-jen Poo, President of the National Domestic Workers Alliance and Jenn Stowe, Executive Director of the National Domestic Workers Alliances, called the order “a major step toward modernizing” the U.S. care system.

²³⁹ CHARLES, 25.

²⁴⁰ CENTESIMUS ANNUS ¶ 48.

²⁴¹ SOLLICITUDO REI SOCIALIS, ¶ 39 at 72-73 (30 December 1987). (Emphasis original.)

“Care is a need that we can no longer overlook,” they said in a joint statement. “As the care workforce crisis intensifies across the country and families continue to struggle to afford care, this set of executive actions marks the all-in commitment we need to make sure care jobs are good jobs and that Americans can access care for generations to come.”

Biden is directing nearly every federal agency to identify grant programs that can pay for childcare and long-term care benefits for workers on federal projects, and to consider requiring companies applying for federal job-creation funds to expand access to care for their workers.

*The Commerce Department pioneered this approach last month when it required companies seeking major funding under its \$52 billion U.S. semiconductor manufacturing and research program to show how they will help workers access affordable childcare.*²⁴²

In particular, DOC’s guidance for eligibility for semiconductor manufacturing subsidies stated with respect to affordable childcare and employment discrimination that DOC is “not requiring or expecting applicants to provide free care,” but “that those seeking funding ‘should strongly consider defraying the price of care such that it is within reach for low- and medium-income households.’”²⁴³ This guidance also said “workforce development plans must detail ‘specific commitments of proactive employer engagement and mobilization and efforts to train and hire workers into good jobs that offer competitive wages, including by offering programs to expand employment opportunities for economically disadvantaged individuals.’”²⁴⁴ So, trade-related economic policies and social justice goals can be mutually reinforcing. That is another way of saying that the Classical and Neo-Classical economic paradigms are not the only ones through which to analyze international trade. Rather, as the Ancient and Medieval philosophers and theologians knew, trade is about far more than trade *per se*.²⁴⁵

Of course, appealing to human dignity, or to the responsibility of the rich, are not the only rationales for granting a preference to the poor. That preference, and a rationale for it, exists in the Old Testament legal codes, such as the Decalogue (*Exodus* 20:1-17) and the Book of the Covenant (*Exodus* 20:22-23:33). They articulate aspects of the “proper

²⁴² Andrea Shalal, Biden, *Facing Roadblocks in Congress, to Issue Executive Order on Childcare, Eldercare*, REUTERS, 18 April 2023, www.reuters.com/world/us/biden-facing-roadblocks-congress-issue-executive-order-childcare-eldercare-2023-04-18/. (Emphasis added.)

²⁴³ Quoted in David Shepardson, *U.S. Issuing New Childcare Guidance for Semiconductor Chips Subsidy Program*, REUTERS, 27 March 2023, www.reuters.com/technology/us-issuing-new-childcare-guidance-semiconductor-chips-subsidy-program-2023-03-27/. (Emphasis added.) [Hereinafter, *U.S. Issuing New Childcare Guidance*.]

²⁴⁴ Quoted in *U.S. Issuing New Childcare Guidance*. (Emphasis added.)

²⁴⁵ Of course, resistance to this proposition exists. For example, “[s]ome Republicans have criticized Commerce Department conditions including childcare requirements.” *U.S. Issuing New Childcare Guidance*. That resistance can be ironic insofar as it belies the trade-morality connection that always has been at the heart of the Christian approach to trade, yet is offered by officials touting their fidelity to religion.

relationship to God which comes about through observance of his laws.”²⁴⁶ In *Economic Justice for All*, American Bishops discuss the significance of the preference to the poor expressed in them:

Far from being an arbitrary restriction on the life of the people, these codes *made life in community possible*. The specific laws of the covenant protect human life and property, demand respect for parents and the spouses and children of one’s neighbor, and manifest a *special concern for the vulnerable members of the community: widows, orphans, the poor, and strangers in the land*. ... The codes of Israel reflect the norms of the covenant: reciprocal responsibility, mercy, and truthfulness. They embody a life in freedom from oppression: worship of the One God, rejection of idolatry, mutual respect among people, *care and protection for every member of the social body*. Being free *and being a co-responsible community* are God’s intentions for us.²⁴⁷

Like their American colleagues, Latin American Bishops have noted the importance of the preference for the poor. It is a central feature of Liberation Theology.²⁴⁸

It may seem counter-intuitive, from a hard-headed realist perspective, to think of a preference for the poor as making life in a community possible. Yet, it does precisely that, and in the context of the WTO, the idea of a preference for the poor should not at all be a strange one. Roughly 80% of the Members are impoverished countries. Most developed countries are (officially or not) predominantly Christian, at least by history and tradition.

²⁴⁶ BOHR, 326.

²⁴⁷ National Conference of Catholic Bishops, *Economic Justice for All: A Pastoral Letter on Catholic Social Teaching and the U.S. Economy*, ¶ 36 (1985), www.cctwincities.org/document.doc?id=93. (Emphasis added.)

²⁴⁸ See BOHR, 355-56 (identifying “the preferential option for the poor” as one of the six “central” characteristics of liberation theology, and recounting the emphasis Latin American bishops placed on it at their 1968 conference in Medellín, Colombia).

The preferential option for the poor undergirds the moral argument in favor of debt relief for developing and (especially) least developed countries. See *Holy See at U.N. Advocates Debt Relief for Poor Countries*, Vatican News, 9 October 2020, www.vaticannews.va/en/vatican-city/news/2020-10/holy-see-debt-relief-poor-countriesun-caccia.html (observing that “in his latest Encyclical, *Fratelli Tutti*, he [Pope Francis] spoke about debt relief within the context of the fundamental right of peoples to subsist and grow,” [yet] “[t]his right ... is at times ‘severely restricted by the pressure created by foreign debt,’ [t]hat debt stifles and severely limits development, [and] ‘[w]hile respecting the principle that all legitimately acquired debt must be repaid, the way in which many poor countries fulfil this obligation should not end up compromising their very existence and growth.’”). At the 75th Session of the U.N. General Assembly in October 2020, the Permanent Observer of the Holy See to the United Nations, Archbishop Gabriele Caccia, “pointed out in a statement that due to the demands imposed on the poorer countries by debt servicing and the economic impact of the pandemic, many of them are obliged to ‘divert scarce national resources from fundamental programs of education, health and infrastructure to debt payments,’” that “there is extensive evidence that developing nations, faced with the obligation of diverting scarce resources towards debt repayment, risk undermining “integral development, weaken healthcare and education systems, as well as reduce the capacity of States to create conditions for the realization of fundamental human rights.” *Id.* Thus, “[t]he Archbishop ... urged the international community to address the economic imbalances between nations by debt restructuring and ultimately cancellation ‘in recognition of the severe impacts of the medical, social and economic crises’ faced by the most vulnerable countries as a result of the ongoing pandemic.” *Quoted in id.*

Thus, through their everyday sufferings, their traditional religious backgrounds, or (for some countries) both, virtually every WTO Member is in a position to grasp the importance of the preference. It might be asked rhetorically whether the WTO could function as a community of trading nations without a manifest preference for the poor?

In addition to the Old Testament justification for the preference, there is also a New Testament rationale. In a compelling way, taking special account of the needs of the poor is evident from the example of Jesus. “His Paschal mystery [*i.e.*, the Easter mystery, which is the mystery of the Passion, Resurrection, and Ascension of Christ] is the ultimate ground and source of Catholic social teaching.”²⁴⁹ His specific expressions of the preference are found in his teachings, such as the Beatitudes (*Matthew* 5:3-11; *Luke* 6:20-26), the Parable of the Rich Man and Lazarus (*Luke* 16:19-31), and the Parable of the Good Samaritan (*Luke* 10:29-37). Thus, in *Sollicitudo Rei Socialis*, Saint John Paul II connects the preference with one of these famous stories:

[G]iven the worldwide dimension which the social question has assumed, this love of preference for the poor, and the decisions which it inspires in us, cannot but embrace the immense multitudes of the hungry, the needy, the homeless, those without medical care and, above all, those without hope of a better future. It is impossible not to take account of the existence of these realities. To ignore them would mean becoming like the “rich man” who pretended not to know the beggar Lazarus lying at his gate (*cf.* Lk 16:19-31).²⁵⁰

Likewise, in *Fratelli Tutti*, Pope Francis links the Good Samaritan Parable to special respect for the poor:

At the heart of the new Encyclical’s appeal to Catholics is a meditation on Jesus’ parable of the good Samaritan and particularly on how Jesus takes a legal scholar’s question, “Who is my neighbor,” and turns it into a lesson on being called not to identify one’s neighbors but to become a neighbor to all, especially those most in need of aid.

“The parable eloquently presents the basic decision we need to make in order to rebuild our wounded world. In the face of so much pain and suffering, our only course is to imitate the good Samaritan.... Any other decision would make us either one of the robbers or one of those who walked by without showing compassion for the sufferings of the man on the roadside.”

“The parable ... shows us how a community can be rebuilt by men and women who identify with the vulnerability of others, who reject the creation

²⁴⁹ BOHR, 327. Special concern for the poor also was shown by early apostolic communities. *Id.*
²⁵⁰ SOLLICITUDO REI SOCIALIS, ¶ 42.

of a society of exclusion, and act instead as neighbors, lifting up and rehabilitating the fallen for the sake of the common good.”²⁵¹

Overall, expressions of the preference also are explicit in Christ’s lifestyle of charity.²⁵²

Accordingly, Saint John Paul II writes in *Sollicitudo Rei Socialis* that “the love of preference for the poor” is “a special form of primacy in the exercise of Christian charity” that “affects the life of each Christian inasmuch as he or she seeks to imitate the life of Christ.”²⁵³ It also “applies equally to our *social responsibilities* and hence to our manner of living, and to the logical decisions to be made concerning the ownership and use of goods.”²⁵⁴ Those decisions must be informed not only by a sense of the validity and necessity of private property, but also by the “characteristic principle of Christian social doctrine,” namely, that “the goods of this world are *originally meant for all*.”²⁵⁵ In conducting our social responsibilities in an economic society, we are to keep in mind that “[p]rivate property ... is under a ‘*social mortgage*,’ which means that it has an intrinsically social function, based upon and justified precisely by the principle of the universal destination of goods.”²⁵⁶

To whom are these social responsibilities due? Who exactly are the “poor” to whom – from the example of Jesus – a preference is needed? As in the time of Christ, they include agricultural and industrial workers materially deprived relative to an agreed-upon minimum standard. Pope Leo XIII wrote in 1891 “wage earners are numbered among the multitude of the poor,” and so also need special attention of governmental authorities responsible for the common good.²⁵⁷ In *Laborem Exercens* (1981), Saint John Paul II took special note of farm workers, whose toils involve:

considerable difficulties, including unremitting and sometimes exhausting physical effort and a lack of appreciation on the part of society, to the point of making agricultural people feel that they are social outcasts and of speeding up the phenomenon of their mass exodus from the countryside to the cities and unfortunately to still more dehumanizing living conditions. Added to this are the lack of adequate professional training and of proper equipment, the spread of a certain individualism, and also *objectively unjust situations*. In certain developing countries, millions of people are forced to cultivate the land belonging to others and are exploited by the big landowners, without any hope of ever being able to gain possession of even a small piece of land of their own. There is a lack of forms of legal protection for the agricultural workers themselves and for their families in

²⁵¹ *Belief in God* (quoting FRATELLI TUTTI, ¶ 67).

²⁵² That lifestyle is obvious through, for example, the many stories of healing, such as in *Mark* 1:32-34 (Other Healings), 1:40-42 (The Cleansing of a Leper), 2:3-12 (The Healing of a Paralytic), 3:1-5 (A Man with a Withered Hand), and 6:55-56 (The Healings at Gennesaret).

²⁵³ SOLLICITUDO REI SOCIALIS, ¶ 42. (Emphasis original.)

²⁵⁴ ENCYCLICAL LETTER, SOLLICITUDO REI SOCIALIS, ¶ 42. (Emphasis original.)

²⁵⁵ ENCYCLICAL LETTER, SOLLICITUDO REI SOCIALIS, ¶ 42. (Emphasis original.)

²⁵⁶ ENCYCLICAL LETTER, SOLLICITUDO REI SOCIALIS, ¶ 42. (Emphasis added.)

²⁵⁷ RERUM NOVARUM, ¶¶ 37-38 (quoted in CHARLES, 35).

case of old age, sickness or unemployment. Long days of hard physical work are paid miserably. Land which could be cultivated is left abandoned by the owners. Legal titles to possession of a small portion of land that someone has personally cultivated for years are disregarded or left defenseless against the “land hunger” of more powerful individuals or groups.²⁵⁸

But, though the class of “poor” is dominated by the materially deprived, there are other “poor” people for whom a preference is to be given.

The Beatitudes identifies different types of poor, and speaks first of the poor in spirit. Most definitely, the concept of “poverty” is not exclusive:

The special option for the poor, far from being a sign of particularism or sectarianism, manifests the universality of the Church’s being and mission. *This option excludes no one.* This is why the Church cannot express this option by the means of reductive categories which would make this preference a partisan choice and a source of conflict.²⁵⁹

The “poor” may be defined in general terms as those who suffer injustice, as Saint John Paul II suggests in *Sollicitudo Rei Socialis*:

... in today’s world there are many other *forms of poverty*. For are there not certain privations or deprivations which deserve this name? The denial or the limitation of human rights – as for example the right to religious freedom, the right to share in the building of society, the freedom to organize and to form unions, or to take initiatives in economic matters – do these not impoverish the human person as much as, if not more than, the deprivation of material goods? ...

In brief, modern underdevelopment is not only economic but also cultural, political and simply human....²⁶⁰

This inclusive definition leads to a deeper understanding of why the poor need a preference. To agree upon this definition of “the poor,” yet think nothing of it, is more than uncompassionate. It shows a lack of commitment to the common good. The process of identifying who they are is foundational to articulating a preference for their treatment.

The poor are not to be treated as a means to an end. Setting aside dry economic terminology, they are not a “factor of production” whose “cost” is to be “minimized” in

²⁵⁸ JOHN PAUL II, ENCYCLICAL LETTER, LABOUREM EXERCENS (“On Human Work”) ¶ 21 (14 September 1981). (Emphasis original.) [Hereinafter, LABOUREM EXERCENS.] In the same *Encyclical*, Saint John Paul II writes movingly of the disabled, who are “one of us and participate[] fully in the same humanity that we possess.” *Id.* at ¶ 22.

²⁵⁹ CONGREGATION FOR THE DOCTRINE OF THE FAITH, LIBERTATIS CONSCIENTIA ¶ 68 (1986) (*quoted in* CHARLES, 35.) (Emphasis added.)

²⁶⁰ SOLLICITUDO REI SOCIALIS, ¶ 15. (Emphasis original.)

order to “maximize” profits, nor an “alienated” “proletariat” to be exploited through the extraction of “surplus” in the service of capital. Rather, special care must be taken to respect the dignity, which is innate and inalienable in all human beings, of the poor. Their status as poor is degrading enough, and renders them vulnerable to further degradations. Special attention must be paid to ensure the poor have an opportunity to earn a decent living (one of the human rights obviously abused in the case of the poor).

In what contexts, does this special care and attention occur? There is the micro level, the individual context wherein a single well-off person behaves charitably toward a downtrodden person. There is also the macro level, the contexts of political society and economic society. In macro contexts, the importance of solidarity, based on shared supernatural heritage, again is evident. The solidarity at issue is obviously not of the rich with the rich, nor even of the poor with the poor.²⁶¹ Rather, it is “solidarity with the poor to which the rich are called,”²⁶² and consequent action by organizations led by the rich (such as the WTO) to benefit the poor. How better is that possible than through acknowledgment by the rich that their nature is hardly different from that of the poor?

One of the most controversial macro contexts in which the preferential option for the poor is not exercised is weaponry, specifically, expenditures on, including government procurement of, armaments. In the 1967 Encyclical, *Populorum Progressio* (“On The Development of Peoples”) Saint Paul VI (1897-1978, Pope, 1963-1978), called upon “world leaders to set aside part of their military expenditures for a world fund to relieve the needs of impoverished peoples.”²⁶³ Thereafter, little in the way of diverting military spending to address food security occurred. So, 53 three years later, in 2020, Pope Francis repeated this call with renewed vigor. He identified the causal factors as “an unequal distribution of the fruits of the earth,” along with climate change, underinvestment in agriculture – and conflict.²⁶⁴ Speaking to the FAO about *Fratelli Tutti*, he intoned: “a courageous decision would be to use the money spent on arms and other military expenditures to constitute a ‘Global Fund’ so that we can definitively defeat hunger and help the development of the poorest countries.”²⁶⁵ Such a Fund has yet to be created.

Finally, notwithstanding theological justifications for exercising a preferential option for the poor to advance social justice, there also is a practical one: citizen preference. That is, many people simply prefer to live in a more, rather than less, egalitarian society:

²⁶¹ That is not to say the poor have no responsibilities. In the spirit of human solidarity, they “should not adopt a purely passive attitude or one that is destructive of the social fabric, but, while claiming their legitimate rights, should do what they can for the good of all.” SOLLICITUDO REI SOCIALIS, ¶ 38.

²⁶² CONGREGATION FOR THE DOCTRINE OF THE FAITH, LIBERTATIS CONSCIENTIA ¶ 89 (1986), *quoted in* CHARLES, 26.

²⁶³ POPULORUM PROGRESSIO, ENCYCLICAL OF POPE PAUL VI, ON THE DEVELOPMENT OF PEOPLES, ¶ 51
26 March 1967, www.vatican.va/content/paul-vi/en/encyclicals/documents/hf_p-vi_enc_26031967_populorum.html. [Hereinafter, POPULORUM PROGRESSIO.]

²⁶⁴ Cindy Wooden, *Pope Repeats Call to Divert Funds from Military to Fighting Hunger*, CATHOLIC NEWS SERVICE, 16 October 2020, www.catholicnews.com/pope-repeats-call-to-divert-funds-from-military-to-fighting-hunger/#noredirect. [Hereinafter, *Pope Repeats Call*.]

²⁶⁵ *Pope Repeats Call*.

Where would you rather live? A society where the rich are extraordinarily rich and the poor are very poor, or one where the rich are merely very well off but even those on the lowest incomes also enjoy a decent standard of living?

For all but the most ardent free-market libertarians, the answer would be the latter. *Research has consistently shown that while most people express a desire for some distance between top and bottom, they would rather live in considerably more equal societies than they do at present. Many would even opt for the more egalitarian society if the overall pie was smaller than in a less equal one.*

On this basis, it follows that one good way to evaluate which countries are better places to live than others is to ask: *is life good for everyone there, or is it only good for rich people?*

To find the answer, we can look at how people at different points on the income distribution compare to their peers elsewhere. ...

Starting at the top of the ladder, Britons enjoy very high living standards by virtually any benchmark. Last year the top-earning 3 per cent of U.K. households each took home about £84,000 after tax, equivalent to \$125,000 after adjusting for price differences between countries. This puts Britain's highest earners narrowly behind the wealthiest Germans and Norwegians and comfortably among the global elite.

So, what happens when we move down the rungs? For Norway, it's a consistently rosy picture. The top 10 per cent rank second for living standards among the top deciles in all countries; the median Norwegian household ranks second among all national averages, and all the way down at the other end, Norway's poorest 5 per cent are the most prosperous bottom 5 per cent in the world. Norway is a good place to live, whether you are rich or poor.

Britain is a different story. While the top earners rank fifth, the average household ranks 12th and the poorest 5 per cent rank 15th. Far from simply losing touch with their western European peers, last year the lowest-earning bracket of British households had a standard of living that was 20 per cent weaker than their counterparts in Slovenia.

It's a similar story in the middle. In 2007, the average U.K. household was 8 per cent worse off than its peers in north-western Europe, but the deficit has since ballooned to a record 20 per cent. On present trends, the average Slovenian household will be better off than its British counterpart by 2024, and the average Polish family will move ahead before the end of the decade.

A country in desperate need of migrant labor may soon have to ask new arrivals to take a pay cut.

Across the Atlantic it's the same story, only more so. The rich in the U.S. are exceptionally rich – the top 10 per cent have the highest top-decile disposable incomes in the world, 50 per cent above their British counterparts. But the bottom decile struggle by with a standard of living that is worse than the poorest in 14 European countries including Slovenia.

To be clear, the U.S. data show that both broad-based growth *and* the equal distribution of its proceeds matter for wellbeing. ...

*But redistributing the gains more evenly would have a far more transformative impact on quality of life for millions. The growth spurt boosted incomes of the bottom decile of U.S. households by roughly an extra 10 per cent. But transpose Norway's inequality gradient on to the U.S., and the poorest decile of Americans would be a further 40 per cent better off while the top decile would remain richer than the top of almost every other country on the planet.*²⁶⁶

Why different individuals are willing to sacrifice some of their own comforts to promote less inequality in their societies depends on the individual. Personal security and political depolarization are among them, both undergirded by the reality that micro- and macro-level safety is enhanced when all societal members have a positive stake in the *status quo*.

- **Fourth Pillar: Subsidiarity**

What is the best level at which to make decisions – individual, family, voluntary association, community, district, provincial, national, regional, international, supra-national? Catholic Social Theory proposes that the lowest or smallest competent level possible, the closest to the individual, is the best. It is best because it respects the dignity of the human person. The autonomy and rights of the human person are inalienable, and it is the consent of persons that confers legitimacy on a governing authority. Conversely, when a centralized authority arrogates power to itself, it tends to view itself as the source and grantor of rights, including human rights, to persons in its jurisdictions. That power easily and repeatedly corrupts, resulting in authoritarian and totalitarian regimes that degrade the individual and family.²⁶⁷ So, the term “subsidiarity” arises because higher, central levels of authority should be “subsidiary” to lower, decentralized ones, especially

²⁶⁶ John Burn-Murdoch, *Britain and the U.S. are Poor Societies with Some Very Rich People*, FINANCIAL TIMES, 15 September 2022, www.ft.com/content/ef265420-45e8-497b-b308-c951baa68945?shareType=nongift. (Emphasis added except for penultimate paragraph.)

²⁶⁷ As the *Catechism of the Catholic Church* states in Paragraph 1885: “The principle of subsidiarity is opposed to all forms of collectivism. It sets limits for state intervention. It aims at harmonizing the relationships between individuals and societies. It tends toward the establishment of true international order.” CATECHISM OF THE CATHOLIC CHURCH ¶ 1885 at 460 (Vatican City: Liberia Editrice Vaticana, 2nd ed.). (Emphasis original.) [Hereinafter, CATECHISM.]

the individual and family. They should be charged with decision-making responsibilities that cannot competently be performed by those other ones.

In his 1891 Encyclical, *Rerum Novarum*, Pope Leo XIII proposed subsidiarity as an appropriate middle path between the extremes of (1) subordination of the individual to the state under centralized leadership in a Communist economy and (2) excessive, undisciplined individualism in a *laissez faire* Capitalist economy with no centralized regulatory authority. In 1931, Pope Pius XI elaborated on the concept in his Encyclical Letter, *Quadragesimo Anno*, explaining:

It is a fundamental principle of social philosophy, fixed and unchangeable, that one should not withdraw from individuals and commit to the community what they can accomplish by their own enterprise and industry.²⁶⁸

A correlative moral imperative is “positive subsidiarity:” all levels should create the framework for maximum development of the individual and family.

What are the implications of subsidiarity for International Trade Law? What scope do GATT-WTO rules, and rules in FTAs and CUs, give to decentralized decision-making? Consider these questions especially in respect of S&D treatment? To what extent are developing countries and LDCs subordinated to higher authorities?

- **Fifth Pillar: Universal Destination of Goods**

The universal destination of goods, also referred to as the common use of created goods, is a moral pillar of Catholic Social Justice Theory. It is closely aligned with the Doctrine of the Universal Economy (discussed in a separate Chapter). Indeed, it may be said that the universal destination rests on, or is a logical extension of, that Doctrine. Indeed, as Pope Francis points out in *Fratelli Tutti*, Saint John Paul said, that “God gave the earth to the whole human race for the sustenance of all its members, without excluding or favoring anyone.”²⁶⁹

In *Fratelli Tutti*, Pope Francis identifies the meaning of the universal destination pillar as follows:

The right to private property, and the benefits to individuals and society of protecting that right ... “can only be considered a secondary natural right.”

“The right of some to free enterprise or market freedom cannot supersede the rights of peoples and the dignity of the poor, or, for that matter, respect for the natural environment.” ... “Business abilities, which are a gift from God, should always be clearly directed to the development of others and to

²⁶⁸ QUADRAGESIMO ANNO, ¶ 79. The U.S. Conference of Catholic Bishops, in their 1986 Pastoral Letter, *Economic Justice for All*, articulate this moral pillar.

²⁶⁹ *Belief in God* (quoting *Fratelli Tutti*, ¶¶ 120, 122-123).

eliminating poverty,” especially through the creation of jobs that pay a living wage.²⁷⁰

Notably, the universal destination of goods is not anti-Capitalist. That is, it is respectful of the individual right to private property and the legitimate exercise of ownership. Instead, it calls for governmental regulation, when appropriate, to advance the common good.

Accordingly, Paragraphs 2403 and 2405 in the *Catechism of the Catholic Church* state:

2403 The *right to private property*, acquired or received in a just way, does not do away with the original gift of the earth to the whole of mankind. The *universal destination of goods* remains primordial, even if the promotion of the common good requires respect for the right to private property and its exercise....

...

2405 Goods of production – material or immaterial – such as land, factories, practical or artistic skills, oblige their possessors to employ them in ways that will benefit the greatest number. Those who hold goods for use and consumption should use them with moderation, reserving the better part for guests, for the sick and the poor.²⁷¹

Likewise, Paragraph 177 of the *Compendium of the Social Doctrine of the Church* says:

*Christian tradition has never recognized the right to private property as absolute and untouchable: “On the contrary, it has always understood this right within the broader context of the right common to all to use the goods of the whole of creation: the right to private property is subordinated to the right to common use, to the fact that goods are meant for everyone.” [Quoting John Paul II, *Encyclical Letter, Laborem Exercens*, Section 14 (1981).] The principle of the universal destination of goods is an affirmation both of God's full and perennial lordship over every reality and of the requirement that the goods of creation remain ever destined to the development of the whole person and of all humanity. This principle is not opposed to the right to private property but indicates the need to regulate it.²⁷²*

More bluntly, in *Populorum Progressio*, Saint Paul VI quoted from Saint Ambrose: ““You are not making a gift of what is yours to the poor man, but you are giving him back what is his. You have been appropriating things that are meant to be for the common use of everyone. The earth belongs to everyone, not to the rich.””

²⁷⁰ *Belief in God (quoting Fratelli Tutti).*

²⁷¹ CATECHISM ¶ 2403 at 577, ¶ 2405 at 578.

²⁷² PONTIFICAL COUNCIL FOR JUSTICE AND PEACE, COMPENDIUM OF THE SOCIAL DOCTRINE OF THE CHURCH ¶ 177 at 77 (Vatican: Liberia Editrice Vaticana, United States Conference of Catholic Bishops, 2004). (Emphasis original.) [Hereinafter, COMPENDIUM.]

Also notable is the matter of ends versus means. Catholic Social Justice Theory holds that private property, through suitable regulation in favor of the common good with particular concern for the poor, is a way to achieve the universal destination of goods. Paragraph 177 of the *Compendium* explains: *Private property, in fact, regardless of the concrete forms of the regulations and juridical norms relative to it, is in its essence only an instrument for respecting the principle of the universal destination of goods; in the final analysis, therefore, it is not an end but a means.*²⁷³

What are the implications for International Trade Law and Policy of this pillar? In 1963, Saint Paul VI argued in *Populorum Progressio*:

Equity in Trade Relations

56. Efforts are being made to help the developing nations financially and technologically. Some of these efforts are considerable. Yet all these efforts will prove to be vain and useless, if their results are nullified to a large extent by the unstable trade relations between rich and poor nations. The latter will have no grounds for hope or trust if they fear that what is being given them with one hand is being taken away with the other.

Growing Distortion

57. Highly industrialized nations export their own manufactured products, for the most part. Less developed nations, on the other hand, have nothing to sell but raw materials and agricultural crops. As a result of technical progress, the price of manufactured products is rising rapidly and they find a ready market. But the basic crops and raw materials produced by the less developed countries are subject to sudden and wide-ranging shifts in market price; they do not share in the growing market value of industrial products.

This poses serious difficulties to the developing nations. They depend on exports to a large extent for a balanced economy and for further steps toward development. Thus the needy nations grow more destitute, while the rich nations become even richer.

Free Trade Concept Inadequate

58. It is evident that the principle of free trade, by itself, is no longer adequate for regulating international agreements. It certainly can work when both parties are about equal economically; in such cases

²⁷³ COMPENDIUM, ¶ 177 at 77. (Emphasis original.) See also *id.*, ¶¶ 182-184 (on the universal destination of goods and preferential option for the poor).

it stimulates progress and rewards effort. That is why industrially developed nations see an element of justice in this principle.

But the case is quite different when the nations involved are far from equal. Market prices that are freely agreed upon can turn out to be most unfair. It must be avowed openly that, in this case, the fundamental tenet of liberalism (as it is called), as the norm for market dealings, is open to serious question.²⁷⁴

Consider, for example, the use of trade sanctions and export controls (discussed in separate Chapters). Are they moral? Does the existence of a humanitarian exception to them (whereby goods and services for basic needs are exempt from such sanctions or controls) matter to their moral integrity?

²⁷⁴ POPULORUM PROGRESSIO, ¶¶ 56-58.

Chapter 5

ETHICS THEORY



I. Two Analytical Axes

Moral assessments in International Trade Law need not be woolly headed. They can be made with precision along two axes:

- (1) **Level of Analysis:**
What is at issue?
There are two possibilities, a transaction (*e.g.*, imports, exports, trade barriers, or subsidies), and a transactor (*i.e.*, trader), or the “thing” versus the “individual.”
- (2) **Method of Analysis:**
What is the metric for moral assessment?
Here, there are three philosophical schools, or paradigms, of ethical theory. Additionally, there are religious paradigms in which to assess the morality of an international trade transaction or an international trader.

Table 5-1 summarizes these axes, and their elements are discussed below.

Table 5-1
Ethics Theory Analytical Axes

<i>Level of Analysis</i>  <i>Method of Analysis</i> 	<i>Morality of International Trade Transaction?</i>	<i>Morality of International Trader?</i>
Utilitarianism	Hedonistic, Preference, Act, and Rule Utilitarianism?	
Virtue Ethics	The right character traits?	
Deontological Theory	Intrinsic nature according to moral norm?	

II. Utilitarian Theory (Act and Rule)

SEVEN PILLARS INSTITUTE FOR GLOBAL FINANCE AND ETHICS,
*DICTIONARY OF MORAL AND FINANCIAL TERMS (2023)*²⁷⁵

Definition and Types:

²⁷⁵ www.sevenpillarsinstitute.org.

Utilitarianism states that actions are morally right if and only if they maximize the good (or, alternatively, minimize the bad). Classical Utilitarians like Jeremy Bentham and John Stuart Mill (as well as many contemporary Utilitarians) take ‘the good’ to be pleasure or well-being. Thus, actions are morally right, on this view, if and only if they maximize pleasure or well-being or minimize suffering.

This approach is sometimes called *Hedonistic Utilitarianism*. For hedonistic Utilitarians, the rightness of our actions are determined solely on the basis of consequences of pleasure or pain.

Utilitarian theories may take other goods into consideration. *Preference Utilitarianism*, for example, takes into account not just pleasures, but the satisfaction of any preference.

Utilitarianism can also be divided along other lines. *Act Utilitarianism* claims that we must apply a utilitarian calculation to each and every individual action. By making this calculation, we can thereby determine the moral rightness or wrongness of each action we plan to take.

Rule Utilitarianism eases the burden that act-utilitarianism places on practical reasoning by establishing moral rules that, when followed, brings about the best consequences. Rule Utilitarianism can be illustrated by the rule “do not kill.” As a general rule, we would be better off, that is, the best consequences, or state of affairs, would be brought about, if we all followed the rule “do not kill.”

Objections to Utilitarianism:

There are a number of objections to Utilitarian theories, both in their Act ... and ... Rule formulations.

- (1) Act Utilitarianism, for example, seems to be impractical. To stop to calculate the possible outcomes of *every* act we intend to make, as well as the outcomes of all of the possible alternatives to that act is unrealistic. Moreover, it may hinder one’s ability to bring about the best consequences – for example, in cases where a quick response is vital (as in responding to a car wreck).
- (2) Others have objected to Utilitarianism on the grounds that we cannot always predict the outcomes of our actions accurately. One course of action may *seem* like it will lead to the best outcome, but we may be (and often are) mistaken. The best it seems we can do, then, is to guess at the short-term consequences of our actions.
- (3) Objections to Utilitarianism have also been made on the grounds that it is excessively demanding and places too large a burden on individuals. Since

utilitarianism says that acts are morally right if and only if they maximize pleasure or well-being, it seems that leisure activities, such as watching television, may be morally wrong because they do not maximize well-being. Any person watching television could, after all, be doing something else – something that *would* maximize utility, like helping others or volunteering.

- (4) Finally, Utilitarianism receives criticism because seemingly immoral acts and rules can be justified using Utilitarianism (this criticism is applicable both to Act and Rule Utilitarianism). Genocides, torture, and other evils may be justified on the grounds that they, ultimately, lead to the best outcome. Unjust rules – for example, laws that legalize slavery or apartheid – might also be justified on utilitarian grounds.

III. Virtue Ethics Theory

SEVEN PILLARS INSTITUTE FOR GLOBAL FINANCE AND ETHICS, *DICTIONARY OF MORAL AND FINANCIAL TERMS (2023)*²⁷⁶

Origins and Emphasis:

Virtue ethics takes its philosophical root in the work of the ancient Greek philosopher Aristotle. Virtue theories claim that ethics is about agents, not actions or consequences. Living an ethical, or good life, then, consists in the possession of the right character traits (virtues) and having, as a result, the appropriate moral character.

Unlike deontological accounts, which focus on learning and, subsequently, living by moral rules, virtue accounts place emphasis on developing good habits of character. In essence, this means developing virtuous character traits – dispositions to act in a certain way – and avoiding bad character traits, or vices of character.

Character traits commonly regarded as virtues include courage, temperance, justice, wisdom, generosity, and good temper (as well as many others). This approach to normative ethics also emphasizes moral education. Since traits of character are developed in youth, adults are responsible for instilling in their children the appropriate dispositions.

Objections to Virtue Ethics:

- (1) The first difficulty, which any virtue theorist must surmount, is figuring out which characteristics count as virtues (and which count as vices). Given that different cultures sometimes hold different traits of character to be virtuous, it seems that virtue ethical theories are susceptible to the difficulties involved with cultural relativism.

²⁷⁶ www.sevenpillarsinstitute.org.

- (2) It also seems that virtuous characteristics can be exhibited even when the actions carried out are immoral. Courage, for example, is often regarded as a virtue, but can there not be courageous bank robbers? It certainly seems that a bank robber could exhibit courage while robbing a bank, yet we generally agree that robbing is morally wrong.

This consequence is problematic because the aim of any normative theory is to arrive at standards, or norms, of behavior for living a moral life. In the case of the courageous bank robber, it seems that the bank robber lives according to the standard set by virtue ethics (that is, he acts courageously) but his behavior is nevertheless immoral.

It may be suggested in response to this objection that the courageous bank robber, though meeting the requirements of the virtue of courage, fails to live according to the standard set by some other virtue – for example, honesty. This response, however, only serves to highlight another objection to virtue ethics – competing virtues.

- (3) Virtue theories encounter problems with moral dilemmas in which 2 (or more) virtues conflict. In other words, the requirements of one virtue may be opposed, or contradictory, to the requirements of another. The requirements of honesty, for example, require us to tell the truth, even if it is hurtful. The virtues of kindness or compassion, on the other hand, point to remaining silent, or perhaps even lying, in order to avoid harm.

IV. Deontological Theory

SEVEN PILLARS INSTITUTE FOR GLOBAL FINANCE AND ETHICS, *DICTIONARY OF MORAL AND FINANCIAL TERMS (2023)*²⁷⁷

Definition and Kantian Deontology:

Deontological theories (derived from the Greek word for duty, *deon*) base morality on certain duties, or obligations, and claim that certain actions are intrinsically right or wrong, that is, right or wrong in themselves, regardless of the consequences that may follow from those actions. What makes a choice or an action right is its conformity with a moral norm. Thus, an agent has a duty to act in accordance with a moral norm, irrespective of the (potentially beneficial) effects of acting otherwise.

We might say that parents, for example, have an obligation to take care of their children. On a deontological view, parents must fulfill this obligation, even if breaking the obligation were to result, for the parents, in some great benefit (increased financial savings, for example).

²⁷⁷ www.sevenpillarsinstitute.org. (Emphasis original.)

The deontological view holds that some actions cannot be justified by their consequences. In short, for the deontologist, the ends *do not* justify the means.

Indeed, Immanuel Kant, whose formulation of deontological ethics is perhaps the most well-known, wrote that one must “act so that you treat humanity, both in your own person and in that of another, always as an end and never merely as a means.” As with other deontologists (Thomas Hobbes and John Locke, for example), Kant held that the basis of our moral requirements is a standard of rationality. In the case of Kant, the standard is a *categorical imperative*. This single principle of rationality comprehensively includes all of our particular duties.

Objections to Kantian Deontology:

- (1) Kant’s claim is that the moral status of our actions is determined solely on the basis of the rightness or wrongness of the action itself. This means that it is categorically wrong to, for example, lie, in any circumstances, regardless of the consequences. It seems implausible, however, to hold that lying is categorically wrong in all circumstances. Imagine, for example, a situation in which a serial killer is on the hunt for your daughter. While searching for her, the killer, whom you *know* to be the killer, encounters you and asks for information regarding your daughter’s whereabouts. According to Kant’s deontological theory, you would be required to tell the truth. Does this seem reasonable?

Chapter 6

ETHICAL PRACTICE

I. Overview of 1977 FCPA

- **Background and Key Terms**

The *Foreign Corrupt Practices Act (FCPA)* was passed by unanimous vote in both Houses of Congress and signed by President Jimmy Carter (1924-, President, 1977-1981) in 1977.²⁷⁸ The FCPA contains civil sanctions enforced by the SEC and criminal sanctions enforced by the DOJ. The statute forbids bribery of foreign government officials, that is, any transfer of a thing of value (above a low *de minimis* threshold) for the purpose of obtaining a benefit (*e.g.*, a government procurement contract.) Summarized, the FCPA makes unlawful the “use of the mails or any means or instrumentality of interstate commerce:”²⁷⁹

- (1) corruptly,
- (2) in furtherance of an offer, payment, promise to pay, or authorization of the payment or of any money, or offer, gift, promise to give, or authorization of the giving of anything of value,
- (3) to any foreign official [, which includes] any foreign political party or official thereof, any candidate for foreign political office, or to any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly to any foreign official,
- (4) for purposes of influencing any act or decision of such foreign official in his official capacity; inducing such foreign official to do or omit to do any act in violation of his lawful duty; securing any improper advantage; or inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,
- (5) in order to obtain or retain business for or with, or direct business

²⁷⁸ *Foreign Corrupt Practices Act of 1977*, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78a, 78dd-1, 78dd-2, 78ff, 78m, 78o (2006)), *amended by Foreign Corrupt Practices Act Amendments of 1988*, 15 U.S.C. §§ 78dd-1 to -3, 78ff (2006) and *International Anti-Bribery and Fair Competition Act of 1998*, 15 U.S.C. §§ 78dd-1 to -3, 78ff (2006).

²⁷⁹ 15 U.S.C. § 78dd-1(a) (2006).

to, any person.²⁸⁰

Significantly, the *FCPA* contains an affirmative defense, plus an exemption from the bribery prohibitions.

The affirmative defense is narrow. It applies if “the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations” of the foreign country.²⁸¹ In other words, the affirmative defense is a local law exception. But, that local law “must be affirmatively stated and written; neither negative implication, custom, nor tacit approval” is allowed under the affirmative defense.²⁸²

The exemption is for facilitation, or so-called “grease,” payments. The “Grease Payment” exception is an express one to the *FCPA* prohibition of bribery for:

facilitating or expediting payments[s] ... to expedite or to secure the performance of a routine governmental action....²⁸³

“Routine governmental action” is defined as:

only an action which is ordinarily and commonly performed by a foreign official ... [and] ... does not include any decision by a foreign official whether, or on what terms, to award new business to or to continue business with a particular party....²⁸⁴

Examples mentioned in the *FCPA* include processing governmental papers such as visas, providing phone service, giving police protection, and loading and unloading cargo.²⁸⁵

As regards the “Grease Payment” exception, the *FCPA* resembles the *Guidelines* published by the ICC. That is, the *Guidelines* contain a similar exemption.²⁸⁶ In contrast, the *Anti-Bribery Convention of the Organization for Economic Cooperation and Development* (OECD *Anti-Bribery Convention*) contains no exception for facilitation payments.²⁸⁷ This variance is the subject of complaints by some German (and other

²⁸⁰ The summary is provided by, Amy Deen Westbrook, *Enthusiastic Enforcement, Informal Legislation: The Unruly Expansion of the Foreign Corrupt Practices Act*, 45 *GEORGIA LAW REVIEW* 489, 503-504 (2011). [Hereinafter, *Enthusiastic Enforcement*.]

²⁸¹ 15 U.S.C. §§ 78dd-1(c)(1), -2(c)(1), -3(c)(1).

²⁸² *Enthusiastic Enforcement*, 506.

²⁸³ 15 U.S.C. §§ 78dd-1 (b), -2(b), -3(b).

²⁸⁴ 15 U.S.C. §§ 78dd-1(f)(3), -2(h)(4), -3(f)(4).

²⁸⁵ *See id.* §§ 78dd-1(f)(3)(A)(i)-(v), -2(h)(4)(A)(i)-(v), -3(f)(4)(A)(i)-(v).

²⁸⁶ *See* COMBATING EXTORTION AND BRIBERY: ICC RULES OF CONDUCT AND RECOMMENDATIONS, (2005), www.iccwbo.org/uploadedFiles/ICC/policy/anticorruption/Statements/ICC_Rules_of_Conduct_and_Recommendations_2005_Revision.pdf.

²⁸⁷ *See* Organization for Economic Cooperation and Development, *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, 17 December 1997, 112 Stat. 3302, 37 I.L.M. 1, www.oecd.org/dataoecd/4/18/38028044.pdf. 9 December 2009 marked the 10th anniversary of the entry into force of the *OECD Anti-Bribery Convention*. *See also* *OECD Recommendation for Further*

European) companies, which argue they are at a competitive disadvantage *vis-à-vis* American firms. U.S. firms are governed by the *FCPA* and can utilize the exemption. German companies must work under the *Convention*. These complaints are somewhat ironic, because for years until the Convention was adopted, American businesses argued the *FCPA* handicapped them in their dealings with foreign government officials. A further issue that is important in considering the different anti-bribery regimes is the permissibility (or lack thereof) of tax deductions for facilitation payments.

- **Enforcement**

Since 2002, enforcement under the *FCPA* has increased significantly. It is estimated there are currently (as of early 2011) 140 open *FCPA* investigations.²⁸⁸ Compare that number to the first 28 years the *FCPA* was in force, when there were 2 or 3 cases initiated a year, and fines generally did not exceed \$1,000,000.²⁸⁹ Another measure of the increased enforcement is that in 2000, there were just 8 *FCPA* investigations, whereas by 2010 the figure surpassed 100.²⁹⁰ Due to the upsurge in vigorous enforcement, a number of American businesses and individuals have been caught running afoul of *FCPA* regulations, resulting in billions of dollars in fines paid to the DOJ and SEC, and an increase in the number of individual prison sentences.

For example, in 2007 Lucent Technologies Inc. agreed to pay \$2.5 million after an *FCPA* investigation regarding payments of travel and entertainment expenses for Chinese officials.²⁹¹ It was alleged Lucent improperly accounted for certain expenditures related to the Chinese officials in company books and records.

In 2008, Daimler AG paid almost \$200 million (\$93.6 million to the DOJ and \$91.4 million to the SEC, which included \$4 million for related alleged violations of the United Nations Oil-for-Food Program) to settle alleged *FCPA* violations.²⁹² The company neither admitted nor denied the SEC allegations, but did agree to an independent compliance monitor for a period of 3 years to oversee *FCPA* compliance.

Also in 2008, in one of, if not the, largest case to date, Siemens was ordered to pay \$800 million in penalties to U.S. authorities for *FCPA* violations.²⁹³ \$350 million was paid to settle SEC charges and \$450 million was paid to settle DOJ criminal charges. The SEC's allegations against Siemens included, but were not limited to: bribes paid in connection

Combating Bribery of Foreign Public Officials in International Business Transactions, 26 November 2009, www.oecd.org/dataoecd/11/40/44176910.pdf.

²⁸⁸ See *Enthusiastic Enforcement*, 496.

²⁸⁹ See *Enthusiastic Enforcement*, 495.

²⁹⁰ See Michael Bologna, *DOJ Official Says FCPA Investigations Continue "Full Blast" Despite Setbacks*, 29 *International Trade Reporter* (BNA) 746 (10 May 2012). [Hereinafter, *DOJ Official Says*.]

²⁹¹ See *Lucent Paying \$2.5 Million in SEC, DOJ Pacts Over Payments of Chinese Officials' Expenses*, 25 *International Trade Reporter* (BNA) 79 (17 January 2008).

²⁹² See Yin Wilczek, *Daimler to Pay \$200 Million to Settle SEC, DOJ's FCPA Charges, Court Filings Say*, 27 *International Trade Reporter* (BNA) 514 (08 April 2010).

²⁹³ See, e.g., *SEC Charges Siemens AG for Engaging in Worldwide Bribery*, www.sec.gov/news/press/2008/2008-294.htm.

with construction regarding transit lines in Venezuela and refineries in Mexico, bribes to obtain business in Argentina regarding the development of national identity cards, and kickbacks to Iraqi ministers under the U.N. Oil for Food Program. The SEC further alleged the violations took place between 12 March 2001 and 30 September 2007, and involved employees at all levels within the company. Siemens neither admitted nor denied the SEC allegations.

Regarding the criminal charges brought by the DOJ against the company, Siemens AG, Siemens S.A. – Argentina (Siemens Argentina), Siemens Bangladesh Limited (Siemens Bangladesh), and Siemens S.A. – Venezuela (Siemens Venezuela) all pled guilty to at least one count of violations related to the *FCPA*.²⁹⁴ As another instance, in February 2012, Albert (Jack) Stanley, the former Chairman and Chief Executive Officer of Kellogg, Brown & Root, Inc. (KBR), was sentenced to 30 months in prison for *FCPA* violations.²⁹⁵ Mr. Stanley participated (with 2 others) in a conspiracy to bribe Nigerian government officials, resulting in construction contracts worth over \$6 billion. Mr. Stanley also was ordered to pay \$10.8 million in restitution to KBR, which was the victim in the kickback scheme.

Fines are not the only means of punishment for *FCPA* violations. In 2010, Virginia resident, Charles Paul Edward Jumet, was sentenced to 87 months in prison for bribing former government officials in Panama.²⁹⁶ At the time, 87 months was the longest prison term imposed for violating the *FCPA*. Jumet also was ordered to serve 3 years of supervised release at the end of his prison term and pay a fine of \$15,000.

Finally, there exists a cooperation program that can be implemented when there are known *FCPA* violations within a company or by an individual. The SEC announced this cooperation initiative in January 2010. In December 2010, the SEC handed down its first non-prosecution agreement (NPA), in a deal with Carter’s Inc., regarding alleged violations by a company sales executive. The SEC has since entered into 25 cooperation agreements (*i.e.*, NPAs) with individuals.²⁹⁷

In addition to the use of NPAs, on 17 May 2011 the SEC announced its first-ever deferred prosecution agreement (DPA):

DPAs are written agreements between the SEC and a cooperating individual or company in which the commission foregoes enforcement action if the company or individual agrees to cooperate, undertake certain measures for

²⁹⁴ See, *e.g.*, *Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay \$450 Million in Combined Criminal Fines*, www.justice.gov/opa/pr/2008/December/08-crm-1105.html.

²⁹⁵ See *United States v. Stanley*, U.S. District Court for the Southern District of Texas, Criminal Number H-08-597 (24 February 2012); *Former KBR Chief to Serve 30 Months Over Role in Foreign Bribery Conspiracy*, 29 International Trade Reporter (BNA) 340 (1 March 2012).

²⁹⁶ See *Virginia Resident’s 87-Month Jail Sentence Is Longest for Violation of FCPA, DOJ Says*, 27 International Trade Reporter (BNA) 639 (29 April 2010).

²⁹⁷ See Yin Wilczek, *SEC Signs First Deferred Prosecution Pact; Tenaris to Pay Almost \$9M Over Breaches*, 28 International Trade Reporter (BNA) 857 (26 May 2011). [Hereinafter, *SEC Signs*.]

a set period of time, pay penalties and/disgorgements, and to tolling of the statute of limitations.²⁹⁸

The SEC entered into an agreement with Tenaris S.A. regarding allegations that company employees bribed Uzbekistan officials in order to secure oil pipeline contracts.

In the case of Tenaris, the company self-reported *FCPA* violations to the SEC. Furthermore, Tenaris fully cooperated with the SEC and DOJ throughout the case. The DPA agreement was effective from 17 May 2011 to 17 May 2013. During that time Tenaris, was required to “...strengthen its *FCPA* compliance procedures and controls, ... implement due diligence requirements with respect to the retention and payment of agents, and to provide *FCPA* training for workers.”²⁹⁹ The DOJ resolved its case against Tenaris through an NPA.

While the cooperation program seemed to work successfully for Tenaris, the program is new and requires further clarity from the SEC. For example, there is a lack of detail available concerning the specific cooperation provided by Tenaris. Therefore, practicing attorneys have little to go on when advising clients regarding whether to cooperate with the SEC.

In 2010, legislation – commonly called the *Dodd-Frank Act*³⁰⁰ – was adopted to create programs within the SEC to encourage individuals to report violations of laws or regulations, including ones pertaining to the *FCPA*, which take place in their jurisdiction. (The precise scope of what constitutes the jurisdiction of an individual may be unclear.) Significantly, the *Dodd-Frank Act* helps such individuals, who are “whistleblowers,” by creating a number of protections for whistleblowers, and by expanding on relief for whistleblowers afforded under the *Sarbanes-Oxley Act*. Further, the *Dodd-Frank Act* clarifies the *FCPA*, and anti-bribery enforcement thereunder, is subject to the jurisdiction of the SEC. Finally, the *Dodd-Frank Act* also requires issuers to disclose publicly to the SEC payments made to the American or foreign governments regarding commercial development of oil, natural gas, and minerals.³⁰¹

The “radicalization” of *FCPA* enforcement is a recent phenomenon that has changed the *Act* itself, yet has left the business community with little or no official guidance regarding compliance.³⁰² The line between acceptable and unacceptable business practices is not clearly defined. Without official, detailed guidance, companies cannot build effective compliance programs, let alone understand the full scope of *how* to comply. Former

²⁹⁸ *SEC Signs*.

²⁹⁹ *SEC Signs*.

³⁰⁰ See Public Law 111-203, 124 U.S. Statutes at Large. 1376, codified in scattered sections of the U.S. Code, including Titles 12 and 15.

The full title of the *Dodd-Frank* legislation is (too) lengthy, but starts out as the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. This legislation was the response of the Congress to the financial crisis of 2008-2010.

³⁰¹ See, Stuart H. Deming, *Anti-Bribery Enforcement, Significant Developments in More Settings*, 40 INTERNATIONAL LAW NEWS 1, 4-6 (Spring 2011).

³⁰² *Enthusiastic Enforcement*, 489.

General Counsel of the SEC, James Doty, argues “[a]ggressive enforcement, based on an expansive interpretation of a vague statute, a little-used DOJ opinion process, and the temptation perhaps to assume that more draconian criminal enforcement is better, have all led to a lack of predictability in law enforcement and ... some incorrect application of” the *FCPA*.³⁰³

The evolution of the *FCPA* into the ever more aggressive and prominent statute that it is today can be seen as a reaction to various events in the not so distant past. The development of international anti-corruption rules, such as the *OECD Convention*, the 2002 *Sarbanes-Oxley Act*,³⁰⁴ and the corruption-plagued United Nations Oil-for-Food Program,³⁰⁵ all encouraged the SEC and DOJ to enforce the *FCPA* vigorously. Likewise, the global economic crisis triggered by the September 2008 collapse of Lehman Brothers, and Wall Street scandals (including the Bernard L. Madoff \$50 billion Ponzi scheme and R. Allen Stanford \$8 billion investment fraud)³⁰⁶ elicited a public perception of regulatory failure and a call for authorities to “do something.” One such “something” was increased *FCPA* enforcement. To aid companies in their compliance with *FCPA* regulations, general guidance and official classification of acceptable conduct must come from the agencies themselves. The *FCPA* is “... a law which is substantively well-suited to the challenges of the 2010s.” But, the rigorous enforcement cannot, or at least ought not to, continue without authorities providing formal guidelines so that the private sector has a clearer idea of how best to comply with the *FCPA*.³⁰⁷

To be sure, not all *FCPA* investigations result in success for the government.³⁰⁸ In one of the largest attempted prosecutions, the “SHOT” case (named after the “SHOT Show,” which is an annual trade fare for firearms, hunting, and shooting manufacturers) concerning an alleged plot to bribe government officials in Gabon, the government had to dismiss all charges against 22 defendants. Like many investigations, that case involved an undercover sting operation by the FBI, and such operations can pose legal problems.

II. Application of *FCPA*

UNITED STATES DEPARTMENT OF JUSTICE, CRIMINAL DIVISION, AND UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ENFORCEMENT DIVISION, *FCPA – A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (14 NOVEMBER 2012)*³⁰⁹

³⁰³ *Enthusiastic Enforcement*, 574 (quoting James R. Doty, *Toward a Reg. FCPA: A Modest Proposal for Change in Administering the Foreign Corrupt Practices Act*, 62 BUSINESS LAWYER 1233, 1233-1239 (2007)).

³⁰⁴ *Sarbanes-Oxley Act of 2002*, Public Law Number 107-204, 116 Stat. 745.

³⁰⁵ See The Independent Inquiry Committee into the UN. Oil for Food Program (IIC), <http://reliefweb.int/organization/iic>.

³⁰⁶ *Enthusiastic Enforcement*, 520-521.

³⁰⁷ *Enthusiastic Enforcement*, 577.

³⁰⁸ See DOJ Official Says.

³⁰⁹ Endnotes and box insets omitted, emphases original. See also U.S. DEPARTMENT OF JUSTICE & U.S. SECURITIES AND EXCHANGE COMMISSION, *FCPA – A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT* (2nd ed., July 2020), www.justice.gov/criminal-fraud/file/1292051/download (updating the 1st edition; though substantially similar to that 1st edition, the updates cover (1) changes in DOJ policy

THE *FCPA*: ANTI-BRIBERY PROVISIONS

The *FCPA* addresses the problem of international corruption in two ways: (1) the anti-bribery provisions, which are discussed below, prohibit individuals and businesses from bribing foreign government officials in order to obtain or retain business and (2) the accounting provisions, ... impose certain record keeping and internal control requirements on issuers, and prohibit individuals and companies from knowingly falsifying an issuer's books and records or circumventing or failing to implement an issuer's system of internal controls. Violations of the *FCPA* can lead to civil and criminal penalties, sanctions, and remedies, including fines, disgorgement, and/or imprisonment.

In general, the *FCPA* prohibits offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business.

Who Is Covered by the Anti-Bribery Provisions?

The *FCPA*'s anti-bribery provisions apply broadly to three categories of persons and entities: (1) "issuers" and their officers, directors, employees, agents, and shareholders; (2) "domestic concerns" and their officers, directors, employees, agents, and shareholders; and (3) certain persons and entities, other than issuers and domestic concerns, acting while in the territory of the United States.

Issuers – 15 U.S.C. § 78dd-1

...

Section 30A of the *Securities Exchange Act of 1934* (the *Exchange Act*), which can be found at 15 U.S.C. § 78dd-1, contains the anti-bribery provision governing issuers. A company is an "issuer" under the *FCPA* if it has a class of securities registered under Section 12 of the *Exchange Act* [15 U.S.C. § 781] or is required to file periodic and other reports with SEC under Section 15(d) of the *Exchange Act* [15 U.S.C. § 78o(d)]. In practice, this means that any company with a class of securities listed on a national securities exchange in the United States, or any company with a class of securities quoted in the over-the-counter [OTC] market in the United States and required to file periodic reports with SEC [Securities and Exchange Commission], is an issuer. A company thus need not be a U.S. company to be an issuer. Foreign companies with American Depositary Receipts that are listed on a U.S. exchange are also issuers [and the SEC has taken many enforcement actions against foreign issuers]. As of December 31, 2011, 965 foreign companies were

concerning mergers and acquisitions (M&A) transactions, corporate compliance programs, use of corporate monitors, and enforcement, and (2) implementation of new case law, particularly *United States v. Hoskins*, 902 F.3d 69 (Number 16-1010, 2nd Cir. 2018), which (as discussed above) addresses *FCPA* jurisdiction over a foreign national based on accessory or conspiracy liability, as well as cases concerning the SEC's disgorgement power, statute of limitations for accounting violations, and criminal violations of books-and-records requirements).

registered with SEC. Officers, directors, employees, agents, or stockholders acting on behalf of an issuer (whether U.S. or foreign nationals), and any co-conspirators, also can be prosecuted under the *FCPA*.

Domestic Concerns – 15 U.S.C. § 78dd-2

The *FCPA* also applies to “domestic concerns” [15 U.S.C. § 78dd-2]. A domestic concern is any individual who is a citizen, national, or resident of the United States, or any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship that is organized under the laws of the United States or its states, territories, possessions, or commonwealths or that has its principal place of business in the United States [15 U.S.C. § 78dd-2(h)(1)]. Officers, directors, employees, agents, or stockholders acting on behalf of a domestic concern, including foreign nationals or companies, are also covered [15 U.S.C. § 78dd-2(a)].

Territorial Jurisdiction – 15 U.S.C. § 78dd-3

The *FCPA* also applies to certain foreign nationals or entities that are not issuers or domestic concerns [15 U.S.C. § 78dd-3(a)]. Since 1998, the *FCPA*’s anti-bribery provisions have applied to foreign persons and foreign non-issuer entities that, either directly or through an agent, engage in *any* act in furtherance of a corrupt payment (or an offer, promise, or authorization to pay) while in the territory of the United States. [This change occurred via the *International Anti-Bribery and Fair Competition Act of 1998*, Public Law 105-366, 112 Stat. 3302 (1998), 15 U.S.C. § 78dd-3(a), which amended the *FCPA* to conform to, and implement, the *OECD Anti-Bribery Convention*]. Also, officers, directors, employees, agents, or stockholders acting on behalf of such persons or entities may be subject to the *FCPA*’s anti-bribery prohibitions [15 U.S.C. § 78dd-3(a)].

What Jurisdictional Conduct Triggers the Anti-Bribery Provisions?

The *FCPA*’s anti-bribery provisions can apply to conduct both inside and outside the United States. Issuers and domestic concerns – as well as their officers, directors, employees, agents, or stockholders – may be prosecuted for using the U.S. mails or any means or instrumentality of interstate commerce in furtherance of a corrupt payment to a foreign official. The *Act* defines “interstate commerce” as “trade, commerce, transportation, or communication among the several States, or between any foreign country and any State or between any State and any place or ship outside thereof . . .” [15 U.S.C. § 78dd-2(h)(5), -3(f)(5)]. The term also includes the *intrastate* use of any interstate means of communication, or any other interstate instrumentality [*see id.*]. Thus, placing a telephone call or sending an e-mail, text message, or fax from, to, or through the United States involves interstate commerce – as does sending a wire transfer from or to a U.S. bank or otherwise using the U.S. banking system, or traveling across state borders or internationally to or from the United States.

Those who are not issuers or domestic concerns may be prosecuted under the *FCPA* if they directly, or through an agent, engage in *any* act in furtherance of a corrupt payment

while in the territory of the United States, regardless of whether they utilize the U.S. mails or a means or instrumentality of interstate commerce [15 U.S.C. § 78dd-3]. Thus, for example, a foreign national who attends a meeting in the United States that furthers a foreign bribery scheme may be subject to prosecution, as may any co-conspirators, even if they did not themselves attend the meeting. A foreign national or company may also be liable under the *FCPA* if it aids and abets, conspires with, or acts as an agent of an issuer or domestic concern, regardless of whether the foreign national or company itself takes any action in the United States.

In addition, under the “alternative jurisdiction” provision of the *FCPA* enacted in 1998, U.S. companies or persons may be subject to the anti-bribery provisions even if they act outside the United States [15 U.S.C. § 78dd-1(g)]. The 1998 amendments to the *FCPA* expanded the jurisdictional coverage of the Act by establishing an alternative basis for jurisdiction, that is, jurisdiction based on the nationality principle. [That is, the 1998 Act implementing the *OECD Anti-Bribery Convention* and amending the *FCPA* provides for jurisdiction over the actions of American businesses or citizens concerning unlawful payments that occur entirely outside of the United States]. In particular, the 1998 amendments removed the requirement that there be a use of interstate commerce (*e.g.*, wire, email, telephone call) for acts in furtherance of a corrupt payment to a foreign official by U.S. companies and persons occurring wholly outside of the United States.

What Is Covered? – The Business Purpose Test

...

The *FCPA* applies only to payments intended to induce or influence a foreign official to use his or her position “in order to assist ... in obtaining or retaining business for or with, or directing business to, any person” [15 U.S.C. § 78dd-1(a), -2(a), -3(a)]. This requirement is known as the “business purpose test” and is broadly interpreted.

...

Not surprisingly, many enforcement actions involve bribes to obtain or retain government contracts. The *FCPA* also prohibits bribes in the conduct of business or to gain a business advantage. For example, bribe payments made to secure favorable tax treatment, to reduce or eliminate customs duties, to obtain government action to prevent competitors from entering a market, or to circumvent a licensing or permit requirement, all satisfy the business purpose test. [Likewise, a payment to win a contract, influence government procurement, gain access to non-public bid tender information, influence adjudication of a lawsuit or an enforcement action, get an exception to a regulation, or avoid termination of a contract, would be considered a bribe in pursuit of obtaining or retaining business.]

In 2004, the U.S. Court of Appeals for the Fifth Circuit addressed the business purpose test in *United States v. Kay* [359 F.3d 738, 755-756 (5th Cir. 2004)] and held that bribes paid to obtain favorable tax treatment – which reduced a company’s customs duties and sales taxes on imports – could constitute payments made to “obtain or retain” business within the meaning of the *FCPA*. The court explained that in enacting the *FCPA*, “Congress meant to prohibit a range of payments wider than only those that directly influence the acquisition or retention of government contracts or similar commercial or industrial arrangements” [*id.* at 749]. The *Kay* court found that “[t]he congressional target was

bribery paid to engender assistance in improving the business opportunities of the payor or his beneficiary, irrespective of whether that assistance be direct or indirect, and irrespective of whether it be related to administering the law, awarding, extending, or renewing a contract, or executing or preserving an agreement” [*id.* at 750]. Accordingly, *Kay* held that payments to obtain favorable tax treatment can, under appropriate circumstances, violate the *FCPA*:

Avoiding or lowering taxes reduces operating costs and thus increases profit margins, thereby freeing up funds that the business is otherwise legally obligated to expend. And this, in turn, enables it to take any number of actions to the disadvantage of competitors. Bribing foreign officials to lower taxes and customs duties certainly *can* provide an unfair advantage over competitors and thereby be of assistance to the payor in obtaining or retaining business.

* * *

[W]e hold that Congress intended for the *FCPA* to apply broadly to payments intended to assist the payor, either directly or indirectly, in obtaining or retaining business for some person, and that bribes paid to foreign tax officials to secure illegally reduced customs and tax liability constitute a type of payment that can fall within this broad coverage. [*Id.* at 749-55.]

In short, while the *FCPA* does not cover every type of bribe paid around the world for every purpose, it does apply broadly to bribes paid to help obtain or retain business, which can include payments made to secure a wide variety of unfair business advantages [*id.* at 756].

What Does “Corruptly” Mean?

To violate the *FCPA*, an offer, promise, or authorization of a payment, or a payment, to a government official must be made “corruptly.” [Interestingly, there is no explicit definition of “corruptly” in the *FCPA*. But, House Report Number 95-640, at 7, and the Senate Report quoted below, explain that in drafting the *FCPA*, Congress intended to use the same meaning for the term as in the domestic criminal bribery statute, 18 U.S.C. § 201(b)]. As Congress noted when adopting the *FCPA*, the word “corruptly” means an intent or desire to wrongfully influence the recipient:

The word “corruptly” is used in order to make clear that the offer, payment, promise, or gift, must be intended to induce the recipient to misuse his official position; for example, wrongfully to direct business to the payor or his client, to obtain preferential legislation or regulations, or to induce a foreign official to fail to perform an official function. [Senate Report Number 95-114, at 10.]

Where corrupt intent is present, the *FCPA* prohibits paying, offering, or promising to pay money or anything of value (or authorizing the payment or offer) [15 U.S.C. § 78dd-

1(a), 2(a), 3(a)]. By focusing on intent, the *FCPA* does not require that a corrupt act succeed in its purpose. Nor must the foreign official actually solicit, accept, or receive the corrupt payment for the bribe payor to be liable. For example, in one case, a specialty chemical company promised Iraqi government officials approximately \$850,000 in bribes for an upcoming contract. Although the company did not, in the end, make the payment (the scheme was thwarted by the U.S. government’s investigation), the company still violated the *FCPA* and was held accountable.

Also, as long as the offer, promise, authorization, or payment is made corruptly, the actor need not know the identity of the recipient; the attempt is sufficient. Thus, an executive who authorizes others to pay “whoever you need to” in a foreign government to obtain a contract has violated the *FCPA* – even if no bribe is ultimately offered or paid.

What Does “Willfully” Mean and When Does It Apply?

In order for an individual defendant to be criminally liable under the *FCPA*, he or she must act “willfully” [15 U.S.C. § 78dd-1(c)(2)(A), 2(g)(2)(A), 3(3)(2)(A)]. Proof of willfulness is not required to establish corporate criminal or civil liability, though proof of corrupt intent is.

The term “willfully” is not defined in the *FCPA*, but it has generally been construed by courts to connote an act committed voluntarily and purposefully, and with a bad purpose, *i.e.*, with “knowledge that [a defendant] was doing a ‘bad’ act under the general rules of law.” [United States v. Kay, 513 F.3d 432, 448 (5th Cir. 2007).] As the Supreme Court explained in *Bryan v. United States*, “[a]s a general matter, when used in the criminal context, a ‘willful’ act is one undertaken with a ‘bad purpose.’ In other words, in order to establish a ‘willful’ violation of a statute, ‘the Government must prove that the defendant acted with knowledge that his conduct was unlawful.’” [524 U.S. 184, 191-192 (1998).]

Notably, as both the Second Circuit and Fifth Circuit Courts of Appeals have found, the *FCPA* does not require the government to prove that a defendant was specifically aware of the *FCPA* or knew that his conduct violated the *FCPA*. [See *Kay* at 447-448.] To be guilty, a defendant must act with a bad purpose, *i.e.*, know generally that his conduct is unlawful.

What Does “Anything of Value” Mean?

In enacting the *FCPA*, Congress recognized that bribes can come in many shapes and sizes – a broad range of unfair benefits – and so the statute prohibits the corrupt “offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of *anything of value* to” a foreign official. [15 U.S.C. § 78dd-1(a), 2(a), 3(a). The *FCPA* does not define “anything of value.” But, case law under the domestic criminal bribery statute indicates the phrase includes tangible and intangible benefits.]

An improper benefit can take many forms. While cases often involve payments of cash (sometimes in the guise of “consulting fees” or “commissions” given through intermediaries), others have involved travel expenses and expensive gifts. Like the domestic bribery statute, the *FCPA* does not contain a minimum threshold amount for corrupt gifts or payments. Indeed, what might be considered a modest payment in the United States could be a larger and much more significant amount in a foreign country.

Regardless of size, for a gift or other payment to violate the statute, the payor must have corrupt intent – that is, the intent to improperly influence the government official. The corrupt intent requirement protects companies that engage in the ordinary and legitimate promotion of their businesses while targeting conduct that seeks to improperly induce officials into misusing their positions. Thus, it is difficult to envision any scenario in which the provision of cups of coffee, taxi fare, or company promotional items of nominal value would ever evidence corrupt intent, and neither DOJ nor SEC has ever pursued an investigation on the basis of such conduct. Moreover, as in all areas of federal law enforcement, DOJ and SEC exercise discretion in deciding which cases promote law enforcement priorities and justify investigation. Certain patterns, however, have emerged: DOJ’s and SEC’s anti-bribery enforcement actions have focused on small payments and gifts only when they comprise part of a systemic or long-standing course of conduct that evidences a scheme to corruptly pay foreign officials to obtain or retain business. These assessments are necessarily fact specific.

Cash

The most obvious form of corrupt payment is large amounts of cash. In some instances, companies have maintained cash funds specifically earmarked for use as bribes. One U.S. issuer headquartered in Germany disbursed corrupt payments from a corporate “cash desk” and used offshore bank accounts to bribe government officials to win contracts. In another instance, a four-company joint venture used its agent to pay \$5 million in bribes to a Nigerian political party. The payments were made to the agent in suitcases of cash (typically in \$1 million installments), and, in one instance, the trunk of a car when the cash did not fit into a suitcase.

Gifts, Travel, Entertainment, and Other Things of Value

A small gift or token of esteem or gratitude is often an appropriate way for businesspeople to display respect for each other. Some hallmarks of appropriate gift-giving are when the gift is given openly and transparently, properly recorded in the giver’s books and records, provided only to reflect esteem or gratitude, and permitted under local law.

Items of nominal value, such as cab fare, reasonable meals and entertainment expenses, or company promotional items, are unlikely to improperly influence an official, and, as a result, are not, without more, items that have resulted in enforcement action by DOJ or SEC. The larger or more extravagant the gift, however, the more likely it was given with an improper purpose. DOJ and SEC enforcement cases thus have involved single instances of large, extravagant gift-giving (such as sports cars, fur coats, and other luxury

items) as well as widespread gifts of smaller items as part of a pattern of bribes. For example, in one case brought by DOJ and SEC, a defendant gave a government official a country club membership fee and a generator, as well as household maintenance expenses, payment of cell phone bills, an automobile worth \$20,000, and limousine services. The same official also received \$250,000 through a third-party agent.

In addition, a number of *FCPA* enforcement actions have involved the corrupt payment of travel and entertainment expenses. Both DOJ and SEC have brought cases where these types of expenditures occurred in conjunction with other conduct reflecting systemic bribery or other clear indicia of corrupt intent.

A case involving a California-based telecommunications company illustrates the types of improper travel and entertainment expenses that may violate the *FCPA*. Between 2002 and 2007, the company spent nearly \$7 million on approximately 225 trips for its customers in order to obtain systems contracts in China, including for employees of Chinese state-owned companies to travel to popular tourist destinations in the United States. Although the trips were purportedly for the individuals to conduct training at the company's facilities, in reality, no training occurred on many of these trips and the company had no facilities at those locations. Approximately \$670,000 of the \$7 million was falsely recorded as "training" expenses.

...

Likewise, a New Jersey-based telecommunications company spent millions of dollars on approximately 315 trips for Chinese government officials, ostensibly to inspect factories and train the officials in using the company's equipment. In reality, during many of these trips, the officials spent little or no time visiting the company's facilities, but instead visited tourist destinations such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios, and New York City. Some of the trips were characterized as "factory inspections" or "training" with government customers but consisted primarily or entirely of sightseeing to locations chosen by the officials, typically lasting two weeks and costing between \$25,000 and \$55,000 per trip. In some instances, the company gave the government officials \$500 to \$1,000 per day in spending money and paid all lodging, transportation, food, and entertainment expenses. The company either failed to record these expenses or improperly recorded them as "consulting fees" in its corporate books and records. The company also failed to implement appropriate internal controls to monitor the provision of travel and other things of value to Chinese government officials.

...

[In addition to the aforementioned cases, examples of improper travel and entertainment payments include (1) a \$12,000 birthday trip for a Mexican government official that included winery visits and dinners, (2) a trip to Italy for eight Iraqi government officials who spent most of the time sightseeing, and received \$1,000 each in pocket money, and (3) a trip to Paris for a foreign government official and his wife that consisted mainly of chauffeur-driven tours.]

Companies also may violate the *FCPA* if they give payments or gifts to third parties, like an official's family members, as an indirect way of corruptly influencing a foreign

official. For example, one defendant paid personal bills and provided airline tickets to a cousin and close friend of the foreign official whose influence the defendant sought in obtaining contracts. The defendant was convicted at trial and received a prison sentence.

As part of an effective compliance program, a company should have clear and easily accessible guidelines and processes in place for gift-giving by the company's directors, officers, employees, and agents. Though not necessarily appropriate for every business, many larger companies have automated gift-giving clearance processes and have set clear monetary thresholds for gifts along with annual limitations, with limited exceptions for gifts approved by appropriate management. Clear guidelines and processes can be an effective and efficient means for controlling gift-giving, deterring improper gifts, and protecting corporate assets.

The *FCPA* does not prohibit gift-giving. Rather, just like its domestic bribery counterparts, the *FCPA* prohibits the payments of bribes, including those disguised as gifts.

Charitable Contributions

Companies often engage in charitable giving as part of legitimate local outreach. The *FCPA* does not prohibit charitable contributions or prevent corporations from acting as good corporate citizens. Companies, however, cannot use the pretense of charitable contributions as a way to funnel bribes to government officials.

For example, a pharmaceutical company used charitable donations to a small local castle restoration charity headed by a foreign government official to induce the official to direct business to the company. Although the charity was a bona fide charitable organization, internal documents at the pharmaceutical company's subsidiary established that the payments were not viewed as charitable contributions but rather as "dues" the subsidiary was required to pay for assistance from the government official. The payments constituted a significant portion of the subsidiary's total promotional donations budget and were structured to allow the subsidiary to exceed its authorized limits. The payments also were not in compliance with the company's internal policies, which provided that charitable donations generally should be made to healthcare institutions and relate to the practice of medicine.

...

Proper due diligence and controls are critical for charitable giving. In general, the adequacy of measures taken to prevent misuse of charitable donations will depend on a risk-based analysis and the specific facts at hand. In Opinion Procedure Release No. 10-02, DOJ ... described the due diligence and controls that can minimize the likelihood of an *FCPA* violation. In that matter, a Eurasian-based subsidiary of a U.S. non-governmental organization was asked by an agency of a foreign government to make a grant to a local microfinance institution (MFI) as a prerequisite to the subsidiary's transformation to bank status. The subsidiary proposed contributing \$1.42 million to a local MFI to satisfy the request. The subsidiary undertook an extensive, three-stage due diligence process to select the proposed grantee and imposed significant controls on the proposed grant, including ongoing monitoring and auditing, earmarking funds for capacity building, prohibiting

compensation of board members, and implementing anti-corruption compliance provisions. DOJ explained that it would not take any enforcement action because the company's due diligence and the controls it planned to put in place sufficed to prevent an *FCPA* violation.

Other opinion releases also address charitable-type grants or donations. Under the facts presented in those releases, DOJ approved the proposed grant or donation, based on due diligence measures and controls such as:

- certifications by the recipient regarding compliance with the *FCPA*;
- due diligence to confirm that none of the recipient's officers were affiliated with the foreign government at issue;
- a requirement that the recipient provide audited financial statements;
- a written agreement with the recipient restricting the use of funds;
- steps to ensure that the funds were transferred to a valid bank account;
- confirmation that the charity's commitments were met before funds were disbursed; and
- on-going monitoring of the efficacy of the program.

Legitimate charitable giving does not violate the *FCPA*. Compliance with the *FCPA* merely requires that charitable giving not be used as a vehicle to conceal payments made to corruptly influence foreign officials.

...

[Thus, before making a "charitable" payment in a foreign country, a company should consider the purpose of the payment, whether a foreign government official requested the payment, whether a foreign government official is associated with the charity and in a position to make decisions about the company, and whether the payment is conditioned on the company receiving benefits.]

Who Is a Foreign Official?

The *FCPA*'s anti-bribery provisions apply to corrupt payments made to (1) "any foreign official"; (2) "any foreign political party or official thereof"; (3) "any candidate for foreign political office"; or (4) any person, while knowing that all or a portion of the payment will be offered, given, or promised to an individual falling within one of these three categories [15 U.S.C. §§ 78dd-1(a)(1)-(3), -2(a)(1)-(3), -3(f)(2)(A)]. Although the statute distinguishes between a "foreign official," "foreign political party or official thereof," and "candidate for foreign political office," the term "foreign official" in this guide generally refers to an individual falling within any of these three categories.

The *FCPA* defines "foreign official" to include:

any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such

public international organization [Section 30A(f)(1)(A) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(f)(1)(A); -2(h)(2)(A), -3(f)(2)(A)].

As this language makes clear, the *FCPA* broadly applies to corrupt payments to “any” officer or employee of a foreign government and to those acting on the foreign government’s behalf [Section 30A(f)(1)(A), 15 U.S.C. §§ 78dd-1(f)(1)(A); -2(h)(2)(A), -2(f)(2)(A)]. The *FCPA* thus covers corrupt payments to low-ranking employees and high-level officials alike.

The *FCPA* prohibits payments to foreign *officials*, not to foreign *governments*. That said, companies contemplating contributions or donations to foreign governments should take steps to ensure that no monies are used for corrupt purposes, such as the personal benefit of individual foreign officials.

Department, Agency, or Instrumentality of a Foreign Government

Foreign officials under the *FCPA* include officers or employees of a department, agency, or instrumentality of a foreign government. When a foreign government is organized in a fashion similar to the U.S. system, what constitutes a government department or agency is typically clear (*e.g.*, a ministry of energy, national security agency, or transportation authority). However, governments can be organized in very different ways. Many operate through state-owned and state-controlled entities, particularly in such areas as aerospace and defense manufacturing, banking and finance, healthcare and life sciences, energy and extractive industries, telecommunications, and transportation. By including officers or employees of agencies and instrumentalities within the definition of “foreign official,” the *FCPA* accounts for this variability.

The term “instrumentality” is broad and can include state-owned or state-controlled entities. Whether a particular entity constitutes an “instrumentality” under the *FCPA* requires a fact-specific analysis of an entity’s ownership, control, status, and function. A number of courts have approved final jury instructions providing a non-exclusive list of factors to be considered:

- the foreign state’s extent of ownership of the entity;
- the foreign state’s degree of control over the entity (including whether key officers and directors of the entity are, or are appointed by, government officials);
- the foreign state’s characterization of the entity and its employees;
- the circumstances surrounding the entity’s creation;
- the purpose of the entity’s activities;
- the entity’s obligations and privileges under the foreign state’s law;
- the exclusive or controlling power vested in the entity to administer its designated functions;
- the level of financial support by the foreign state (including subsidies, special tax treatment, government-mandated fees, and loans);
- the entity’s provision of services to the jurisdiction’s residents;

- whether the governmental end or purpose sought to be achieved is expressed in the policies of the foreign government; and
- the general perception that the entity is performing official or governmental functions.

Companies should consider these factors when evaluating the risk of *FCPA* violations and designing compliance programs.

DOJ and SEC have pursued cases involving instrumentalities since the time of the *FCPA*'s enactment and have long used an analysis of ownership, control, status, and function to determine whether a particular entity is an agency or instrumentality of a foreign government. For example, the second-ever *FCPA* case charged by DOJ involved a California company that paid bribes through a Mexican corporation to two executives of a state-owned Mexican national oil company. And in the early 1980s, DOJ and SEC brought cases involving a \$1 million bribe to the chairman of Trinidad and Tobago's racing authority.

DOJ and SEC continue to regularly bring *FCPA* cases involving bribes paid to employees of agencies and instrumentalities of foreign governments. In one such case, the subsidiary of a Swiss engineering company paid bribes to officials of a state-owned and controlled electricity commission. The commission was created by, owned by, and controlled by the Mexican government, and it had a monopoly on the transmission and distribution of electricity in Mexico. Many of the commission's board members were cabinet-level government officials, and the director was appointed by Mexico's president. Similarly, in another recent case, Miami telecommunications executives were charged with paying bribes to employees of Haiti's state-owned and controlled telecommunications company. The telecommunications company was 97% owned and 100% controlled by the Haitian government, and its director was appointed by Haiti's president.

While no one factor is dispositive or necessarily more important than another, as a practical matter, an entity is unlikely to qualify as an instrumentality if a government does not own or control a majority of its shares. However, there are circumstances in which an entity would qualify as an instrumentality absent 50% or greater foreign government ownership, which is reflected in the limited number of DOJ or SEC enforcement actions brought in such situations. For example, in addition to being convicted of funneling millions of dollars in bribes to two sitting presidents in two different countries, a French issuer's three subsidiaries were convicted of paying bribes to employees of a Malaysian telecommunications company that was 43% owned by Malaysia's Ministry of Finance. There, notwithstanding its minority ownership stake in the company, the Ministry held the status of a "special shareholder," had veto power over all major expenditures, and controlled important operational decisions. In addition, most senior company officers were political appointees, including the Chairman and Director, the Chairman of the Board of the Tender Committee, and the Executive Director. Thus, despite the Malaysian government having a minority shareholder position, the company was an instrumentality of the Malaysian government as the government nevertheless had substantial control over the company.

Companies and individuals should also remember that, whether an entity is an instrumentality of a foreign government or a private entity, commercial (*i.e.*, private-to-private) bribery may still violate the *FCPA*'s accounting provisions, the *Travel Act*, anti-money laundering laws, and other federal or foreign laws. Any type of corrupt payment thus carries a risk of prosecution.

Public International Organizations

In 1998, the *FCPA* was amended to expand the definition of “foreign official” to include employees and representatives of public international organizations [*International Anti-Bribery and Fair Competition Act of 1998*, Pub. L. 105-366 § 2, 112 Stat. 3302, 3303, 3305, 3308 (1998)]. A “public international organization” is any organization designated as such by Executive Order under the International Organizations Immunities Act, 22 U.S.C. § 288, or any other organization that the President so designates [Section 30A(F)(1)(B) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(f)(1)(B), -2(h)(2)(B), and -3(f)(2)(B)]. Currently, public international organizations include entities such as the World Bank, the International Monetary Fund, the World Intellectual Property Organization, the World Trade Organization, the OECD, the Organization of American States, and numerous others. A comprehensive list of organizations designated as “public international organizations” is contained in 22 U.S.C. § 288 and can also be found on the U.S. Government Printing Office website at <http://www.gpo.gov/fdsys/>.

How Are Payments to Third Parties Treated?

The *FCPA* expressly prohibits corrupt payments made through third parties or intermediaries [Section 30A(a) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(a), -2(a), and -3(a)]. Specifically, it covers payments made to “any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly,” [Section 30A(a)(3) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(a)(3), -2(a)(3), -3(a)(3)] to a foreign official. Many companies doing business in a foreign country retain a local individual or company to help them conduct business. Although these foreign agents may provide entirely legitimate advice regarding local customs and procedures and may help facilitate business transactions, companies should be aware of the risks involved in engaging third-party agents or intermediaries. The fact that a bribe is paid by a third party does not eliminate the potential for criminal or civil *FCPA* liability.

For instance, a four-company joint venture used two agents – a British lawyer and a Japanese trading company – to bribe Nigerian government officials in order to win a series of liquefied natural gas construction projects. Together, the four multi-national corporations and the Japanese trading company paid a combined \$1.7 billion in civil and criminal sanctions for their decade-long bribery scheme. In addition, the subsidiary of one of the companies pleaded guilty and a number of individuals, including the British lawyer and the former CEO of one of the companies' subsidiaries, received significant prison terms.

Similarly, a medical device manufacturer entered into a deferred prosecution agreement as the result of corrupt payments it authorized its local Chinese distributor to pay to Chinese officials. Another company, a manufacturer of specialty chemicals, committed multiple *FCPA* violations through its agents in Iraq: a Canadian national and the Canadian's companies. Among other acts, the Canadian national paid and promised to pay more than \$1.5 million in bribes to officials of the Iraqi Ministry of Oil to secure sales of a fuel additive. Both the company and the Canadian national pleaded guilty to criminal charges and resolved civil enforcement actions by SEC.

In another case, the U.S. subsidiary of a Swiss freight forwarding company was charged with paying bribes on behalf of its customers in several countries. Although the U.S. subsidiary was not an issuer under the *FCPA*, it was an "agent" of several U.S. issuers and was thus charged directly with violating the *FCPA*. Charges against the freight forwarding company and seven of its customers resulted in over \$236.5 million in sanctions.

Because Congress anticipated the use of third-party agents in bribery schemes – for example, to avoid actual knowledge of a bribe – it defined the term "knowing" in a way that prevents individuals and businesses from avoiding liability by putting "any person" between themselves and the foreign officials [Section 30A(a) of the *Exchange Act*, 15 U.S.C §§ 78dd-1(a)(3), -2(a)(3), and -3(a)(3)]. Under the *FCPA*, a person's state of mind is "knowing" with respect to conduct, a circumstance, or a result if the person:

- is aware that [he] is engaging in such conduct, that such circumstance exists, or that such result is substantially certain to occur; or
- has a firm belief that such circumstance exists or that such result is substantially certain to occur [Section 30A(f)(2)(A) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(f)(2)(A), -2(h)(3)(A), and -3(f)(3)(A)].

Thus, a person has the requisite knowledge when he is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist [Section 30A(f)(2)(B) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(f)(2)(B), -2(h)(3)(B), and -3(f)(3)(B)]. As Congress made clear, it meant to impose liability not only on those with actual knowledge of wrongdoing, but also on those who purposefully avoid actual knowledge:

[T]he so-called "head-in-the-sand" problem – variously described in the pertinent authorities as "conscious disregard," "willful blindness" or "deliberate ignorance" – should be covered so that management officials could not take refuge from the *Act's* prohibitions by their unwarranted obliviousness to any action (or inaction), language or other "signaling device" that should reasonably alert them of the "high probability" of an *FCPA* violation.

Common red flags associated with third parties include:

- excessive commissions to third-party agents or consultants;
- unreasonably large discounts to third-party distributors;

- third-party “consulting agreements” that include only vaguely described services;
- the third-party consultant is in a different line of business than that for which it has been engaged;
- the third party is related to or closely associated with the foreign official;
- the third party became part of the transaction at the express request or insistence of the foreign official;
- the third party is merely a shell company incorporated in an offshore jurisdiction; and
- the third party requests payment to offshore bank accounts.

Businesses may reduce the *FCPA* risks associated with third-party agents by implementing an effective compliance program, which includes due diligence of any prospective foreign agents.

...

What Affirmative Defenses Are Available?

The *FCPA*'s anti-bribery provisions contain two affirmative defenses: (1) that the payment was lawful under the written laws of the foreign country (the “local law” defense), and (2) that the money was spent as part of demonstrating a product or performing a contractual obligation (the “reasonable and bona fide business expenditure” defense). Because these are affirmative defenses, the defendant bears the burden of proving them.

The Local Law Defense

For the local law defense to apply, a defendant must establish that “the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the foreign official’s, political party’s, party official’s, or candidate’s country.” [Section 30A(c)(1) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(c)(1), -2(c)(1), and -3(c)(1)]. The defendant must establish that the payment was lawful under the foreign country’s written laws and regulations at the time of the offense. In creating the local law defense in 1988, Congress sought “to make clear that the absence of written laws in a foreign official’s country would not by itself be sufficient to satisfy this defense.” Thus, the fact that bribes may not be prosecuted under local law is insufficient to establish the defense. In practice, the local law defense arises infrequently, as the written laws and regulations of countries rarely, if ever, permit corrupt payments. Nevertheless, if a defendant can establish that conduct that otherwise falls within the scope of the *FCPA*'s anti-bribery provisions was lawful under written local law, he or she would have a defense to prosecution.

In *United States v. Kozeny*, the defendant unsuccessfully sought to assert the local law defense regarding the law of Azerbaijan. [*United States v. Kozeny*, 582 F. Supp. 2d 535, 537-40 (S.D.N.Y. 2008).] The parties disputed the contents and applicability of Azeri law, and each presented expert reports and testimony on behalf of their conflicting interpretations. The court ruled that the defendant could not invoke the *FCPA*'s affirmative defense because Azeri law did not actually legalize the bribe payment. The court concluded

that an exception under Azeri law relieving bribe payors who voluntarily disclose bribe payments to the authorities of criminal liability did not make the bribes legal.

Reasonable and Bona Fide Expenditures

The *FCPA* allows companies to provide reasonable and bona fide travel and lodging expenses to a foreign official, and it is an affirmative defense where expenses are directly related to the promotion, demonstration, or explanation of a company's products or services, or are related to a company's execution or performance of a contract with a foreign government or agency [Section 30A(c)(2)(A), (B) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(c)(2), -2(c)(2), and -3(c)(2)]. Trips that are primarily for personal entertainment purposes, however, are not *bona fide* business expenses and may violate the *FCPA's* anti-bribery provisions.¹⁴⁵ Moreover, when expenditures, bona fide or not, are mischaracterized in a company's books and records, or where unauthorized or improper expenditures occur due to a failure to implement adequate internal controls, they may also violate the *FCPA's* accounting provisions. Purposeful mischaracterization of expenditures may also, of course, indicate a corrupt intent.

DOJ and SEC have consistently recognized that businesses, both foreign and domestic, are permitted to pay for reasonable expenses associated with the promotion of their products and services or the execution of existing contracts. In addition, DOJ has frequently provided guidance about legitimate promotional and contract-related expenses – addressing travel and lodging expenses in particular – through several opinion procedure releases. Under the circumstances presented in those releases, DOJ opined that the following types of expenditures on behalf of foreign officials did not warrant *FCPA* enforcement action:

- travel and expenses to visit company facilities or operations;
- travel and expenses for training; and
- product demonstration or promotional activities, including travel and expenses for meetings.

Whether any particular payment is a bona fide expenditure necessarily requires a fact-specific analysis. But the following non-exhaustive list of safeguards, compiled from several releases, may be helpful to businesses in evaluating whether a particular expenditure is appropriate or may risk violating the *FCPA*:

- Do not select the particular officials who will participate in the party's proposed trip or program or else select them based on pre-determined, merit-based criteria.
- Pay all costs directly to travel and lodging vendors and/or reimburse costs only upon presentation of a receipt.
- Do not advance funds or pay for reimbursements in cash.
- Ensure that any stipends are reasonable approximations of costs likely to be incurred and/or that expenses are limited to those that are necessary and reasonable.

- Ensure the expenditures are transparent, both within the company and to the foreign government.
- Do not condition payment of expenses on any action by the foreign official.
- Obtain written confirmation that payment of the expenses is not contrary to local law
- Provide no additional compensation, stipends, or spending money beyond what is necessary to pay for actual expenses incurred.
- Ensure that costs and expenses on behalf of the foreign officials will be accurately recorded in the company's books and records.

In sum, while certain expenditures are more likely to raise red flags, they will not give rise to prosecution if they are (1) reasonable, (2) bona fide, and (3) directly related to (4) the promotion, demonstration, or explanation of products or services or the execution or performance of a contract.

What Are Facilitating or Expediting Payments?

The *FCPA's* bribery prohibition contains a narrow exception for “facilitating or expediting payments” made in furtherance of routine governmental action. The facilitating payments exception applies only when a payment is made to further “routine governmental action” that involves non-discretionary acts. Examples of “routine governmental action” include processing visas, providing police protection or mail service, and supplying utilities like phone service, power, and water. Routine government action does *not* include a decision to award new business or to continue business with a particular party [Section 30A(f)(3)(B) of the *Exchange Act*, 15 U.S.C. §§ 78dd-1(f)(3)(B), -2(h)(4)(B), and -3(f)(4)(B)]. Nor does it include acts that are within an official's discretion or that would constitute misuse of an official's office. Thus, paying an official a small amount to have the power turned on at a factory might be a facilitating payment; paying an inspector to ignore the fact that the company does not have a valid permit to operate the factory would not be a facilitating payment.

...

Whether a payment falls within the exception is not dependent on the size of the payment, though size can be telling, as a large payment is more suggestive of corrupt intent to influence a non-routine governmental action. But, like the *FCPA's* anti-bribery provisions more generally, the facilitating payments exception focuses on the *purpose* of the payment rather than its value. For instance, an Oklahoma-based corporation violated the *FCPA* when its subsidiary paid Argentine customs officials approximately \$166,000 to secure customs clearance for equipment and materials that lacked required certifications or could not be imported under local law and to pay a lower-than-applicable duty rate. The company's Venezuelan subsidiary had also paid Venezuelan customs officials approximately \$7,000 to permit the importation and exportation of equipment and materials not in compliance with local regulations and to avoid a full inspection of the imported goods. In another case, three subsidiaries of a global supplier of oil drilling products and services were criminally charged with authorizing an agent to make at least 378 corrupt payments (totaling approximately \$2.1 million) to Nigerian Customs Service

officials for preferential treatment during the customs process, including the reduction or elimination of customs duties.

Labeling a bribe as a “facilitating payment” in a company’s books and records does not make it one. A Swiss offshore drilling company, for example, recorded payments to its customs agent in the subsidiary’s “facilitating payment” account, even though company personnel believed the payments were, in fact, bribes. The company was charged with violating both the *FCPA*’s anti-bribery and accounting provisions.

Although true facilitating payments are not illegal under the *FCPA*, they may still violate local law in the countries where the company is operating, and the OECD’s Working Group on Bribery recommends that all countries encourage companies to prohibit or discourage facilitating payments, which the United States has done regularly. In addition, other countries’ foreign bribery laws, such as the United Kingdom’s, may not contain an exception for facilitating payments. Individuals and companies should therefore be aware that although true facilitating payments are permissible under the *FCPA*, they may still subject a company or individual to sanctions. As with any expenditure, facilitating payments may still violate the *FCPA* if they are not properly recorded in an issuer’s books and records.

...

Does the *FCPA* Apply to Cases of Extortion or Duress?

Situations involving extortion or duress will not give rise to *FCPA* liability because a payment made in response to true extortionate demands under imminent threat of physical harm cannot be said to have been made with corrupt intent or for the purpose of obtaining or retaining business. In enacting the *FCPA*, Congress recognized that real-world situations might arise in which a business is compelled to pay an official in order to avoid threats to health and safety. As Congress explained, “a payment to an official to keep an oil rig from being dynamited should not be held to be made with the requisite corrupt purpose.”

Mere *economic* coercion, however, does not amount to extortion. As Congress noted when it enacted the *FCPA*: “The defense that the payment was demanded on the part of a government official as a price for gaining entry into a market or to obtain a contract would not suffice since at some point the U.S. company would make a conscious decision whether or not to pay a bribe.” The fact that the payment was “first proposed by the recipient ... does not alter the corrupt purpose on the part of the person paying the bribe.”

This distinction between extortion and economic coercion was recognized by the Court in *United States v. Kozeny*. [*United States v. Kozeny*, 582 F. Supp. 2d 535, 540 n.31 (S.D.N.Y. 2008).] There, the court concluded that although an individual who makes a payment under duress (*i.e.*, upon threat of physical harm) will not be criminally liable under the *FCPA*, ... a bribe payor who claims payment was demanded as a price for gaining market entry or obtaining a contract “cannot argue that he lacked the intent to bribe the official because he made the ‘conscious decision’ to pay the official.” [*Kozeny*, 582 F. Supp. 2d at 540, *citing* S. Rep. No. 95-114, at 10-11]. While the bribe payor in this situation “could have turned his back and walked away,” in the oil rig example, “he could not.”

Businesses operating in high-risk countries may face real threats of violence or harm to their employees, and payments made in response to imminent threats to health or safety do not violate the *FCPA*. If such a situation arises, and to ensure the safety of its employees, companies should immediately contact the appropriate U.S. embassy for assistance.

Principles of Corporate Liability for Anti-Bribery Violations

General principles of corporate liability apply to the *FCPA*. Thus, a company is liable when its directors, officers, employees, or agents, acting within the scope of their employment, commit *FCPA* violations intended, at least in part, to benefit the company. Similarly, just as with any other statute, DOJ and SEC look to principles of parent-sub subsidiary and successor liability in evaluating corporate liability.

Parent-Subsidiary Liability

There are two ways in which a parent company may be liable for bribes paid by its subsidiary. First, a parent may have participated sufficiently in the activity to be directly liable for the conduct – as, for example, when it directed its subsidiary’s misconduct or otherwise directly participated in the bribe scheme.

Second, a parent may be liable for its subsidiary’s conduct under traditional agency principles. The fundamental characteristic of agency is control. Accordingly, DOJ and SEC evaluate the parent’s control – including the parent’s knowledge and direction of the subsidiary’s actions, both generally and in the context of the specific transaction – when evaluating whether a subsidiary is an agent of the parent. Although the formal relationship between the parent and subsidiary is important in this analysis, so are the practical realities of how the parent and subsidiary actually interact.

If an agency relationship exists, a subsidiary’s actions and knowledge are imputed to its parent. Moreover, under traditional principles of *respondeat superior*, a company is liable for the acts of its agents, including its employees, undertaken within the scope of their employment and intended, at least in part, to benefit the company. Thus, if an agency relationship exists between a parent and a subsidiary, the parent is liable for bribery committed by the subsidiary’s employees. For example, SEC brought an administrative action against a parent for bribes paid by the president of its indirect, wholly owned subsidiary. In that matter, the subsidiary’s president reported directly to the CEO of the parent issuer, and the issuer routinely identified the president as a member of its senior management in its annual filing with SEC and in annual reports. Additionally, the parent’s legal department approved the retention of the third-party agent through whom the bribes were arranged despite a lack of documented due diligence and an agency agreement that violated corporate policy; also, an official of the parent approved one of the payments to the third-party agent. Under these circumstances, the parent company had sufficient knowledge and control of its subsidiary’s actions to be liable under the *FCPA*.

Successor Liability

Companies acquire a host of liabilities when they merge with or acquire another company, including those arising out of contracts, torts, regulations, and statutes. As a general legal matter, when a company merges with or acquires another company, the successor company assumes the predecessor company's liabilities. Successor liability is an integral component of corporate law and, among other things, prevents companies from avoiding liability by reorganizing. Successor liability applies to all kinds of civil and criminal liabilities, and *FCPA* violations are no exception. Whether successor liability applies to a particular corporate transaction depends on the facts and the applicable state, federal, and foreign law. Successor liability does not, however, create liability where none existed before. For example, if an issuer were to acquire a foreign company that was not previously subject to the *FCPA*'s jurisdiction, the mere acquisition of that foreign company would not retroactively create *FCPA* liability for the acquiring issuer.

DOJ and SEC encourage companies to conduct pre-acquisition due diligence and improve compliance programs and internal controls after acquisition for a variety of reasons. First, due diligence helps an acquiring company to accurately value the target company. Contracts obtained through bribes may be legally unenforceable, business obtained illegally may be lost when bribe payments are stopped, there may be liability for prior illegal conduct, and the prior corrupt acts may harm the acquiring company's reputation and future business prospects. Identifying these issues before an acquisition allows companies to better evaluate any potential post-acquisition liability and thus properly assess the target's value. Second, due diligence reduces the risk that the acquired company will continue to pay bribes. Proper pre-acquisition due diligence can identify business and regional risks and can also lay the foundation for a swift and successful post-acquisition integration into the acquiring company's corporate control and compliance environment. Third, the consequences of potential violations uncovered through due diligence can be handled by the parties in an orderly and efficient manner through negotiation of the costs and responsibilities for the investigation and remediation. Finally, comprehensive due diligence demonstrates a genuine commitment to uncovering and preventing *FCPA* violations.

In a significant number of instances, DOJ and SEC have declined to take action against companies that voluntarily disclosed and remediated conduct and cooperated with DOJ and SEC in the merger and acquisition context. And DOJ and SEC have only taken action against successor companies in limited circumstances, generally in cases involving egregious and sustained violations or where the successor company directly participated in the violations or failed to stop the misconduct from continuing after the acquisition. In one case, a U.S.-based issuer was charged with books and records and internal controls violations for continuing a kickback scheme originated by its predecessor. Another recent case involved a merger between two tobacco leaf merchants, where prior to the merger each company committed *FCPA* violations through its foreign subsidiaries, involving multiple countries over the course of many years. At each company, the bribes were directed by the parent company's senior management. The two issuers then merged to form a new public company. Under these circumstances – the merger of two public companies

that had each engaged in bribery – both the new entity and the foreign subsidiaries were liable under the *FCPA*. The new parent entered into a non-prosecution agreement with DOJ and settled a civil action with SEC, while the company's subsidiaries, which also merged, pleaded guilty.

...

More often, DOJ and SEC have pursued enforcement actions against the predecessor company (rather than the acquiring company), particularly when the acquiring company uncovered and timely remedied the violations or when the government's investigation of the predecessor company preceded the acquisition. In one such case, an Ohio-based health care company's due diligence of an acquisition target uncovered *FCPA* violations by the target's subsidiary, and, before the merger was completed, the subsidiary's violations were disclosed to DOJ and SEC. The subsidiary pleaded guilty and paid a \$2 million criminal fine, the acquisition target settled with SEC and paid a \$500,000 civil penalty, and no successor liability was sought against the acquiring entity. In another case, a Pennsylvania-based issuer that supplied heating and air conditioning products and services was subject to an ongoing investigation by DOJ and SEC at the time that it was acquired; DOJ and SEC resolved enforcement actions only against the predecessor company, which had by that time become a wholly owned subsidiary of the successor company.

DOJ and SEC have also brought actions only against a predecessor company where its *FCPA* violations are discovered after acquisition. For example, when a Florida-based U.S. company discovered in post-acquisition due diligence that the telecommunications company (a domestic concern) it had acquired had engaged in foreign bribery, the successor company disclosed the *FCPA* violations to DOJ. It then conducted an internal investigation, cooperated fully with DOJ, and took appropriate remedial action – including terminating senior management at the acquired company. No enforcement action was taken against the successor, but the predecessor company pleaded guilty to one count of violating the *FCPA* and agreed to pay a \$2 million fine. Later, four executives from the predecessor company were convicted of *FCPA* violations, three of whom received terms of imprisonment.

On occasion, when an enforcement action has been taken against a predecessor company, the successor seeks assurances that it will not be subject to a future enforcement action. In one such case, a Dutch predecessor resolved *FCPA* charges with DOJ through a deferred prosecution agreement. While both the predecessor and successor signed the agreement, which included a commitment to ongoing cooperation and an improved compliance program, only the predecessor company was charged; in signing the agreement, the successor company gained the certainty of conditional release from criminal liability, even though it was not being pursued for *FCPA* violations. In another case, after a Connecticut-based company uncovered *FCPA* violations by a California company it sought to acquire, both companies voluntarily disclosed the conduct to DOJ and SEC. The predecessor company resolved its criminal liability through a non-prosecution agreement with DOJ that included an \$800,000 monetary penalty and also settled with SEC, paying a total of \$1.1 million in disgorgement, pre-judgment interest, and civil penalties. The successor company proceeded with the acquisition and separately entered into a non-

prosecution agreement with DOJ in which it agreed, among other things, to ensure full performance of the predecessor company's non-prosecution agreement. This agreement provided certainty to the successor concerning its *FCPA* liability.

Importantly, a successor company's voluntary disclosure, appropriate due diligence, and implementation of an effective compliance program may also decrease the likelihood of an enforcement action regarding an acquired company's post-acquisition conduct when pre-acquisition due diligence is not possible.

...

Additional Principles of Criminal Liability for Anti-Bribery Violations: Aiding and Abetting and Conspiracy

Under Federal law, individuals or companies that aid or abet a crime, including an *FCPA* violation, are as guilty as if they had directly committed the offense themselves. The aiding and abetting statute provides that whoever "commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission," or "willfully causes an act to be done which if directly performed by him or another would be an offense against the United States," is punishable as a principal [18 U.S.C. § 2]. Aiding and abetting is not an independent crime, and the government must prove that an underlying *FCPA* violation was committed.

Individuals and companies, including foreign nationals and companies, may also be liable for conspiring to violate the *FCPA* – *i.e.*, for *agreeing* to commit an *FCPA* violation – even if they are not, or could not be, independently charged with a substantive *FCPA* violation. For instance, a foreign, non-issuer company could be convicted of conspiring with a domestic concern to violate the *FCPA*. Under certain circumstances, it could also be held liable for the domestic concern's substantive *FCPA* violations under *Pinkerton v. United States*, which imposes liability on a defendant for reasonably foreseeable crimes committed by a co-conspirator in furtherance of a conspiracy that the defendant joined [*Pinkerton v. United States*, 328 U.S. 640, 647-48 (1946)].

A foreign company or individual may be held liable for aiding and abetting an *FCPA* violation or for conspiring to violate the *FCPA*, even if the foreign company or individual did not take any act in furtherance of the corrupt payment while in the territory of the United States. In conspiracy cases, the United States generally has jurisdiction over all the conspirators where at least one conspirator is an issuer, domestic concern, or commits a reasonably foreseeable overt act within the United States [*United States v. MacAllister*, 160 F.3d 1304, 1307 (11th Cir. 1998); *United States v. Winter*, 509 F.2d 975, 982 (5th Cir. 1975)]. For example, if a foreign company or individual conspires to violate the *FCPA* with someone who commits an overt act within the United States, the United States can prosecute the foreign company or individual for the conspiracy. The same principle applies to aiding and abetting violations. For instance, even though they took no action in the United States, Japanese and European companies were charged with conspiring with and aiding and abetting a domestic concern's *FCPA* violations.

Additional Principles of Civil Liability for Anti-Bribery Violations:

Aiding and Abetting and Causing

Both companies and individuals can be held civilly liable for aiding and abetting *FCPA* anti-bribery violations if they knowingly or recklessly provide substantial assistance to a violator [Section 20(e) of the *Exchange Act*, 15 U.S.C. § 78t(e)]. Similarly, in the administrative proceeding context, companies and individuals may be held liable for causing *FCPA* violations [Section 21C(a) of the *Exchange Act*, 15 U.S.C. § 78u-3(a)]. This liability extends to the subsidiaries and agents of U.S. issuers.

In one case, the U.S. subsidiary of a Swiss freight forwarding company was held civilly liable for paying bribes on behalf of its customers in several countries. Although the U.S. subsidiary was not an issuer for purposes of the *FCPA*, it was an “agent” of several U.S. issuers. By paying bribes on behalf of its issuers’ customers, the subsidiary both directly violated and aided and abetted the issuers’ *FCPA* violations.

What Is the Applicable Statute of Limitations?

Statute of Limitations in Criminal Cases

The *FCPA*’s anti-bribery and accounting provisions do not specify a statute of limitations for criminal actions. Accordingly, the general five-year limitations period set forth in 18 U.S.C. § 3282 applies to substantive criminal violations of the *Act*.

In cases involving *FCPA* conspiracies, the government may be able to reach conduct occurring before the five-year limitations period applicable to conspiracies under 18 U.S.C. § 371. For conspiracy offenses, the government generally need prove only that one act in furtherance of the conspiracy occurred during the limitations period, thus enabling the government to prosecute bribes paid or accounting violations occurring more than five years prior to the filing of formal charges.

There are at least two ways in which the applicable limitations period is commonly extended. First, companies or individuals cooperating with DOJ may enter into a tolling agreement that voluntarily extends the limitations period. Second, under 18 U.S.C. § 3292, the government may seek a court order suspending the statute of limitations posed in a criminal case for up to three years in order to obtain evidence from foreign countries. Generally, the suspension period begins when the official request is made by the U.S. government to the foreign authority and ends on the date on which the foreign authority takes final action on the request.

Statute of Limitations in Civil Actions

In civil cases brought by SEC, the statute of limitations is set by 28 U.S.C. § 2462, which provides for a five-year limitation on any “suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture.” The five-year period begins to run “when the claim first accrued.” The five-year limitations period applies to SEC actions seeking civil penalties, but it does not prevent SEC from seeking equitable remedies, such as an

injunction or the disgorgement of ill-gotten gains, for conduct pre-dating the five-year period. In cases against individuals who are not residents of the United States, the statute is tolled for any period when the defendants are not “found within the United States in order that proper service may be made thereon.” Furthermore, companies or individuals cooperating with SEC may enter into tolling agreements that voluntarily extend the limitations period.

III. 2010 U.K. *Bribery Act*

Receiving Royal Assent on 8 April 2010, the U.K. *Bribery Act* took effect on 1 July 2011. The SFO administers it, and compliance with the American *FCPA* does not ensure compliance with the British legislation. Indeed, the *Bribery Act* has been described as the “*FCPA* on steroids.”³¹⁰

That is for good reason. In sharp contrast to the *FCPA*, the *Bribery Act* is not restricted to payments to public officials. The *Bribery Act* also covers payments to persons in the private sector. Also unlike the American legislation, the British law does not contain an exception for facilitation payments. Table 3-2 summarizes key similarities and differences between the *FCPA* and *Bribery Act*.

The *Bribery Act* applies to any “commercial organization,” a term open to judicial interpretation. Assuredly, it includes any partnership or corporation doing business anywhere in the world with a footprint in the U.K. That is, if the commercial organization conducts all or part of its business in the U.K., it is within the scope of the *Bribery Act*. Examples, therefore, include Amazon, Apple, Google, McDonalds, Monsanto, and Starbucks.

IV. 1998 OECD *Anti-Bribery Convention*

The OECD expanded its work in 1997 with an *Anti-Bribery Convention* that aims to establish “legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective.”³¹¹ The *Convention* entered into force on 15 February 1999, with 39 OECD member state signatories and four non-member state signatories – Argentina, Brazil, Bulgaria, and South Africa. In February 2012, Russia became the 39th party to the

³¹⁰ Rossella Brevetti, *U.S. Multinationals Should Pay Attention to United Kingdom Bribery Act, Lawyers Say*, 30 *International Trade Reporter* (BNA) 1278 (15 August 2013) (quoting Douglas Tween, Attorney, Baker & McKenzie, New York). See also Antonio Suarez-Martinez, *Investigating and Self-Reporting Corruption: New Serious Fraud Guidance on the U.K. Bribery Act Raises Stakes*, 42 *INTERNATIONAL LAW NEWS* 24-26 (winter 2013) (explaining why companies may need to self-report, and the consequences thereof).

For a comparative analysis of U.S. and Australian anti-bribery laws, see Stephen Kikiros & Camilla Andersen, *Failing to “Fail to Prevent” Bribery in International Trade: A Comparative Analysis of the Anti-Bribery Laws in Australian and the U.K.*, 26 *INTERNATIONAL TRADE LAW & REGULATION* issue 1, 1-14 (2020) (calling for a relaxation of normative understandings of bribery in a cultural context, and that commercial laws and practices are neither culture free nor uniformly understood, hence merely transplanting anti-bribery laws from one jurisdiction to another is dubious).

³¹¹ See OECD, www.oecd.org/document/21/0,3746,en_2649_34859_2017813_1_1_1_1,00.html.

Convention.³¹² Joining the *Convention* is a key requirement for accession to the OECD. A total of 44 countries have ratified or acceded to the *Convention* (all 37 OECD members, plus 7 non-members, as of May 2018).³¹³

The key requirement of the *Anti-Bribery Convention* is to pass domestic legislation that criminalizes bribery of foreign public officials, establishes penalties against corrupt acts, and bars tax deductibility of bribes. In 2009, the OECD strengthened the *Convention* provisions banning the tax deductibility of bribes.

In a 20 May 2008 letter to the Administration of George W. Bush, numerous American business groups called for increased enforcement of the provisions of the *Anti-Bribery Convention*. They saw transnational bribery as a serious threat to investment, economic development, democracy, and national security. The letter specifically targeted Canada, Japan, and the U.K. as being lax in following through on their international commitment to crack down on foreign bribery.³¹⁴

³¹² See Rick Mitchell, *Accession Instrument for Anti-Bribery Pact Brings Russia Closer to OECD Membership*, 29 International Trade Reporter (BNA) 285 (23 February 2012).

³¹³ See www.oecd.org/daf/anti-bribery/WGBRatificationStatus.pdf.

³¹⁴ Gary G. Yerkey, *U.S. Companies Call on Bush Administration to Press U.K., Japan, Canada Over Bribery*, 25 International Trade Reporter (BNA) 831 (5 June 2008).

Table 6-2
Comparison and Contrast of British and American Anti-Bribery Rules³¹⁵

Provisions	2010 U.K. <i>Bribery Act</i>	1977 U.S. <i>FCPA</i>
Bribery of Foreign Public Officials (FPOs)?	Yes. (Section 6)	Yes. But, the <i>FCPA</i> applies only to bribery of foreign officials. (15 U.S.C. §§ 78dd-1(a) and (f)(1))
Private-to-Private Bribery (<i>i.e.</i> , bribery of private officials)?	Yes. The main provisions of the <i>Bribery Act</i> apply to the private sector as well as the public, sector except for the FPO offense.	No.
Receipt of a bribe?	Yes. (Section 2)	No.
Intent?	Mixed. Intention is required for some “cases” of the Section 1 and 2 offences. No “corrupt or improper” intent is required in the FPO offense. (Section 7)	In alleging violations of the bribery provisions of the <i>FCPA</i> , the government must show the defendant had the requisite state of mind with respect to his actions <i>i.e.</i> , negligence, recklessness, intent. (15 U.S.C. § 78dd-1(f)(2))
Exception for Facilitation Payments?	No. The <i>Act</i> does not permit an exception for facilitation payments.	The <i>FCPA</i> permits, under very limited circumstances, facilitation payments, namely, when paid to foreign officials in order to expedite or secure the performance of a “routine governmental action.” This phrase excludes a decision by a foreign official to award new business or to continue business with a particular party, for example, to obtain a license or be granted a concession. (15 U.S.C. §78dd-1(b) and §78dd-1(f)(3))
Exception for Promotional Expenses?	No. The <i>Act</i> makes no specific provision for promotional expenses.	Yes. The <i>FCPA</i> allows an affirmative defense for promotional expenses, if those expenses are reasonable and <i>bona fide</i> business expenses that are directly related to the promotion, demonstration or explanation of products or services (<i>e.g.</i> , a

³¹⁵ This Table is adapted from Transparency International, *The 2010 UK Bribery Act Adequate Procedures* (July 2010), www.transparency.org.uk.

		demonstration or tour of a pharmaceutical plant), or in connection with the execution of a particular contract with a foreign government.
Extraterritorial Application?	Yes. Persons are liable for Sections 1, 2 or 6 offenses committed outside the U.K., if they have a “close connection” with the U.K. The “failure to prevent bribery” offence applies to: (1) U.K. entities that conduct business in the U.K. or elsewhere; and (2) any corporation, wherever formed, which carries on business or part of a business in the U.K. (Section 7(5)).	Yes. The <i>FCPA</i> applies to violative acts by U.S. issuers, domestic concerns, and their agents and employees that occur wholly outside United States territory, and to acts by U.S. citizens or residents, wherever they occur. However, as per the August 2018 decision of the United States Court of Appeals for the Second Circuit in <i>United States v. Hoskins</i> (Number 16-1010), a foreign national cannot be found guilty of violating the <i>FCPA</i> under a theory of conspiracy or accomplice liability, if that foreign party is not otherwise directly liable under the <i>FCPA</i> . As the Court reasoned, the <i>FCPA</i> “does not impose liability on a foreign national who is not an agent, employee, officer, director or shareholder of an American issuer or domestic concern – unless that person commits a crime within the territory of the United States.” Simply put, if a foreign national is not otherwise covered by the <i>FCPA</i> , a theory of conspiracy or complicity is insufficient to allow for the extraterritorial application of the statute. Note, however, the <i>Hoskins</i> decision applies to the <i>FCPA</i> ’s anti-bribery rules, but not necessarily to its provisions on books and records.
Third Parties?	Yes, third party liability exists for acts of associated persons who perform services for, or on behalf of, the pertinent company.	Yes. The <i>FCPA</i> prohibits corrupt payments through intermediaries. It is unlawful to make a payment to a third party, while knowing that all or a portion of the payment will go directly or indirectly to a foreign official. The term “knowing” includes conscious disregard and deliberate ignorance. “Intermediaries” include joint venture partners or agents.
Failure to Keep Accurate Books and Records?	No. But, failure to keep accurate books and records is covered by other legislation.	Yes.
Criminal Penalties?	Yes. For individuals, imprisonment up to 10 years and unlimited fines. For companies, unlimited fines.	Yes. Corporations and other business entities are subject to a fine of up to \$2,000,000 per violation. Officers, directors, stockholders, employees and agents are subject to a fine of up to \$250,000 per violation and imprisonment for up to 5 years. Under the <i>Alternative Fines Act</i> , the actual fine may be up to twice the benefit

		the defendant sought to obtain by making the corrupt payment. Fines imposed on individuals may not be paid by their employer or principal.
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V. Ethical Conduct in American Trade Practice

Lack of regulation in the monitoring of ethical behavior of legal practitioners before various U.S. trade agencies and Courts has led to a rise in fraud and misrepresentations in cases before these agencies and courts. Section 782(b) of the *Tariff Act of 1930*, as amended, states any person providing factual information in an AD or CVD case to the DOC must certify the information is accurate and complete.³¹⁶ But, trade agencies, such as the DOC and ITC, which lack regulatory and disciplinary authority over the professional ethical behavior of lawyers, can report complaints to the District of Columbia Court of Appeals (D.C. Court of Appeals). The D.C. Court of Appeals investigates and sanctions abuses of rules, including ethical canons.

However, not only are complaints rarely made to the Court, but also the regulatory mechanism available to the Court is little used and ineffective. Furthermore, the regulations cover only the actions of a barred attorney (*i.e.*, a lawyer who has passed a relevant bar examination and thereby is licensed to practice). So, the regulations do not govern actions of a non-lawyer representative (*e.g.*, an accountant or consultant) appearing before the agencies. If a representative of a client perpetrates fraud in a case before an agency, then the only remedy of the agency is to punish the client by applying adverse inferences (against the client) in the case. The case of the client might suffer, yet the culpable practitioner is in no way directly accountable for her actions, even if her involvement in the fraudulent activity is clear.

As a result of increased fraud and misrepresentation in international trade cases, more vigorous remedies have been considered. One such proposal is greater application of Rule 11 sanctions by the CIT and the development of a licensing system that individuals must be a part of prior to appearing before a United States trade agency. This version of Rule 11, arising under the CITs procedures, tracks Rule 11 of the *Federal Rules of Civil Procedure (FRCP)*. (The *FRCP* technically are inapplicable in CIT proceedings.)

CIT Rule 11 reads:

By presenting to the Court a pleading, written motion, or other paper – whether by signing, filing, submitting, or later advocating it – an attorney or unrepresented party certifies that to the best of the person’s knowledge, information, and belief, formed after any inquiry reasonable under the circumstances:

- (1) it is not being presented for any improper purpose, such as to harass,

³¹⁶ The DOC implementing rules are at 19 C.F.R. § 351.303(g), which contain content requirements for these certifications. Procedural submissions are excluded, hence the following matters do not require certification: requests for time limit extensions (*e.g.*, to respond to questionnaires), hearings, reviews, verifications, alignments with a parallel proceeding, and requests for extensions of preliminary and final determinations and results. Thus, non-procedural submissions are subject to the certification requirement: responses to questionnaires; information on surrogate values; and all other factual information on the record.

- (2) cause necessary delay, or needlessly increase the cost of litigation; the claims, defenses, and other legal contentions are warranted by existing law or by a non-frivolous argument for extending, modifying, or reversing existing law or for establishing new law;
- (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
- (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonable based on belief or a lack of information.³¹⁷

Traditionally, the CIT has not granted Rule 11 sanctions with much frequency.

However, if the trend of increasing fraud and misrepresentations continues, then the CIT most likely will be forced to impose sanctions on legal counsel who violate ethical obligations. To be sure, this regulatory mechanism always has been available to the Court, even if rarely used. Therefore, in dealing with fraud and misrepresentation before the CIT, there is no need to implement a new regulatory system, but simply to utilize the one already in place.

While the CIT has its own regulatory provisions available to it, United States trade agencies, which lack such provisions, possibly could stop violations before they occur by implementing a licensing system for any individual (*e.g.*, barred attorney, foreign lawyer, lay person consultant) appearing before the agency. Various federal agencies already regulate individuals, both lawyers and lay persons, who appear before the agency, such as the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF or Bureau). Practitioners must be enrolled to represent a client before the Bureau. Enrollment consists of completing an application that includes naming their technical qualifications and paying a small fee. Once enrolled the Bureau has the authority to suspend or disbar an individual from appearing before it for reasons such as incompetency, or refusal to comply with the rules set forth by the Bureau.

Similarly, the FERC conditions appearances before it on the individual, lawyer or lay person, being in good standing with the Commission. Furthermore, the U.S. PTO has regulated individuals appearing before it since 1861. The PTO has this authority: “for gross misconduct he [the PTO Commissioner] may refuse to recognize any person as a patent agent, either generally or in any particular case.”³¹⁸ In 1899, the PTO increased its regulation by requiring registration of all individuals practicing before it.

Specifically, the ITA and ITC, in implementing a licensing system to stem fraud and misrepresentation, would not be in the minority, but would join the numerous federal agencies that already successfully use such a system. Suggestions for the licensing system include:

³¹⁷ Court of International Trade Rule 11(b).

³¹⁸ *Act of March 2, 1861*, c. 88, s 8, (12 Stat. 247).

- (1) filing an application with the agency, a requirement that would apply to both lawyers and non-lawyers;
- (2) requiring a licensed practitioner to disclose to the agencies the names of those assisting her in the matter;
- (3) granting a license to a practicing individual, not the firm or employer of the individual;
- (4) prohibiting an individual from appearing before the agency without a license;
- (5) granting the agency removal authority in the case of incompetence or unethical behavior.

VI. Ethical Conduct in GATT-WTO Practice

WTO Members, like their GATT contracting party predecessors, hardly have been at the forefront of developing rigorous rules for ethical conduct in any of their activities: negotiations, reporting, evaluation, or adjudication. To a large extent, they self-police, or not, in respect of how they interact with one another. A Hobbesian characterization of their professional world, while cynical, is perhaps not too far off the mark.

Not until April 2014, almost 20 years after its birth, did the WTO Appellate Body show some courage by adopting new *Guidelines* to deal with conflicts-of-interest in cases involving former judges and staff members.³¹⁹ Among their key points are:

- (1) A former Appellate Body judge, WTO Secretariat official or intern is restricted from serving as a Panelist or adviser in a dispute in which that person was involved while in her former position, and in a dispute in which the same measures are at issue or claims raised.
- (2) A former Appellate Body judge is barred from serving as a WTO Panelist in any dispute for two years following her tenure as a judge.
- (3) A former WTO Secretariat official or intern is not allowed to attend an oral hearing of appeal during a designated “cooling off” period subsequent to her departure.

Manifestly, the *Guidelines* cover only Appellate Body operations. Their goals are to protect the independence and unbiasedness of the Appellate Body, promote its integrity by avoiding actual or perceived conflicts of interest, and limit the temptation to leak confidential information. The *Guidelines* have nothing to do with pressures one country might pile on another during a negotiation, or even with unscrupulous conduct during litigation.

Whether and how compliance with the *Guidelines* is enforced is unclear. Also in doubt is whether they are a work in progress to a multilateral trading system that cares as much about the “means” by which it liberalizes trade as it professes to care about the “end” of free trade.

³¹⁹ See Daniel Pruzin, *WTO Appellate Body Adopts Conflict-of-Interest Guidelines*, 31 International Trade Reporter (BNA) 756 (24 April 2014).

Part Three

TRANSACTIONAL FOUNDATIONS

Chapter 7

DOCUMENTARY SALE

I. International Commercial Transaction Types

The sale of goods across one or more international boundaries is an international commercial transaction.³²⁰ It is not the only example of such a transaction. Another illustration is FDI (including through licensing of overseas production, JVs, and franchising). Two other prominent ones are the sale of services, or transfer (via sale or licensing) of IP across an international boundary. Even temporary migration of professional or non-professional workers may be considered an international commercial transaction, or at least a movement that occurs in connection with trade in goods, services, FDI, or IP deals.

These examples are to be distinguished from international financial transactions, which involve the cross-border flow of funds or financial instruments. They are motivated not only by the need to pay for underlying commercial transactions, but also by portfolio investment. Indeed, portfolio investment dwarfs trade-related financial flows. Such investment may be long- or short-term in nature, the latter, of course, being dubbed “speculation.” In these transactions, the major players are, of course, commercial and investment banks.

International Trade Law sets out rules for cross-border trade in goods, services, and IP. To some degree, it deals with FDI, and to a lesser degree, with financial flows. That is true at the multilateral, regional, or domestic level, *i.e.*, with respect to the law of the GATT and the WTO, FTAs, and CUs, or a particular country.

The traditional and still paradigmatic commercial transaction motivating much of International Trade Law is the Documentary Sale. This sale involves goods, though services and IP also can be involved. It also requires a payment flow, from a Buyer-Importer in one country to a Seller-Exporter in another country. In depth coverage of the Documentary Sale is the subject of courses typically titled “International Commercial Law,” “International Business Transactions,” or “International Economic Law” (a term particularly wanting because it is underinclusive as to the interdisciplinarity of cross-border transactions). Yet, proficiency with how this Sale works allows for a fuller understanding of International Trade Law. Hence, the Documentary Sale is reviewed in this Chapter, and special attention is given to Trade Finance in the subsequent Chapter.

II. Risks Abound

³²⁰ See JOHN W. HEAD, *GLOBAL BUSINESS LAW: PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCE AND INVESTMENT* 184 (Durham, North Carolina: Carolina Academic Press ed., 3rd ed., 2012). See also the 4th edition (2018) of this work for a treatment of international commercial transactions including updates on pertinent laws.

- **Distance and Lack of Knowledge and Trust**

Throughout both Chapters, a single, realistic hypothetical example is used, the overview of which is as follows. Suppose the American on-line retailing company, Amazon.com (Amazon), wants to purchase tea from the Sri Lankan company, Dilmah. Manifestly, the parties are separated by geographic distance. Indeed, except with respect to domestic sales in physically large countries like Russia and Canada, a principal difference between selling goods domestically and internationally is geographic distance. The goods themselves must move over long distances and cross international borders.

The physical distance between a Seller-Exporter and a Buyer-Importer implies a lack of knowledge. The two do not know each other in a large number of international commercial transactions. Without knowledge, there is no basis for the parties to trust one another. This lack of knowledge and trust is exacerbated by, indeed, because of, the different legal, ethnic, social, religious, cultural, and linguistic backgrounds of the Exporter and Importer.

- **Review of Types of Risks**

A principal business concern of Amazon is it will pay for the tea without actually receiving the goods. Similarly, Dilmah will be worried it will ship the tea, but never receive payment from Amazon. Simply put, each party faces the risk the other will hold both the goods and the money for those goods. This problem is one of the credit risk of Amazon: Dilmah might not get paid by Amazon. It might not pay for a variety of reasons, such as liquidity (cash flow), fraud, or insolvency, in which case the risks are called “liquidity risk,” “fraud risk,” and insolvency risk,” respectively. If either Amazon or Dilmah were a subsidiary of the other, then such risks would be reduced (though not entirely eradicated, as the possibility of a rogue subsidiary always exists). Or, if either the American or Sri Lankan government assumed the credit risk of Amazon, then Dilmah might rest at ease (though, again, not entirely, depending on government credit ratings).

Additionally, Amazon and Dilmah will be concerned about currency (foreign exchange, or FX) risk. Suppose Dilmah invoices Amazon for the tea in Sri Lankan rupees, which appreciates relative to the dollar between the time they enter into their contract and the time payment is due. Amazon then must expend more dollars, convert them to rupees, and use them to pay for the tea, than it otherwise anticipated. Still another problem is political (country) risk. What happens if there is a *coup d'état* in Sri Lanka, or serious civil unrest between its Buddhist and Muslim communities? Could these occurrences disrupt the deal?

Indeed, by way of review, the two parties will be concerned about the following types of risks:

- (1) **Credit and Insolvency Risks**

Any Seller is naturally reluctant to part with control of goods before

receiving payment for them, unless it can retain an interest in the goods as security for payment. That is true in the domestic or international context, but it is magnified in the latter, as reclaiming goods shipped overseas can be impracticable if not impossible. Due to the geographic distance between them, a Seller-Exporter may not know much about a Buyer-Importer. In particular, the Seller-Exporter will not know about the creditworthiness or the integrity of the Buyer-Importer. Therefore, the central risk faced by the Seller-Exporter is it will not get paid by the Buyer-Importer, but already will have shipped the goods. Along with this standard credit risk is the possibility the Buyer is teetering on or goes bankrupt, which is insolvency risk – a kind of credit risk in the extreme.

The L/C plays a critical role in reducing this risk. As discussed later, once a Seller-Exporter presents conforming documents to its Confirming Bank, along with a draft drawn on the Issuing Bank, the Seller-Exporter can be assured of payment. Consequently, the Seller-Exporter need not worry it has parted with the merchandise.

(2) Shipping Risk

In either a domestic or international context, a Buyer naturally is reluctant to pay for goods before it receives them, unless it can obtain some kind of legal right over them. This reluctance is all the more true in an international commercial transaction, again because of the geographic distance between the Buyer-Importer and Seller-Exporter and consequent dearth of knowledge and trust. So, the central risk faced by a Buyer-Importer is the goods are not shipped, but the Buyer-Importer already has paid the Seller-Exporter.

Here again, the L/C helps mitigate this risk. A Buyer-Importer knows that its Seller-Exporter will ship the goods in assurance of payment by the Confirming Bank against presentment of conforming documents and a draft.

(3) Casualty Risk

Closely related to the matter of transporting goods is the problem of insurance. Because the goods must be carried a long distance, typically across an ocean, they are at a greater risk of loss or damage than in a routine domestic sales transaction. What happens if the cargo vessel carrying goods from a Seller-Exporter to Buyer-Importer sinks, runs aground, or is seized by pirates? Or, what if the Carrier stows the goods or operates the ship in such a negligent manner that they are damaged in transit?

The arrangements for carrying the goods help address these questions. These include a contract of carriage and insurance policy.

(4) Non-Conformity Risk

Another risk concerns whether goods conform to the wishes of their Buyer. Typically, a Buyer-Importer would like to delay payment until after it has inspected the quantity and quality of the goods upon their arrival at the port of discharge. However, that is impracticable, if not impossible, due to the geographic distance between the Buyer-Importer and the Seller-Exporter.

It also ought not to be necessary. The contract of sale should specify conformity as to the quantity and quality of goods, and the Buyer-Importer could hire a pre-shipment inspection (PSI) service to check for conformity before the merchandise leaves the port of shipment.

(5) FX Risk

Another risk in an international commercial transaction concerns currency for payment. The Seller-Exporter may want payment in its local currency. Alternatively, if the Seller-Exporter is from a “soft” currency country (*e.g.*, Pakistan or Vietnam), then it will prefer payment in a “hard” currency (*i.e.*, one freely exchangeable and convertible, such as the United States dollar).

The Buyer-Importer, located in a different country with a different currency, bears the risk its currency will depreciate against the currency of payment (the Seller’s currency or some designated hard currency). If this depreciation occurs, then the effective cost of the imported goods goes up. Foreign exchange hedging is a risk-minimizing device used by the Buyer-Importer.

Some foreign governments impose currency exchange controls. Indeed, some free trade agreements (FTAs) preserve their right to do so. Such controls may occur in a variety of forms, but common to all of them is the restriction on the purchase or sale of local currency by foreigners. Argentina and China are well known for imposing currency exchange controls.

(6) Cultural and Political Risks

The different legal systems, cultures, and languages of each party in a Documentary Sale can be as problematic as it is stimulating during the negotiation, formation, and performance of their respective contractual obligations. Misunderstandings borne of differences in race, ethnicity, religion, or language are broadly called “culture risk.”

Furthermore, an international commercial sale is more susceptible to political risk than a domestic commercial transaction in a stable country, at least insofar as there are a minimum of two countries involved. Events could

happen in the country of the counterparty result from government policies, which adversely affect the import-export transaction. For example, sanctions (like an embargo) might be imposed. Alternatively, political strife, perhaps arising from a controversial change in control of government could occur that jeopardizes the commercial transaction.

Education and experience are the best remedies for culture risk. Political risk may be managed through risk insurance schemes offered by public or private insurers.

(7) Legal Risk

It may be odd to think of the Documentary Sale, which is so carefully constructed and the documents in which are so carefully drafted, to entail legal risk. Lawyers should not be surprised to learn that there is a risk the documents they draft for their clients may not be enforced in a court of a foreign jurisdiction at all, or in the way anticipated. Another kind of legal risk that ought not to come as a surprise is a change in law. That is, one of the countries associated with a Documentary Sale may change rules that pertain to that regime. For instance, suppose a country were to declare it would not respect a particular provision in the *Uniform Customs and Practices for Documentary Credits (UCP)*. That may seem unlikely, but then again who would have foreseen the drastic legal changes ushered in by the 1978-1979 Iranian Revolution?

One mechanism to reduce legal risk is a precise choice of law clause, coupled with a clear choice of forum clause, and possibly also an arbitration clause. Unsurprisingly given their legal stability and long-term familiarity with global transactions, such provisions often specify the laws and forums of New York or England.

(8) Fraud Risk

As with many transactions, the risk of fraud is present in international commercial deals. For example, the bill of lading could be forged, so that no goods are shipped. Alternatively, the bill of lading and attached draft, both *bona fide*, could be stolen and presented to the Buyer's Bank (*i.e.*, the Issuing Bank) by a thief impersonating the Buyer. The Documentary Sale attempts to mitigate the risk of fraud.

Given this litany of risks, and the possibility of yet more uncertainties, Amazon and Dilmah will ask themselves and each other how they can Dilmah and Amazon structure their import-export transaction in a way that minimizes the risks each company voluntarily undertakes? The answer is a Documentary Sale.

This structure goes far in alleviating risk, particularly credit risk. To be sure, the

Documentary Sale cannot resolve all such risks. To mitigate FX risk, Amazon can buy a forward contract, or hedge with an option. To mitigate country risk, the parties may obtain political risk insurance from a private company or official entity, like OPIC.

A “Documentary Sale” is a generic term for an international sales transaction that uses a letter of credit (L/C) and transfers shipping documents from a Seller-Exporter, such as Dilmah, to a Buyer-Importer, such as Amazon, through the international banking system. In theory, a Documentary Sale involves no less than four parties: Seller-Exporter; Buyer-Importer; Issuing and Confirming Bank (*i.e.*, a single Bank at which both Seller and Exporter hold accounts, and thus which issues and confirms the L/C); and Carrier (*i.e.*, carriage company, which may transport the goods via sea, air, rail, and/or land). That means there are a minimum of three contracts: one for the sale of goods between Exporter and Importer; one for the L/C between Importer and Bank; and one for carriage between the Exporter and Carrier.

In practice, however, Documentary Sales involve numerous parties and, consequently, numerous contractual relationships. For instance, the Issuing and Confirming Banks may be distinct, as Importer and Exporter do not hold accounts at the same Bank. If these two Banks do not hold accounts with each other, then a third, or Intermediary, Bank, is needed. As another example, the Exporter may rely on a Freight Forwarder, and the Importer on a Customs Broker, to facilitate the shipment of merchandise and its clearance through customs formalities. So, as its name implies, a “Documentary Sale” utilizes many types of documents. Note that these documents are increasingly (and sometimes only) electronic, and exchanged using the familiar tools of modern IT.

III. Three Levels and Private-Public Distinction

There are three levels of rules that affect the Documentary Sale. The first level is the international one. It involves international bodies, particularly the ICC, which publishes rules on international contracts for the sale of goods, and on L/Cs, and UNCITRAL, which also promulgates rules on the international sale of goods, and promotes model laws on topics such as electronic funds transfers (commonly called “wire transfers”). The second level is the national one, populated by central and sub-central governments and their agencies. In the United States, the United States Congress and State legislatures pass laws affecting sales of goods, L/Cs, and electronic funds transfers. The third level is the private one. It pertains to a contractual arrangement between private parties, including the Buyer-Importer and Seller-Exporter, the Buyer-Importer and a Bank, and the Seller-Exporter and a carriage company.

The importance of private party regulation cannot be overstated. International commerce operates successfully, when it does, in part because of respect for party autonomy and freedom of contract. Bluntly put, to invert the importance of levels two and three would be to return to the post-Second World War era in which Communist and Socialist countries controlled import and export transactions, and many Capitalist countries operated SOEs and STEs. To emphasize the first level of rule-making over the second

would infringe on national sovereignty in favor of a kind of commercial global governance that might squelch rather than support trade.

This said, International Trade Law at the GATT-WTO, FTA, CU, and national levels, provides the framework in which International Commerce operates. As the breadth and depth of the rest of this *E-Textbook* suggests, International Commerce among private parties generates a vast array of issues and outright controversies that the parties themselves cannot fully or efficiently address. They cannot, for example, decide to grant all other parties MFN treatment, create a regime to distinguish legal from illegal subsidies, or a mechanism to respect their IP rights in multiple countries. For these grander and more widespread problems, the private sector needs multilateral, regional, and national level trade rules drafted by governments, albeit with advice and lobbying from private parties.

In brief, this Chapter, and the one on Trade Finance, necessarily emphasize private party regulation. Conversely, the remainder of the *E-Textbook* operates at the levels of multilateral, regional, and national legal regimes. The framework of these regimes helps level the playing field on which private parties compete in International Commerce. It also helps redress long-standing inequities faced by private parties from certain countries, particularly developing and least developed ones. In turn, it might be said that the traditional private-public distinction is rather blurry in the world of International Commerce and Trade.

IV. Parties

To mitigate the risks described earlier, a Documentary Sale distributes risk among the parties based upon the role and expertise of each party. Allocating and shifting risks among many parties ensures no one party bears all the risk, and allows for parties in the best position to assume a risk to bear it.

- **Buyer-Importer and Seller-Exporter**

Any international sale involves a Buyer-Importer and a Seller-Exporter. They negotiate the terms of the sale and enter into the contract for the sale of goods. In the hypothetical transaction, Amazon is the Buyer-Importer and Dilmah is the Seller-Exporter. Amazon and Dilmah negotiate and enter into a contract of sale for tea.

The Buyer-Importer and Seller-Exporter may be large firms with their own import-export departments. Or, they may operate through agents. The Buyer-Importer often is referred to as the “Consignee,” particularly with respect to the contract of carriage and bill of lading. The Seller-Exporter often is dubbed the “Shipper,” particularly with respect to the contract of carriage and bill of lading. The contract of carriage and bill of lading are documents associated with the transportation of goods.

- **Export House or Confirming House**

A Confirming House is a firm with specialized knowledge of and capacity to handle

international sales transactions. It may act as an agent for the Buyer-Importer or Seller-Exporter. The exact arrangement may take a variety of forms, including an agency, principal, or confirmation arrangement.

In an agency arrangement, the Confirming House acts as agent for the Buyer-Importer. The laws of agency apply to this type of arrangement. The contract of sale is made between the Seller-Exporter and Buyer-Importer. The Buyer-Importer can instruct the Confirming House to buy the goods in the name of the Confirming House from the Seller-Exporter. Then, the Buyer-Importer pays the Confirming House for the price of the goods, plus a commission.

Note the Confirming House has a dual function. First, with respect to the Seller-Exporter, the Confirming House is a principal. The Confirming House enters into a contract with the Seller-Exporter in its own name. The Confirming House is responsible for performance of the Buyer-Importer's portion of the contract, namely, accepting the goods and paying for them. Second, with respect to the Buyer-Importer, the Confirming House is its agent. The Confirming House is responsible for performing the duties attendant to this agency relationship.

As a legal matter, there remains a direct contractual relationship between the Seller-Exporter and Buyer-Importer. That is because the Confirming House enters into the contract as agent for a disclosed principal, the Buyer-Importer. Thus, that disclosed principal, the Buyer-Importer, ultimately is liable on the contract. Therefore, if the Confirming House were to refuse to pay for the goods that are accepted, then the Seller-Exporter would proceed against the Buyer-Importer.

In a principal arrangement, a Confirming House can buy goods from the Seller-Exporter and resell them to the Buyer-Importer. In some cases, the Confirming House can be a principal in the contract between the Seller-Exporter and the Confirming House, as well as in the contract between the Confirming House and the Buyer-Importer. Note that in this arrangement, there is no direct contractual relationship between the Seller-Exporter and Buyer-Importer. In effect, the Confirming House is a true middleman or trader between the two, and there are two separate sales contracts, possibly buying the goods "low" and selling them "high."

Finally, in a confirmation arrangement, the Buyer-Importer can instruct a Confirming House to buy the goods from the Seller-Exporter in the name of the Buyer-Importer and "confirm" to the Seller-Exporter. To "confirm" to the Seller-Exporter means the Confirming House gives the Seller-Exporter its (the Confirming House's) own undertaking that the contract will be performed.

Just like with an agency arrangement, the same dual function of the Confirming House can be seen here. First, the Confirming House is a principal with respect to the Seller-Exporter. Second, the Confirming House is an agent with respect to the Buyer-Importer. What is the difference between a confirmation versus agency arrangement? In the agency arrangement, the Seller-Exporter and Buyer-Importer have a direct contractual

relationship. Conversely, in the confirmation arrangement, the transaction runs through the Confirming House by virtue of its undertaking.

- **Carrier**

Any international sale of goods must involve a Carrier. The Carrier transports merchandise from the country of the Seller-Exporter to that of the Buyer-Importer. About 90 percent of world trade shipments are by ocean, hence the term “Ocean Carriers,” with the remaining portion by air, rail, or road. Note that multi-modal transport is common, such as ocean freight followed by rail carriage. Indeed, harmonization of containers to facilitate multi-modal transport is an important logistical matter for international commercial parties.

The term “Shipper” should not be confused with the term “Carrier.” The “Carrier” is the party that carries (transports) the goods. The “Shipper” is the party that instructs the goods be shipped, *i.e.*, calls upon the Carrier for its services. Thus, the Shipper is typically the Seller-Exporter, such as Dilmah. The Carrier could be the Danish company Maersk, which is the largest container carrier in the world.

- **Customs Broker**

Consider the terms “Importer of Record” and “Ultimate Consignee.” Usually, these terms refer to the same party, namely, the Buyer-Importer. However, the Buyer-Importer might choose to use a Customs Broker. A Customs Broker acts as agent for the Buyer-Importer. The Broker receives the goods at the port where they are discharged, shepherds them through the unloading process and customs clearance formalities, and ensures they are shipped from the port of discharge to the warehouse of the Buyer-Importer.

Normally, the Buyer-Importer gives its Customs Broker its power of attorney. This power allows the Customs Broker to take legal actions. The actions may include the authority to file and sign documents, such as entry forms required by the U.S. CBP, on behalf of the Buyer-Importer. In such cases, the Buyer-Importer is listed as both “Importer of Record” and “Ultimate Consignee,” because the Customs Broker has the power of attorney to list the Buyer-Importer as both.

However, if the Customs Broker does not have a power of attorney from the Buyer-Importer, then the “Importer of Record” is the Customs Broker. After all, a Customs Broker is the one that actually receives the goods. For example, suppose Amazon just hired a Customs Broker and has not had the chance to give it a power of attorney. Then, because it does not have power of attorney from Amazon, the Customs Broker is the “Importer of Record.” The “real” importer will be the “Ultimate Consignee,” which is the Buyer-Importer, Amazon.

It is important to appreciate Customs Brokers do not like to be Importers of Record. That is because they are liable for any unpaid customs duties, meaning they are responsible for payment of tariffs, as well as remedial trade duties such as AD duties or CVDs.

- **Freight Forwarder**

A Freight Forwarder facilitates the cross-border transportation of goods. In practice, a Freight Forwarder, or Forwarding Agent, is used in Documentary Sales transactions by the Seller-Exporter (though potentially they could assist a Buyer-Importer). A principal-agency relationship exists between a Freight Forwarder and Seller-Exporter, with the former acting as agent for the latter.

Freight Forwarders play an important, albeit little noticed, role. They are the “plumbing” or “grease” that makes an L/C transaction work. Why?

A Freight Forwarder acting on behalf of a Seller-Exporter is an intermediary between that Seller-Exporter and a Confirming or Issuing Bank, and also between a Seller-Exporter and a Carrier. The Freight Forwarder prepares and sends the necessary documents to the appropriate parties. For example, consider the contract of carriage, which is the contract to get the goods across an ocean from a Seller-Exporter to a Buyer-Importer. Typically, the Seller does not make the contract of carriage with a Carrier directly. Instead, it uses a Freight Forwarder to make all the arrangements for carriage.

As another example, consider an L/C (discussed in more detail later). An L/C specifies certain documents a Seller-Exporter must present to a Bank to receive payment from that Bank on behalf of a Buyer-Importer. The listed documents confirm the Seller-Exporter shipped the merchandise to the Buyer-Importer. These documents commonly are called “shipping documents.” In reality, a Freight Forwarder, not a Seller-Exporter, prepares the shipping documents, and then sends them to the Bank so that the Seller-Exporter can receive payment for the goods.³²¹

- **Loading Broker**

As indicated above, a Seller-Exporter itself typically does not negotiate a carriage contract with a shipping company, but rather employs a Freight Forwarder to do so. In turn, the Carrier often employs a Loading Broker to obtain physically cargoes, *i.e.*, the goods to ship, for it. Thus, a Loading Broker is an agent of a Carrier.

The Loading Broker hires or employs on a regular basis persons known as “stevedores,” that is, “dockworkers” or “longshoremen.” Stevedores actually load cargo onto a ship at the port of shipment, and offload it at the port of discharge. Note in some cases, the same company may act as the Freight Forwarder for a Seller-Exporter and Loading Broker for a Carrier. Note, too, that at many ports the heyday of the “strong back”

³²¹ Suppose a Freight Forwarder acts as agent for a Buyer-Importer. It is then an intermediary between the Buyer-Importer and Carrier. To move the goods off of the dock, out of an airport hanger, or from a road transportation storage facility, the Buyer-Importer must receive from its Seller-Exporter, or its agent, conforming documents, *i.e.*, the shipping documents as called for by the L/C. Among these documents, a bill of lading is particularly important. On behalf of the Buyer-Importer, the Freight Forwarder could prepare the customs clearance forms, and obtain the shipping documents. Then, the Freight Forwarder could go to the docks, hanger, or facility, clears the goods through customs, and bring them to the Buyer-Importer. However, ordinarily a Customs Broker provides these services.

stevedore is over. Such ports load and unload cargo less with physical strength and more with high-technology, in the form of multi-million dollar cranes and sophisticated computer systems. Such technology is efficient, even to the degree of minimizing the sway of containers in the wind as they are being loaded and unloaded.

- **Commercial Banks**

Commercial Banks (as distinct from Investment Banks or Securities Broker-Dealers) facilitate payment from a Buyer-Importer to a Seller-Exporter. Both a Seller-Exporter and a Buyer-Importer have Banks. The flow of funds goes from an account of the Buyer-Importer at the Buyer-Importer's Bank (the Issuing Bank), to an account of that Bank held at the Seller-Exporter's Bank (the Confirming Bank), to an account of the Seller-Exporter at that Bank. This flow is a rolling series of electronic debit and credit entries (debits and credits) to the respective accounts, which sum to what is commonly called a "wire transfer," or electronic funds transfer. In some cases, namely, when the Issuing Bank does not have an account at the Confirming Bank (or *vice versa*), one or more other Banks may serve as an intermediary between the Issuing and Confirming Banks.

- **Insurer**

An Insurer provides, at a fee called a "premium," insurance to protect against the risk of loss or damage to the goods. When the goods are carried by sea, the insurance policy is called "marine insurance." For example, members of the insurance market (as it is technically not a company) known as Lloyds of London are underwriters of marine insurance policies.

V. Documents

In a Documentary Sale, the following types of documents, each of which creates a contractual relationship between distinct parties, are essential to minimizing risk.

- (1) Sales contract
- (2) L/C
- (3) Contract of carriage and bill of lading
- (4) Draft
- (5) Insurance certificate

Observe immediately that what appears to the businessperson as a single transaction is to the lawyer a complex web of contracts, each with its own parties and special features. There also are many attendant documents. Collectively, these documents are called "shipping documents." To be technically accurate, the sales contract usually is not considered a "shipping document."

- **Sales Contract**

Just as in a domestic sales transaction between a Buyer and Seller, an international

sales transaction involves a sales contract. A sales contract memorializes detailed understandings between or among parties, often using internationally accepted terms. The purpose of this contract is to allocate the risks and costs of a transaction. The contract of sale not only specifies the goods to be delivered by a Seller-Exporter, but also the price to be paid by a Buyer-Importer. Additionally, it covers other critical matters, namely, the carriage of goods from Seller-Exporter to Buyer-Importer, insurance of the goods while they are in transit, and the financial technology used for payment.³²²

The ICC publishes a standard set of commercial terms that allocate the risks, costs, and functions of a Seller-Exporter and a Buyer-Importer in an international commercial transaction. These terms are known as *Incoterms*. *Incoterms* commonly are incorporated into international sale of goods contracts. The terms differ from one another on the basis of the time at which responsibility for the goods is transferred from the Seller-Exporter to the Buyer-Importer, and the allocation of the expenses associated with the transaction between a Seller-Exporter and a Buyer-Importer.

Occasionally, the ICC revises the *Incoterms*. The 2010 *Incoterms* are divided into two broad categories. The first group of *Incoterms* may be used when the goods are shipped by any method (or methods) of transportation, such as rail, water, and air. The second category of *Incoterms* applies to international transactions where the single method of transportation is over water. *Incoterms* are designated by three letters. Two commonly used *Incoterms* are FOB (free on board) and CIF (cost, insurance, and freight).

FOB and CIF fall into the second category of *Incoterms*, and, therefore, they may be used only when the method of transportation is across water. Under FOB terms, a Seller-Exporter must deliver goods on board a vessel at the agreed port of shipment, and clear the goods for export. A Buyer-Importer selects and purchases the carriage and insurance. The risks and costs transfer from a Seller-Exporter to a Buyer-Importer once the goods are delivered on board the vessel.³²³

Under CIF terms, a Seller-Exporter not only delivers the goods on board a vessel at the agreed port of loading, but also arranges and pays for their carriage and marine insurance. Here again, a Seller-Exporter is responsible for clearing the goods for export. Under CIF terms, only the risk transfers from a Seller-Exporter to a Buyer-Importer when the goods are delivered on board the vessel.³²⁴ The cost transfers from a Seller-Exporter to a Buyer-Importer when the goods arrive at the port of discharge.³²⁵

³²² The International Chamber of Commerce provides a model international sale contract, *see* INTERNATIONAL CHAMBER OF COMMERCE, ICC MODEL INTERNATIONAL SALE CONTRACT (International Chamber of Commerce ed., 2013).

³²³ *See* JOHN W. HEAD, GLOBAL BUSINESS LAW: PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCE AND INVESTMENT 183 (Durham, North Carolina: Carolina Academic Press ed., 3rd ed. 2012).

³²⁴ *See* JOHN W. HEAD GLOBAL BUSINESS LAW: PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCE AND INVESTMENT 183 (Durham, North Carolina: Carolina Academic Press ed., 3rd ed. 2012).

³²⁵ *See* JOHN W. HEAD, GLOBAL BUSINESS LAW: PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCE AND INVESTMENT 183 (Durham, North Carolina: Carolina Academic Press ed., 3rd ed. 2012).

In addition to *Incoterms*, international contracts for the sale of goods include a number of other important clauses, including:

- (1) Controlling Language
- (2) Currency
- (3) Governing Law
- (4) Dispute Resolution
- (5) *Force Majeure*
- (6) Corrupt Practices and Anti-Bribery

Typically, international sales contracts also include standard terms found in domestic sales contracts, such as representations and warranties, notice, term and termination, and assignment provisions.

- **Commercial L/C**

A Seller-Exporter likely is worried about whether it will receive payment from a Buyer-Importer. A Seller-Exporter does not want to give the goods to a Buyer-Importer if the Buyer-Importer has not paid for them. Likewise, a Buyer-Importer does not know whether a Seller-Exporter actually will ship the goods. A Buyer-Importer does not want to pay for the goods unless it knows the Seller-Exporter has released the merchandise. Consequently, a unique form of financing is used, namely, the L/C. What follows is an overview of an L/C, with a more detailed explanation in a subsequent Chapter.

An L/C is a promise by a Commercial Bank to pay a Seller-Exporter upon presentation of certain documents, which are described in an L/C. That is, it is a promise by a Bank to make a specified payment under particular and well-defined circumstances. An L/C may be thought of as the contract for payment.

L/Cs are popular in the world of international commerce for two reasons. First, they efficiently transfer risk. Second, they are governed by a widely accepted set of rules, the Uniform Customs and Practices (UCP) of the ICC. Through an L/C, a Seller-Exporter takes the risk a Bank (as opposed to a Buyer-Importer) will not pay.

Why is the chance a Bank will not pay a more acceptable credit risk than the risk the Buyer-Importer will not pay? The traditional answer is it is more acceptable because a Seller-Exporter is in a better position to evaluate the safety and soundness, and creditworthiness, of a Bank that issues or confirms an L/C than to ascertain the credit position of its contractual counterparty, a Buyer-Importer. (To be sure, scenarios exist in which the opposite may be true. For instance, it may be easier to appraise the risk of a major multinational corporate Buyer-Importer than a commercial bank in a country with poor regulation and non-transparent financial records.)

There are several steps involved in issuing an L/C. First, a Buyer-Importer goes to its Bank and requests an L/C in favor of a Seller-Exporter. The Bank that issues an L/C is referred to as the “Issuing Bank.” A Buyer-Importer is called the “Account Party” or

“Applicant” on an L/C, because it is the party on whose Bank account an L/C is issued, and because it applied for the L/C. A Seller-Exporter is the “Beneficiary” of an L/C because, through an L/C, a Seller-Exporter is paid for the goods it ships to a Buyer-Importer. An L/C instructs the Beneficiary to present certain required documents before it can receive payment from the Bank. Typically, these documents include the commercial invoice, bill of lading and insurance certificates.

Second, in many transactions, an Issuing Bank sends the L/C it prepares to a “Confirming Bank.” Often, the Confirming Bank is located in the same country as the Seller-Exporter, and pays the Seller-Exporter when the terms in the L/C are satisfied. In this way, a Seller-Exporter is assured of being paid by a Bank in its own country. A Confirming Bank will confirm an L/C and inform a Seller-Exporter of an L/C.

At what point can a Seller-Exporter draw on this credit, *i.e.*, obtain payment? The general answer is when a Seller-Exporter presents the appropriate and conforming documents listed in the L/C to a Confirming Bank. The documents evidence, among other things, a Seller-Exporter has shipped the goods to the Buyer-Importer. Note these documents must be deemed “conforming” by the Bank.

A Bank is interested in the documents as a security, not in the goods that are represented by the documents. (As the adage goes, banks deal in documents, and hate to deal in goods.) Accordingly, a Bank will refuse to accept documents that do not meet the specifications laid down by an L/C. Even a minor difference between the documents presented by the Seller-Exporter and the specifications in an L/C could result in a decision by a Bank to reject the documents, and withhold payment. This careful inspection of the required documents helps mitigate the risk of fraud.

- **Contract of Carriage and Bill of Lading**

The most common way in which to transport goods internationally is by waterways. Goods also can be transported by air or land. Consider that while the goods are being transported, neither a Seller-Exporter nor a Buyer-Importer has any physical control over the merchandise. The goods are in the hands of a Carrier and its agents or sub-contractors. The transit may last for several weeks, especially if transportation is by sea. During this time, the merchandise is subject to inherent dangers. Therefore, a Carrier, Seller-Exporter, and Buyer-Importer must know what liabilities a Carrier owes to a Seller-Exporter or Buyer-Importer, and what contractual rights they may have against it.

The contract of carriage specifies the circumstances under which a Carrier is liable to the owner of the goods as a result of any loss or damage to the goods while they are in the charge of the Carrier. It may also specify exemptions from such liability. A bill of lading is a form provided by a Carrier and filled out by a Seller-Exporter. As a practical matter, it is typically a Freight Forwarder, and not a Seller-Exporter itself, that fills out a bill of lading. Note that in bill of lading terminology, a Buyer-Importer is referred to as the “Consignee,” and the Seller-Exporter as the “Shipper.” The standard terms and conditions of the contract of carriage are printed on the back of the bill of lading.

Notably, the bill of lading is not the contract of carriage as between Shipper and Carrier, but rather evidence of that contract of carriage between them. As for all other parties, the bill of lading is the contract of carriage. Why?

As between a Seller-Exporter and a Carrier, the bill of lading is only evidence of the contract of carriage. However, eventually the bill of lading is transferred by endorsement to a third party during the L/C transaction. In that case, the Third-Party Transferee, namely, the Confirming and Issuing Banks and the Buyer-Importer, takes over all of the rights and liabilities of the original Shipper under the contract of carriage.

Yet, this Third-Party Transferee is unaware of the terms agreed to between the original Shipper (Seller-Exporter) and Carrier that are in the contract of carriage, but which for whatever reason are not (or might not be) set forth in the bill of lading. The Third Party is remote from them, and will not know whether there is extrinsic (parol) evidence of terms agreed by Shipper and Carrier that are not embodied in the bill of lading. Thus, it would not be fair to hold the Third-Party Transferee to such terms, if they exist, so they do not bind the transferee. Thus, as between a Carrier and a Third-Party Transferee of the bill of lading, the bill of lading is in fact the contract of carriage. No parol evidence can supplement this contract. In contrast, the bill of lading merely is evidence of the contract as between the Seller-Exporter and Carrier.

This transformation means a bill of lading has a strange relationship to a contract of carriage. In the hands of the original Seller-Exporter, the bill of lading is evidence of the underlying carriage contract. Once the bill of lading is endorsed to a Third-Party Transferee, then it becomes, for all practical purposes, the contract of carriage between the Transferee and the Carrier. Consequently, the bill of lading serves three primary purposes.

- (1) The bill of lading is evidence a contract of carriage exists between a Carrier, which is responsible for shipping the goods overseas, and a Seller-Exporter or Freight Forwarder. The bill of lading evidences that a Carrier has taken the goods, and ownership of the goods, from a Seller-Exporter. That could not occur unless the Seller-Exporter fulfills the condition required of it, namely, given title to the captain of the ship.
- (2) The bill of lading is a document of title, which means it represents title to the goods. Ownership or possession of the merchandise can be transferred from one party to another by delivering, or endorsing and delivering, the bill of lading. Moreover, it gives the Holder (a commercial law status discussed later) of the bill the right to take legal action against the Carrier. In sum, the bill of lading stands for the goods themselves. Through it the goods can be sold or pledged, and they can be used as security for payment. That fact is important for commercial Banks involved in an L/C transaction, because they need the bill of lading as security for making payment.
- (3) The bill of lading serves as a receipt indicating the shipping company

actually received the goods. Where the Carrier uses a Loading Broker, the Broker signs and gives the Shipper the bill. Otherwise, the Carrier itself gives the Shipper the bill of lading.

The bill of lading itself embodies several important notations.

This bill states “clean,” “on board,” and either “freight collect” or “freight paid.” The notation “clean” indicates the goods are not damaged or defective. “On board” means the goods physically are on board the vessel. If the contract calls for FOB terms, then the notation “freight collect” appears. Conversely, the bill of lading says “freight paid” if the *Incoterm* used is CIF.

Finally, a bill of lading may be “negotiable” or “non-negotiable.” It is negotiable if the Consignee space on the bill of lading form reads “to order of” the Seller-Exporter. Conversely, if the Buyer-Importer appears in the Consignee box of the bill of lading, then it is non-negotiable. That is important, because if the bill of lading is negotiable, then it serves to pass title to the goods. Conversely, if the bill of lading is non-negotiable, then it cannot serve to pass title.³²⁶

One of the simplest frauds to commit against a gullible Buyer-Importer is to sell goods represented by a forged bill of lading. In this situation, the bill is forged on the standard form of a known carriage company, or a form is concocted for the occasion using imaginary names for the Carrier, ship, master, etc. The carrying vessel does not even exist, and even if it does, it may be involved in an entirely different transaction. The bill of lading, therefore, can be used as a vehicle for documentary fraud.

In a case of a forged bill of lading, consider two scenarios. First, suppose the sale is on CIF terms, and no goods have been shipped. Then, the Seller-Exporter has not performed its obligation. The fact the Seller is not privy to the non-shipment (because it is unaware of the forged bill) is irrelevant in considering its liability to a Buyer-Importer. The Seller still is obliged to ship the goods under its original contract with the Buyer, and as per “CIF,” is responsible for cost, insurance, and freight.

Second, suppose the sale is on FOB terms. Then, the result may be different. Under FOB terms, the Buyer-Importer is obliged to book shipping space, and it takes the bill of lading in its own name. Therefore, the problem that the Seller has not fulfilled its obligation to ship goods should not arise. In sum, *Incoterms* allocates responsibility as between Seller and Buyer. Note in both scenarios, where a bill of lading is a forgery, the Carrier in whose name is forged is not bound by it.

- **Documentary Draft**

The documentary draft is part of an L/C transaction. It is a negotiable instrument, like a check, by which payment from the Issuer of the L/C to the Beneficiary actually is

³²⁶ See JOHN W. HEAD, *GLOBAL BUSINESS LAW: PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCE AND INVESTMENT* 213 (Durham, North Carolina: Carolina Academic Press ed., 3rd ed. 2012).

accomplished. It also is called a bill of exchange, or simply a draft. A Seller-Exporter presents the draft to the Confirming Bank, along with the other specified documents in the L/C, to receive payment. (The draft is discussed in a separate Chapter.)

- **Insurance Policy or Certificate**

A Buyer-Importer and Seller-Exporter typically require insurance to protect against the financial consequences of loss or damage to the goods. An insurance policy is the risk-minimizing device for casualty risk. In practice, a Carrier would be foolish to assume liability for loss or damage to goods while they are in transit, unless the merchandise was insured.

A marine insurance policy is used when goods are shipped over waterways. Most marine insurance policies cover not only sea transit, but also incidental surface transit. “Incidental surface transit” refers to transit from the place of business of the Seller-Exporter to the port of loading, and from the port of discharge to the place of business of the Buyer-Importer, *i.e.*, the pre-carriage and on-carriage. Typically, the document reflecting the marine insurance policy is the policy itself. However, in many instances, an Insurer issues a certificate of insurance, which is the relevant document.

The marine insurance policy on the goods is assignable. Assignability is necessary because if a Seller-Exporter takes out the policy in its own name (*e.g.*, under a CIF contract), then the Seller-Exporter later can assign the policy to the Buyer-Importer. Possession of the insurance policy gives the possessor the right to claim against the Insurer for any loss of or damage to the goods, which is covered by the policy. Accordingly, if the goods are lost or damaged after the property in the goods (risk of loss) passes to the possessor of the policy, *i.e.*, the Buyer-Importer to which the policy has been assigned, then the Buyer-Importer can claim under the policy. Of course, the assignment does not prevent the Insurer from asserting the same defenses against the Buyer-Importer as the Insurer would have had against the Seller-Exporter.

- **Attendant Documents**

There are additional documents common in international trade transactions, described briefly below:

- (1) **Commercial Invoice**

A commercial invoice provides the most detailed description of the goods. It lists the country in which the goods originated and their destination. It includes the terms of delivery, such as CIF or FOB, and price. Ordinarily, customs authorities accept that price for purposes of customs valuation as the Transaction Value of the shipped merchandise. This process implicates the *WTO Agreement on Customs Valuation*. The invoice also includes the quantity, weight, and description of the goods, including serial or model numbers, if applicable. The commercial invoice provides the names and addresses of the parties.

- (2) **Certificate of Inspection**
 A certificate of inspection often is required for certain products that require testing before entering a country. Products such as plants or animals usually must be certified under applicable SPS measures. Some electronic devices may also require technical certification. These certifications implicate the WTO *SPS* and *TBT Agreements*. The products that require certification vary according to the regulations of the importing country.
- (2) **Packing list**
 The packing list describes the contents of the shipping containers. It lists the number of containers in the shipment, as well as the weight and dimensions of each container. Customs officials of the importing country may use the packing list as a checklist to verify the incoming cargo. As a result, the import regulations of some countries require a packing list be provided to clear the goods at customs. Such regulations include post 9-11 border security rules in the United States and other countries.
- (3) **Export License**
 Export licenses often are required when the goods are deemed “sensitive” by the government of the exporting country. These goods typically include weapons and dual use goods, such as certain GPS devices. In the U.S., DDTC of the Department of State issues export licenses for military goods, while the BIS in the DOC issues export licenses for dual use goods. It is critical to appreciate that violation of United States export control rules is a criminal offense carrying serious penalties.
- (4) **Import License**
 Like export licenses, import licenses may be required. The government of the country of import grants import licenses. Argentina is well known for requiring import licenses for many different goods.
- (5) **Certificate of Origin**
 A Certificate of Origin is required for country of origin labeling purposes, and to receive preferential treatment under a FTA, CU, or developing country preference scheme like the *GSP*. Often, the Certificate of Origin must be notarized.

(The International Trade Law rules implicated by these documents are discussed in separate Chapters.)

- **Electronic Documents**

Traditionally, Documentary Sales relied entirely on the physical transfer of paper documents. Increasingly, electronic contracts and documents are preferred and utilized by merchants and governments alike. They are faster, easier, and (with adequate protection)

less vulnerable to fraud and more secure than tangible documents. Perhaps the quintessential example of the use of electronic documents in international shipments is the PSA.

Singapore has applied the fruits of the IT revolution to develop its Port into one of the largest and most efficient in the world. PSA terminals handle approximately one-seventh of total container transshipment throughput in the world, and five percent of global container throughput.³²⁷ In 2012, PSA terminals handled 31.26 million TEUs of containers. A decade later, in 2022, this figure increased to 37.3 million – a reduction from 37.6 million TEUs in 2021, or 0.7 percent.³²⁸ This reduction was far less than the 3-4% fall in global container trade, and thus a testament to the efficiency of the PSA.

Yet, legal reforms have not kept pace with the IT revolution. So, paper documents are still prevalent in Documentary Sales. That is especially true in developing and least developed countries, where in addition to lacking the necessary legal infrastructure, there is a deficit in the electronic infrastructure.

Among the salient legal reforms is the 1999 *Uniform Electronic Transactions Act (UETA)* is a model law governing digital signatures and electronic transmissions in the United States. Most American states have adopted it.³²⁹ This high adoption rate is due, in part, to encouragement at the federal level through the 2000 *Electronic Signatures in Global and National Commerce (E-SIGN) Act*. The *E-SIGN Act* stipulates if a state adopts *UETA*, then that state legislation will not be pre-empted by federal regulation.

The *E-SIGN Act* and *UETA* grant digital signatures and electronic transmissions the same legal status as written signatures and paper documents. Both laws prevent a transaction from being denied legal effect merely because the transaction is electronic. Other countries or trade blocs have their own national laws that also grant legal effect to electronic transactions and digital signatures, such as the European Union 2000 *Directive on Electronic Commerce* and 1999 *Directive on Digital Signatures*.

At the multinational level, UNCITRAL adopted the *Model Law on Legal Aspects of Electronic Data Interchange and Related Means of Communication (Model Law)* to address some of the concerns surrounding electronic commerce, particularly its legal enforceability. Electronic commercial transactions typically employ an EDI system, which is an international standard for electronic communications. The *Model Law* permits EDI usage in all aspects of contract formation and, like the *UETA*, gives electronic

³²⁷ PSA SINGAPORE, www.singaporepsa.com/aboutus.php.

³²⁸ See Chin Hui Shan, *S'pore Ports Handled Second-highest Number of Containers in 2022 Despite Fall in Global Container Trade*, THE STRAITS TIMES (Singapore), 14 January 2023, www.straitstimes.com/singapore/s-pore-ports-handled-second-highest-number-of-containers-in-2022-despite-fall-in-global-container-trade.

³²⁹ This discussion draws from John W. Head, *Global Business Law: Principles and Practice of International Commerce and Investment* 283-296 (Carolina Academic Press ed., 3rd ed. 2012) and Jerold A. Friedland, *Understanding International Business and Financial Transactions* 226-228, 241-242 (LexisNexis ed., 3rd ed. 2010).

communications and signatures the same legal standing as written communications and signatures. The *Model Law* also includes provisions regarding the evidentiary value of EDI.

A bill of lading, by its nature and role in a Documentary Sale, is particularly difficult to digitalize. Several rules and methods have emerged to address some of the concerns about digitalizing bills of lading. *Comité Maritime International* (CMI) rules, Bolero system, trading partner agreements, and Trade Card System facilitate the use of electronic bills of lading in Documentary Sales.

The CMI, which is a private organization based in Antwerp, Belgium, adopted the *Rules of Electronic Bills of Lading*. Parties to a commercial transaction may incorporate these rules into their contracts. Under these *CMI Rules*, parties also may submit and transfer electronic bills of lading in a private registry. As with a written bill of lading, a Carrier creates the electronic bill of lading. The Carrier keeps the document securely by creating a private access code. The Carrier can transfer the electronic bill of lading to a recipient, such as the Seller-Exporter, by sharing the private code. The Seller can enter that code to gain access the document. The recipient can then erase the original code and create a new private code, which can be disclosed to a third party, such as the Confirming Bank or Buyer-Importer.

A group of shipping companies, banks, and telecommunications companies operates the Bills of Lading for Europe (Bolero) system in the EU. Bolero, based on the CMI system, utilizes a private registry for electronic bills of lading. Under Bolero, a Carrier submits an electronic bill of lading to a title registry and lists the Seller-Exporter as the owner. The Seller-Exporter can then transfer the title by notifying the registry of the new holder.

Finally, there exist electronic trading partner agreements, which are contractual agreements typically entered into by parties that expect to have a long-term commercial relationship. The Trade Card system works similarly to the credit-debit system of a commercial bank. However, it is limited because it requires all parties to the Documentary Sale to be members of the system.

VI. 12 Steps

A generic Documentary Sale may be disaggregated into 12 steps, which Diagram 7-1 summarizes, and which are explained in detail below:

- (1) Contract of sale
- (2) Obtaining L/C
- (3) Use of Confirming Bank
- (4) Transmittal of L/C
- (5) Delivery of goods and receipt of bill of lading
- (6) Negotiation of bill of lading, other documents, plus draft
- (7) Confirmation and payment
- (8) Examination of documents, and payment against documents

- (9) Acceptance of time draft, conversion to Banker's Acceptance (BA)
- (10) Release of documents to improper
- (11) Pick up the goods
- (12) Secondary market sale of BA

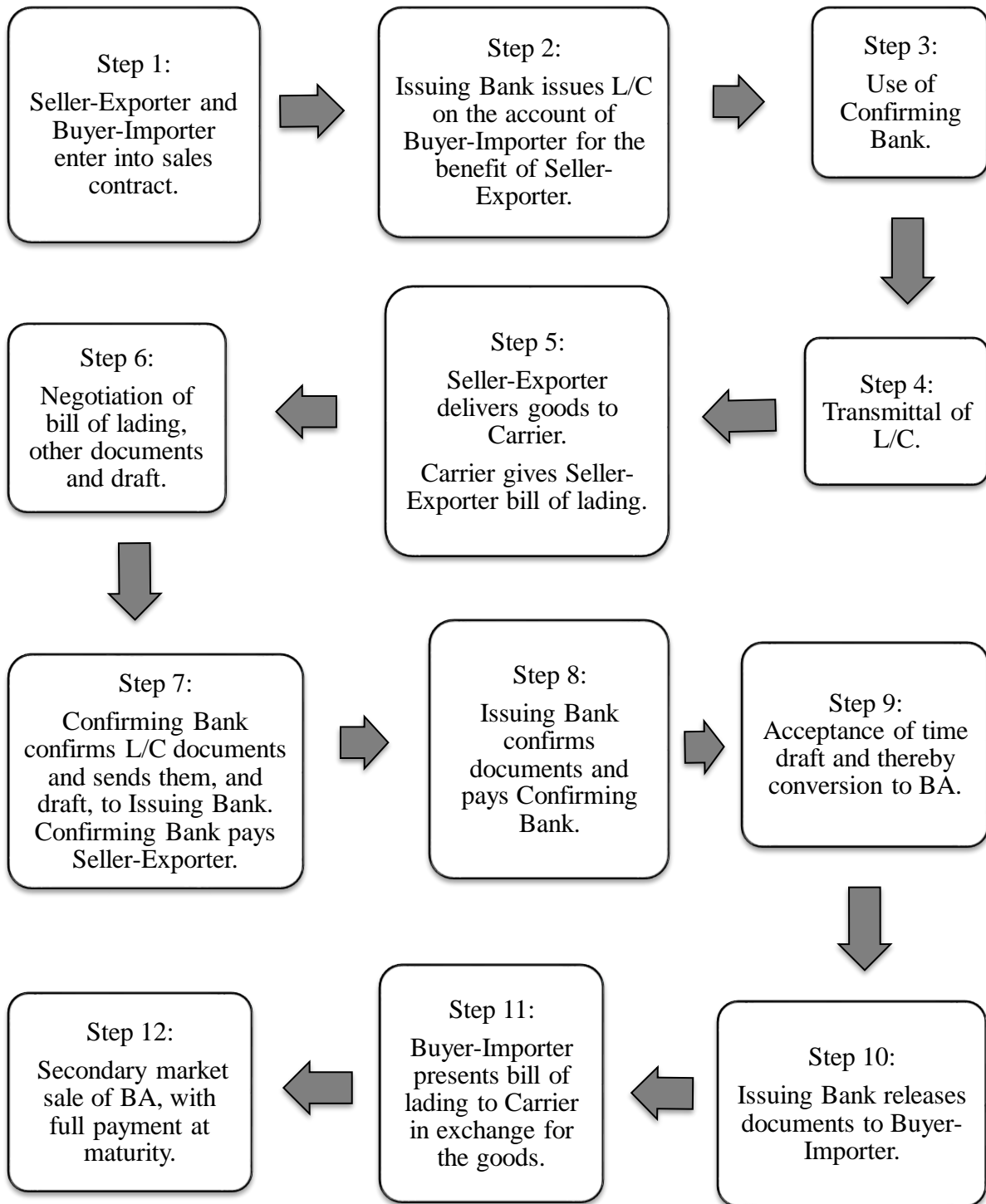
While reading through the steps, keep in mind the bill of lading and L/C operate in tandem. The bill of lading addresses the risk to the Buyer-Importer that no goods are shipped. In contrast, the L/C addresses the risk to the Seller-Exporter that no payment is made.

- **Step 1: Contract of Sale**

Typically, a Buyer-Importer contacts a Seller-Exporter about purchasing goods (though the Seller could initiate the contact as part of its marketing strategy). The Seller-Exporter may supply a *pro forma* invoice, and the Buyer-Seller may submit an order to purchase the goods. The Buyer-Importer and Seller-Exporter then enter into a contract for the sale of goods.

Ideally, their contract includes governing law, dispute resolution, and currency clauses. If the contract incorporates the term "CIF," then the price listed in the contract includes the cost of freight and insurance. Conversely, if the contract includes the expression "FOB," then the price for the goods does not include the cost of insurance or freight.

Diagram 7-1
Step-by-Step Generic Documentary Sale Transaction



- **Step 2: Obtaining L/C**

Once the contract for the sale of goods is complete, the Buyer-Importer requests its Bank to issue an L/C. Thus, the Buyer-Importer is the “Applicant,” and its bank is the “Issuer,” of the L/C. The L/C typically names the Seller-Exporter as the “Beneficiary.”

Recall an L/C is a promise made by the Issuing Bank on behalf of the Buyer-Importer for the benefit of the Seller-Exporter. In effect, an L/C assures the Seller-Exporter that the Buyer-Importer will pay the named Beneficiary (*i.e.*, the Seller-Exporter) when the documents listed in the L/C are presented to the right Bank.

In return for this promise from the Issuing Bank, the Buyer-Importer promises it will reimburse the Issuing Bank for any payment the Bank makes on its behalf to the Beneficiary of the L/C. The Issuing Bank charges a fee for the L/C, and the fee is paid by the Buyer-Importer.

- **Step 3: Use of Confirming Bank**

Once an L/C is issued, the Issuing Bank selects and notifies a Confirming Bank. Occasionally, the Seller-Exporter may select the Confirming Bank. The Confirming Bank is located near the Seller-Exporter, and logically is the Seller-Exporter’s Bank. It is usually one at which the Issuing Bank has an account, as that simplifies the payment by eliminating the need for an Intermediary Bank, and reduces risk in this transaction by cutting the number of payment transactions. But, if the Issuing Bank does not have an account with the Confirming Bank, an Intermediary Bank may be used to facilitate the transaction.

After the Confirming Bank receives notification of issuance of the L/C naming its customer, the Seller-Exporter, as Beneficiary, it notifies the Seller-Exporter. This notification includes the amount of time the Seller-Exporter has to draw on the credit, and the maximum amount of payment the Confirming Bank will guarantee.

- **Step 4: Transmittal of L/C**

The Issuing Bank sends the L/C to the Confirming Bank. It may do so by electronic transfer, courier, or some other expedient, but reliable means.

- **Step 5: Delivery of Goods and Receipt of Bill of Lading**

There are many steps a Seller-Exporter must take to get the goods from its warehouse in one country to the doorstep of the Buyer-Importer in another country. The Seller-Exporter may engage a Freight Forwarder to make the shipping arrangements and organize the shipping documents.

Once the required shipping documents are in order and the Freight Forwarder completes the shipping arrangements, the goods are transported from the warehouse or

facility of the Seller-Exporter to the dock at the port of shipment. A dock receipt may be issued that shows the goods arrived at the dock, and are waiting to be loaded onto the ship. The Carrier, or its agent (*i.e.*, a Loading Broker), signs the dock receipt as acknowledgment it received the goods.

Vitally, when the merchandise is loaded onto the ship, the Carrier issues the bill of lading to the Seller-Exporter. The Seller-Exporter negotiates that bill of lading to the order of the Buyer-Importer. Then, the Carrier begins its journey with the cargo to the port of discharge.

- **Step 6: Negotiation of Bill of Lading, Other Documents, Plus Draft**

The shipping documents listed in the L/C typically include a packing list, commercial invoice, certificate of origin, and certificate of inspection. The Seller-Exporter prepares a packing list and commercial invoice. The Seller-Exporter requests a certificate of origin, if necessary, from its local Chamber of Commerce or other appropriate authority. If it engages one, then the Seller-Exporter gives the required shipping documents to the Freight Forwarder.

A certificate of inspection may be required if the country of export or import requires one, or if the Buyer-Importer requests it. If the Buyer-Importer seeks an inspection, which it may do to ensure the goods conform to the specifications of the sales contract, then the certificate of inspection generally is included in the list of documents called for under the terms of the L/C. That certificate serves as proof to the Buyer-Importer the goods were, in fact, inspected for conformity, and thereby reduces the risk of non-conformity or outright fraud.

- **Step 7: Confirmation and Payment**

Now the goods are in transit, the Seller-Exporter airmails, faxes, or e-mails, or otherwise sends all the documents called for under the L/C, such as the bill of lading, certificate of origin, import and export license, insurance policy or certificate, etc., *i.e.*, the shipping documents, to the Confirming Bank. These documents are important, because the Seller-Exporter must provide exactly the right shipping documents called for in the L/C to receive payment. The Confirming Bank will check to ensure the documents conform to the L/C. If approved, the Confirming Bank will honor the draft and pay the Seller-Exporter in return for the documents.

- **Step 8: Examination of Documents and Payment against Documents**

Then, the Confirming Bank airmails, faxes, e-mails, or sends by express mail or courier the documents it receives from the Seller-Exporter to the Issuing Bank. The Issuing Bank also examines the documents tendered to it by the Seller-Exporter. If they conform to the list in (*i.e.*, the terms of) the L/C, then the Issuing Bank pays the Confirming Bank for the benefit of the Beneficiary, the Seller-Exporter. It is critically important to understand that a Bank that issues an L/C is required under the L/C to pay against

documents. That is, an Issuing Bank must pay the Confirming Bank upon the presentation of documents by that Bank that conform to those described in the L/C.

Also crucial to appreciate is that, thanks to the Independence Principle (discussed in a separate Chapter) it is not the job of the Bank (whether Issuing, Intermediary, or Confirming) to check the goods. Suppose the Buyer-Importer is not satisfied the goods conform to the sales contract. That dispute is between the Buyer-Importer and Seller-Exporter, not with the Bank. That is why, from the perspective of the Issuing Bank, an L/C is the surest method of payment in an international trade transaction. The appropriate Bank must pay so long as the shipping documents conform to the L/C.

- **Step 9: Acceptance of Time Draft, Conversion to BA**

In addition to the aforementioned documents, a Seller-Exporter draws and presents a sight or time draft. With a confirmed L/C, this presentment is to the Confirming Bank. If the Confirming Bank is supposed to pay immediately upon examination and confirmation of the L/C documents, then the draft is a sight draft, *i.e.*, the Seller-Exporter draws and presents a sight draft.

If, however, payment is to occur on a later date, a Seller-Exporter presents a time draft. After a Confirming Bank confirms the documents are in order, then it pays on the draft, and forwards it with the documents to the Issuing Bank. The Issuing Bank accepts the time draft by placing its stamp and signature on it. By doing so, that Bank converts the time draft into a Banker's Acceptance, or "BA." The Issuing Bank may sell the BA in the market for short term financial instruments for its present discounted value (PDV). At maturity (*e.g.*, Day 30 on a BA based on a 30-day time draft), the Ultimate Holder of, *i.e.*, Investor in, the BA presents this instrument to the Issuing Bank for payment of its full-face value.

In some instances of a confirmed L/C, the Confirming Bank may accept the time draft, thereby converting it to a BA. The Confirming Bank then could sell it for its PDV in the money market. Upon maturity the Investor in the BA presents it to the Confirming Bank for payment of full-face value.

Note, then, that (1) whichever Bank accepts the time draft is the Bank that would sell the draft-turned-BA to a money market investor, and (2) the Bank that pays the Ultimate Holder the full-face value of the BA at maturity. Where the Issuing Bank stamps "acceptance" on the time draft, once the Confirming Bank pays the Seller-Exporter on the time draft and forwards the draft to the Issuer for its acceptance, the role of the Confirming Bank in the transaction is complete.

In an unconfirmed L/C transaction, because there is no Confirming Bank, it always is the Issuing Bank that accepts a time draft. A BA is a negotiable instrument. So, the Confirming Bank, if it accepts it, could present the BA to the Seller-Exporter. The Seller-Exporter could hold it until its maturity, or sell it to another party at its PDV for immediate payment. However, the Seller-Exporter, if not a regular player in the money market, is

likely to prefer payment from the Confirming Bank for the goods it shipped to the Buyer-Importer.

The market for short term financial instruments also is called the “money market.” “Short term” is loosely defined as one year or less. Hence, traded in the money market are privately-issued instruments such as BAs and commercial paper, as well as publicly-issued ones such as United States Treasury bills, the maturity of which is one year or less.

- **Step 10: Release of Documents to Importer**

After the Issuing Bank pays the Seller-Exporter-Beneficiary, that Bank requires the Buyer-Importer-Applicant to pay it for the L/C, that is, reimburse the Bank for the funds it paid to the Beneficiary. Then, the Issuing Bank gives the shipping documents to the Buyer-Importer. Note, then, the Buyer-Importer’s Bank requires the Buyer-Importer to reimburse any payment before releasing the shipping documents. That is the bargained-for promise in the L/C application. In addition, the Issuing Bank takes a security interest in the goods, and insists the bill of lading be negotiated to it.

Recall the bill of lading, if it is negotiable, may be negotiated from Seller-Exporter to Issuing Bank, and then from Issuing Bank to Buyer-Importer. During the time the bill of lading remains with the Issuing Bank, the Bank has an ownership claim to the goods by virtue of the bill, which is a document of title. When the Issuing Bank gives the documents to the Buyer-Importer, including the bill of lading, the Bank relinquishes its security interest in the collateral (the goods).

Of course, it is possible the Buyer-Importer and Issuing Bank have done business for a long time, and the Issuing Bank appraises the Buyer-Importer as a low credit risk. In such instances, the Bank simply may pay the Confirming Bank for the benefit of the Seller-Exporter, even before it is reimbursed by the Buyer-Importer. The implication of payment in advance of reimbursement is the Issuing Bank extends the Buyer-Importer a line of credit, thus taking on the credit risk of the Buyer-Importer.

- **Step 11: Pick up Goods**

Once the Buyer-Importer receives the shipping documents, it presents the bill of lading to the Carrier, in return for a receipt of the goods from the Carrier. Before issuing that receipt and releasing the goods to the Buyer-Importer, the Carrier checks the bill of lading for conformity with the copy held by the Carrier. Then, the Buyer-Importer, or Customs Broker acting on its behalf, clears the goods through customs formalities.

These formalities may include payment of an applicable tariff (based on correct tariff classification and valuation), adherence to an applicable quota or TRQ, and inspections for conformity with technical standards or SPS measures. Notably, they also include a host of safety screens mandated by border security legislation and regulation that followed the September 11 terrorist attacks. All such formalities, which fall under the broad rubric of “Customs Law,” are treated later.

- **Step 12: Secondary Market Sale of BA**

As mentioned, a time draft may be transformed into a BA. This transformation allows the Holder of the BA, which may be the Confirming Bank, Issuing Bank, or Seller-Exporter, to sell the BA to a Third-Party Investor at a discounted price. By doing so, the Holder receives immediate payment. At maturity, the ultimate Holder is paid full face value of the BA by the Bank that previously accepted the time draft.

VII. Hypothetical Documentary Sale Transaction

The following example applies the generic steps in a Documentary Sale to a hypothetical, but real world, transaction. The steps in this hypothetical transaction are summarized below, and encapsulated in Diagram 7-2.

The steps in the hypothetical match those of generic example. Assume, as before, Amazon wants to purchase tea from the Sri Lankan company Dilmah. The Dilmah tea is planted and harvested in Sri Lanka. It is shipped from the Colombo port by the cargo line, Maersk. Amazon receives the goods at the port of discharge in Houston, Texas. The Issuing Bank is Bank of America, and the Confirming Bank is Standard Chartered. Consider each of the four basic documents, the contract of sale, bill of lading, L/C, and time draft.

- **Step 1: Contract of Sale**

Amazon contacts Dilmah, inquiring about an order for tea. Dilmah sends Amazon a *pro forma* invoice. Then, Amazon sends Dilmah a purchase order, and Dilmah sends Amazon a confirmation. Amazon and Dilmah agree to a contract of sale, the terms of which include FOB Houston. The price does not, therefore, include the cost of insurance or freight (*i.e.*, it is not a CIF contract). Amazon arranges for a vessel and procures a marine insurance policy.

- **Step 2: Obtaining L/C**

Dilmah does not want to ship the tea to Amazon on open account, because it has not dealt with Amazon previously, or has not yet established a regular course of dealing with Amazon to feel comfortable with it, or simply needs certainty as to its sale revenues, perhaps because of liquidity concerns. So, Dilmah is unwilling to assume the credit risk of Amazon and, therefore, before the goods are shipped, requires Amazon to obtain an L/C in which Dilmah is named as the beneficiary.

Amazon applies to its Bank, Bank of America in Houston, for an L/C. Bank of America approves the application. Bank of America issues the L/C on the account of Amazon for the benefit of Dilmah. Amazon almost certainly will have to pay in advance to the Bank a fee for this L/C.

The L/C issued by Bank of America reads:

“Dear Dilmah,

On receipt of a bill of lading, commercial invoice, certificate of insurance, inspection certificate, and import and export licenses, for 500 boxes of tea, we, Bank of America, will honor your time draft in the amount of \$7,500.”

- **Step 3: Use of Confirming Bank**

Assume Dilmah cannot evaluate the safety and soundness of Bank of America, or (especially following the September 2008 global financial crisis), does not trust that Bank. Thus, Dilmah selects its Bank, Standard Chartered, which has an office in Colombo, Sri Lanka, to act as the Confirming Bank. Consequently, the payment transaction is a confirmed L/C. By acting as Confirming Bank, Standard Chartered adds its guarantee to that of the Issuing Bank, Bank of America. Thus, Dilmah can sue the Confirming Bank on its commitment to pay or, failing that, sue Bank of America on its commitment to pay.

If Bank of America holds an account with Standard Chartered, then there is no need for an Intermediary Bank. However, if Bank of America does not hold an account with Standard Chartered, then an Intermediary Bank, such as Deutsche Bank, will facilitate the transfer the funds from the account of Amazon with Bank of America to the account of Dilmah with Standard Chartered.

- **Step 4: Transmittal of L/C**

Bank of America sends by expeditious, reliable means (such as courier or electronic transmission) the L/C to Standard Chartered. If necessary, then it may use an Intermediary Bank, such as Deutsche Bank.

- **Step 5: Delivery of Goods and Receipt of Bill of Lading**

Dilmah then puts the tea in containers and gives them to the Carrier, Maersk. There is a contract of carriage between Dilmah and Maersk. This contract is evidenced by the bill of lading.

Dilmah receives a negotiable bill of lading that reads “clean,” “on board,” and “freight - collect” from Maersk. Recall the words “clean on board” mean the shipper says the tea is undamaged and, in fact, on board the ship. The short-hand expression “FOB” dictates the freight was not prepaid.

- **Step 6: Negotiation of Bill of Lading, Other Documents, Plus Time Draft**

Dilmah gives the bill of lading to its Bank, Standard Chartered. It also gives this Bank the other documents required under the L/C, such as the commercial invoice,

insurance certificates, inspection certificate, and import or export licenses. Dilmah presents the documents, along with a bank draft, to Standard Chartered.

Note the use of the term “bank draft” reflects the fact the drawer of the draft, Dilmah, draws this payment order on a bank, Bank of America Houston. (A draft drawn on a non-bank is called a “trade draft.”)

As to the bank draft, Dilmah draws it naming itself as payee, and ordering the Bank of America to pay it \$7,500. While the draft could be payable at sight (a sight draft), assume it is a 30-day time draft. A subsequent Chapter explains these types of drafts in detail, as well as extensions of credit under them.

Bank of America, the Issuing Bank, is the drawee of the draft, *i.e.*, the party ordered to pay by the drawer, Dilmah. Essentially, this bank-time draft says:

“Dear Bank of America [the drawee],
At maturity in 30 days, pay to the order of Dilmah [the payee]
\$7,500.
Signed, Dilmah [the drawer].”

- **Step 7: Confirmation and Payment**

As the Confirming Bank, Standard Chartered confirms the documents conform to the terms of the L/C. Standard Chartered then air mails, couriers, or electronically transfers the documents and draft it receives from Dilmah to Bank of America.

It is possible that at this point Standard Charter pays Dilmah. If so, then it effectively extends credit to Dilmah, because Bank of America has not yet paid Standard Chartered. There are many mechanisms for the extension of short-term credit.

It also is possible Standard Chartered, as the Confirming Bank, accepts the draft, thus converting it to a BA. However, assume as in the normal case that Bank of America, as the Issuing Bank, accepts the draft (Step 9).

- **Step 8: Examination of Documents, and Payment against Documents**

Bank of America receives the documents from Standard Chartered (or an Intermediary Bank, such as Deutsche Bank, if one is used), and examines them. As long as the documents conform to those described in the L/C, Bank of America must pay Standard Chartered. Bank of America does not go to the Port of Houston, wait for the Maersk ship to sail in, and inspect the goods. Bank of America has no legal obligation to examine the underlying goods.

Assume the documents are in order and, therefore, Bank of America pays Standard Chartered. In turn, Standard Chartered pays Dilmah (if it has not already done so).

- **Step 9: Acceptance of Time Draft, Conversion to BA**

Because the draft drawn by Dilmah on Bank of America is a time draft, Bank of America stamps the draft “Accepted.” This stamp turns the draft from a time draft to a BA, meaning the Bank will pay the ultimate Holder of the BA its full-face value at maturity. So, for example, if the BA is for \$100 at a 30-day maturity date, then whoever holds the BA on Day 30 can present it to Bank of America for payment of that amount.

That also means Bank of America can sell the BA to secondary market investors for its present discounted value (PDV). For example, it could sell it on Day 5 at a discounted amount. The BA then trades in the secondary market, specifically, the money market (discussed in a subsequent Chapter), and the ultimate Holder on Day 30 presents it to Bank of America for full face value payment.

- **Step 10: Release of documents to importer**

Amazon goes to Bank of America and gets the documents from Bank of America. Why? Because Amazon (or its Customs Broker) is the party that goes to the Houston port to greet the Maersk ship and obtain the goods. But, Amazon cannot obtain the goods without the documents, particularly the bill of lading, which is the document of title. Amazon needs the documents to get the tea. Of course, Bank of America debits the account of Amazon.

- **Step 11: Pick up the goods**

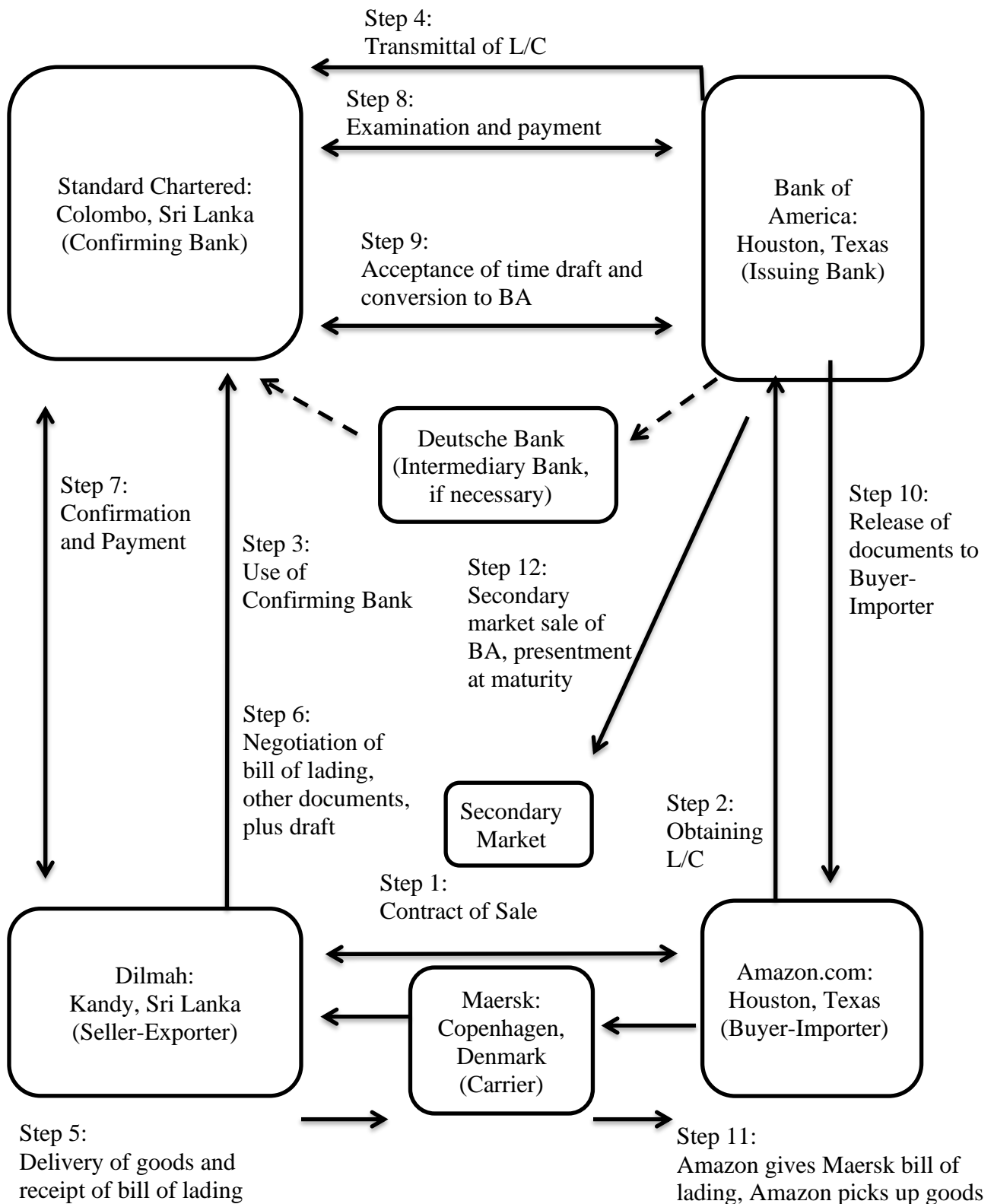
Amazon (or its Customs Broker) receives the goods, following compliance with all applicable United States Customs Law.

- **Step 12: Secondary Market Sale of BA, Presentment of BA at Maturity**

A time draft is transformed into a short-term financial instrument, a BA, capable of being traded on the secondary market. At maturity, the Ultimate Holder (Investor) presents the BA to the Bank that accepted it, here the Issuing Bank (Bank of America). That Bank pays the Holder the full-face value.

In sum, the Documentary Sale allows multiple parties to shoulder different risks involved in international commercial transactions. Furthermore, each party bears these risks according to its position and expertise. For example, Freight Forwarders specialize in facilitating international shipments, while insurance companies obviously have a comparative advantage in issuing marine insurance policies. Financing is among the regular activities commercial banks have performed for centuries.

**Diagram 7-2
Hypothetical Documentary Sale Transaction**



Chapter 8

TRADE FINANCE³³⁰

I. Overview and L/C versus Open Account

A documentary sale manages risk in a cross-border transaction. In theory, a documentary sale with a confirmed letter of credit (L/C) can and should be a seam- less transaction benefitting all parties. Many such sales are not without difficulties. Close examination of the documentary sale reveals one document in particular, the L/C, is the anchor of the entire transaction.³³¹ Moreover, the L/C is the most used instrument in financing international trade transactions. Over 90% of import-export transactions are paid for through trade finance, such as commercial and standby L/Cs, performance guarantees, and insurance, and the global market for trade finance is about \$10 trillion annually.³³² Among these instruments, the L/C is preeminent. Accordingly, what follows is a detailed consideration of the L/C. How does it work to the benefit of the parties? What issues arise with a bungled L/C? Why is it so important in international trade finance?

An L/C is the promise of a financial institution, most commonly a bank, called the Issuer or Issuing Bank, to guarantee payment from a Buyer (typically the importer of merchandise from overseas) to a Seller (typically the producer and/or exporter of that merchandise). The fundamental problem, or risk, is credit: the Seller may not be familiar with the Buyer, and thus not trust the Buyer to pay. The L/C mitigates that risk. As for the Issuer, typically it is chartered as a commercial bank. Investment banks, the predominant work of which is in underwriting and dealing in securities, tend not to be engaged in the L/C business.

Therefore, in its most basic form, an L/C involves a minimum of three parties:

- (1) Buyer-Importer,
- (2) Seller-Exporter, and
- (3) Issuing Bank.

³³⁰ Documents References:

- (1) *UCP* (latest version)
- (2) *Incoterms* (latest version)
- (3) *Hamburg Rules* (latest version)
- (4) *Hague Visby Rules* (latest version)

³³¹ See Norman Mugarura, *The Letter of Credit, Its Resilience and Viability in Securing International Transactions*, 13 *Journal of International Trade Law and Policy* issue 3, 246-264 (2014) (explaining the continued appeal of L/Cs, despite the availability of other payment mechanisms, and highlighting the need to keep abreast of developments on key legal issues such as document discrepancy, substantive compliance, the independence principle, the fraud exception, and conflicts of law).

³³² See Daniel Pruzin, *Global Downturn Drives Down Demand for Trade Financing, Funding Stabilizes*, 26 *International Trade Reporter (BNA)* 1237 (17 September 2009).

The buyer and seller have entered into a contract for the sale of goods. It specifies the price, quantity, and other material terms of their import-export transaction, and is governed by the law of a particular country, the U.N. *Convention on Contracts for the International Sale of Goods (CISG)*, or the ICC *Incoterms* (a short hand for *International Commercial Terms*).³³³ The shipment of the merchandise is the subject of their contract of carriage, and governed by a regime such as the *Hague-Visby* or *Hamburg Rules*.³³⁴ Their payment vehicle is the L/C, for which they need at last an Issuer. The Issuer is considered an independent third party, even in instances when Buyer, Seller, or both hold accounts at the Issuing Bank. While the Buyer and Seller are in different countries, the Bank may be in either of those countries, or in a third country.

The “independence” of the Issuer is a critical point in any L/C transaction, and why the L/C works to the benefit of the Buyer and Seller in mitigating credit risk. “Independence” means the L/C, that is, the guarantee of the Issuer to pay, is entirely independent of the original contract of sale between the Buyer and Seller. The independence of the L/C guarantees payment to the beneficiary (the Seller) of the L/C upon presentation of all documents specified in that L/C. Presentation of those documents is proof of the successful and accurate completion of the sales (and related carriage) contracts between the Buyer and Seller. Therefore, in the simplest three-party L/C deal, the Seller collects its payment from the Issuer once it fulfills its contractual obligations to the Buyer concerning the underlying goods and their shipment. Note this “Independence Principle” (also called the “Autonomy Principle”) presumes “strict compliance,” that is, strict compliance with proper presentation by the Seller of all requisite documents. Note also the underlying contract of sale could be for services, or even IP.

What if the parties opt not to use an L/C, perhaps because they are familiar with one another through course of dealing, business affiliations, or family ties, and thus the Seller is not concerned about the credit worthiness of the Buyer? They can agree on a sale on open account, *i.e.*, an open account transaction. Recall in a documentary sale with a confirmed L/C, the Seller draws a draft on the Issuing Bank and presents it along with the necessary documents to the Confirming Bank. (In a three-party L/C deal, the Issuing and Confirming Banks are the same.) The Confirming Bank then pays the Seller, and forwards the documents to the Buyer’s Bank, which is the Issuing Bank. Drawing the draft, presenting the documents, and receiving payment all occur prior to the Buyer physically obtaining the goods. In contrast, in an open account transaction, a Seller ships goods, expecting payment at a later date, after the buyer has received the goods.

II. Example

³³³ See UNCITRAL. 52 *Federal Register* 6262, 6264–6280 (2 March 1987); *United States Code Annotated*, Title 15, Appendix (Supp. 1987). The *CISG* is posted at www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf. See ICC, *Incoterms*, www.iccwbo.org.

³³⁴ See The Hague Rules as Amended by the Brussels Protocol 1968 (*Hague-Visby Rules*) posted at www.jus.uio.no/lm/sea.carriage.hague.visby.rules.1968/doc.html; United Nations Convention on the Carriage of Goods by Sea, 30 March 1978, (*Hamburg Rules*), www.jus.uio.no/lm/un.sea.carriage.hamburg.rules.1978/doc.html.

Suppose a Buyer-Importer, Amazon, in Houston, Texas, and a Seller-Exporter, Dilmah, in Kandy, Sri Lanka, enter into a contract for tea to be shipped from the port in Colombo, Sri Lanka, to the port in Houston. Assume Amazon and Dilmah know each other, because they have been doing business for a number of years. Consequently, Dilmah agrees to ship the tea on an open account to the Amazon. Dilmah does so today (“Day 1”), records the payment as an account receivable on its books, and expects payment from Amazon at a mutually agreed upon future time, such as 60 days (“no later than Day 60”) after the tea has cleared United States customs procedures in Houston for the benefit of Amazon.

This open account sale is unusual. It presumes extraordinary trust between Dilmah and Amazon, and means Dilmah assumes all credit risk. It could ship tea as called for in the contract of sale, and Amazon could fail to pay. This failure could arise because of liquidity or insolvency problems at Amazon, or outright fraud. Therefore, more often than not, when dealing with unfamiliar parties across international boundaries, or with parties for which there is no basis for trust, an L/C is used. The L/C addresses the risk to Dilmah that Amazon fails to pay, *i.e.*, the Buyer ends up with both the goods and money.

To be sure, not any bank will suffice to mitigate credit risk. This independent party, the Issuer, also must be trustworthy. The bank must have a strong reputation, if its promise to guarantee payment to the Beneficiary, such as Dilmah, is to be credible. Indeed, reputational integrity, whether of the bank, the buyer, or seller, are important motivators and constraints in international business. A bank develops this reputation because of (*inter alia*) a strong capital adequacy ratio, healthy balance sheet, robust regulation, and long-term experience with L/Cs. Note that L/Cs entail a capital adequacy requirement under the guidelines published by the Basle Supervisors Committee and BIS in Basle, Switzerland.

So, to modify the above transaction, suppose it is done using an L/C. Suppose the Buyer-Importer Amazon and Seller-Exporter Dilmah enter in a contract for tea. Assume neither company is familiar with the other, hence they do not agree to an open account transaction. Suppose also Amazon uses Bank of America Houston as the Issuer, as that is its local bank with which it is familiar.

As a general proposition, once an Issuing Bank agrees to issue an L/C on behalf of a Buyer for the benefit of the seller, a Confirming Bank must be named. Typically, the Issuing Bank chooses the Confirming Bank for many of the same reasons a Buyer chooses an Issuing Bank: familiarity and past or ongoing ordinary course of dealings. So, assume Bank of America Houston chooses Standard Chartered in Kandy, Sri Lanka. With these selections, each party – Buyer, Seller, and Banks – deal with institutions with which they are comfortable, and most likely with which they have done past business.

Does it matter whether Amazon has heard or dealt with Standard Chartered in Sri Lanka, or any of the Standard Chartered branches or agencies anywhere around the globe? No. Does it matter whether Dilmah has heard or dealt with Bank of America Houston or any of its branches or agencies? No. What matters is that Amazon knows Bank of America, Dilmah knows Standard Chartered, and Standard Chartered and Bank of America know each other. Quite obviously, banks are in the business of banking, so they learn about the

reputation of other banks, selecting some as correspondents and affiliates, while eschewing transactions with others. Here, it is assumed Bank of America Houston is comfortable doing business with Standard Chartered, and vice versa, as each recognizes the other as a creditworthy counterparty.

Therefore, when Bank of America Houston, the Issuing Bank, issues an L/C at the request of its customer, Amazon, in favor of Dilmah, Standard Chartered, the Confirming Bank, will pay Dilmah upon presentation by Dilmah of the draft and required documents. Note the customer of the Issuing Bank, *i.e.*, the party that requests issuance of an L/C, sometimes is referred to as the “Applicant,” or “Account Party.” The party to be paid under an L/C sometimes is called the “Beneficiary.”

The L/C itself, which is the contract of payment, specifies precisely what documents are “required.” It follows immediately that as a general proposition, L/Cs deal in documents, not goods. Indeed, commercial banks rather hate dealing in goods. There is a world of documents (often electronic ones). Thus, an L/C also is known as a “documentary credit.” The principal international set of rules governing L/Cs is the *UCP*.

III. *UCP*

- **Usage**

The *UCP* is the most commonly used set of rules regarding L/Cs. The *UCP* not only sets out rules about how L/Cs operate, such as the Independence Principle and the definition of strict compliance, but also explains how to resolve disputes. The International Chamber of Commerce first published the *UCP* in 1933 and since has updated it episodically. For example, it revised the *UCP* in July 2007, known as version 600 or *UCP 600*. (*UCP 600* has 39 Articles, whereas its predecessor, *UCP 500* had 49 Articles.)

Technically, the *UCP* is not a statute, in contrast to Article 5 of the Uniform Commercial Code (U.C.C.), which covers L/Cs and which American states have enacted as a statute.³³⁵ Rather, the *UCP* is *law merchant*, or *lex mercatoria*. It embodies the long-standing, widely-accepted customs and practices of merchants that now have become rules. In that respect, the *UCP* is akin to *Incoterms*.

Approximately 95 percent of all L/Cs globally are issued subject to the *UCP*. They contain a choice of law clause stating they are governed by the *UCP*. Indeed, the *UCP* generally is regarded as the single most harmonizing document in International Law. Notably, there exists a non-uniform provision in the U.C.C. as enacted in New York. Section 5-116 of the New York U.C.C. covers choice of law and forum. Parties to an L/C can choose to apply the *UCP*, thus making the U.C.C. not applicable. The ability of commercial parties to opt out of the U.C.C., particularly in New York because of its global commercial significance, is a strong inducement for banks to subscribe to the *UCP*.

³³⁵ Technically, the U.C.C. is not a law, but rather a recommendation from its drafter, the National Conference of Commissioners on Uniform State Laws (NCCUSL), which then states are free to adopt, modify, or ignore.

There are four additional reasons for the widespread success of the *UCP*:

(1) *Flexibility*

Parties are free to negotiate the terms of the documentary credit to suit their needs, and very little is barred. The words “unless otherwise stipulated in the credit” are found throughout the *UCP*.

(2) *Certainty*

Parties can predict what will happen, as the *UCP* makes clear how banks must act.

(3) *Familiarity*

Given that the *UCP* was first published nearly a century ago, banks and their customers are familiar with its terms and their practical meaning in everyday transactions.

(4) *Advisory Opinions*

The ICC has a Banking Commission that renders advisory opinions on queries related to the *UCP*. These opinions ensure consistency and uniformity. They also provide for flexibility, and ensure the Commission can render opinions responsive to changes in modern commerce.

- **Three Fundamental Principles**

Three fundamental principles govern the operation of L/Cs:

- (1) The Rule of Independence.
- (2) The Rule of Strict Construction.
- (3) The responsibility of banks to deal in documents only.

The third principle, contained in *UCP* Article 5, is discussed earlier. The first two, in Articles 4 and 14 are discussed in turn below.

- **Independence Principle**

As *UCP* Articles 3(a) and 4 state, credits by their nature are transactions separate from sales of other contracts. This is true even if an L/C refers to the underlying international sales contract. Regardless of such a reference, an L/C is a self-contained agreement involving an Issuing Bank (such as Standard Chartered), the customer of that Bank (the Buyer-Importer, or Applicant, such as Amazon), and the Beneficiary (the Seller-Exporter, such as Dilmah). So, among the most important features of the *UCP* is its embodiment of the Independence Principle in Article 4(a).

This critical provision states:

A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contact, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate, or to fulfill any other obligation under the credit is not subject to claims or defenses by the Applicant resulting from its relationships with the Issuing Bank or the Beneficiary.³³⁶

This provision means Banks involved in an L/C transaction are responsible only for checking that the relevant documents are in order and conform to the terms specified in the L/C. Banks are not required to investigate beyond the documents. So, neither the Issuing nor Confirming Bank bears a general duty to inspect physically the goods shipped by the Exporter to the Importer, or to investigate their respective performance obligations. The Banks deal only in the documents; that is the essence of the Independence Principle. If those documents are in good order, then the Banks must pay on the L/C. (To be sure, sometimes this results in an injustice, but that is another matter.)

Article 5 reinforces these points: “Banks deal with documents and not with goods, services, or performance to which the documents may relate.” The Independence Principle means payment under an L/C must be made by the Confirming Bank to the Beneficiary (Seller-Exporter, such as Dilmah in the hypothetical) against presentation by the Beneficiary to that Bank of appropriate and conforming documents. “Appropriate” means the Beneficiary does, in fact, present all of the documents it is required to present pursuant to the terms specified in the L/C. “Conforming” signifies the nature and specifications of the documents that meet the requirements in the L/C. Additional key aspects of the *UCP* are discussed below.

- **Principle of Strict Compliance**

Suppose documents called for in an L/C fail to conform to the terms specified in the credit. Then, the rule of strict construction, also referred to as “Strict Compliance,” arises. There is no doctrine of substantial compliance regarding L/Cs, only strict compliance. In other words, the required documents submitted by the Seller- Exporter to the Confirming Bank (along with the draft the Seller-Exporter draws on the Issuing Bank and presents to the Confirming Bank with those documents) must be identical to that which is specified in the L/C. To be sure, in practice the issue of Strict Compliance is the subject of some controversy.

In sophisticated financial centers like London, Singapore, and New York, between one-half and two-thirds of all documentary presentations contain at least one discrepancy upon initial tender. Most of these cases are remedied by the Beneficiary (such as Dilmah) obtaining a changed and conforming document, or by the Applicant (such as Amazon)

³³⁶ Emphasis added.

agreeing to waive the discrepancies. *UCP* Article 16 addresses waivers. In about 90% of the cases in which the Applicant is asked for a waiver, it agrees to do so. That is because most defects are minor and technical, and because the Applicant seeks to preserve its good business relationship with the Beneficiary.

There is existing case law that covers Strict Compliance, and it is embodied in *UCP* Articles 14-16. In particular, Article 14(d) states:

Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document, or the credit.

In brief, minor discrepancies, such as insignificant typographical errors, are exceptions to the Principle of Strict Compliance. However, these exceptions are narrow so as to keep the risk exposure of banks to a minimum and, therefore, keep costs down.

- **Review of Shipping Documents**

The responsibility of banks to deal in documents only is clear. *UCP* Article 14(a) states:

... [the] confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.³³⁷

What, exactly, are the duties incumbent on banks in an L/C transaction?

Suppose Standard Chartered receives the required documents from Dilmah. The clerk at Standard Chartered assigned to review the documents and verify they are conforming was just hired by Standard Chartered after serving as a summer intern. The new clerk takes 10 minutes to examine five documents: the bill of lading, invoice, certificate of inspection, marine insurance policy, and export license. Has the clerk done her job, and has Standard Chartered satisfied its *UCP* duties?

The answer is “yes.” *UCP 500*, Article 13(a), stated a Bank must examine all documents with “reasonable care” to ascertain “on their face” (*prima facie*) they “appear” to be in accordance with the terms and conditions of the credit. That threshold was low. Reasonable care was not special care, or even ordinary care. A Bank needed only to look at the face of the documents and not beyond. A Bank was not called on to take on the role of detective. Appearance of the documents was what matters. *UCP 600* eliminated even this “reasonable care” standard, replacing it with the operative language quoted above in Article 14(a).

³³⁷ Emphasis added.

The standard of care, then, was dropped further, or was it? Arguably, the *UCP 600* standard is modestly higher than that in *UCP 500*. Commentary from the ICC *UCP 600* Drafting Group suggests as much. *UCP 600* imposes strict liability on Banks to check documents, coupled with specific requirements defining conformity of each kind of document in Articles 18-28. Moreover, the phrase “on their face” refers not merely to a front and back examination of a document, but also to the data contained within that document.

In any event, there is good reason for a low threshold: it facilitates the flow of goods across borders by encouraging banks to finance international commerce. They would not do so if their duties were not kept to a minimum, or they would do so only for an exorbitant fee to cover their costs of investigation beyond documents and attendant liabilities. To render trade simple, routine, and efficient, payments for that trade must be simple, routine, and efficient. Moreover, in terms of a Torts-like better-position analysis, Banks involved in international trade finance typically are not in the best position to police problems that arise in an underlying sale of goods transaction between Buyer-Import and Seller-Exporter.

But, suppose there is a problem: the documents presented to an Issuing or Confirming Bank do not appear on their face to conform to the terms of the credit. In this case, the Bank must decide under *UCP* Article 14(a), on the basis of the documents alone, whether the documents “constitute a complying presentation” or not. The Bank must make its decision within five banking days of receiving the documents. (*UCP 600* cut out the term “reasonable time” from *UCP 500*, replacing it with the more specific five banking day examination period.)

Furthermore, under *UCP* Article 16(d), if an Issuing or Confirming Bank decides to refuse to honor or negotiate the L/C, then it is required to give a single notice within five banking days to the presenter of the documents. Therefore, the Bank has one chance to identify all the discrepancies on which it may seek to rely one “bite at the apple,” as it were. This notice obligation is a shift from prior versions: Article 16 of *UCP 500* gave banks seven banking days to decide to refuse to honor or negotiate, and Article 16 of *UCP 400* allowed them “reasonable time.”

When an Issuing or Confirming Bank gives proper notice regarding its refusal to honor or negotiate an L/C, then the Bank is to claim a refund, including interest, for any reimbursement it already paid. That is clear from *UCP* Article 16(g). Finally, suppose the Bank fails to act during the 5-banking day period. That is, it fails to examine the documents, object to them, notify the presenter, and supply the reasons for a refusal by the close of business on the fifth banking day. Then, under Article 16(f), the Bank is precluded from asserting the defect.

IV. Example

Returning to the earlier example, the phrase “payment against documents” means the Confirming Bank, Standard Chartered will pay Dilmah only after Dilmah draws a draft on the Issuing Bank, Bank of America Houston, and presents the required documents to

Standard Chartered. Along with the draft, what documents must Dilmah, the Seller-Exporter, present to its Confirming Bank?

UCP Articles 14(c) and 17(a) specify they include, unless Dilmah and Amazon agree otherwise:

- (1) One or more Transport Documents, which may be a Negotiable Bill of Lading (Article 20), Non-Negotiable Sea Waybill (Article 21), Charter Party Bill of Lading (Article 22), Air Transport Document (Article 23), Road, Rail, or Inland Waterway Transport Document (Article 24), Courier Receipt, Post Receipt, or Certificate of Posting (Article 25), and which are subject to rules about On Deck carriage (Article 26) and Clean Transport (Article 27).
- (2) Insurance Certificate (Article 28).
- (3) Packing List (Articles 20-21 and 38, which speak of a Weight List or Certificate).
- (4) Commercial Invoice (Article 18).
- (5) Certificate of Origin (Articles 20-21, which speak of ports of shipment and discharge).
- (6) Certificate of Inspection (Articles 20-21).

Presentation must be made on or behalf of the Beneficiary (Dilmah) no later than 21 days after the date of shipment of the underlying goods.

Article 14 contains the standards for examination Standard Charter must apply when presented with the documents. Upon satisfactory presentation of the draft and these documents, and assuming the documents are conforming under Article 14, Articles 8 and 15(b) obligate Standard Chartered to honor the draft and pay Dilmah in return for the entire set of documents. If the Issuing and Confirming Bank are the same, then this obligation arises under Article 7.

Next, also acting under Article 15(b) Standard Chartered forwards the documents to Bank of America Houston, which in turns pays Standard Chartered. The payment to Standard Chartered from Bank of America Houston most likely takes the form of a credit to an account Standard Chartered already has with Bank of America Houston. That account relationship is another reason Issuing Banks choose a particular bank with which to work as Confirming Bank. It allows for a simple “in house” transfer on the books of Bank of America Houston: a debit to the account of Bank of America Houston and a credit to the account of Standard Chartered held by Bank of America Houston.

There are other possibilities. Bank of America Houston might have an account with Standard Chartered. Then, the in-house transfer is on the books of Standard Chartered: a debit to the account of Bank of America and a credit to the account of Standard Chartered on the books of Standard Chartered.

What if an in-house transfer is not possible, because neither the Issuing nor Confirming Bank has a direct account relationship with the other? Then an intermediary bank is used. This intermediary, or Correspondent Bank, is one with at which both the Issuing and Confirming Bank hold an account. For example, suppose Bank of America Houston and Standard Chartered hold accounts at Deutsche Bank in Frankfurt, Germany. Then, Bank of America Houston would instruct Deutsche Bank to debit its (Bank of America's) account, for credit to the account of Standard Chartered (at Deutsche Bank). As a practical matter, correspondent banking relationships are common throughout trade finance and international finance generally.

Vitaly, the entire package of documents must be transferred by the Beneficiary to the Confirming Bank before the seller gets paid, and likewise the Confirming Bank must forward them to the Issuing Bank before the Confirming Bank gets paid.³³⁸ Again, these mandates illustrate why under an L/C payment is made against documents only, as per *UCP* Article 5.

In fact, U.C.C. Article 2-320(4), which discussed the terms “C.I.F.,” (cost, insurance, and freight) and “C&F” (cost and freight), expressly forbids a Seller from tendering the goods themselves instead of the documents unless expressly agreed. The reason is because of the role the Issuing Bank plays in financing an international trade transaction. An Issuing Bank (like Bank of America Houston) that pays money to a Seller (like Dilmah) on behalf of its customer, the Buyer (like Amazon), takes a security interest in the imported goods (such as the tea). By doing so, the Issuing Bank is better able to protect its security interest if the Seller is not allowed to avoid tendering the documents.

Why? Consider two counterfactual possibilities. Suppose the Seller could deliver goods to the Confirming Bank, rather than the Buyer, to get paid. Then, the Confirming Bank would be in possession of the goods, which could undermine the security interest of the Issuing Bank in the goods. Lacking such protection, fraud may occur.

Alternatively, suppose that to get paid, the Seller were allowed to tender goods directly to the buyer instead of tendering the required documents to the Confirming or Issuing Bank. The Buyer that received the goods could offer them as collateral to another lender, free of the lien of the Issuing Bank on those goods. Then, the Issuing Bank would not be able to look to those goods for any money owed by the Buyer to the Bank for issuing the L/C.

Finally, documents called for under an L/C serve a notice-giving function. Suppose the Seller supplies goods of inferior quality and/or value than what is required by the contract for the sale of goods with the Buyer. For instance, Dilmah ships tea dust (low quality tea) instead of tea to Amazon. Normally, that is a problem between Seller and Buyer. Could the Seller make a disclosure as to inferior quality in a document called for by the L/C, and still get paid? Asked differently, would such a disclosure give the Confirming and Issuing Banks the notice they need to make payment with confidence?

³³⁸ These points are not set out in *UCP 600*.

Under *UCP* Article 10, the relevant parties – particularly the Issuing and Confirming Banks and the Beneficiary – could agree to amend the credit.

But, suppose the Confirming Bank (in the hypothetical, Standard Chartered) pays the full amount called for by the credit, but then learns the Buyer (Amazon) wants a partial refund, owing to a defect in quality of the goods. The Bank will need to obtain the partial refund from the Seller, and pass it to the Issuing Bank, for credit to the Buyer. Specification in the documents called for by the L/C as to the quality of the goods serves a notice to the Bank that it might need to take steps to protect itself, such as obtain funds from the Seller.

V. L/C Drafting and Fees

• Minimum Standards for Drafting an L/C

There are few formalistic rules in the *UCP*. Generally, parties are free to do as they choose. That creates a tension between flexibility and sloppiness. A common problem with L/Cs and payment against documents is the terms of the credit are poorly drafted. Interpreting those terms sometimes is difficult, even though several *UCP* rules of interpretation are intended to provide certainty, and keep the flow of commerce and payments moving.

As a practical matter, there are some basic rules to which parties must adhere when drafting a credit. The most important ones are:

- (1) Parties must expressly invoke use of the *UCP*. Article 1 instructs parties must state the *UCP* governs in the L/C document.
- (2) All L/Cs must state whether the credit (funds) is available:
 - (a) At sight, as soon as a sight draft is presented to the Issuing Bank;
 - (b) By deferred payment, after a certain period of time following the presentation of a draft to the Issuing Bank;
 - (c) By acceptance, whereby the Issuing Bank stamps a time draft presented to it “ACCEPTED” and pays a discounted amount; or
 - (d) By negotiation, *i.e.*, by the Issuing Bank paying a negotiable draft presented to it.
- (3) Under *UCP* Articles 2 and 9, an Issuing Bank might instruct another Bank, called an Advising Bank, to advise a credit, and in addition, might intend a confirmation by mail to be the operative credit instrument. The Advising Bank may be a foreign correspondent of the Issuer, advises the Beneficiary (Seller-Exporter) about the credit, and sends documents called for under the L/C from the Beneficiary to the Issuer. Often, the Advising Bank also is the Confirming Bank, providing a guarantee of payment to the Beneficiary under the L/C.

- (4) An L/C must state precisely the documents against which payment is to be made.
- (5) An L/C must have an expiry date, as per *UCP* Article 6. Documents must be presented to the Issuing Bank for the purpose of obtaining payment, acceptance, or negotiation by that date.

Obviously, as is true in drafting any document associated with import-export transactions, care in drafting an L/C is a necessary (but not sufficient) condition for avoiding disputes.

- **Fees**

Banks earn large fees for issuing or confirming an L/C. Among the fees charged in an L/C transaction are:

- (1) Issuing fees

From the perspective of the Issuing Bank, issuing an L/C is the same as making a loan. There is credit risk, namely, will it get paid by its obligor, the Buyer-Importer, which applied for the L/C. Therefore, the issuer fee varies with the creditworthiness of the Buyer.

- (2) Interbank fees

A confirmation fee is an example of an interbank fee. This fee is less than an Issuing Fee. That is because there is less risk, *i.e.*, the creditworthiness of a bank normally is better than that of the Buyer.

- (3) Acceptance commission

The acceptance commission is the rate charged by a Bank (typically, the Issuing Bank), for putting its stamp of acceptance on a draft. Historically, it is about 150 basis points, or 1.5%. (One basis point is 1/10 of 1 percent, or 0.01%.) Also historically, in Japan, banks earn 20-25 basis points, and in Korea, 30-35 basis points.

- (4) Discount fee

The rate of interest at which a Banker's Acceptance, or BA, is sold in the money market to investors by the Issuing Bank. This rate is based on the present discounted value of the BA.

Banks can be ingenious in charging fees, so this list is not necessarily exclusive.

VI. Drafts and Bankers Acceptances

- **Sight versus Time Drafts**

Generally, the Seller-Exporter presents to its Bank, the Confirming Bank, the following:

- (1) Clean on-board bill of lading.
- (2) Commercial invoice.
- (3) Marine insurance policy or certificate.
- (4) Import and export licenses.

Each of these documents should meet the requirements of Articles 18–25 of *UCP 600*. And, these documents typically are presented electronically.

Additionally, to obtain payment the Seller-Exporter attaches a draft to the documents. (Traditionally, reflecting British terminology, a draft is called a “bill of exchange.”) The draft is effectively a check written by the Seller, which the Seller draws on the Issuing Bank, that is, on the Bank of the Buyer-Importer, for the amount of the contract price. In some transactions, the Seller may draw the draft on the Buyer itself. To say a Seller “gets paid under an L/C” is to make a generic statement. What is the precise mechanism by which the Seller gets paid? The answer is the draft.

By way of analogy, a check is a form of draft. A check is a draft drawn by a drawer on the drawer’s bank in favor of a payee named in the check. It is an order from the drawer to the drawer’s bank to pay the payee. The drawer is, then, the party who writes and signs the instruction. (If the instrument is a promissory note, then that party is called the “maker.”) The person or entity (such as a bank) to whom (or to which) the instruction is called the “Drawee” (or “Addressee” if a note is involved). The person to whom payment is to be made is the “payee.”

In international trade finance, a draft is an instruction to pay money to the order of a named beneficiary, the payee. It is not a promise to pay, nor is it a commitment to pay. Rather, it is an order to pay, *i.e.*, a payment order. A draft may be payable at sight, or on a deferred basis.

Hence, there are two categories of drafts (technically, of bank drafts, as distinct from trade drafts, discussed below): sight drafts (also called demand drafts), and time drafts:

- (1) Sight (Demand) Draft

This type of payment order is payable on demand, which means it is payable immediately at sight. What is the moment of “sight,” *i.e.*, what does “at sight” mean? It is when the Confirming Bank has reviewed the documents and found them in order (*i.e.*, conforming). When it does so, two events happen.

First, the instrument (the draft) is “sighted.” Second, the Confirming Bank accepts the draft, stamping “accepted” on it, thereby transforming the draft into a Bankers Acceptance (BA). By accepting the draft, the Confirming Bank unconditionally promises to pay the full-face amount of the draft (now a BA) on the pertinent date. That date is immediate, if the draft is a sight draft. Otherwise, for time drafts (discussed below), it is the maturity date.

So, for a sight draft, the Confirming Bank pays the full-face amount of the draft immediately, by crediting the Seller’s account. In turn, the Confirming Bank presents the sight draft-transformed-to-BA to the Issuing Bank (possibly via an Intermediary Bank), which is the drawee on the draft. This Bank also pays the full-face amount at sight. The Issuing Bank then obtains reimbursement for the funds it has paid to the Confirming (or Intermediary) Bank from the Buyer-Importer. The Issuing Bank simply may debit the account of the Buyer-Importer.

(2) Time Draft

A time draft is an order to make payment at a later point in time, that is, at a point some days after the relevant bank sights the draft. For example, a 30-day time draft would instruct the Bank to pay “30 days after sight.” Once that period expires, the bank pays, and the funds flow as they would with a Sight Draft.

But, what is special about a time draft is it is an investment vehicle that is routinely traded in financial markets around the world. When a time draft is used, with a confirmed L/C, either the Issuing or Confirming Bank may “accept” the draft (assuming, of course, there are no problems in the L/C transaction). Critically, it is the use of a time draft, and its conversion to a BA, that links international trade in goods by companies on “Main Street” with investors on “Wall Street.”

Consider the following scenarios.

Assume, as in the normal case, the Issuing Bank accepts the time draft. That would mean the Confirming Bank receives the time draft, pays the Seller-Exporter on it, and presents the draft to the Issuing Bank for payment. The Issuing Bank stamps “acceptance” on the draft, pays the Confirming Bank, but then sells the BA on the secondary market for an amount equal to the present discounted value (PDV) of the BA. This PDV depends on the relevant interest rate and maturity date. At maturity, the ultimate holder presents the BA to the Issuing Bank, because it is the Bank that accepted the time draft. As the acceptor, it must pay the full-face amount of the BA.

Conversely, suppose the Confirming Bank accepts the draft, thereby turning it into a BA. A confirmed L/C transaction may be flexible enough to accommodate this possibility. Then, the Confirming Bank sells the BA on the secondary market for its PDV.

At maturity, the ultimate holder presents the BA to the Confirming Bank, which then pays that holder the full face value of the BA. As the acceptor, this Bank must pay. The Confirming Bank then presents the BA to the Issuing Bank to get paid on the BA. Why does the Confirming Bank present the BA to the Issuing Bank? Because the Issuing Bank is the party on which the original payment order (the time draft) was drawn, *i.e.*, the Issuer is the Drawee. (Presentment could be via an Intermediary Bank.) The Issuer pays the Confirming Bank, and then gets reimbursed from its customer, the Buyer-Importer.

What happens if the L/C is unconfirmed? That is the “easy” case. With an unconfirmed L/C, the Issuing Bank “accepts” the draft when it receives, as there is no Confirming Bank.

In both the confirmed and unconfirmed L/C instances, to “accept” a time draft means to agree to make payment on it when presented with it on the date it matures. However, the Bank on which the time draft is drawn, namely, the Issuing Bank, always is ultimately liable to pay the draft, regardless of which Bank accepts the draft.

So, suppose a Seller-Exporter, like Dilmah, draws a 30-day time draft on the Issuing Bank, Bank of America Houston. Assume Dilmah presents it to the Confirming Bank, Standard Chartered in Colombo, on Day 1. Dilmah does not want to wait one month to get paid, and it need not. Standard Chartered accepts the draft, converting it to a BA by virtue of this acceptance, and pays on that Day (or the next available business day). Then, Standard Chartered presents this 30-day BA (with the requisite documents) to Bank of America. Assume this presentation occurs on Day 5. Bank of America pays Standard Chartered right away (or the next business day). Bank of America then obtains reimbursement from its customer, the Buyer-Importer, Amazon.

At this point, in contrast to a sight draft, Bank of America can and likely will sell the BA to investors seeking a short-term financial instrument, such as a corporate treasury department, or mutual or pension fund. The sale price of the BA will be the PDV of the future stream of earnings from the BA. That is, based on the relevant interest rate and time to maturity, the BA will have a secondary market value that will be less than its full-face amount. The longer the time between the secondary market sale date and the maturity date, the deeper the discount. As the maturity date approaches, that value gets closer to the face value. At maturity, the investor holding, *i.e.*, the Ultimate Holder, presents the BA to the Issuing Bank, which then pays the face value. This presentation is to the Issuing Bank, because the BA originally was drawn on that Bank.

Note, then, that each Seller-Investor of the BA has bought the BA at a lower price (further from the maturity date), and sold it at a higher price (closer to, or at, maturity), thereby profiting from a spread. This secondary market for BAs is a vibrant, global one. And, BAs are regarded as relatively safe investments. Note, too, the alternative: to hold funds in cash, which earns a lower interest rate, or to invest in a short-term instrument that might earn a higher return, but in exchange for higher risk.

- **Why a Time Draft?**

Why would a Seller-Exporter draw a time draft instead of a sight draft? With a sight draft the Seller is paid the full-face value immediately, in a sense getting full price for the merchandise it shipped to the Buyer-Importer. The answer is “to make the sale.” The Buyer-Importer may need financing to purchase the merchandise, *i.e.*, it may be able to buy the goods only if it can defer payment. In such instances, the Seller chooses a time draft, which is the vehicle for short-term financing.

So, for example, without financing, Amazon in the above hypothetical might not be willing or able to buy tea from Dilmah. Of course, Dilmah is not a bank and, therefore, is not in the business of making loans. Yet, Dilmah can (in effect) make an extension of credit and, at the same time, get paid immediately through a time draft. To do so, Dilmah, like any Seller opting for a time draft, will have to pay the discount charges associated with discounting the draft to the Confirming Bank, plus an acceptance commission charged by that Bank for accepting the draft and creating a BA from it. These added costs seem to make discounting less attractive than a simple sight draft. However, Sellers like Dilmah can pass on these charges to Buyers like Amazon by charging more in the underlying contract for sale of goods. The higher charge is justified, because the Seller provides financing to the Buyer. Therefore, a deal that might not otherwise take place (because the Buyer did not have funds to pay immediately) does, in fact, succeed.

When a time draft is used, the underlying agreement, namely, the payment terms in the contract of sale between Seller-Exporter and Buyer-Importer, specify as much. So, the sale contract between Dilmah and Amazon will indicate the former gives the latter 90 days (for example) to pay for the tea. Put differently, the use of a time draft reflects the contractual arrangement between Buyer and Seller whereby the Seller gives the Buyer up until a specified maturity date to pay.

- **Time Drafts, BAs, and Discounting**

Below is an outline of how time drafts typically work in international trade finance:

- (1) The Seller-Exporter presents a time draft to the Confirming Bank, assuming the L/C is a confirmed L/C. If the L/C is not a confirmed L/C, then the Seller-Exporter presents the time draft to the Issuing Bank.
- (2) The Confirming Bank stamps “acceptance” on the time draft, and pays the Seller that presented the time draft the PDV of the draft, for example, \$90 on a \$100 face value.
- (3) The Confirming Bank sells what is now a BA, by virtue of its acceptance of the time draft, on the secondary market to an investor (a third party) for the appropriate discounted amount, such as \$94 on a \$100 face value. (Because it is closer to the maturity date than in Step (2), the PDV must be higher than \$90, *i.e.*, closer to the face value.)

- (4) The ultimate holder of the BA (the party holding the BA on the maturity date of the BA) presents the BA to the Confirming Bank (because the Confirming Bank accepted it) on the maturity date. (If the Issuer had accepted the time draft, then the holder would present the BA to the Issuing Bank.) The ultimate holder is paid the full-face value of the BA, because it has reached the maturity date, and the instrument is worth its full face value of \$100.
- (5) The Confirming Bank presents the BA to the Buyer's Bank (the Issuing Bank) for payment of the full-face value of \$100. The Buyer's Bank is paid \$100 by debiting the account of the Buyer.

Of course, flexibility exists in structuring any trade finance transaction, so variations from this pattern are possible.

- **Presentation Possibilities**

In the above discussion, the Seller-Exporter is presumed to draw the draft on the Issuing Bank and presents it to the Confirming Bank. Is that always the pattern?

The answer is “no.” To be sure, the Seller-Exporter draws the draft, and names itself as payee, so it is both drawer and payee. That pattern is the normal one, but there actually are three possibilities as to the party to which the Seller-Exporter gives the draft:

- (1) To the Buyer-Importer

In this case, the draft is called a “trade draft.” The fact a draft can be drawn directly on the Buyer-Importer, and the Buyer-Importer can make payment directly to the Seller-Exporter, shows how flexible a draft is. Unlike a check, it need not be drawn on a bank. So, when the contracting parties use a trade draft, banks are not involved in the payment transaction.

- (2) To the Buyer-Importer's Bank, *i.e.*, the Issuer of the L/C

In this instance, the draft is called a “bank draft.” That is true whether it is a sight or time draft. If an L/C is unconfirmed, that is, if there is no Confirming Bank, then a bank draft is used. This draft is drawn on the Issuing Bank, and presented to the Issuing Bank.

- (3) To the Seller-Exporter's Bank, *i.e.*, the Confirming Bank

This kind of draft also is a bank draft, but the context is a confirmed L/C. That is, when an L/C is confirmed (a “confirmed credit”), meaning a Confirming Bank is present in the transaction, the Seller-Exporter draws the draft on the Issuing Bank, and presents it to that Bank for payment.

Despite these variations, the same parties are involved: the Beneficiary of an L/C is one and the same as the payee of the draft, namely, the Seller-Bank, which also is the drawer. The Issuer of the L/C, or the Confirming Bank, is the drawee of the draft. The ultimate payor is the Buyer-Importer.

- **Features of Draft**

Bank drafts have important features worth noting:

First: BAs versus Trade Acceptances

As discussed above, to receive payment, the Seller-Exporter-payee must first present a draft to the Drawee for payment. This draft is presented at the same time as the other documents called for in the L/C. That is, the draft is presented along with the bill of lading, commercial invoice, insurance policy or certificate, import and export licenses, etc. The Drawee, which is the Bank that issued or confirmed the L/C, then stamps the word “acceptance” on the draft. This stamp signifies the Drawee accepts the order to pay and, at this moment, the draft is called a “BA.”

But, suppose the draft is drawn on a non-bank, such as the Buyer-Importer. Then, the same process of acceptance occurs. However, the draft is then called a “trade acceptance.” So, a trade acceptance is drawn on a company and accepted by that company.

If an L/C is not involved in an export-import transaction, then the Seller-Exporter could send the Buyer an invoice and a draft. Then, the Buyer could accept the draft and send it back to the Seller. Finally, the Seller would send the draft for collection.

Second: Negotiability

Similar to a check, a draft is a negotiable instrument. Therefore, by an appropriate endorsement, the Seller-Exporter-Payee on the draft can direct that the payment called for by the draft can be made to a Third Party, instead of to that Payee. Thus, the Seller can sell the draft to a Third-Party Transferee, in exchange for funds equivalent to PDV of the draft from the Transferee. That Transferee, which then is the new holder of the draft, can do the same, *i.e.*, negotiate it to another Third Party in exchange for the requisite funds. Or, the Transferee can simply hold the draft until it matures, at which point payment is made to it.

How does negotiation occur? The Payee endorses the draft, typically by writing on it specific words such as “Pay to the Order of _____,” followed by the name of the Third Party. The Drawee Bank then pays that identified Third Party. As indicated, the financial term for this transfer is called “discounting,” but as a legal matter what happens is “negotiation.” Thus, the negotiability feature of the draft makes discounting possible. Obviously, any Transferee must be willing and able to pay the PDV of the draft to the Seller-Exporter-Payee, and likewise for a second to a first Transferee.

The legal transfer by negotiation confers on the Transferee a special commercial law status known as Holder in Due Course (HDC). Similar to an order bill of lading, as well as to a check, an HDC is a party that takes the instrument for value with no knowledge of problems (*i.e.*, as) associated with the draft, and free of any claims or defenses that may be available against earlier holders of that draft. Consequently, suppose the Bank on which the draft is drawn has a claim against the Seller-Exporter-Payee, or first Third-Party Transferee.

But, the second Third Party transferee is a *bona fide* purchaser in good faith, and thus is unaware of any problems. The Bank cannot decline to pay the second Transferee on the draft by asserting a claim or defense that it might have against prior holders of the draft.

Because of the HDC status, it is easy to transfer drafts, deposit them into accounts, and clear them like checks. That is, drafts are highly liquid.

Third: Financing and Credit

As discussed earlier, every L/C has associated with it a draft. If the draft is a sight draft, financing is not possible. However, if the draft is a time draft, then financing is possible. “Financing” means lending funds or extending credit.

This point is worth amplifying. An L/C is not a one-dimensional instrument, that is, only a payment instrument. An L/C also is – indeed, most importantly is – a credit instrument. An L/C may be used in various ways for credit. To see how an L/C with a time draft amounts to an extension of credit to the Buyer-Importer, while giving the Seller-Exporter immediate payment, consider these features of a typical case of drawing a draft under an L/C:

- (1) The Seller-Exporter is the Drawer and Payee of a draft. Via the draft, the Seller instructs that it, not a Third Party, gets paid by the Bank on which the draft is drawn.
- (2) If the L/C is unconfirmed, then the draft is drawn on the Issuer, which is not the Bank of the Seller, but rather the Bank of the Buyer-Importer. If the L/C is confirmed, then the draft is drawn on the Confirming Bank (though L/Cs are flexible enough to allow for drawing on the Issuing Bank).
- (3) Assuming a confirmed L/C, the Seller presents the draft to its bank, the Confirming Bank, for acceptance and payment. Acceptance, of course, turns the draft into a BA. When the Seller drew the draft, it did so making it payable either at sight (a sight draft), or at a later time (a time draft).
- (4) With a sight draft, the Confirming Bank pays Seller the full-face value of the BA immediately. Then, the Confirming Bank presents the BA to the Issuing Bank to obtain cover (*i.e.*, to get reimbursed) for the payment it made to the Seller.

- (5) With a time draft, the Confirming Bank pays the Seller immediately, but at a discount, that is, at the PDV of the draft. The Confirming Bank accepts the draft, and then sells the BA to a Third Party in the secondary market for money market instruments such as BAs. There, the BA likely is re-sold several times at the appropriate discount rate. The ultimate holder of the BA (*i.e.*, the party, which is an HDC, holding it on the maturity date) presents it to the Issuer for full face value payment on the maturity date. The Issuer then debits the account of the Buyer-Importer-Account Party for the full-face value.

In the above transaction, the Account Party (*i.e.*, the Buyer-Importer) receives the benefit of 90-day interest-free financing. The Seller is paid on Day 1 by its Bank, the Confirming Bank. But, because of the process of acceptance and discounting associated with a time draft, the Issuing Bank does not pay out on the BA until Day 90. Therefore, the Issuing Bank does not seek reimbursement until Day 90 from the Buyer-Importer. That deferral is an extension of finance, or credit. During those 90 days, the Buyer has had the opportunity not only to obtain the imported merchandise, but also sell them (to wholesale or retail customers), and thereby garner sale proceeds to fund repayment of the L/C.

Furthermore, parties in the Wall Street chain – banks and third-party investors in the money market – profit from a “spread” from presenting and selling the BA. Suppose on Day 1, after the Seller presents a 90-day time draft for acceptance and is paid \$90 by the Confirming Bank, on Day 2 the Confirming Bank sells the BA for \$91. Clearly, the Confirming Bank makes a \$1 spread. Then, suppose on Day 3, the Third-Party Investor that bought the BA for \$91 (on Day 2) sells it for \$92. This Investor obtains a \$1 spread. Finally, suppose the ultimate holder buys the BA on Day 89 for \$99.90. It presents it on Day 90 for \$100, thus making a \$0.10 spread.

Why does the Seller not sell the draft directly to money market investors? Why bother getting the draft “accepted” by a Bank, and having that Bank sell it on the secondary market? That is, why does the Seller present the time draft to the Drawee (Confirming or Issuing Bank), which then keeps the draft, stamps “acceptance” on it, and then sells the BA? The answer is most Sellers do not have as broad, deep, and direct access to investors as Banks do. Sellers tend to be producer-exporters of goods. Unless they are large corporations with sophisticated treasury management operations, they are unlikely to be prominent players in the inter-bank market.

Therefore, there are two reasons the Seller does not itself sell the draft directly in the secondary market: lack of access to investors; and lack of a stamp of “acceptance” on the draft from a bank. These two deficiencies mean investors would regard a draft directly from a Seller as a riskier instrument than a proper BA. To assuage their concerns, the Seller would have to sell it to investors at a deeper discount, to give them a higher rate of return to justify the deeper discount.

Here, then, is part of the “magic” of a time draft-BA: it connects Main Street and Wall Street. The presenter of a BA is a third party in the Wall Street money market, an investor with nothing to do with the underlying international trade transaction. Yet, this investor is connected to that import-export deal by virtue of the BA, which arises from a time draft, which arises from the trade finance device of the L/C.

VII. Money Market

● **BA Market Operation**

In the same hypothetical above, assume the Seller-Exporter, Dilmah, presents a draft to its bank, Standard Chartered, the Confirming Bank. Standard Chartered discounts the draft, thus giving Dilmah cash less a discount, based on the agreement between Amazon and Dilmah. Standard Chartered then sells the draft in the money market. Thus, Standard Chartered gets the proceeds of the sale of the draft. In 90 days, the draft will be presented to Standard Chartered, because it was drawn on that Confirming Bank. Therefore, on Day 90, Standard Chartered contacts Bank of America Houston, the Issuer of the L/C, and requests payment on the draft. Bank of America Houston pays Standard Chartered, and Standard Chartered debits the account of the Buyer, Amazon.

It is important to realize that after Standard Chartered sells the draft in the money market, the draft returns back to this bank at its maturity, because it is drawn on and accepted by that Confirming Bank. However, the draft could be drawn on and accepted by Bank of America Houston, the Issuing Bank. Time drafts are presented, upon maturity, to the bank on which they are drawn.

When a draft is drawn on a Confirming Bank, the Issuer is notified when the maturity date arrives. The Issuing Bank, here Bank of America Houston, pays the Confirming Bank, here Standard Chartered, so Standard Chartered can, in turn, pay the ultimate holder of the BA at maturity, or be reimbursed for already having done so. The L/C terms lay out these actions.

To be a bit more precise about the above hypothetical, assume Dilmah, the Seller-Exporter, draws a time draft. The L/C is a confirmed credit, therefore, Dilmah draws the time draft on the Confirming Bank, Standard Chartered. That draft is payable 90 days at sight. In other words (not to be confused with a sight draft), starting from the day the credit is sighted, Standard Chartered has 90 days to pay. As the Drawer, Dilmah can take one of two actions as regards its time draft:

- (1) keep the draft, and wait the 90-day maturity period, or
- (2) discount the draft.

In 99% of the cases, Seller-Exporters elect to discount the time draft they have drawn with their Confirming Bank, the Bank on which they drew the draft. That is, most often, a Seller sells the time draft to the Confirming Bank. The Confirming Bank buys the draft from the Seller for a discounted fee, and stamps acceptance on its face thereby converting it to a BA.

So, Dilmah is likely to pursue option (2). Notably, when a Confirming Bank, such as Standard Charter, accepts the draft, it receives an acceptance commission, *i.e.*, a fee for acceptance. Standard Chartered, the Drawee, takes the BA drawn on it by Dilmah, and discounts it by selling it in the money market. The discount rate is the rate at which a bank sells its own paper in the money market, *i.e.*, the rate at which the BA is re-discounted.

Assume the Confirming Bank discounts the BA from the Seller at 7%. In the hypothetical, that means Standard Chartered bought a \$100 BA at \$93. In other words, Standard Chartered paid \$93 to Dilmah for the BA. That \$93 is the payment for the tea Dilmah shipped to Amazon.

Next, assume the Confirming Bank, Standard Chartered, discounts at 6 percent the BA to a Money Market Mutual Fund run by Merrill Lynch in New York. That means Standard Chartered sells the BA to Merrill Lynch for \$94. Standard Chartered makes a \$1 spread (\$94 minus \$93). There is always a spread between (1) the price at which a Confirming Bank (Standard Chartered) buys the draft from a Seller-Exporter (Dilmah) and (2) the price at which the Confirming Bank sells the draft in the money market to a Third-Party Investor (Merrill Lynch). Ideally, that spread is positive. And, the same discounting process, with a spread, may continue until maturity. So, for instance, Merrill Lynch might sell the BA at \$92 to American Century Funds in Kansas City, which might hold the BA until maturity. Merrill Lynch will make a \$1 spread (\$93 minus \$92), and American Century will make an \$8 spread (\$100 minus \$92).

These spreads are, in effect, wealth distribution. Each investor makes \$1 (or more) it would not otherwise have made. Note again that if Standard Chartered were to hold onto the BA until maturity (after paying Dilmah the discounted amount of \$93), and then presented the BA to Bank of America Houston upon maturity for the full-face value of \$100, Standard Chartered would receive the entire aggregate of the spread of funds – \$7 (\$100 minus \$93). That is, Standard Chartered would keep all of the investment gain for itself. But, by repeated sales of the BA in the money market, the wealth is distributed among players in that market.

- **Money Market Features**

The money market is not confined to Wall Street. It is a global one consisting of short-term instruments of good (*i.e.*, low) risk. Treasurers of financial companies (like Merrill Lynch and American Century) and industrial and service corporations (like Honda and Apple) use this market to “lay off” liquidity they do not need currently, that is, to purchase investments for cash that is temporarily idle. Examples of such high-quality instruments are BAs, commercial paper, government debt, and Fed funds. It is economically irrational to let funds sit in an account paying a low rate of interest when they can be put to work via an investment in a money market instrument that earns a higher rate of return.

The short-term instruments are highly liquid, and as noted, their market is a secondary one. The instruments are not newly issued. A BA represents a draft a Seller-Exporter has previously drawn and presented to a bank. The bank then places the BA in the secondary market in one of two ways. The bank can sell the BA directly to an investor based on its own network and connections, or the bank can sell the BA through a dealer in BAs, which maintains its own network of connections. Most discount houses, or dealers, operate primarily in the United Kingdom. They regularly buy and re-sell BAs in the money market. This is generally performed on a large scale with transactions that also include government bonds and treasury bills. Note that as for their primary issuance, BAs, and some other money market instruments (like commercial paper) do not require registration with the Securities and Exchange Commission. They qualify for exemptions under the *Securities Act of 1933*.

The discount rate on a BA depends on the bank that accepts it (or, to use banking parlance, “creates” the BA by accepting the draft). The stronger the credit standing and reputation of the creating bank, the lower the discount (e.g., \$95 of \$100 face instead of \$93). Before the Eurozone crisis that commenced in October 2009, and before the lost decades of 1991-2010 in Japan, only major European and Japanese banks, along with healthy American ones, could place their paper in the money market. Banks from developing and least developed countries were, and typically still are, unable to do so. Generally, the discounting cost (rate) approximates the loan rate (*i.e.*, the same interest rates).

- **Bank Regulatory Limits on BAs**

There are limits on the number of BAs a bank can create. For example, Section 13(7) of the 1913 *Federal Reserve Act* (12 U.S.C. Section 372) limits the maximum dollar volume of outstanding acceptances to a specific percentage of the capital of the bank that creates the acceptance.

The limit exists because a BA is a liability of the bank that created it by stamping “acceptance” on the time draft that was drawn on and presented to it. Bank regulators do not want a bank to becoming over-exposed, by created too many liabilities on itself.

- **Collection of BA at Maturity**

When an ultimate holder, such as American Century, presents a matured BA to the Confirming Bank, such as Standard Chartered, that Bank then presents the BA to the Issuer of the credit, such as Bank of America Houston. The presentment from the ultimate holder to Standard Chartered is similar to that of a check.

Suppose the ultimate holder was depositing a check in its bank that was drawn on Bank of America Houston. The ultimate would deposit the check physically with its bank, which would then forward the check through the collection process to Bank of America Houston. The process is essentially the same with respect to a matured BA.

The ultimate holder deposits the BA with Standard Chartered, which then forwards it for collection. Likewise, the presentment from Standard Chartered to Bank of America Houston is done through the non-cash collection system of the Federal Reserve. The appropriate Federal Reserve Bank routes the BA from Standard Chartered to Bank of America Houston, debits the reserve account of Bank of America Houston, and credits the reserve account of Standard Chartered. Nothing in this transaction alters the risks Standard Chartered, the Confirming Bank, incurs. It still takes on the credit risk of Bank of America Houston, the Issuing Bank.

Suppose the L/C is established on 1 January with a 3-month expiry date and, through amendments, two 3-month re-financings (a total of 6 months' extension) are agreed to. Then, Standard Chartered is exposed for 9 months. To be sure, it will have paid the Seller, Dilmah, a discounted amount on Day 1, and sold the re-discounted instrument at a slight profit. Nine months later, when the ultimate holder presents the BA to Standard Chartered upon maturity, that Bank requests payment from Bank of America Houston.

Ultimately, what happens is Standard Chartered funds itself. As explained earlier, the Bank first pays the Seller, Dilmah, \$93, but then sells the instrument for \$94. Upon maturity, Standard Chartered pays the ultimate holder \$100, but is reimbursed \$100 by Bank of America Houston. Note again the financing the Buyer, Amazon, has received. Amazon does not have to pay Bank of America Houston, the Issuing Bank, until 90 days after the date the L/C was established.

In sum, BAs are attractive, and there are obvious incentives to discount them. First, a conventional loan, an alternative to financing Amazon in order to pay for tea from Dilmah, cannot be sold as easily as a BA. (There is no market for conventional loans associated with import-export transactions akin to that of mortgage loans, *i.e.*, asset backed securitization for those transactions does not exist.) In contrast to a loan, a BA is a highly liquid, short-term instrument, and some types of BAs – namely, those with maturity less than or equal to 180 days – traditionally have not been subject to Federal Reserve requirements. Second, Buyer-Importers use BAs as a device for import financing. Third, there are spreads to be earned, and overall wealth to be generated.

- **Variations**

The L/C-draft mechanism is flexible, allowing for creativity to suit the needs of the parties. International trade finance professionals often say “you can do what you want with an L/C.” For example, an L/C might be drafted so that the Buyer- Importer pays the discount charges. Assume the Seller-Exporter, Dilmah, does not want to finance the Buyer-Importer, Amazon. The L/C still could call for a 90-day time draft. That implies that Amazon has asked Dilmah 90-day financing.

The L/C reads: “Draw a 90-day time draft on Standard Chartered and *the discount charges are for the Importer.*” Therefore, Dilmah is paid the full 100 percent face value of the draft (\$100), because it collects the discount charges from Bank of America Houston, the Issuing Bank. The account of Bank of America Houston then is debited by Standard

Chartered for the discount charges. So, the full-face value is passed through from Bank of America Houston to Standard Chartered, and finally to Dilmah.

Where do the discount charges ultimately come from? Suppose Dilmah receives a \$6 discount charge from Amazon through Bank of America Houston. Dilmah receives the discounted amount of \$94 from the sale of the BA in the money market. At maturity, the ultimate holder presents the BA for its full-face value (\$100), and is paid by the Confirming Bank, Standard Chartered. Then, Standard Chartered presents the BA to Bank of America Houston, the Issuing Bank, for payment of \$100. Bank of America Houston pays Standard Chartered \$100, and debits the account of Amazon for \$100 in order to make itself whole.

In this scenario, the total amount Amazon paid out is the \$6 discount fee initially paid (on Day 1), plus \$100 maturity value (on Day 90). Amazon has received, for the \$106 it paid out, the benefit of 90 days financing – and paid a \$6 “interest rate” for it. Dilmah also has obtained what it wants, namely, the full-face value immediately, with no discounting.

A second scenario might extend financing for the Buyer-Importer. Assume Bank of America Houston, the Issuing Bank, receives a draft matures after 90 days from Standard Chartered, the Confirming Bank. Bank of America Houston proceeds to pay Standard Chartered. Then, Bank of America Houston negotiates with Amazon to extend to this Buyer-Importer separate financing for a period of up to two years. In other words, Bank of America Houston makes a separate lending arrangement with its customer to allow it more time to pay the amount required under the L/C. That is effectively a separate loan.

VIII. Alternative Types of L/Cs

Generally, in international commercial transactions, documentary credits, or more commonly, commercial L/Cs, are the most important type of L/Cs. A commercial L/C ensures payment is made upon the occurrence of specified events. However, commercial L/C is but one type of L/C used in international transactions. There are others, which are similar to, yet distinguishable from, commercial L/Cs. Again, the L/C-draft mechanism is flexible.

- **Revocable versus Irrevocable L/C**

A revocable L/C can be amended or canceled at any moment, and without prior notice by the Buyer-Importer, and without the agreement of the Seller-Exporter. Revocable L/Cs are rare, and they offer little protection to the Seller.

An irrevocable L/C is a “definite undertaking” of the Issuing Bank to make payment provided the documents stipulated in the L/C are presented and the terms and conditions of the credit are complied with. An irrevocable L/C cannot be amended or cancelled, unless all parties to the credit agree to do so. The *UCP* Article 3 deems all L/Cs to be irrevocable, even if there is no indication to that effect, unless otherwise stated.

- **Confirmed versus Unconfirmed L/C**

A confirmed L/C states an Advising Bank (which may play the role of Confirming Bank), per instructions from the Issuing Bank, adds a confirmation that payments will be made when compliant documents are presented. The commitment of the Advising Bank stands even if the Issuing Bank or Buyer-Importer fails to pay. Usually, an additional fee is charged by the bank issuing a confirming L/C.

In contrast, an unconfirmed L/C is sent directly to the Seller-Exporter from the Advising Bank, without the assurance of that Bank to make a payment or accept responsibility for payment in the future. However, the Bank does confirm the authenticity of the L/C.

- **Standby L/C**

A standby L/C is used in connection with a less secure method of payment for an underlying import-export transaction. It is an alternative in case a party fails to perform its obligations as specified in the underlying contract of sale. There are many different types of standby L/Cs, and the types can be classified according to several factors, such as the nature of the Issuing Bank or method of documentation of payment.

- **Revolving L/C**

Finally, a revolving L/C is used for regular shipments of the same good to the same Buyer-Importer. It, therefore, is useful in avoiding repetitious and costly opening and amending of L/Cs.

IX. Seminal L/C Cases

- **1925 *O'Meara* Case on Independence Principle**³³⁹

Facts and Issue

The *O'Meara* case illustrates the famous Independence Principle in L/C law. However, this 1925 case was decided under United States law, before there was a U.C.C., and not the modern *UCP* rules that typically apply to international documentary sales transactions. The U.C.C. was first published in 1952, and the first version of the *UCP* in 1933.

The plaintiff in *O'Meara* sought to recover damages alleged to have been sustained by the refusal of the defendant to pay three drafts against a confirmed irrevocable L/C. Maurice O'Meara Co. became the plaintiff by virtue of an assignment from Ronconi & Millar, a paper manufacturer in New York. O'Meara was the Seller and Beneficiary of the L/C. National Park Bank, also of New York was the defendant. This Bank was the Issuer

³³⁹ See *Maurice O'Meara v. National Park Bank of New York*, (New York Court of Appeals, 1925).

of the L/C, and the Buyer's Bank. The Buyer, and Account Party (*i.e.*, the Applicant) on the L/C, was Sun-Herald Corporation, a newspaper publisher.

National Park Bank issued an irrevocable L/C in the amount of roughly U.S. \$225,000. This L/C covered a shipment of almost 1,300 tons of newsprint paper from Ronconi & Millar to Sun-Herald. Per standard practice, Ronconi & Millar drew a draft payable to it, and presented the draft to National Park Bank, along with the particular documents for which the L/C called.

But, National Park Bank refused to pay Ronconi & Millar against the documents. National Park Bank refused at the request of its customer, Sun-Herald. Sun-Herald informed the Bank of concerns about the newsprint paper it had been shipped: this paper did not conforming to the description in the pertinent documents. Indeed, Sun-Herald put a stop payment order on the L/C.

As to the timing of events, on 17 December 1920, Ronconi & Millar presented the first draft and documents to the Bank. On 18 December 1920, National Park Bank wrote a letter stating it refused to honor the draft because:

[t]here has arisen a reasonable doubt regarding the quality of the newsprint paper. Until such time as we can have a test made by an impartial and unprejudiced expert, we shall be obliged to defer payment.

On 7 January 1921, a second draft and documents were presented. And, on 13 January 1921 a third draft (and documents) was presented. The Bank refused payment in these presentations, too.

At issue was whether an Account Party has the right to inspect and test goods that are to be paid for under a L/C, and subsequently stop the Issuer of the L/C from paying drafts that are presented along with conforming documents, where the goods are different from what was called for in the underlying contract.

O'Meara moved for summary judgment. The Lower Court denied this motion, ruling in favor of National Park Bank. The Court of Appeals (the highest Court of New York State) reversed the Lower Court, finding in favor of O'Meara, granting summary judgment.

Holding

Overall, the Court of Appeals held National Park Bank was obligated to pay sight drafts when presented with them, if they were accompanied by genuine documents specified in the L/C. As Issuer, National Park Bank had no right to request additional documents from the Seller, but rather was under a duty to make prompt payment against the documents.

Stated differently, the L/C contract was in no way involved in, or connected to, the contract for the purchase and sale of newsprint paper. If the newsprint paper delivered to the Buyer, Sun-Herald, did not correspond to what had been specified in the contract, then the remedy of the Buyer was to proceed directly against the Seller for damages, using a breach of contract suit. Simply put, the obligation to pay under an L/C is independent of the underlying sales of goods contract.

Rationale

National Park Bank was under no obligation to ascertain, by personal examination or otherwise, whether the newsprint paper conformed to the contract between the Buyer and Seller. Whether that paper was what Sun-Herald contracted to buy was of no concern to the Bank, and did not affect its liability to pay. The only concern to National Park Bank was with the draft and accompanying documents.

Therefore, as long as the drafts, when presented, were accompanied by proper documents, the Issuing Bank was absolutely bound to make payment under the L/C, irrespective of whether it knew or had reason to believe the newsprint paper was not to the exact specifications of the paper for which Sun-Herald contracted. Likewise, Sun-Herald had no right to insist an inspection of the paper be made before paying the drafts.

- **1941 *Sztejn* Case on Fraud**³⁴⁰

Facts and Issue

On 7 January 1941, plaintiff *Sztejn*, the Buyer-Importer, contracted to purchase bristles from the defendant *Transea Traders, Ltd.*, the Seller-Exporter. *Transea Traders* was a company located in Lucknow, India. To pay for the bristles, *Sztejn* requested issuance of an irrevocable L/C from defendant, *J. Henry Schroder Banking Corporation*. (The case arose during the days of the British *Raj*. Lucknow is the capital of Uttar Pradesh, the most populous state, located in north central India.)

The L/C was delivered to *Transea Trades* by the correspondent bank of *J. Henry Schroder Bank*. That correspondent bank, which like *Transea Traders* was located in India, was *Chartered Bank of India, Australia, and China*. *Transea Traders* proceeded to ship 50 cases of bristles, and procured a bill of lading and customary invoices. The documents included a description of the bristles called for by the L/C.

Sztejn did not receive 50 cases of bristles, but rather 50 cases filled with cow hair and trash, intending to suggest genuine merchandise and defraud *Sztejn*. Furthermore, *Transea Traders* drew a draft under the L/C to the order of the correspondent bank, *Chartered Bank*. *Chartered Bank* presented the draft and documents to *J. Henry Schroder Bank* for payment. The plaintiff sought judgment to declare the L/C and draft void and injunctive relief to prevent payment of the draft.

³⁴⁰ See *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S.2d 631 (1941).

At issue was whether the Issuing Bank, J. Henry Schroder, must pay on the L/C. In this situation the fraud of the Seller was called to the attention of the Bank before the draft and documents were presented to it for payment. The Independence Principle should not be extended to protect an unscrupulous Seller like Transea Traders. To be sure, an Issuing bank would be protected if it paid on a draft before receiving notice of fraud or forged documents, but that sequence did not occur in the *Sztejn* case. Rather, the Bank got notice of the fraud before payment.

Holding

J. Henry Schroder Bank received notice of the active fraud perpetrated by Transea Traders prior to it accepting or paying the draft. Therefore, J. Henry Schroder Bank is not forced to pay the draft that covers a transaction it has reason to believe is fraudulent. No hardship is caused by allowing the Issuing Bank to refuse payment when fraud is claimed. Put simply, fraud operates as an exception to the Independence Principle.

Rationale

Courts have used broad language to the effect that an L/C is independent of the underlying contract between Buyer and Seller. But, they employ such language when the facts concern breach of warranty, not intentional fraud on part of the Seller. Further, the fraud in *Sztejn* was called to the attention of the Issuing Bank before payment on the draft. So, the *Sztejn* Court distinguished between breach of warranty and active fraud on the part of the seller. As another Court said in 1924, the year before *O'Meara*:

Obviously, when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognize such a document as complying with the terms of a letter of credit.³⁴¹

Comments

The *Sztejn* Court carefully limits itself to make sure it does not create too large a loophole for Buyer-Importers to walk through and receive injunctive relief. Its holding is based on two key facts. First, the Issuing Bank allegedly knew the documents were “forged or false,” even though the documents conformed on their face to the L/C. Second, apparently no one other than the fraudulent party – the Seller-Exporter – had relied on the L/C. In particular, the Bank of the Seller-Exporter had not already paid over funds to the Seller-Exporter. Suppose that Bank had relied on the L/C. Then, the Court surely would have rejected the petition of the Buyer-Importer for an injunction.

• 1976 *United Bank Ltd* Case on Holder in Due Course Status and Fraud in Transaction

³⁴¹ *Old Colony Trust Co. v. Lawyers' Title & Trust Co.*, No. 162, Circuit Court of Appeals, 2nd Circuit, 297 F. 152 at p. 158 (1924).

Defense to Payment³⁴²

Facts and Issue

The parties in United Bank included: Cambridge Sporting Goods Corporation, the Buyer-Importer and Account Party (Applicant) on a L/C; Manufacturers Hanover Trust Company, the Issuing Bank and bank to Cambridge Sporting Goods; Duke Sports, a Pakistani corporation, the Seller-Exporter and Beneficiary on the L/C; and United Bank Limited and Muslim Commercial Bank, both Pakistani banks to Duke Sports.

Cambridge contracted with Duke to purchase new boxing gloves (which, presumably, it would sell on the retail market). The contract was worth approximately U.S. \$43,000. To pay for the gloves, Cambridge obtained an irrevocable L/C from Manufacturers Hanover, issued on its account for the benefit of Duke. Manufacturers Hanover was obligated to pay a 90-day time draft drawn on it 90 days after its acceptance of the draft. (Years later, Manufactures Hanover would be bought by Chemical Bank, which itself would be swallowed by Citibank.)

Due to manufacturing delays, Duke requested an extension of the shipping date, and the date listed on the L/C. Cambridge refused to accept either of the extended dates and cancelled the order. Nonetheless, Duke proceeded to ship the boxing gloves to Cambridge.³⁴³ Additionally, documents and two drafts were presented to Manufacturers Hanover by United Bank and Muslim Commercial Bank, respectively.

Specifically, on 16 July 1971, United Bank presented a first draft, which called for payment to be made by Manufacturers Hanover to United Bank for the first half of the contract price. On 20 August 1971, Muslim Commercial Bank presented a second draft to Manufacturers Hanover. This draft called for payment from Manufacturers Hanover to Muslim Commercial Bank for the second half of the contract price.

Upon inspection of the boxing gloves shipped from Duke to Cambridge, it was discovered the gloves were old, unpadding, ripped, and mildewed. They were not the newly manufactured gloves Cambridge contracted for. Indeed, Duke had shipped grossly defective boxing gloves.

Cambridge sued Duke for breach of contract, and asked the Court to enjoin payment on the L/C against Manufacturers Hanover. The Court granted Cambridge an injunction. Furthermore, it ordered Manufactures Hanover not to pay Duke. Cambridge Sports was able to get back the money it had paid via its account at Manufacturers Hanover by levying on the funds. But, United Bank and Muslim Commercial Bank sued Cambridge, in an attempt to vacate the judgment Cambridge had obtained, and get payment of the drafts on the L/C.

³⁴² See *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 392 N.Y.S.2d 265, 360 N.E.2d 943 (1976).

³⁴³ This fact is curious. If taken seriously, then there should be no case: any presentation of drafts after cancellation of the contract would be invalid. Yet, the Court seems to have ignored this fact.

At issue was whether United Bank was a Holder in Due Course (HDC) and, therefore, immune from the then-existing U.C.C. Section 5-114(2) defense. Three points are noteworthy about this issue.

First, the United Bank Court framed the issue narrowly. The case is not so much about the underlying fraud as it is about HDC status. Nonetheless, in that seemingly technical issue lies a grand problem. On the one hand, if a stop payment order can be put on an L/C as easily as on a check, then international trade could be impeded considerably. Buyer-Importers could order their issuing banks all-too-easily, on a whim at a moment's notice, to cancel payment. On the other hand, if no stop payment order ever can be put on an L/C, then a true victim of fraud by a Seller-Exporter is stuck. It cannot block payment through the banking system. Rather, it must sue the Seller, perhaps in the jurisdiction of that Seller, which in the United Bank case would be Pakistan.

Second, a party loses its entitlement to be an HDC if it engaged in fraud, or even if it has knowledge of the fraud. That is because to qualify as an HDC, a party must be a good faith *bona fide* purchaser (BFP) of the instrument (draft) for value. If United Bank participated with Duke in the fraud, then it thereby acted in bad faith. In turn, United Bank could not take the draft free and clear of defenses (such as those under former U.C.C. Section 5-114(2)) that would enable the Issuing Bank (Manufactures Hanover) to stop payment on the draft at the instruction of the Applicant (Cambridge).

Third, through a 1995 revision to U.C.C. Article 5, Section 5-114 was altered considerably, and what was left of it is in Section 5-109.³⁴⁴

Holding

The Court ultimately found in favor Cambridge. United Bank failed to meet its affirmative burden of proof that it is an HDC.

Rationale

The general rule of former U.C.C. Section 5-114 was that an Issuing Bank is a dealer in documents, not in goods. Therefore, a bank is not responsible for a breach of warranty or non-conformity of goods involved in an underlying sales contract. The *United Bank* Court cited *O'Meara* for that proposition.

However, under the U.C.C., there are certain limited circumstances when an Issuing Bank is relieved from its obligation to pay. Former Section 5-114(2) was one of them. This provision set out when an Issuer may properly refuse to honor a draft drawn under an L/C. It explained when an Account Party may enjoin an Issuer from honoring a draft: the so-called "fraud in the transaction" defense to payment.

There existed two specific requirements for the defense to apply:

³⁴⁴ Accompanying the revision is a Task Force Report (the relevant page of which is 1532).

- (1) Fraud in the transaction must be shown.
- (2) The Holder has not taken the draft in circumstances that would make it an HDC.

An HDC means the Holder takes commercial paper without knowledge of fraud. The two-pronged test of former Section 5-114(2) was the statutory codification of the landmark 1941 *Sztejn* case.

In *United Bank*, there was fraud in the transaction, and the Pakistani banks could not prove they were HDCs. So, both prongs of the test were met. That is, the HDC exception for a Confirming Bank to the fraud-in-the-transaction defense of the Issuing Bank is inapplicable.

Here, United Bank and Muslim Commercial Bank knew there was fraud. The Banks could prove only that they gave value, not that they affirmatively lacked knowledge as to fraud. Note, then, the burden of proof shifted. If the banks in Pakistan could have proved they themselves, and perhaps also their customer, Duke, had no knowledge of fraud, then those banks would be free from liability, because they would have been HDCs. As such, they would have been entitled to payment from Manufacturers Hanover.

Why exactly was United Bank not an HDC? The Court looked to U.C.C. Section 3-307 and 3-302 (as they then existed), on negotiability, because former Section 5-114(2)(a) referred it there. Section 3-307 shifted the burden of proving HDC status to the party that seeks it, namely, United Bank. That party must present affirmative evidence.

Section 3-302 laid down the requirements for HDC status. One was that a Holder must take the instrument without notice of any defense against it on the part of any person. United Bank failed to meet its affirmative burden of proof, which Section 3-307 imposed on it by virtue of Section 5-114(2)(a), that it is not only a Holder, but also an HDC, under Section 3-302. (All HDCs are Holders, but not all Holders are HDCs.)

But, there is a weakness in the rationale. The *United Bank* Court never reached the substantive question of whether United Bank (or Muslim Commercial Bank) was or was not an HDC, in the sense of scrupulously going through the requisites for HDC status and applying them to the facts. The Court simply stated, in a conclusory way, the Pakistani banks failed to prove their burden that they were an HDC. The Court suggests United Bank was “in” on the fraud with Duke, or at least knew of the fraud and tolerated it. Why? Might the fact the banks were Pakistani have influenced the Court, *i.e.*, was there implicit bias against them? Might the outcome have been different if the banks were (say) German?

Losing Argument

United Bank argued it was an HDC with respect to the draft presented to the Bank of the Buyer-Importer, Manufacturers Hanover. Therefore, the “fraud in the transaction defense” Manufacturers Hanover asserted to justify non-payment of the draft, based on

former U.C.C. Section 5-114(2), was inapplicable. There is an important subtlety in this argument.

The Bank of the Seller-Exporter, United, is saying it is an HDC. It is not saying the Seller-Exporter, Duke, is an HDC. The Bank was arguing for itself, claiming it should be paid.

There are three possibilities as to what motivated this argument. First, because United Bank (and Muslim Commercial Bank) already paid their customer, Duke, these banks were trying to be “made whole.” The Pakistani banks were “out” funds to Duke, and did not want to have to sue Duke to recover the payment. Banks normally do not want to sue their customer (especially good customers). Second, the Pakistani banks paid Duke, but Duke is now “long gone” with the funds. Duke cannot be reached, even if the banks were inclined to sue their customer. Third, the Pakistani banks paid Duke, which subsequently went bust, so the banks cannot recover from their customer.

Consistency with O’Meara?

Is this case consistent with *O’Meara*? *O’Meara* stated the Issuing Bank must pay on the grounds of the Independence Principle. The *United Bank* case stands as an exception to the Independence Principle. But, the *United Bank* Court did not define the issue this way.

UCP, U.C.C., and Qualification as HDC

The *United Bank* Court focused on the technicalities of U.C.C. Articles 3 and 5, and requisites for HDC status. The Court applied Article 5 in reference to the New York U.C.C. non-uniform provision in Section 5-102, which said the *UCP* controls, not the U.C.C., if the parties select the *UCP* as the applicable law. But, the parties did not select the *UCP* to govern their L/C.

Usually, a Seller-Exporter will not qualify as an HDC. The Seller does not purchase a draft under an L/C for value. Rather, it is the drawer of the draft. And, the Seller is intimately involved in the underlying transaction and not acting in good faith.

However, what about the Bank of the Seller-Exporter, *i.e.*, the Confirming Bank? The *United Bank* Court would have had to admit if United Bank is an HDC, then it is entitled to payment. That is because fraud by the Seller-Exporter-Beneficiary (here, Duke) may not be interposed (by Manufacturers Hanover) as a defense to payment (*i.e.*, to justify its dishonor of the draft) against an HDC (which United Bank wants to be) to which a draft has been negotiated. Simply put, when the Seller- Exporter’s Bank takes the draft, it takes the draft free of defenses against making payment raised by the Buyer-Importer or its Bank that there is fraud in the under- lying sale of goods transaction.

Burden of Proof, Evidence of Fraud, and Argumentation

In light of the aforementioned points, United Bank looked like an HDC. There was absolutely no evidence United Bank or Muslim Commercial Bank knew of any fraud. There was not even evidence of fraud itself. The problem was the Pakistani banks could not prove they did not know of the fraud, and they had the burden of “proving the negative” to qualify an HDC.

However, it must be admitted the Pakistani banks did little to help themselves. The only evidence submitted to prove they did not know of fraud were conclusory answers to interrogatories, which the trial judge wrongly admitted. The Pakistani banks should have filed depositions and affidavits, and obtained witnesses. Why did they not do so? Perhaps because the Pakistani banks won summary judgment at trial, where they argued the burden of proof was on Manufacturers Hanover to show they were not HDCs. So, the Pakistani banks did not anticipate having to prove they were HDCs (again, by “proving the negative,” namely, that they had no knowledge of the fraud).

Theory of HDC

What was the theory underlying the HDC requirement of U.C.C. Section 5-114(2)? There are two innocent parties, the Buyer-Importer and HDC. The Buyer-Importer chose to deal with the fraudulent Seller. Therefore, the Buyer-Importer should bear the loss. In other words, as between two innocent parties, the one that chose to deal with the wrongdoer should bear the loss.

However, it also is true the Seller-Exporter’s Bank chose to do business with the Seller-Exporter (*i.e.*, to have a banking relationship with the Seller, and to have the Seller present drafts to it) in the same way the Buyer-Importer chose to buy goods from the Seller. And, being a bank, perhaps it is better able to absorb the loss.

- **1982 *United City Merchants Case on Fraud by Third Party*³⁴⁵**

Facts and Issue

In *United City Merchants*, a Peruvian company, Vitrorefuerzos, S.A., the Buyer-Importer agreed to purchase from the Seller-Exporters a factory for the manufacture of glass fibers. The price was U.S. \$662,086 FOB (London). The plant was to be shipped to Callao, Peru and payment was to be made in London. Payment was by a confirmed irrevocable transferable L/C for the invoice price plus freight.

The payment terms included the L/C be payable as to 20% of the invoice price on the opening of the credit, 70% of the invoice price and 100% of the freight price upon presentation of the shipping documents, and the remaining 10% of the invoice price on completion of erection of the plant in Callao.

³⁴⁵ See *United City Merchants (Investments) v. Royal Bank of Canada* (The American Accord), [1982] 2 All E.R. 720, House of Lords, 1982 (Lord Diplock).

Regarding the 70% of invoice price and 100% of freight price, there was nothing unusual in the terms of the L/C. The L/C was made subject expressly to the *UCP*. The L/C called for presentation of sight drafts on the Issuing Bank against delivery, including a full set of “on board” bills of lading evidencing receipt for shipment of the goods from London to Callao. The shipment date was on or before 15 December 1976.

The Peruvian Buyer-Importer arranged with its Peruvian bank, Banco Continental S.A., the Issuing Bank, to issue the necessary credit. Banco Continental S.A., appointed the Royal Bank of Canada as the Confirming Bank. Royal Bank was employed to advise and confirm on its own behalf the credit to the Seller-Exporter.

Likewise, Royal Bank notified the Seller-Exporter on 30 March 1976, of the opening of the confirmed irrevocable transferable L/C. The initial payment of 20 percent of the invoice price was made by Royal Bank payable to the Seller-Exporter, exactly as called for in the L/C. Thereafter, the Seller-Exporter transferred its interest in the L/C as the Beneficiary thereof to its own merchant bankers, United City Merchants (Investments).³⁴⁶

The intention was to load the goods (namely the factory), manufactured by the Seller, using loading brokers acting on behalf of the Carrier, Prudential Lines, Inc. The goods would be carried on board a vessel called the American Legend, which was to arrive at Felixstowe, England. Felixstowe was substituted for London as the port of loading, but nothing in the case turns on this point. All parties acquiesced to this change.

Nonetheless, the American Legend never arrived at Felixstowe, because its arrival was canceled. Another vessel, the American Accord, was substituted by the loading brokers. The date of arrival of the American Accord was scheduled for 16 December 1976. However, the L/C called for a full set of on-board bills of lading that evidenced receipt for shipment of the goods from London (now Felixstowe by agreement) to Callao on or before 15 December 1976. The goods were in fact loaded on the American Accord on 16 December 1976.

The loading brokers, who acted as the agent for the Carrier in issuing bills of lading, issued a set of “received for shipment” bills of lading dated 15 December 1976. The loading brokers handed over these bills of lading to the Seller in return for payment of the freight. The bills of lading were presented by the Seller to Royal Bank on 17 December. Likewise, Royal Bank made various objections as to their form.

The key objection was the bills of lading did not bear any dated on board notation. In other words, the bills of lading did not identify the precise date on which the freight had been loaded. After all, they were received for shipment bills of lading. Accordingly, Royal Bank returned the bills of lading to the loading broker. The loading broker then issued a fresh set of bills of lading with the following notation:

³⁴⁶ Even though the Seller transferred its interest in the L/C as Beneficiary to United City Merchants (Investments), nothing in the case turns on this fact. Therefore, it can be assumed the Seller remained as Beneficiary of the credit throughout.

“These goods are actually on-board 15th December 1976,” signed, E.H. Mondy and Co. (Freight Agents) Ltd. as Agents.

This notation was false. On 22 December 1976, the amended bills of lading, along with other documents, were presented to the Royal Bank and again the Bank refused to pay. Royal Bank refused to pay on the grounds it “had information in their possession which suggested that shipment was not effected as it appears in the bill of lading.”

At issue was whether a Confirming Bank can refuse to pay against a document it believes to be false, but the Seller believes to be true, *i.e.*, where there is no fraud perpetrated by the Seller-Exporter. In other words, does the Fraud Exception to the Independence Principle apply to fraud committed by third parties, other than by the Seller-Exporter?

Holding

The Trial Court, Judge Mocatta, held the loading broker acted fraudulently in issuing bills of lading that bore what the loading broker knew to be a false statement. The false statement concerned the date on which the goods actually were on board the *American Accord*.

Judge Mocatta also found at the time of both presentations of the shipping documents to Royal Bank namely, 17 December and 22 December 1976, the Seller-Exporter-Beneficiary actually believed the goods had in fact been loaded on the American Accord on or before 15 December 1976. In other words, the Trial Court found the Seller-Exporter had no knowledge of the fraud perpetrated by the loading broker. The Trial Court decided in favor of the Seller, and ordered that it be paid.

The Court of Appeals reversed the Trial Court. The Court of Appeals started from the premise that a Confirming Bank could refuse to pay against a document it knew to be false, even though the Seller had no knowledge of the fraud. Thus, it said Royal Bank need not pay.

The facts in this case do not fall within the *Sztejn* Fraud Exception to the Independence Principle, largely because the Seller-Exporter had no knowledge of the fraud. That is, a Confirming Bank must pay the Beneficiary upon presentation of facially apparent appropriate and conforming documents, where a third party (such as the Carrier) has fraudulently altered a document (such as the bill of lading) unbeknownst to the Beneficiary.

In the end the Court of Appeal was overruled. The Court found for the Seller-Exporter-Beneficiary, specifically, its transferee on the credit, United City Merchants (Investment), the plaintiff. Payment must be made to the plaintiff by the Royal Bank of Canada on the L/C.

Rationale

The Court identified four autonomous, though inter-connected, relationships in an L/C transaction:

- (1) The underlying contract for sale of goods between the Buyer-Importer and the Seller-Exporter.
- (2) The L/C contract between the Account Party and the Issuing Bank.
- (3) The arrangement with the Confirming Bank.
- (4) The arrangement between the Confirming Bank and Beneficiary.

It is the fourth contractual relationship that was at issue in this case. The basic rule pertaining to the contract between the Confirming Bank and Beneficiary is the Independence Principle.

This rule exists notwithstanding the fact the Confirming Bank has knowledge the Seller-Exporter, at the time of presentation of the conforming documents, is alleged by the Buyer-Importer, to have – and, in fact, already has – committed a breach of the contract for the sale of goods that would have entitled the Buyer to treat the contract of sale as rescinded, reject the goods, and refuse to pay the Seller the purchase price.

The commercial purpose of the Independence Principle is to give the Seller-Exporter the assurance it will be paid before it parts with control of the goods. This purpose does not permit any dispute with the Buyer as to performance of the contract of sale from being used as a ground for non-payment, or even reduction or deferment of payment.

There is only one established exception to the Independence Principle: fraud. If the Seller-Exporter, for the purpose of drawing on the credit, fraudulently presents to the Confirming Bank documents that contain (expressly or by implication) a material misrepresentation of fact, then payment need not be made. This exception was established in the landmark case, *Sztejn*.

Sztejn was referred to with approval in an English Court of Appeal case, *Edward Own Engineering Ltd. v. Barclays Bank International* [1978] 1 All E.R. 979, [1978] Q.B. 159. The Court here in *United City Merchants* does not say so, but the implication of its discussion is that the *Sztejn* exception is now part of English law.

First Losing Argument

The Royal Bank of Canada, the Confirming Bank, made two arguments. First, a Confirming Bank is not under any obligation to the Seller-Exporter to pay the Seller the sum stipulated in the L/C against presentation of documents, if the documents presented, although conforming on their face with the terms of the credit, nevertheless contain some statement of material fact that is not accurate. Whether the Seller-Exporter knows of the existence of the inaccuracy is irrelevant.

However, this first argument put forward by the Royal Bank of Canada was so broad as to render the Fraud Exception superfluous. The argument did not require any knowledge on the part of the Seller. It is so implausible it would undermine the whole system of financing international trade by means of documentary credits.

Furthermore, under the first argument, there would be a strange anomaly in commercial law. On the one hand, there is a contractual duty owed by a Con- firming Bank and an Issuing Bank to the Buyer-Importer to honor the credit on presentation of apparently conforming documents despite the fact that they contain inaccuracies or are forged. On the other hand, there would be no corresponding contractual obligation of the Confirming Bank to the Seller-Exporter, in the absence of fraud by the Seller, to pay the sum stipulated in the credit on presentation of apparently conforming documents. That is, if the broad proposition argued for by the Royal Bank of Canada were accepted, then the contractual duties would not match.

Second Losing Argument

A bank, because it desires to protect its reputation in the competitive L/C market, will never exercise its right against a Seller-Exporter to refuse to honor a credit, except in a case where at the time of the refusal the bank has irrefutable evidence that the documents presented are inaccurate. In other words, the Confirming Bank is stating it will not abuse its right to reject. Because the bank wants to maintain the reputation of a bank that pays confirmed credits, it will not unreasonably withhold payment.

However, it is not enough to leave matters to a bank and suppose it will always behave in such a way as to protect its reputation. This argument, in effect, gave every bank an option, exercisable at the discretion of the bank, regardless of any instructions from the Account Party, as to whether to pay or reject.

Comments

Lord Diplock took a strict view of the Independence Principle and the need to pay. Lord Diplock wanted L/Cs to be paid to keep the wheels of commerce going. But, even under this view, if a Seller-Exporter has knowledge of fraudulent alteration by a third party, then that Seller is brought within the fraud exception – even if the Seller did not condone the alteration and knew nothing of it until just before it tendered the documents.

What incentive for Sellers does Lord Diplock’s opinion create? A “Don’t ask, don’t tell!” attitude. It protects shrewd Sellers who utilize the services of third parties that are discreet enough to keep their fraudulent practices to themselves. Sellers are discouraged from inquiring about the details of the activities of third parties, as long as the bills of lading appear valid, because any knowledge of wrongdoing will jeopardize the chance of the Seller being paid.

Therefore, was Lord Diplock wrong? Should a bank not have the option of refusing to honor a draft if it possesses firm evidence of fraud that directly affects the genuineness

and validity of the documents required to be tendered under an L/C, even if the documents appear on their face to be valid?

If the bank pays anyway, then the Account Party can refuse to reimburse the bank, the bank can sue the Account Party for reimbursement, and the Account Party can defend on the grounds that the bank (1) did not act in good faith in not heeding its customer's warnings, (2) there was ample evidence of fraud and forgery that the Account Party gave to the bank, and (3) the bank exceeded its mandate to pay only against genuine and valid documents.

In sum, does Lord Diplock's holding, that a Confirming Bank must pay even when given strong evidence of third-party fraud, not make a mockery of the importance of faultless tender? Lord Diplock requires a bank to ignore evidence of fraud, which implicitly sanctions fraudulent activity and denies the bank's concern for security. So, shouldn't the bank be free to reject documents tainted by the fraud or forgery of third parties as well as Beneficiaries – an exception to the Independence Principle? As a practical matter, how are most banks likely to learn of possible fraud? Hearsay. The evidence in many cases may not stand up to closer scrutiny. Thus, perhaps Lord Diplock was right.

- **1979 Iran Case on Standby L/Cs**³⁴⁷

Facts and Issue

After the 1978-1979 Islamic Revolution in Iran (discussed in a separate Chapter), increased attention was given to the possibility the beneficiary of a standby L/C may require payment on the basis of “bad faith” or other “arbitrary” reasons, as opposed to requiring payment based on the intentional failure of a contractor to perform the contract.

Civil insurrection is an example of an “arbitrary” reason a Beneficiary would use to require payment. Recall that under an L/C, the Issuing Bank is required to honor a draft presented to it, as long as that draft also is presented with documents that conform to the L/C. The only exception to this requirement is where there is fraud in the transaction.

In the U.S., Account Parties (*i.e.*, Applicants or Seller-Exporters) argue the “fraud in the transaction” exception regarding the duty of the Issuer to pay under an L/C should be enough on its own to block payments. However, several courts have refused to enjoin payment because of insufficient evidence of fraud.³⁴⁸ Courts also have refused to enjoin payment where a Seller-Exporter argued in favor of an expanded definition of “fraud.”³⁴⁹ Additionally, some Courts have issued a “notice injunction.” This kind of injunction requires an Issuer to provide notice to the Seller-Exporter prior to transferring funds to the

³⁴⁷ See *American Bell International v. The Islamic Republic of Iran*, 474 F. Supp 420 (S.D.N.Y. 1979). [Hereinafter, *American Bell*.]

³⁴⁸ See *KMW International v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 16 (2d Cir 1979). [Hereinafter, *KMW*.]

³⁴⁹ *American Bell*, 420.

Beneficiary of a standby L/C, after it has received a demand for payment.³⁵⁰ The notice period typically is between 3-10 days. Finally, some courts have granted preliminary injunctions that last indefinitely.³⁵¹

The 1979 *Iran* case on Standby L/Cs, involves an instance where an L/C was used as a guarantee to secure performance. As indicated, the Islamic Revolution took place in Iran in 1978-1979. Before the upheaval associated with the *Āyatollāh's* movement, American businesses had been providing Iranian customers with goods and services. So, the American businesses were billing their customers, and many had open invoices with them that later went unpaid amidst the chaos of the Revolution.

One such American business was AT&T (specifically, American Bell International, or simply, Bell). Bell had a contract with the pre-revolution Iranian government of the Shah to provide consulting services and equipment. At the time, the Shah was working to upgrade international and domestic telecommunications systems. The contract between Bell and the Shah's government was worth U.S. \$280 million, including a \$39 million down payment. The Iranian government had the right to demand return of its down payment anytime. A key provision of the contract required the down payment be secured. To assure that Bell would return the \$39 million down payment, if so demanded by the Iranian Government, the parties used a "letter of guarantee."

Therefore, Bell was required to open an unconditional, irrevocable guarantee. The guarantee had to be issued by an acceptable Iranian bank, namely Bank Iranshahr. The beneficiary of the guarantee was the Iranian government.³⁵² So, if the Iranian government demanded payment of its \$39 million down payment, then Bank Iranshahr would pay it back pursuant to the guarantee. Of course, if Bank Iranshahr paid the Iranian Government, then it would expect reimbursement from Bell. But, what would stop Bell from simply not paying Bank Iranshahr?

One solution was for Bank Iranshahr to require Bell to collateralize the guarantee by pledging cash or readily marketable securities worth \$39 million to Bank Iranshahr. The response of Bell to this possibility was "not a chance." Bell did not want to tie up such a large amount of assets in a country of the brink of revolution. Thus, the parties agreed to use a standby L/C to assure payment from Bell to Bank Iranshahr if the Iranian government called on Bank Iranshahr for its down payment.

The standby L/C was issued by Manufacturers Hanover (which subsequently merged into Chemical Bank, which thereafter merged into Chase Manhattan Bank). Bank Iranshahr was the Beneficiary. Bell was the Account Party (*i.e.*, Applicant). Under the

³⁵⁰ See *Stromberg-Carlson Corp. v. Bank Melli Iran*, 467 F. Supp. 530 (S.D.N.Y. 1979). [Hereinafter, *Stromberg-Carlson*.]

³⁵¹ See *Dynamics Corp. of America v. Citizens and Southern National Bank*, 356 F. Supp. 991 (N.D. Ga 1973). [Hereinafter, *Dynamics*.]

³⁵² At the time of this case, in 1979, American banks were prohibited from issuing bank guarantees, based on Federal banking law dating back to the 1930s. However, that is no longer true. American banks generally still do not issue bank guarantees, but provide other types of promissory notes, intended to fulfill the same function.

terms of the standby L/C, funds were to be paid under the standby L/C to Bank Iranshahr, but only if Bank Iranshahr had to pay the Iranian government.

To pay on the standby L/C, Bank Iranshahr would be required to send a message to Manufacturers Hanover notifying Manufacturers Hanover that the Iranian government had demanded payment from Bank Iranshahr under the letter of guarantee. Thus, the purpose of the standby L/C was to substitute the credit risk of a known international bank, Manufacturers Hanover, for an unknown (or less well known), Bell.

The type of standby L/C issued by Manufacturers Hanover is known as a “suicide credit,” because the obligation of the Issuing Bank is unconditional. The Issuer must pay upon nothing more than a simple demand made by the Beneficiary. There are no shipping documents to be presented, and no need for a check of appropriate-ness and conformity.

Note Bell paid a fee to Manufacturers Hanover for issuing the standby L/C. Note also Bell had to agree it would reimburse immediately Manufacturers Hanover for all amounts paid by Manufacturers Hanover to Bank Iranshahr.

For several months, business proceeded as usual. Bell commenced performance of the underlying contract, until the Revolution disrupted business. Once this tumultuous event occurred, Bell was left “holding the bag,” *i.e.*, Bell was owed money for previously performed services, but was left with unpaid bills. In response, Bell ceased performance in Iran in January 1979. The Iranian government owed Bell money, but refused to pay, thereby breaching its payment agreement. (Bell certainly was not the only American company the Iranian government refused to pay.) The Iranian government (of the Shah) had breached the contract, and the successor Islamic government repudiated the contract.

Initially, no demand was made on Bell by Bank Iranshahr for payment under the standby L/C. Because Bank Iranshahr had not asked for payment on the standby L/C, there was no formal request for Bell to fight. But, Bell sought to take the offensive and act preemptively. Bell filed for a preliminary injunction against Manufacturers Hanover from honoring any demand for payment from Bank Iranshahr under the standby L/C. Bell anticipated an attempt by Bank Iranshahr to collect payment under the standby L/C, and tried to devise an a priori strategy to repel it.

Bell brought its action seeking a preliminary injunction in New York State Court. Bell lost. The Court would not grant Bell a preliminary injunction. On 25 and 29 July 1979, Bank Iranshahr attempted to draw funds on Manufacturers.

Bank Iranshahr sent two tested telex demands to Manufacturers Hanover for payment. The response of Manufacturers Hanover was to stall. It played for time to help its customer, Bell. Manufacturers Hanover knew Bell would not want it to honor the demand – after all, Bell already had tried unsuccessfully in New York State Court to obtain a preliminary injunction against Manufacturers Hanover.

First, Manufacturers Hanover told Bank Iranshahr that its demand via texted telex message did not conform to the technical terms of the standby L/C. Then, Manufacturers Hanover immediately notified Bell that the Iranians wanted payment. The stalling efforts of Manufacturers Hanover gave Bell the time it needed to prepare the legal papers required to seek a temporary restraining order (TRO) to prevent payment in the United States District Court for the Southern District of New York.

The TRO was granted on 29 July 1979, the same day the second tested telex message from Bank Iranshahr was received by Manufacturers Hanover. The TRO was good only for a short period of time. Specifically, the District Court did not reach a judgment on the merits. The Court said that if the Iranians sent a tested telex message that does conform to the terms of the standby L/C, then Manufactures must notify Bell. Then, Bell would have 48 hours to return to the Court, because the enjoining of payment would hold only for that long.

On 1 August, Manufacturers Hanover received a conforming tested telex message from Bank Iranshahr. Bell again moved for a preliminary injunction against Manufacturers Hanover to prevent it from paying the government of Iran or the bank of the Iranian government, Bank Iranshahr.

Procedural Posture

In a majority of American Courts, a party seeking a preliminary injunction must demonstrate four criteria before a court will issue a preliminary injunction, which is an equitable remedy:

- (1) Substantial likelihood of success on the merits of the case.
- (2) Substantial threat of irreparable damage or injury if an injunction is not granted.
- (3) The balance of harms weighs in favor of the party seeking the preliminary injunction.
- (4) Public Interest.

The fourth criterion was irrelevant here, as this case did not deal significantly with public interest.

Judgment

The Southern District of New York ruled against Bell, in favor of Iran. It denied the motion for a preliminary injunction against Manufacturers Hanover paying Bank Iranshahr.

Holding

The Court held that Bell failed to show it would incur irreparable injury if Manufacturers Hanover paid Bank Iranshahr – the first prong of the test for a preliminary

injunction. Bell also failed to show the second prong of the test, namely, probable success on the merits, and the third and fourth prongs, serious questions and balance of hardships.

Losing Argument

Payment under an L/C can be enjoined where a germane document is forged or fraudulent, or where there is fraud in the “transaction.” So, in fighting against any preliminary injunction, Manufacturers Hanover claimed the “transaction” was the L/C transaction, not necessarily the underlying transaction. On this view, Bell could not win, because it did not contend that Bank Iranshahr fraudulently induced the L/C that was issued.

In contrast, seeking the preliminary injunction, Bell claimed the “transaction” is the totality of the circumstances. Bell argued the behavior of the Iranian government – at that time, the government of the *Āyatollāh* Ruhollah Khomeini (1902-1989, Supreme Leader, 1979-1989)) – in connection with the consulting contract, sufficed to make its demand on the letter of guarantee issued by Bank Iranshahr fraudulent. In turn, the ensuing demand from Bank Iranshahr on the standby L/C was tainted with fraud.

Ultimately, the Court refused to decide this thorny issue of the law, *i.e.*, what is the “transaction” in the fraud in the transaction defense against payment of a standby L/C. The Court ruled on technical procedural grounds, such as that the probability of success for Bell on the merits was low.

Rationale

Regarding the tests that must be met to win a preliminary injunction, on irreparable injury, the Court said Bell failed to show it. Suppose Manufacturers Hanover paid Bank Iranshahr in violation of the standby L/C terms. Then, Bell could sue Manufacturers Hanover. If Bell recovered, then it would be made whole. Therefore, the preservation of the right of Bell to sue meant Bell was not “irreparably” injured.

Second, on probable success on the merits, the Court said it was not probable – better than 50% that Bell would be able to prove either (1) the demand for payment was not in conformity with the terms of the credit, or (2) there was fraud in the transaction. A demand for payment must conform to the terms of the credit. This is a “bedrock” principle of L/C law. A trial court would find that the Iranians had complied. Likewise, Bell was unlikely to be able to show fraud in the transaction. Thus, the District Court stated: “On the evidence before us, fraud is no more inferable than an economically rational decision by the government to recoup its down payment.”³⁵³

On the third and fourth criteria, serious questions and balance of hardships, the Court considered what might happen if Bell lost and Manufacturers Hanover was forced to pay. Then, Manufacturers Hanover would lose the \$39 million it had to pay Bank Iranshahr.

³⁵³ See *American Bell*, 420, 425.

If Bell won, and Manufacturers did not have to pay, then there was a possibility of an equally great loss. Indeed, there was a “parade of horrors.”

Bank Iranshahr could initiate a suit on the L/C, and attach \$39 million of assets of Manufacturers Hanover located in Iran. Or, Bank Iranshahr could hold Manufacturers Hanover liable for consequential damages beyond the sum resulting from failure to make timely payment. Finally, the Iranian government could retaliate against the recalcitrance of Manufacturers Hanover and nationalize the assets Manufacturers Hanover held in Iran. This “parade of horrors” seemed more realistic given what was going on when this case was litigated — the upheaval of the Iranian Revolution. (The American Embassy in Tehran was not stormed, and the hostages not taken, until 4 November 1979.)

Additionally, thought the Court, Manufacturers Hanover would face a loss of credibility in international banking circles because of failure to make good on the L/C. Manufacturers Hanover did not need the help of the Court to make sure its reputation was not sullied. The Court provided yet another rationale. Bell was a sophisticated multinational corporation advised by competent counsel. It entered into the deals with the Iranians with “its corporate eyes open.” As between two innocent parties, the party that undertakes by contract the risk of political uncertainty and governmental caprice must bear the consequences when the risk comes home to roost.

Comments

What was Bell trying to do? Bell was trying to offset the money owed to it by Iran against the down payment it received.

Why did the Court not conclude its opinion after the irreparable injury holding? I did not want to get reversed by the Second Circuit. So, the Court dealt with the other prongs of the test, probable success on the merits and sufficiently serious questions on the merits and balance of hardships. The Court raised the possibility that Bell would have to go to Iran and sue there.

Did the Iranians really conform? The Court admitted the payee in the demand telex was changed. It was “Government of Iran Ministry of Defense, Successor to the Imperial Government of Iran Ministry of War.” This payee was an entirely different payee than the Shah’s Government, or more technically, country risk. Therefore, from the perspective of Manufacturers, it was an entirely different credit risk. Manufacturers may not have issued the credit in the first place if it had known of the switch in payees.

Why did Manufacturers Hanover resist non-payment, and therefore aid Bell by not paying? Because U.C.C. Section 5-114(2)(b) did not allow it to do this. The statute anticipated banks will want to help their customers by doing this. Therefore, the statute requires the party seeking to stop payment (the bank’s customer) obtain a court injunction against the bank.

Should the Independence Principle apply in a standby L/C case? A standby, in contrast to a commercial, L/C is not designed to assure that a Seller-Exporter is paid for the goods that are shipped. Rather, a standby serves a non-payment function to assure a Beneficiary payment if the contractor does not supply goods or services.

This area of law remains in turmoil. Some Courts grant “notice” injunctions whereby issuers are required to give 3-10 days’ prior notice before transferring money to the beneficiary of the standby after demand for payment.³⁵⁴ Alternatively, some courts grant preliminary injunctions of indefinite duration.³⁵⁵ Many Courts decline to enjoin payment because of insufficient evidence of fraud.³⁵⁶ Finally, like the Bell court, some Courts deny a motion to enjoin payment because they refuse to go along with the account party’s expanded definition of fraud.

³⁵⁴ See *Stromberg-Carlson*, 530.

³⁵⁵ *Dynamics*, 991.

³⁵⁶ See *KMW*, 10, 16.

Part Four

ECONOMIC FOUNDATIONS

Chapter 9

CLASSICAL AND NEO-CLASSICAL FREE TRADE THEORY³⁵⁷

I. Mercantilism

The starting point for virtually every modern International Economics textbook is a basic question: why trade? The invariable answer is the Law of Comparative Advantage. This “Law,” or more accurately, economic principle, is associated with the 19th century English political economist, David Ricardo (1772-1823). In Chapter 7 of his classic *On the Principles of Political Economy and Taxation* (1817), Ricardo laid out the case for international trade. But, what motivated Ricardo to write that Chapter?

To be sure, Adam Smith (1723-1790), in *An Inquiry into the Wealth of Nations* (1776), investigated the benefits of free trade.³⁵⁸ Smith, the second scholar to hold a professorship in moral philosophy at the University of Glasgow, was a student of Francis Hutcheson (1694-1746), the first holder of the moral philosophy chair at Glasgow, whose primary works were *Inquiry into the Original of Our Ideas of Beauty and Virtue* (1725) and *An Essay on the Nature and Conduct of the Passions and Affections, with Illustrations of the Moral Sense* (1728). Ricardo – the first in England to hold a Chair in Political Economy – built on the ideas of Smith and Hutcheson. Reading *The Wealth of Nations* at age 27 stimulated Ricardo’s interest in economics. Smith wrote partly in response to the prevailing economic orthodoxy of the 16th to 18th centuries, namely, Mercantilism.

Mercantilism is not an anti-trade doctrine. Rather, it is an anti-free trade doctrine that calls for government intervention to generate a trade surplus. Mercantilists source the wealth of a nation in its stock of precious metals, such as gold. Their economic prescription in favor of government regulation to promote exports and thereby generate wealth is in service of a political objective: to increase state power *vis-à-vis* rivals.

Why does the stock of precious metals rise? The answer is payment for exported goods is received in such metals. This wealth can be used to invest in assets in other countries, and such investments give the surplus country economic and political influence in the other countries. In contrast, imports cost a nation in precious metals, thus diminishing

³⁵⁷ Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

³⁵⁸ For an analysis of how “starting with Adam Smith, positive economics came to the forefront and gradually excluded other fields of analysis,” resulting in “the primacy of economics over politics” and “more importantly, the replacement of politics with economics in examining many aspects of social life,” and argument that “[t]he free trade versus protectionism dichotomy has never provided the trade debate with two radical competing views,” but “[r]ather protectionism and free trade have represented two different strategies, each claiming to better enable the achievement of the same economic end,” see Donatella Alessandrini, *WTO and Current Trade Debate: An Enquiry into the Intellectual Origins of Free Trade Thought*, 11 INTERNATIONAL TRADE LAW & REGULATION issue 2, 53-60, 54, 60 (March 2005).

wealth. Accordingly, Mercantilists seek to maximize wealth by maximizing exports and minimizing imports, and thereby maximize the net outflow of goods, *i.e.*, a positive balance of trade, and the net inflow of payments. Mercantilist trade policy calls for restrictions, such as high tariffs, on imports, and support, such as subsidies, for exports. It relies on an alliance between the government and national corporations favored by the government, thus rendering it susceptible to the criticism the government picks winners and losers among enterprises and industries.

Despite public pronouncements of politicians and trade negotiators, consider whether and to what extent classical and neo-classical economic arguments against Mercantilism and in favor of free trade are manifest in negotiated outcomes, *i.e.*, in trade agreements. Free trade rhetoric aside, do officials behave like Neo-Mercantilists, focusing excessively on a “favorable” trade balance? Do they seek to maximize the net inflow of funds, through net exports, and then invest the funds in foreign financial assets (*e.g.*, stocks, bonds, and real estate)? If so, then is their goal to maximize influence abroad? Conversely, does this goal lead them to fear surpluses in other countries, such as China (in the 2000s), Japan (in the 1980s), and Saudi Arabia (in the 1970s), which may lead to foreign dominance?

The logic of Mercantilism and Neo-Mercantilism presumes protection and export subsidies can generate a trade surplus. Lerner’s Symmetry Theorem encapsulates one reason why this logic – slashing imports through higher tariffs will boost exports – is flawed. The higher tariffs increase the cost of imported inputs, that is, those inputs for which manufacturers cannot easily find a close domestic substitute. Incorporation of those tariff-induced higher-cost inputs raises the cost of finished goods. Those goods, then, are less competitive in export markets *vis-à-vis* foreign competitors. So, foreign buyers shy away from the higher-cost finished goods shipped by the Mercantilist country.

The logic also is undermined by a reality most economists accept: the critical long-run determinant of a country’s trade balance is its savings rate – not protectionist measures (or the threat of such measures). Few foreign barriers make a noticeable impact on exports (the CAP of the EU is an exception). Even if such measures reduce imports, they do not boost exports. By producing more goods than it consumes, a country creates an exportable surplus, and it can export this excess over what it consumes. China, Japan, and Korea, which have high savings rates, have been examples. With an abysmally low savings rate, the U.S. is a counter-example.

Arguably, neither the size of a bilateral trade deficit, nor the nationality of the owner of an asset, ought to matter. Rather, overall macroeconomic performance and the quality of management of an asset ought to be of concern. For instance, a trade surplus hardly is “favorable” if the material well-being of residents in the net exporting country deteriorates because they are starved of imports. That scenario occurred in Romania in the 1980s, under the Communist ex-dictator Nicolae Ceaușescu (1918-1989). Exports may be viewed as a means of paying for what people want from overseas. Similarly, a trade deficit is not “unfavorable” if it results from imports of capital equipment, such as machine tools, and the capital is put to such good use that the rate of return on it exceeds its cost. This

phenomenon is observed in well-run developing countries in Southeast Asia. In the 1980s, the U.S. ran large trade deficits financed by inflows of foreign savings (*e.g.*, purchases of American treasury securities by Japanese investors). The U.S. used these funds in part to finance military buildups, which in turn assisted in facing down the Soviet Empire and ending the Cold War. Might a trade deficit favor the common good?

II. Adam Smith and Absolute Advantage

In his attack on Mercantilism, Adam Smith urged the dominant contributor to national wealth and power is economic growth. In turn, economic growth depends on an efficient division of labor. The Mercantilist policy of erecting trade barriers inhibits the expansion of markets. Such barriers limit the size of a market (for example, by preventing one country from selling goods to another country). In turn, the potential for more efficient division of labor, and specialization of production, is choked off. Smith examined the instance of “absolute advantage,” which refers to the ability of one country to produce a good using fewer resources than any other country. Trade allows a country to specialize in the production of a good in which it has an absolute advantage, rather than have to generate some output of several goods, which it must do under autarky.

For instance, suppose China can produce one ready-made garment, such as a pair of blue jeans, and one ton of a steel product, such as “H” beams, with 10 hours’ worth of work by garment workers and 20 hours’ worth of work by steel workers, respectively. India requires 25 labor hours for the garment, but just 5 labor hours for the steel, to generate the same volume of output in each sector. Table 9-1 sets out these figures.

Table 9-1
Absolute Advantage

Output and Country	China	India
	<i>Labor Needed per unit of Output</i>	<i>Labor Needed per unit of Output</i>
Garments – <i>Unit = 1 blue jeans</i>	10 labor hours	25 labor hours
Steel – <i>Unit = 1 ton of “H” beams</i>	20 labor hours	5 labor hours

China has an absolute advantage in the production of garments, but India holds the absolute advantage in steel. Smith argued international trade would allow for an appropriate division of labor across countries, and thereby allow each country to specialize in the production of the good in which it possesses an absolute advantage. Accordingly, China would focus on garments, and India on steel.

Table 9-2 illustrates the result from production specialization and attendant international division of labor, and the possibility of trade. Suppose China sacrifices making 1 ton of “H” beams. China can re-allocate to garment production the 20 hours of

labor it had dedicated to steel production (assuming labor is mobile between the sectors). With 20 more hours available for garment work, China can generate 2 additional pairs of blue jeans. Similarly, suppose India foregoes production of garments, and re-allocates labor to the steel sector. The 25 labor hours India shifts from making 1 pair of pants can generate an additional 5 tons of steel. The outcome is clear: total output as between China and India rises, but no additional productive resources are consumed. Each country specializes in making the good in which it has an absolute advantage, and the international division of labor is efficient.

Table 9-2
Absolute Advantage, International Division of Labor, and Total Output

Output and Country	China	India
	<i>Labor Needed per unit of Output</i>	<i>Labor Needed per unit of Output</i>
Garments – <i>Unit = 1 blue jeans</i>	10 labor hours	25 labor hours
Steel – <i>Unit = 1 ton of “H” beams</i>	20 labor hours	5 labor hours
Total Output under Autarky	1 blue jeans and 1 ton of “H” beams	1 blue jeans and 1 ton of “H” beams
Total Output with Free Trade	3 blue jeans	6 tons of “H” beams
Difference in Total Output with Free Trade versus Autarky	1 additional pair of blue jeans (the difference between 3 pairs made by China with free trade, and 1 pair made each by China and India with autarky)	4 additional tons of “H” beams (the difference between 6 tons made by India with free trade, and 1 ton made each by India and China with autarky)

Therefore, Smith urged, a Mercantilist policy, whereby imports are taxed heavily, restricted by quota, or forbidden, makes little sense. Rather, increased output is possible with an international division of labor based on absolute advantage. International trade follows, if neither country consumes all it produces. China can import steel from India that India does not use. India can import surplus garments production from China.

Further, the price at which each country obtains a good from the other, with free trade, is cheaper than the pre-trade autarky price. Why? Consider the pre-trade price ratio of garments to steel in each country. The price of each good in each country is the wage rate per hour in each country multiplied by the number of labor hours needed:

$$\text{Price of good} = (\text{wage rate per hour}) \times (\text{number of labor hours})$$

Thus, in China:

$$P^{C\text{garment}} = W^C \times (10 \text{ hours})$$

$$P^{C\text{steel}} = W^C \times (20 \text{ hours})$$

And in India:

$$P^{I\text{garment}} = W^I \times (25 \text{ hours})$$

$$P^{I\text{steel}} = W^I \times (5 \text{ hours})$$

The symbol “ $P^{C\text{garment}}$ ” stands for the price of a pair of blue jeans, “ W^C ” denotes the hourly wage rate in China, and “ $P^{C\text{steel}}$ ” is the price of 1 ton of “H” beams. Analogous symbols, with “I” for India, apply to the Indian economy. The wage rate in the garment and steel sectors in China is assumed to be the same, because any difference would be eliminated by migration of workers from lower to higher paying jobs. The same assumption is made for India (though, of course, W^I and W^C are not necessarily equal). This assumption presumes labor is freely mobile in each country.

The pre-trade price ratio in each county is:

$$\frac{P^{C\text{garment}}}{P^{C\text{steel}}} = \frac{W^C \times (10 \text{ hours})}{W^C \times (20 \text{ hours})} = 0.5 \text{ in China}$$

$$\frac{P^{I\text{garment}}}{P^{I\text{steel}}} = \frac{W^I \times (25 \text{ hours})}{W^I \times (5 \text{ hours})} = 5 \text{ in India}$$

Calculation of these ratios eliminates wage rates, resulting in the denomination of each good in terms of units of the other. That is, a unit of garments is priced in terms of units of steel, and conversely a unit of steel is priced in terms of garments. (Again, the units are 1 pair of blue jeans and 1 ton of “H” beams.) Accordingly, before trade, 1 unit of garments costs ½ unit of steel in China, but costs 5 units of steel in India. Garments are considerably more expensive in India than China, where expense, is defined in terms of what must be foregone – known as opportunity cost (discussed below). Because of the price differential, there is considerable scope for mutual gain from trade.

Specifically, it is economically rational for India to abandon garment production, focus on steel, and import garments from China. Conversely, steel is relatively expensive in China. One unit of steel is worth 2 garment units in China, but in India 1 unit of steel costs just 1/5 a unit of garments. So, China ought to specialize in garments, and import steel from India. With free trade, there is a single world-market price ratio. Depending on the market forces of supply and demand, it is an intermediate level between the autarky ratios of 0.5 and 5. Suppose the world market price ratio of garments to steel is 3:

$$\frac{p_{\text{garment}}}{p_{\text{steel}}} = 3$$

Table 9-3 summarizes the gains from trade with absolute advantage. At this ratio, China exports 1 unit of garments, which pays for 3 units of steel imported from India. Trade renders both countries better off than before.

Table 9-3
Absolute Advantage and Gains from Trade

Scenario and Country	China	India
<i>Autarky Price Ratio</i>	$\frac{p_{\text{Cgarment}}}{p_{\text{Csteel}}} = 0.5$	$\frac{p_{\text{Igarment}}}{p_{\text{Isteel}}} = 5$
<i>Free Trade Price Ratio (by assumption)</i>	$\frac{p_{\text{garment}}}{p_{\text{steel}}} = 3$	$\frac{p_{\text{garment}}}{p_{\text{steel}}} = 3$
<i>Results Under Autarky</i>	1 unit of garment costs ½ unit of steel. Conversely, 1 unit of steel costs 2 units of garments. China has an absolute advantage in garments.	1 unit of garment costs 5 units of steel. Conversely, 1 unit of steel costs 1/5 unit of garments. India has an absolute advantage in steel.
<i>Incentives</i>	Garments are relatively cheaper in China than India (½ unit of steel in China versus 5 units of steel in India) China should export garments and import steel.	Garments are relatively more expensive in India than China (5 units of steel in India versus ½ unit of steel in China). India should export steel and import garments.
<i>Gains from Trade</i>	China exports 1 unit of garments and imports 3 units of steel. For the 1 unit of garments, China gains 2½ extra units of steel, in comparison with autarky (the difference between 3 and ½ units).	India exports 1 unit of steel and imports ⅓ of a unit of garments. For the 1 unit of steel, India gains an extra 2/15 of a unit of garments (the difference between ⅓ and 1/5 units).

Under autarky, China must give up 2 units of garments to get just 1 unit of steel (or, 3 units of steel would cost China 6 units of garments). China's gain may be quantified as

the difference in the units of steel it imports in return for exporting 1 garment unit versus what it could make on its own if it were to forego making 1 garment unit, *i.e.*, 3 units versus $\frac{1}{2}$ unit, or $2\frac{1}{2}$ units. As for India, it too is better off with trade. India exports 1 unit of steel, and imports from China $\frac{1}{3}$ of a unit of garments. Without trade, a unit of steel (*i.e.*, to forego production of 1 unit of steel and put those factor resources into garment manufacturing) fetches just $\frac{1}{5}$ of a unit of garments. India's gain from trade is the difference between $\frac{1}{3}$ and $\frac{1}{5}$ of a unit of garments ($\frac{2}{15}$ of a unit). Significantly, the additional total output associated with free trade suggests consumers in both countries benefit from expanded consumption opportunities. The production gain from trade, wrought by specialization, leads to greater output, which in turn means more goods are available to consumers at a cheaper price than under autarky.

Absolute advantage is a powerful explanation for international trade in certain markets and among some countries. For instance, why do Brazil and Colombia export coffee, Saudi Arabia oil, and South Africa diamonds? Absolute advantage, which derives from climatic conditions and natural resource endowments in these countries, is the answer. However, the explanation falls short of explaining a considerable part of trade. What happens if one country (say, China in the example) has an absolute advantage in the production of both goods (garments and steel)? In reality, a few major trading countries appear to have an absolute advantage in a large array of goods, and small countries would seem to be helpless. Is a country that nature treats parsimoniously doomed to inauspicious prospects in international trade?

The answer given by many opponents of trade liberalization is “yes.” They assert small countries cannot gain from free trade. This assertion is not new. Readers of *The Wealth of Nations* were concerned about the scenario of one country having an absolute advantage in the production of multiple products – and in the late 18th and early 19th century, that country was Great Britain. Under classical and neo-classical economic theory, however, the assertion is false.

David Ricardo addressed the matter with the Law of Comparative Advantage. Ricardo argued international trade is mutually beneficial for countries, even if one has an absolute advantage in the production of all goods, under the following terms:

- (1) For the country with an absolute advantage in both goods, Ricardo advised specializing in the production of, and exporting, the good in which it has the greatest absolute advantage.
- (2) For the country with an absolute disadvantage in both goods, Ricardo suggested specializing in the production of, and exporting, the good in which it has the least absolute disadvantage.

This rule is the “Law of Comparative Advantage,” which Nobel Prize winning economist Paul Samuelson (1915-2009) calls “the most beautiful idea in economics.”

Under the Law of Comparative Advantage, one country will have more of an

advantage, or less of a disadvantage, in at least one good, compared with another country. Like Smith, Ricardo relied on the concept of “opportunity cost” to evaluate advantage differentials – how much production of one commodity must be sacrificed to release enough factor resources to make an extra unit of another commodity. Ricardo’s insight was to highlight the central role played by relative – not absolute – costs of production in determining the international division of labor, trade flows, and creation of mutual gain.

III. David Ricardo’s Law of Comparative Advantage in Brief

Economists in the classical tradition of Ricardo and Smith, such as Alfred Marshall (1842-1924), a Cambridge scholar, author of *Principles of Economics* (1890) and dominant British economist of his era, are called “neo-classicists.” They elaborate on Ricardo’s Law with arithmetic examples and graphs. What is the connection between classical and neo-classical economic analysis, on the one hand, and modern international trade law, on the other hand? Simply stated, the former tends to drive the latter. The Law of Comparative Advantage is the stated logic for negotiating, drafting, implementing, and enforcing rules to liberalize trade on a multilateral, regional, or bilateral basis.

By no means is the Law of Comparative Advantage the only rationale for rules oriented toward freer trade, and by no means is it universally accepted. Other supporting rationales exist, as do many critics of the Law – including economists – who fault its underlying assumptions, practical feasibility, and effects. Even supporters do not adhere faithfully and at all times to the Law. Trade negotiators, including (reputedly) the USTR, confess (privately) the hypocrisy that they are free traders until they get to the negotiating table, at which point they become Mercantilists. Nevertheless, Comparative Advantage is the major economic paradigm for international trade law. Consequently, thorough familiarity with it, and the arithmetic and graphical proofs of the Law, is essential.

Put succinctly, the Law of Comparative Advantage states the net welfare of a society increases from free trade. The net gain occurs because free trade permits specialization of production, and enhances opportunities for consumption. Specialization of production follows logically from the efficient international division of labor. Enhanced consumption opportunities follow logically from increased total output of all commodities, which is made possible by that efficient division of labor. What criterion determines which country specializes in the production of which good, and thus the division of labor? Comparative cost advantage.

Inevitably, a sector in one country (*e.g.*, T&A producers in the U.S.) with a relative cost disadvantage to its competitor in another country (*e.g.*, T&A producers in India) loses out, meaning that the other country (India) specializes in the production of the good (T&A) in question. But, the gains from specializing in the production of another good (*e.g.*, sophisticated aviation equipment), plus increased consumption opportunities, more than offset that loss. And, if the political system allows, part of the “gain” of the “winners” (the U.S. aviation producers) can be transferred to compensate the “losers” (idled American T&A workers). In other words, the adjective “net” before the word “gain” from free trade cannot be overemphasized. Not everyone is better off from free trade; but on balance, most

are, *i.e.*, most enjoy a higher standard of living, and they can help those who do not.

IV. Division of Labor, Not Job Creation

Neither Ricardo's Law of Comparative Advantage nor Smith's Law of Absolute Advantage are focused on job creation. Through free trade, jobs in sectors with a comparative cost disadvantage are lost, and ones in relatively more efficient sectors are gained. For both Laws, what matters is the efficient international division of labor, which, if it occurs, inevitably means job destruction and job creation. This process is endemic to capitalism: economies re-invent themselves through "creative destruction," wrought in part by free trade. (This term was popularized by the Austrian-American economist, Joseph A. Schumpeter (1883-1950), in the context of entrepreneurship, innovation, and progress, though Karl Marx (1818-1883) and Friedrich Engels (1820-1895) used in *The Communist Manifesto* (1848) to encapsulate the creation and annihilation of wealth in a capitalist economy as it moves from one economic order to another.)

Thus, free trade theory harbors no space for a sentimental, cultural, or political attachment to jobs in a particular sector. What country loses or gains employment in which sector is irrelevant. In the ideal free trade world, there would be maximum division of labor globally through no tariff or non-tariff barriers and a single international currency. Job creation and distribution across countries would be a secondary consequence of free market forces in which competition occurs on the basis of production costs, and factors of production – including labor – are allocated to their highest and best uses. In this ideal paradigm, free traders say material comfort is maximized.

Indeed, focusing on employment maximization contradicts wealth maximization. A country could erect trade barriers, and maximize employment by having one worker dig a ditch or make a product while another worker fills in the ditch or destroys the product. But, allocating two workers in this manner would be an inefficient division of labor, not lead to increased output, and thus not enhance consumption opportunities.

Query, then, whether the CCP, by orchestrating the undervaluation of the Chinese currency (*RMB*, also called "*yuan*") relative to major currencies (such as the U.S. dollar), inflicts long-term damage on the Chinese economy. In the short term, the CCP maximizes employment in export manufacturing sectors, because goods from these sectors are attractive abroad because of their cheap prices (when denominated in major currencies). But, it inhibits the efficient division of labor, within China and across borders, which would occur if the composition and volume of Chinese industrial output were based on comparative cost advantages reflected in accurate international pricing. Does the CCP appreciate this risk, but need to run it nevertheless to avoid social unrest on a scale that might threaten its power?

V. Classical Arithmetic Demonstration of Comparative Advantage

Consider, first, an arithmetic demonstration, akin to the presentation classical economists give. In Ricardo's proof, the example was Portuguese wine and English cloth.

Portugal held an absolute advantage in both goods, because it produced both more cheaply than England. However, Portugal's climate and soil gave it a comparative advantage in wine. That is, Portugal could produce wine more cheaply and efficiently than cotton. Hence, Ricardo showed, Portugal would benefit more by specializing in wine and importing English cloth than producing both wine and cotton. Here, as with the hypothetical case of absolute advantage, the countries are China and India, and the goods are garments (a unit of which is 1 pair of blue jeans) and steel (a unit of which is 1 ton of "H" beams). Table 9-4 sets forth comparative advantage as a basis for trade.

Table 9-4
Comparative Advantage

Output and Country	China	India
	<i>Labor Needed per unit of Output</i>	<i>Labor Needed per unit of Output</i>
Garments – <i>Unit = 1 blue jeans</i>	3 labor hours	12 labor hours
Steel – <i>Unit = 1 ton of "H" beams</i>	6 labor hours	8 labor hours

"Comparative advantage" is a situation in which the price of a good in a country, before trade, is less than the price of the same good in the rest of the world. The country has a comparative advantage in that good, because of the lower relative pre-trade price.

From the Table, it is evident China has an absolute advantage in the manufacture of both goods. China requires 3 labor hours to make a unit of garments, whereas India needs 12 hours. China needs 6 labor hours to make a unit of steel, whereas India needs 8 hours. However, the strength of China's absolute advantage in the two sectors is not the same. China is 4 times more efficient than India in garment production, because China can generate 1 pair of blue jeans in 3 labor hours instead of 12 labor hours. In contrast, China is only $\frac{4}{3}$ more efficient than India in steel production, because China needs 6 labor hours to India's requirement of 8 labor hours (and $\frac{8}{6}$ reduces to $\frac{4}{3}$).

In this scenario, Ricardo's Law calls for China to specialize in garment production. China has the greatest absolute advantage in this sector. India ought to specialize in making steel, as it has the least absolute disadvantage in this sector. China then can export its surplus garments to India in exchange for surplus Indian-made steel. No new factor of production, specifically, no more labor, is required in either country. But, each country must shift labor from one sector to the other. Thus, assume China cuts steel production by 1 unit (*i.e.*, makes 1 fewer ton of "H" beams). China re-allocates the 6 labor hours from the steel to the garment sector. The result is an increase in garment output of 2 units (*i.e.*, 2 more pairs of blue jeans), because China requires 3 labor hours per unit of garments. Conversely, suppose India cuts garment production by 1 unit (*i.e.*, makes 1 fewer pairs of blue jeans). The 12 labor hours freed from garment production shift to making steel, and leads to production of $1\frac{1}{2}$ units of steel (*i.e.*, a further 15 tons of steel). That is because

India needs 8 labor hours per unit of steel (and 12 divided by 8 is 1.5).

Table 9-5 summarizes the gains from trade. It is assumed the single world market price ratio is 1.³⁵⁹

$$\frac{p_{\text{garment}}}{p_{\text{steel}}} = 1$$

With trade barriers dismantled, 1 pair of blue jeans can be exchanged across the Sino-Indian border for 1 ton of “H” beams. Depending on world market supply and demand forces, the price ratio with trade could settle anywhere between the autarky ratios in each country, namely, ½ in China and 1½ in India. These ratios are calculated as follows:

$$\frac{p_{\text{Cgarment}}}{p_{\text{Csteel}}} = \frac{W^{\text{C}} \times (3 \text{ hours})}{W^{\text{C}} \times (6 \text{ hours})} = \frac{1}{2} \text{ in China}$$

$$\frac{p_{\text{Igarment}}}{p_{\text{Isteel}}} = \frac{W^{\text{I}} \times (12 \text{ hours})}{W^{\text{I}} \times (8 \text{ hours})} = 1\frac{1}{2} \text{ in India}$$

Even though there is no increase in factors of production (*i.e.*, no more labor), and even though China holds an absolute advantage in both goods, there is a boost to total – or world – output. With more overall output, resulting from specialization based on comparative advantage, each country is better off by trading its exportable surplus. In turn, consumption possibilities in each country are greater through trade than under autarky. Thus, free trade benefits the supply side of an economy by increasing productive efficiency and income through production specialization. It benefits the demand side of an economy by enhancing the availability of goods for consumption. Of course, free trade does not equalize the standard of living across countries. But, it is a positive sum (not zero sum or negative sum) game. Both trading partners experience a net gain through specialization in production and expansion of consumption opportunities.

Specifically, under autarky assume China and India made 1 unit of garments and steel, hence world (China plus India) output of each product was 2 units. With trade, the world market price ratio is 1. China still can make 1 garment unit, but it forgoes 1 unit of steel production, thereby freeing up 6 labor hours. China can allocate this work to the garment sector, and generate 2 additional units (because it takes China 3 hours per garment unit), for a total of 3 units. By specializing in garments, China produces a net gain of 2 garment units in comparison with autarky. However, with specialization in steel, India gives up garment production, so the loss of its 1 unit must be counted against China’s increase of 2 units. The result is a net world output increase of 1 unit.

³⁵⁹ Each symbol is defined in the same manner as earlier in this Chapter.

Table 9-5
Comparative Advantage and Gains from Trade

Output and Country	China	India
	<i>Labor Needed per unit of Output</i>	<i>Labor Needed per unit of Output</i>
Garments – <i>Unit = 1 blue jeans</i>	3 labor hours	12 labor hours
Steel – <i>Unit = 1 ton of “H” beams</i>	6 labor hours	8 labor hours
Autarky Price Ratios	$\frac{p_{\text{Garment}}}{p_{\text{Steel}}} = \frac{1}{2}$	$\frac{p_{\text{Garment}}}{p_{\text{Steel}}} = 1\frac{1}{2}$
Free Trade Price Ratio <i>(by assumption)</i>	$\frac{p_{\text{Garment}}}{p_{\text{Steel}}} = 1$	$\frac{p_{\text{Garment}}}{p_{\text{Steel}}} = 1$
Domestic Results under Autarky	Garments cost China 3 labor hours per unit. Steel costs China 6 labor hours per unit. China makes 1 garment unit and 1 steel unit.	Garments cost India 12 labor hours per unit. Steel costs India 8 labor hours per unit. India makes 1 garment unit and 1 steel unit.
Total Production under Autarky <i>(China and India combined)</i>	2 garment units (1 each from China and India). 2 steel units (1 each from China and India).	As in column to left.
Results from Specialization based on Comparative Advantage	China continues to make 1 garment unit, but forgoes production of 1 steel unit, which frees up 6 labor hours for production of 2 more garment units. Thus, China makes 3 garment units total. World garment output is 3 units, with production concentrated in China. China can trade 1 unit of garment for 1 unit of steel.	India continues to make 1 steel unit, but forgoes production of 1 garment unit, which frees up 12 labor hours for production of 1½ more steel units. Thus, India makes 2½ units of steel total. World steel output is 2½ units, with production concentrated in India. India can trade 1½ units of steel for 1½ units of garments.

Production Gains from Free Trade <i>(compared to Autarky)</i>	Higher output: 1 extra garment unit is produced. With trade, China makes 3 garment units, but India forgoes production of 1 garment unit. Under autarky, both countries combined for 2 units.	Higher output: ½ extra steel unit is produced. With trade, India makes 2½ steel units, but China foregoes production of 1 steel unit. Under autarky, both countries combined for 2 units.
Consumption Gains from Free Trade <i>(compared to Autarky)</i>	Lower price: Chinese steel consumers get steel at a cost of 1 garment unit, rather than 2 garment units.	Lower price: Indian garment consumers get garments at a cost of 1 steel unit, rather than 1½ steel units.

Given the world price ratio of 1, China can trade one or both of its extra garment units to India for 1 or 2, respectively, units of steel. Suppose China trades 1 garment unit for 1 steel unit. It would have taken China 6 labor hours to generate 1 unit of steel. Thus, China gets 1 steel unit for the 3 labor hours it used to make the traded good – garment – rather than the 6 labor hours it would have needed to make the steel itself. Put differently, China gets the steel at a lower opportunity cost (*i.e.*, the cost associated with foregone alternatives) to itself by trading for the steel rather than producing it domestically.

Similarly, India can continue to produce 1 unit of steel, but scale back garment production by 1 unit, thus freeing up 12 labor hours. India can channel this factor into steel production, and generate 1½ additional units of steel (because it takes India 8 labor hours per unit of steel) compared with what it did as a closed economy. That result is a net increase in Indian steel output of 1½ units. Total Indian output is 2½ units (the sum of the 1 unit India continues to make and 1½ new units). But, with China now specializing in garments, China no longer produces any steel. This diminution (1 unit of foregone Chinese steel production) must be counted against India's gain of 1½ units. The net result is an increase in world steel output of ½ units.

India can trade steel for garments at the world price ratio of 1. For instance, if India trades 1½ units, then it will receive 1½ units of garments in return. It would have taken India 18 labor hours to generate 1½ garment units (12 hours for 1 unit, plus 6 for an additional half unit). Thus, India gets 1½ units of garments for the 12 labor hours it needed to make the good it exported – steel – rather than the 18 hours it would have needed to make the garments itself. Stated equivalently, India gets the garments at a lower opportunity cost to itself by trading for the garments rather than producing them domestically.

Observe, also, the benefit from trade based on comparative advantage to Chinese

and Indian consumers. Chinese steel consumers have steel available to them at a cheaper price (1 garment unit, instead of the autarkic price of 2 garment units). Further, there is a larger output of steel from India available to China, given India's extra output. Similarly, Indian garment consumers can obtain garments at a cheaper cost (1 unit of steel, instead of the autarkic cost of 1½ units of steel). These consumers also gain from having more garments available to them, because of China's extra output.

A key assumption underlying the argument for free trade based on comparative advantage is the mobility of factors of production, especially labor. Contrary to the exuberant rhetoric of some pro-free trade politicians and policy officials, it is simplistic to say free trade creates new jobs. Rather, free trade creates income by re-allocating factors of production from less to more productive sectors within an economy. Economists dub this transfer of resources "allocative efficiency." By increasing average productivity of the factors in an economy, income rises. In this process, jobs are lost in the less productive sector, and expansion in the more productive sector results in additional jobs. What, if anything, can and ought to be done to assist workers in either or both sectors? This question raises issues concerning TAA programs, and the relative abilities of rich and poor countries to fund such programs.

VI. Five Key Microeconomic Concepts for Comparative Advantage

● **Overview**

To understand the graphical presentation of the Law of Comparative Advantage, 5 basic microeconomic concepts are needed. They are:

- (1) PPF
- (2) Marginal Rate of Transformation (MRT)
- (3) Societal Indifference Curve (IC)
- (4) Marginal Rate of Substitution (MRS)
- (5) Relative Price Line (RPL) depicting terms of trade (TOT)

These concepts are explained below.

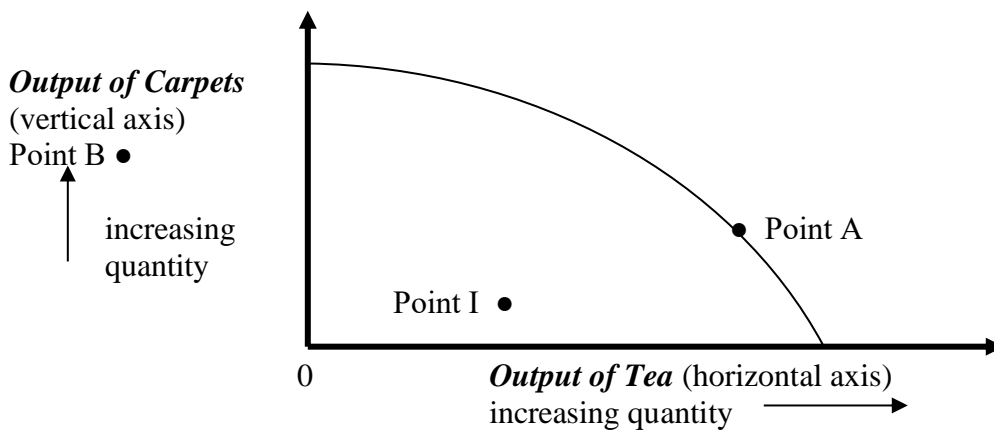
● **PPF and MRT**

A PPF is a diagram of the alternative combinations of two goods that one country can produce with all its factors of production. That is, a PPF shows the maximum amount of one good that can be produced, while making a specific amount of another good. When a country employs fully all factors of production in the most efficient manner, then that country operates on its PPF (such as at Point A). To say factors are deployed "efficiently" means they are engaged in making a combination of goods at the lowest cost with the existing available technology. Graph 9-1 shows a PPF for India.

The goods in question are carpets (on the vertical axis) and tea (on the horizontal axis). Movement upward or rightward along the axes reflects increasing quantities of

carpets or tea, respectively. When a resource is idle, or when a resource is unemployed or underemployed, or not used efficiently, then the country operates at a point inside its PPF. (Point I, on the Graph, would be such an instance.) A country cannot operate beyond its PPF (for example, at Point B on the Graph.) Over time, a PPF shifts outward, as the stock of one or more resources in a country grows (*e.g.*, more labor because of population growth or immigration, more land through land reclamation,³⁶⁰ more physical capital through investment, higher human capital through education, or improved technology). If one or more factors shrink, then the PPF can shift in.

Graph 9-1
PPF for India



The MRT is a microeconomic concept that answers the following question: What does the slope of the PPF indicate? The slope of the PPF is the MRT. Arithmetically, the slope of any line is computed as follows:

$$\text{Slope of Line} = \frac{\text{Change in Vertical Axis}}{\text{Change in Horizontal Axis}} = \frac{\Delta Y}{\Delta X}$$

where “ Δ ” means “change in,” “Y” is the symbol for the vertical axis, and “X” is the symbol for the horizontal axis. Thus, the formula for the MRT:

$$\text{MRT} = \frac{\Delta Y}{\Delta X}$$

³⁶⁰ Singapore is a quintessential example of a country expanding through land reclamation. Since its independence in 1965, this island city-state has expanded by 25%. It has done through principally by “sand mining,” that is, getting sand from around the Southeast Asian region and shipping it home. However, Singapore’s sand mining had negative environmental externalities, such as erosion. Thus, Cambodia (in 2017), Indonesia (in 2007), and Malaysia (in 2018) banned the practice. Burma, too, suffered from this erosion, with rice paddy and vegetable fields lost to the seawater with the dredging and removal of sand from the seabed. See Sam Aung Moon, John Geddie & Poppy McPherson, *As Myanmar Farmers Lose their Land, Sand Mining for Singapore is Blamed*, REUTERS, 3 March 2020, www.reuters.com/article/us-myanmar-sand-singapore-insight/as-myanmar-farmers-lose-their-land-sand-mining-for-singapore-is-blamed-idUSKBN20R0C1.

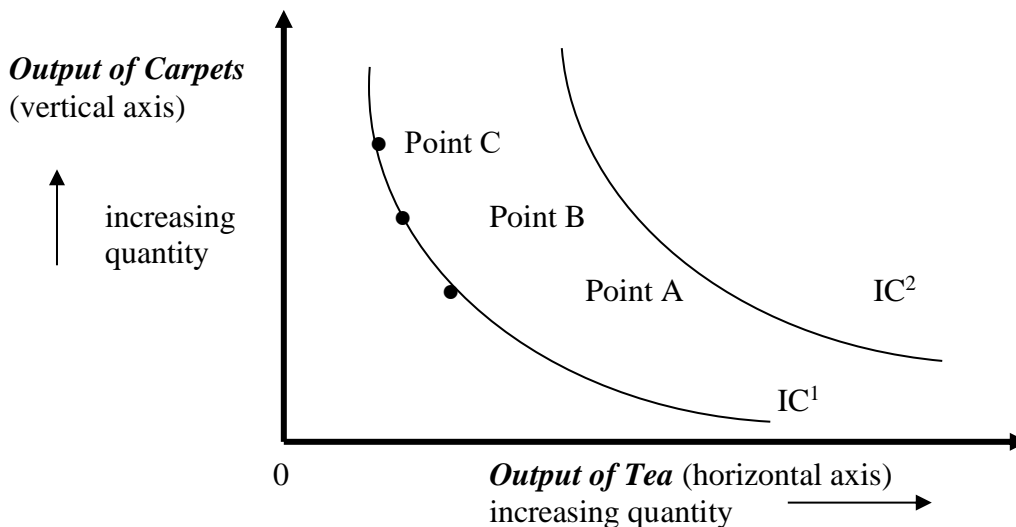
Intuitively, the MRT reflects the opportunity cost of production between two goods. The concept of “opportunity cost” refers to sacrifice, namely, what amount of production of one item must be sacrificed to produce another item. Embedded in this concept is the re-allocation of factors of production from making one good to making another good. Significantly, therefore, the PPF, via the MRT, reveals trade-offs for a society, *i.e.*, the opportunity cost to a society of manufacturing one versus another commodity.

- **Societal ICs and MRS**

The third microeconomic concept, an IC, exhibits the tastes and preferences of an individual, or society. Consequently, it alleviates the need for an assumption that a choice among alternative combinations of goods that could be consumed reflects “given” tastes and preferences that are exogenous (*i.e.*, not explained by the model at hand). An IC represents the different combinations of goods an individual consumer, or a society, could have to yield a particular level of material satisfaction.

Graph 9-2 depicts an IC map for a country, India. The goods in question are, again, carpets and tea. An IC is drawn as a downward-sloping curve that is convex (*i.e.*, bowed inward) to the origin of the graph on which it is plotted. (The “origin” is the zero point, at which the vertical and horizontal axes intersect). The level of satisfaction, or utility, is the same on an IC. Each IC – on a map of them – reflects different levels of utility. Along any single IC, the level of satisfaction is the same. What changes in moving along an IC is the precise combination of goods.

Graph 9-2
Societal ICs for India



For instance, in moving along IC¹ from Point A to Point B, Indians consume fewer carpets and more tea at Point A than at Point B. However, they are indifferent as to consuming at Point A or B, because each point yields the same level of utility. Literally, an IC shows combinations of carpets and tea Indian society could consume to obtain a given level of

satisfaction and among which they are indifferent. Movement from Point A to Point B is nothing more than a substitution of one good for another. The rate at which Indian consumers are willing to substitute between the two goods is the MRS. The MRS is the slope of an IC at a particular point on that IC.

The closer an IC is to the origin of a graph, the lower the level of satisfaction associated with the combinations of goods represented by that IC. Conversely, the further away an IC is from the origin, the higher the utility level obtained from the alternative combinations of goods reflected in that IC. Thus, IC^1 represents a lower level of satisfaction than IC^2 . In other words, a movement upward and to the right in a map of ICs, from one IC to another, means increases in consumer satisfaction. By assumption, economic actors – whether individuals, groups, or countries – seek to attain the highest possible IC, and thereby the greatest level of utility.

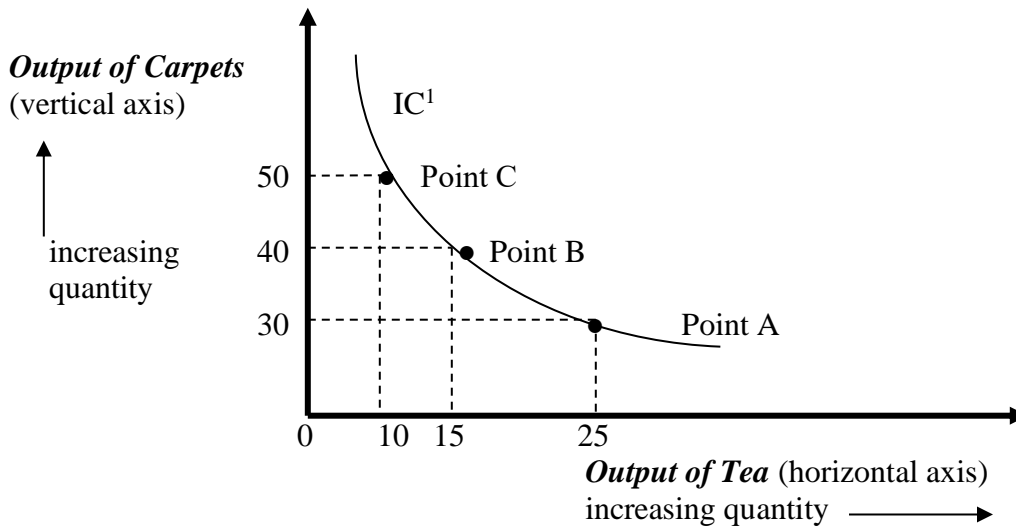
ICs do not intersect. If they did, then it would mean the same combination of goods yields two different levels of utility. That result would be illogical. It also would be contrary to the characteristic of an IC map that the further an IC is from the origin, the higher the level of satisfaction reflected by that curve.

As intimated, an IC can represent the tastes and preferences of a country. Technically, the correct label for such an IC is a “Social Indifference Curve.” By assumption, IC^1 and IC^2 are social ICs. Social ICs have the same characteristics as individual ICs. However, a Social IC is not established simply by summing up all tastes and preferences embodied in the individual ICs of each person in a country. Income distribution matters. That is because different distributions within a county lead to different IC maps.

For instance, if a country liberalizes its trade laws, then some individuals may benefit (*e.g.*, exporters), while others suffer (*e.g.*, producers of products that are like, or compete directly with, imports). Trade liberalization will not have an even effect across all individuals. To account for the distributional effects of freer trade, economists rely on the “Compensation Principle.” Social welfare potentially increases from a policy change like trade liberalization if the gainers take part of their gain to compensate the losers, so that everyone has the potential to become better off. In sum, a Social IC map involves not just the aggregation of individual ICs, but also use of the Compensation Principle.

The fourth microeconomic concept, MRS, is analogous to the MRT. Just as the slope of the PPF is the MRT, the slope of an IC is the MRS. In Graph 9-3, clearly, IC^1 has a steeper slope at Point B than at Point A. As India moves along IC^1 upward and to the left, from Point A to Point B, from Point B to Point C, and so forth, the MRS decreases, which arithmetically means the MRS becomes a larger negative number.

Graph 9-3
MRS along IC for India



The arithmetic fact MRS decreases with movement up and to the left of an IC reflects the economic concept of diminishing marginal utility. Essentially, the more of one good an individual or society consumes of that good, the less utility derived from each incremental unit of that good. (Imagine the difference in satisfaction between the first and second slice of pizza, and the fifth and sixth slice of pizza. The diminution in marginal satisfaction is diminishing marginal utility from pizza. If asked to trade off glasses of fine red wine for the second slice of pizza, a consumer might be willing to give up two glasses. But, having eaten five slices, asked about how much red wine a consumer would give up to get a sixth slice, the likely answer would be less than half a glass!) Diminishing marginal utility also accounts for why ICs are convex to the origin (zero point) of a graph.

For a fuller appreciation of MRS and diminishing marginal utility, recall that the slope of any line is computed as follows:

$$\text{Slope of Line} = \frac{\text{Change in Vertical Axis}}{\text{Change in Horizontal Axis}} = \frac{\Delta Y}{\Delta X}$$

where “ Δ ” means “change in,” “Y” is the symbol for the vertical axis, and “X” is the symbol for the horizontal axis. Thus, the formula for MRS is the same as that for MRT:

$$\text{MRS} = \text{Slope of IC at a point} = \frac{\Delta Y}{\Delta X}$$

Accordingly, as the Graph shows, in moving from Point A to Point B, India consumes less tea (15 instead of 25 units) and more carpets (40 instead of 30 units):

$$\text{MRS in moving from Points A to B} = \frac{\Delta Y}{\Delta X} = \frac{40 - 30}{-(25 - 15)} = -1$$

(The slope is negative, because the denominator reflects a diminution in consumption of tea.) Intuitively, to consume 10 more units of carpets, India must forego consumption of 10 units of tea. To Indians, there is a one-to-one trade-off between carpets and tea.

The trade-off changes if India moves from Point B to Point C. As Graph 9-3 shows, with increased consumption of another 10 carpets (from 40 to 50 units), India's consumption of tea again drops – but by 5 units (from 15 to 10), rather than 10 units as in the movement from Points A to B:

$$\text{MRS in moving from Points B to C} = \frac{\Delta Y}{\Delta X} = \frac{50 - 40}{-(15 - 10)} = -2$$

Intuitively, to consume another 10 units of carpets, India is willing to forego only 5 units of tea. Why? At such a high consumption level of carpets (50 units, at Point C), Indian consumers do not get much utility from the incremental carpet they consume. They will not be induced to consume one more carpet if they have to forego much tea. The diminishing MRS in moving from points A to C, *i.e.*, the increase in the negative number, from -1 to -2 , is the arithmetic statement of diminishing utility to India from consuming ever-larger amounts of carpets.

- **RPL Showing TOT**

The fifth and final microeconomic concept needed to demonstrate the Law of Comparative Advantage is a Price Line. This concept is not different from the MRS or MRT. Essentially, it is a straight line, and the focus of attention is on the slope of the line (defined earlier). On a graph, if the vertical (y) axis measures units of quantity of one good produced or consumed, and horizontal (x) axis gauges units of a second good produced or consumed, then the numerator and denominator of the slope formula (ΔY and ΔX , respectively) obviously consist of quantities of goods. Those quantities reflect a trade-off between production or consumption of one good versus another. That is, the slope is a ratio of exchange between the two goods – hence, the adjective “relative.”

A ratio of exchange between goods is the same as the relative price between goods. The ratio is constructed using quantities. So, relative price is not in terms of a currency, but in terms of units of one good exchangeable for another good. That kind of trade is barter (or counter-trade), and occurs in some markets and contexts. Economists frequently measure relative prices by the ratio of product quantities. They call the RPL the TOT, and they do so for all kinds of goods. The generic formula for a TOT index is:

$$\text{TOT} = \frac{\text{Index of Export Prices}}{\text{Index of Import Prices}} \times 100$$

As its name suggests, the TOT are the relative prices at which two countries trade goods or services, or more specifically, the terms, in the sense of price, which one country receives (from another country) for its exports (to that other country) in relation to the price

that country pays (to the other country) for imports.

Thus, to take one example, consider oil and pharmaceuticals. The relative price of these commodities would be:

$$\text{Relative Price} = \frac{\text{Change in barrels of oil}}{\text{Change in bottles of pills}} = \frac{\Delta Y}{\Delta X} = \frac{P^{\text{OIL}}}{P^{\text{PILL}}}$$

The symbol “ P^{OIL} ” stands for the price of oil, and “ P^{PILL} ” is the price of pharmaceuticals.

Another way to explain this point is as follows. Suppose a barrel of oil costs U.S. \$50, and a bottle of pills cost \$25. Then, the relative price of oil to pills, in terms of nominal (or money) prices would be:

$$\frac{\$50}{\$25} = 2$$

Consequently, one barrel of oil could be sold to purchase two bottles of pills. To generalize, if:

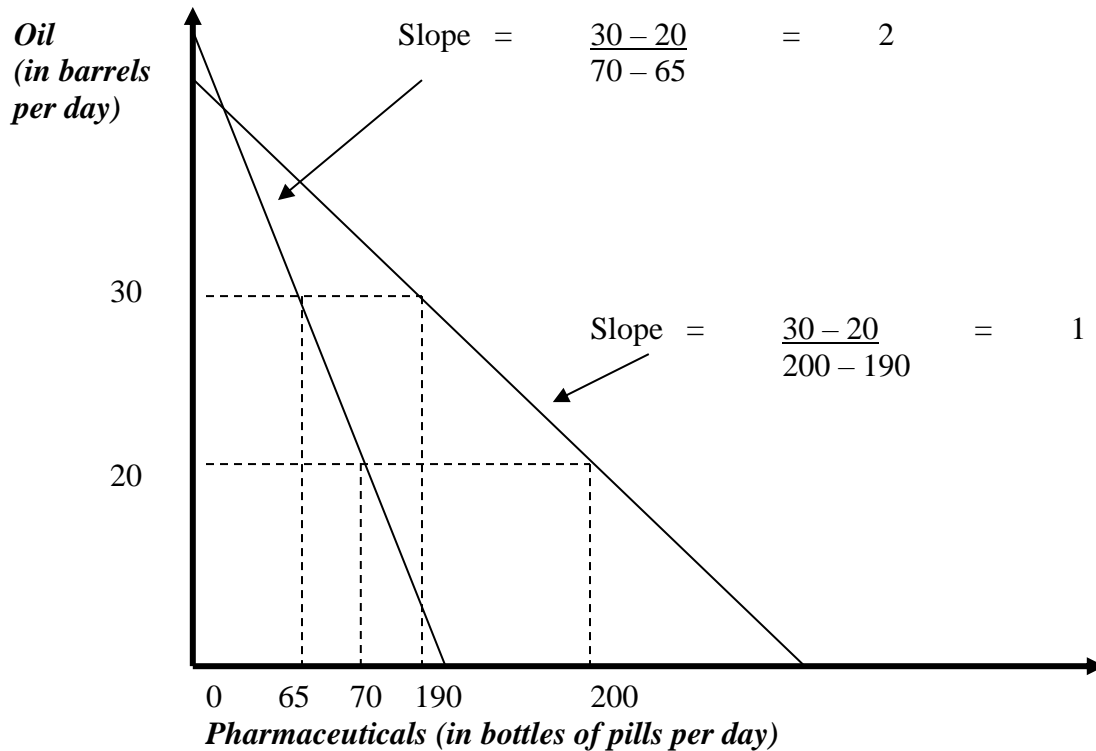
$$\frac{P^{\text{OIL}}}{P^{\text{PILL}}} = k \text{ (where } k = 2, \text{ in the example)}$$

Then, 1 unit of oil equals k (*e.g.*, 2) units of pills.

Graph 9-4, called “RPLs,” shows two different TOTs. The steeper Line, with a slope of 2 (technically, -2), shows oil is twice as dear as medicine. That is because two bottles of pills must be sacrificed for 1 barrel of oil. The second, flatter, Line has a slope of 1 (or -1). Here, 1 barrel may be traded for 1 bottle.

As an added feature, the end points of a RPL show what quantity of a good could be consumed if all income were spent on that good. For example, where the RPL intersects with the vertical axis, all income is spent on oil. Where a RPL intersects with the horizontal axis, all income is spent on pharmaceuticals. This insight suggests a Line also reveals a budget constraint. That is because it depicts the maximum amount of either good, or alternative combinations of a good, which can be purchased. The further the Line from the origin of the Graph (where the axes intersect), the higher the budget.

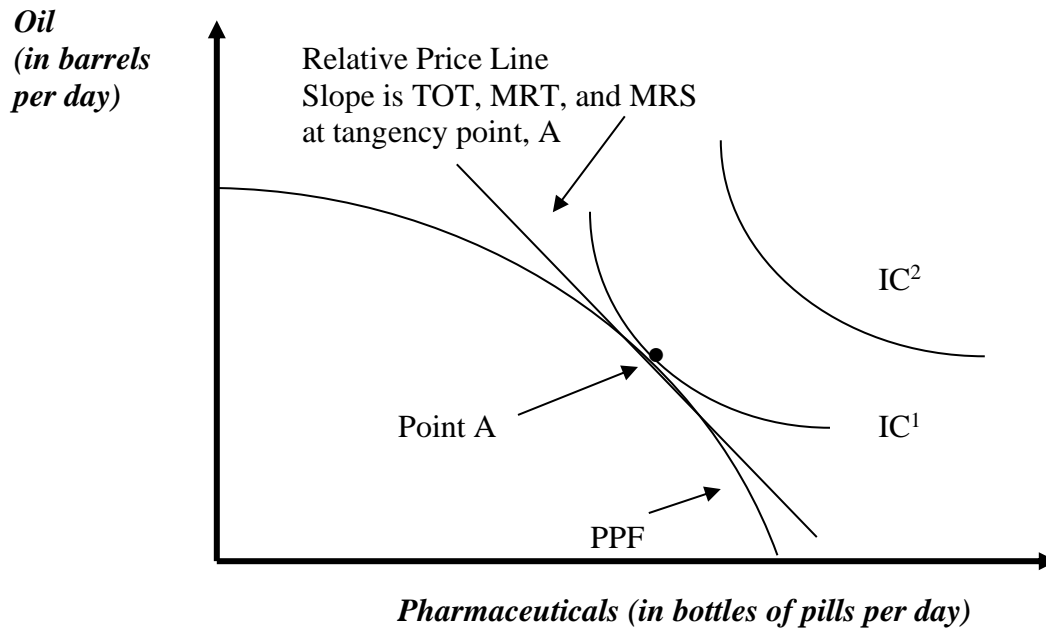
Graph 9-4
RPLs



- **Summary**

In Graph 9-5, all aforementioned concepts are combined, using India, oil, and pharmaceuticals as an example. That is, a PPF with Societal ICs, one of which is tangent to (*i.e.*, just touching) the PPF, is mapped. Alternative RPL, including one through the tangency point, are shown. The slope of a Relative Price Line tangent to the PPF not only reflects the TOT at the tangency, Point A, but also the MRT at that point. Likewise, the slope of a Line tangent to a Societal IC is both a TOT and the MRS at the tangency.

Graph 9-5
Basic Microeconomic Concepts for Law of Comparative Advantage –
Indian Oil and Pharmaceutical Production



VII. Neo-Classical Graphical Demonstration of Comparative Advantage

● **Conditions under Autarky**

Graph 9-6 exhibits a PPF, ICs, and a Price Line for a country. By hypothesis, the country is India before 1991. This Graph is titled “India under Autarky.” This term refers to an economic policy of not participating in international trade, *i.e.*, not importing or exporting any goods (or, presumably, services). An autarkic economy is a closed one. The proof, elaborate as it may at first appear, is designed to make a powerful point: with a fixed stock of factors of production, free trade based on the specialization of production in a good in which a country has a comparative advantage expands consumption opportunities in the country beyond the limits of what that country can produce under autarky.

In brief, free trade generates a net benefit to the country, in the form of a production gain and a consumption gain. The word “net” requires careful attention. The word connotes what comparative advantage says and does not say. Consider what the WTO Director General said in November 2016:

Without naming [President Elect Donald J.] Trump, [Roberto] Azevêdo said certain world leaders have disproportionately blamed global trade agreements for domestic job losses and other economic woes.

“More often than not we see this discussion about trade being a disruptive factor –and it can disrupt in some situations – being hijacked to cover other

situations that have nothing to do with trade” ...

About 20 percent of the jobs being displaced in advanced economies is caused by trade, he said. The other 80 percent “has nothing to do with trade....” It’s about new technologies, it’s about innovation, automation and new methods of production.”

By definition higher productivity means doing more with fewer people, Azevêdo said. “And a lot of those new methodologies of production are doing a lot more with a lot less people. And this is becoming a structural shift in many advanced societies.”

“The shift brought a lot of people from a certain level of employment with guarantees and benefits to other jobs which pay less, are more uncertain, are not necessarily long-term positions....”

...

Azevêdo warned countries to eschew protectionist policies going forward to ensure that the world’s poor and vulnerable groups aren’t unfairly disadvantaged.

“If you block trade from an advanced economy, in very rough numbers the purchasing power will decrease by 30 percent....” “But at the lower level, the purchasing power will diminish by 60 percent.”

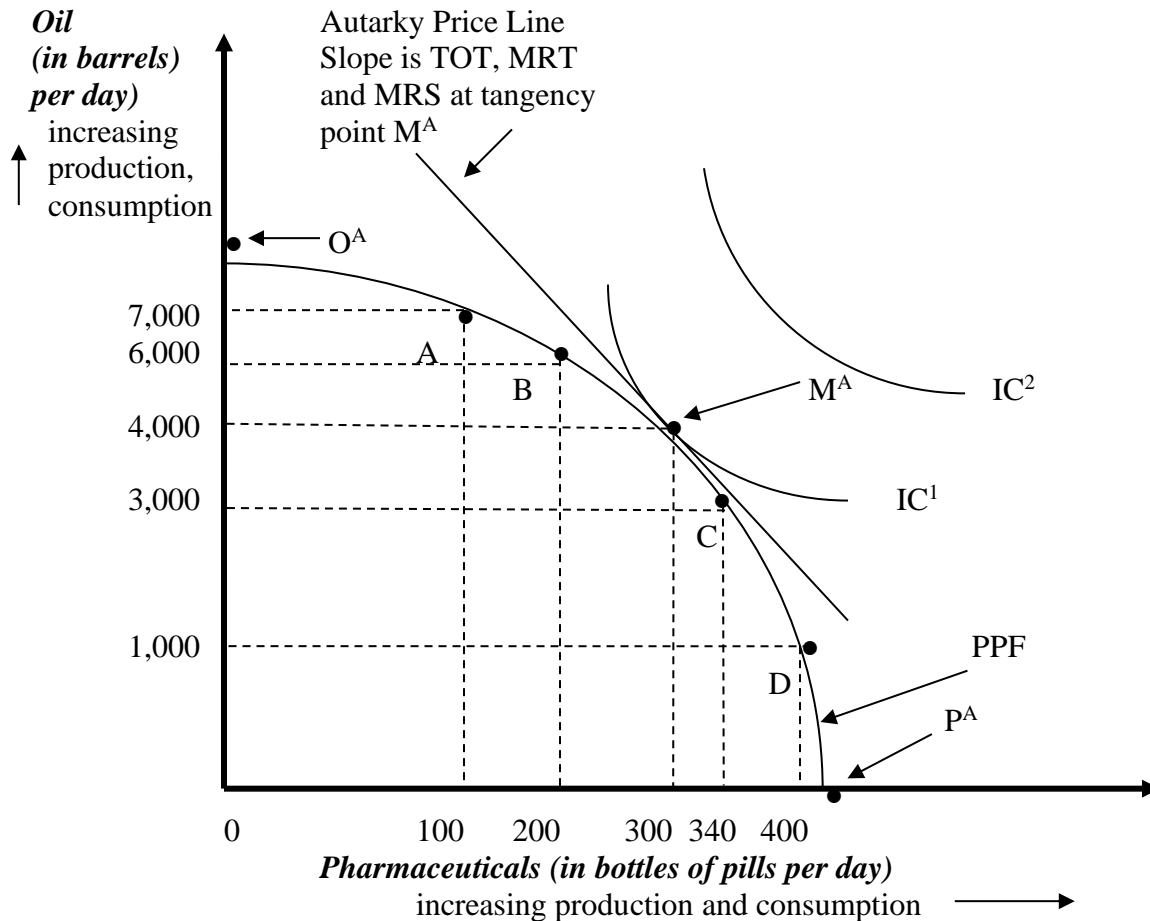
“So you will be doing something which would harm, particularly the poor segments of the population, which are the ones that are more vulnerable and more vocal about this situation today....”³⁶¹

Many politicians knowingly or unwittingly ignore the distinction, between “net” and “gross,” and thereby oversell the benefits of free trade. Concomitantly, free trade critics ascribe adjustment costs to trade.

The key point is that the proof is not free trade benefits all interest groups in society, *i.e.*, all producers, all consumers, and the government. Some groups, most notably, the government (which collects tariff revenue), and certain producers (namely, ones producing a product that is like or directly competitive with imports, or which benefit from quota rents) suffer when trade barriers like tariffs and quotas are dropped. Not surprisingly, then, certain interest groups argue for protection. Likewise, the proof is not the whole world is helped by trade liberalization. Rather, the proof is on balance, a country that dismantles its trade barriers, even unilaterally, is better off than it had been when closed to trade.

³⁶¹ Quoted in Bryce Baschuk, *WTO Chief on TPP's Demise: "Life Goes On,"* 33 International Trade Reporter (BNA) 1687 (1 December 2016).

Graph 9-6
India under Autarky



Before 1991, the Indian economy was not autarkic. But, neither did India pursue aggressive trade liberalization – quite the contrary.

Few are the cases of pure or nearly pure autarky, with Burma from 1962-88, China from 1949-79, and North Korea after 1953, among them. However, from Independence on 15 August 1947 through 1991, India pursued socialist policies championed by Prime Minister Jawaharlal Nehru (1889-1964) and his daughter, Prime Minister Indira Gandhi (1917-1984), as well as self-reliance, a philosophy advocated by Mohandas K. (“Mahatma”) Gandhi (1869-1948). These policies included high tariff barriers, many quotas, and licensing for imports and exports. Thus, for instance, India sought (and, with the help of the Green Revolution in the 1960s, eventually attained) self-sufficiency in food, even becoming a net exporter of grains.

As the axes of Graph 9-6 illustrate, the two commodities at issue are oil (*i.e.*, crude oil), on the vertical axis, and pharmaceuticals (*i.e.*, medicines), on the horizontal axis. Upward movement on the vertical axis indicates increasing quantity of oil produced and consumed (typically measured in barrels per day). Rightward movement on the horizontal

axis indicates increasing quantity of pharmaceuticals produced and consumed (measured in terms of bottles of pills per day). The PPF is the arch sloping downward from the top left of the vertical axis to the far right of the horizontal axis.

At the top left, where the PPF intersects the vertical axis, Point O^A (for “oil under autarky”), India produces and consumes only oil. At the bottom right, where the PPF intersects with the horizontal axis, Point P^A (for “pharmaceuticals under autarky”), India produces and consumes only pharmaceuticals. In the middle of the PPF, at Point M^A (for “mix under autarky”), India produces a 50-50 mix of oil and pharmaceuticals (specifically, 4,000 barrels of oil, and 300 bottles of pills, per day). Movement down and to the right of the PPF means India produces and consumes less oil and more pharmaceuticals, and movement up and to the left suggests the reverse pattern.

India is a diversified economy, producing and consuming more than just oil and medicine. It is possible to depict graphically more than just two commodities. To do so, the axes measure bundles of goods. For instance, the vertical axis could depict a bundle of durable goods (*i.e.*, goods the life of which typically exceeds one year, such as cars and refrigerators), and the horizontal axis could gauge non-durable goods (*i.e.*, merchandise with a less-than-one year life, such as most food items). Using oil and pharmaceuticals is an assumption to simplify the analysis, but broadening the number of commodities does not change the demonstration of the Law of Comparative Advantage.

Why is the PPF shaped like an arch concave (*i.e.*, bowed out) from the origin, Point O , where the axes intersect? The answer is increasing costs of production, specifically, opportunity costs. To make more pharmaceuticals, India must give up production of oil. That is, India must release some factors of production dedicated to oil and re-allocate them to making medicines. The more pharmaceuticals India seeks to produce, the more oil production it must forego. That is, India must forego ever-increasing quantities of one good to produce more of the other good. Stated in economic terms, India faces increasing opportunity costs of production.

For instance, to move from producing 100 bottles of medicine per day to 200 bottles, India must give up production of 1,000 barrels of oil per day. This shift is from Points A to B on the PPF. However, if India wants to increase pharmaceutical production further, from 200 to 300 bottles per day, then it must give up 2,000 barrels of oil per day. This shift is shown from Points B to C on the PPF. If India wants to boost output of medicines from 300 to 400 bottles per day, then it must forego 3,000 barrels of oil per day. This change is from Points C to D on the PPF. In brief, increasing production costs mean for each successive increment in the production of one unit of a good, it is necessary to forego an ever-larger number of units of production of the other good.

Re-allocating resources from the oil to pharmaceutical sector assumes the resources indeed are mobile. In reality, there are likely to be barriers to mobility, as well as transaction costs. Workers may not want to leave their homes and communities, particularly if they have to migrate far from their families to locations where a different language is spoken or religion is practiced. Capital equipment and technology needed to

explore and drill for oil, pump it, and transport it to refineries is not readily convertible to making medicine. Thus, for a country to take advantage of trade liberalization, it often is necessary to implement complementary reforms to allow factors migration to optimally efficient uses based on a new set of world market forces.

In the example, the MRT is the opportunity cost India faces as it selects a particular combination of oil and pharmaceuticals to produce and consume. If production costs are constant, then the MRT is the same at all points on the PPF. After all, the slope of the Line is the same at all points. But, if (as in the Graph) costs are increasing, then MRS changes. At each point on the PPF, MRS is different from each other point. That is because the slope of a straight line drawn tangent to (*i.e.*, just touching, but not intersecting) a point differs from one point to another along the PPF. In specific, with movement down and to the right, MRT increases. The increases reflect growing costs of production – *i.e.*, foregoing ever-larger amounts of oil to make another bottle of pills.

From the Graph, the MRS at different points is apparent. Moving from Points A to B means increasing output of pharmaceuticals from 100 to 200 bottles, but foregoing 1,000 barrels per day of oil. Therefore, the MRS (slope) is:

$$\frac{\Delta Y}{\Delta X} = \frac{-(1,000)}{200 - 100} = -10$$

(The sign on the numerator is negative, because oil production falls.) To shift from points B to C, meaning an increased pharmaceutical output from 200 to 300 but a drop in oil production by 2,000 barrels per day, would imply a greater MRS (steeper slope):

$$\frac{\Delta Y}{\Delta X} = \frac{-(2,000)}{300 - 200} = -20$$

Finally, the shift from points C to D imply yet another boost in output of medicines by 100 bottles per day, but a steeper drop than before in oil output – India forgoes 3,000 barrels per day. The MRS (slope) is:

$$\frac{\Delta Y}{\Delta X} = \frac{-(3,000)}{400 - 300} = -30$$

Clearly, the MRS increases from -10 to -30 , bespeaking increased production costs.

The scenario of increasing production costs is more realistic than imposing an assumption India faces constant costs of production. In fact, most countries have to forego making more of one commodity if they attempt to produce ever-increasing amounts of another commodity. It is possible (indeed, easy) to represent a PPF with constant costs of production – the PPF is a straight line. To say costs are “constant” means the number of units of output of one good a country such as India must forego in order to make an additional unit of another good remains the same. If the PPF in the Graph were a straight line, from points O^A to P^A , then it would mean India faces constant costs of production as

between oil and medicines. The straight-line PPF would indicate India gives up the same amount of oil production, for example, 1,000 barrels per day, to produce more pharmaceuticals, whether the increase is from 100 bottles of pills per day to 200 bottles, or from 300 bottles per day to 400 bottles.

The critical insight to obtain from the Graph is a country under autarky can consume only what it produces. It cannot specialize in the production of one good, generate a surplus for export, and exchange that exportable surplus for imports. After all, the country is closed to trade. At what point will India produce and consume? It can choose any point on, or within, its PPF. It will make the choice based on societal preferences, which are represented by ICs. In the Graph, by assumption India chooses Point M^A. It is confined to producing a mix of goods on its PPF, and it cannot achieve a level of consumer satisfaction beyond that PPF (such as at IC²).

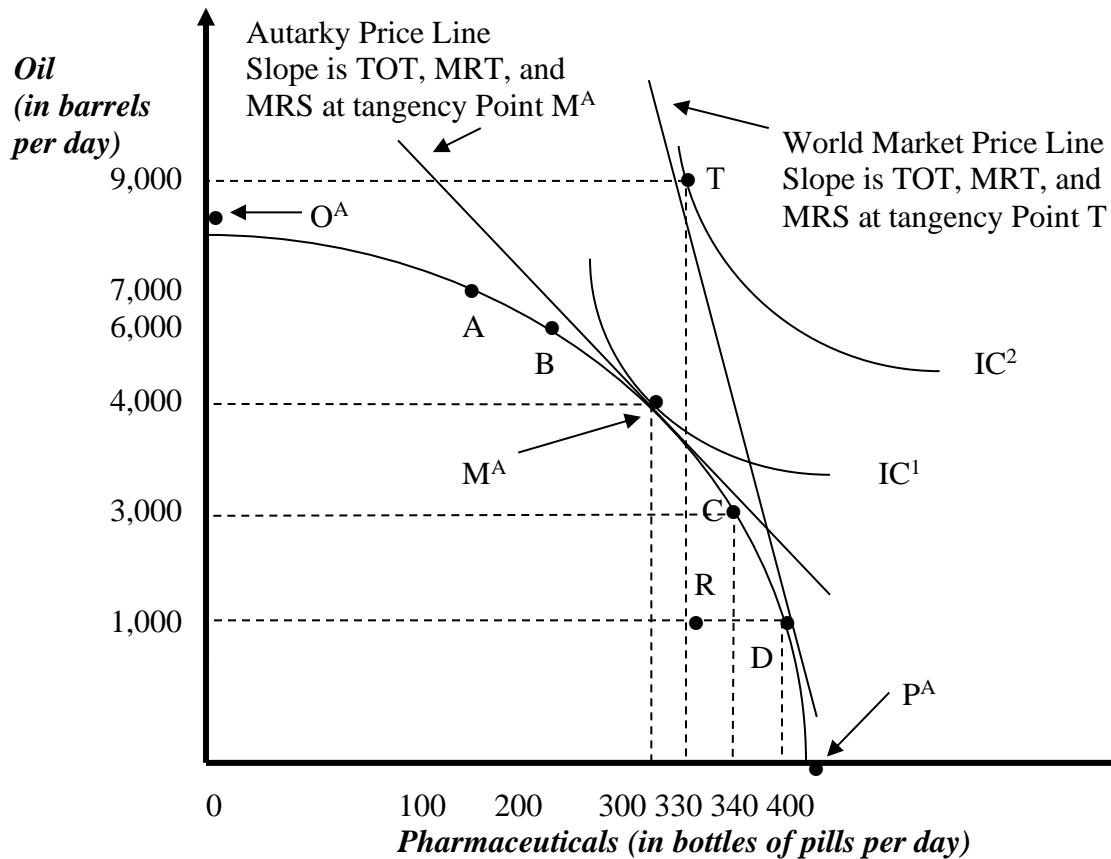
- **Conditions with Free Trade**

In 1991, India undertook serious economic reforms. This policy shift reflected business realities, and had geopolitically strategic implications. Some of India's growth is in the IP sector, including medicines. India makes generic drugs cheaply and in large volumes, and exports them to countries that lack the same manufacturing capacity, such as many Sub-Saharan African nations. As for oil, India now competes, along with China and other big emerging economies, with the U.S., EU, Japan, and established powers to satisfy growing domestic energy demand. Industrialization and rising lifestyle expectations drive that demand.

Graph 9-7 continues the example, showing post-1991 India. Entitled "India with Free Trade," this Graph depicts the effect on India of opening to importation and exportation of goods (and, again, services). India cannot produce enough oil to satisfy domestic needs, and the gap between its own output and consumption grows as does the Indian economy and incomes of Indians. Thus, the Graph shows India imports oil. By hypothesis, its source is Iran. About 60% (as of December 2007) of proven oil reserves in the world are located in the Middle East. Saudi Arabia is home to the largest share, 22% of all proven reserves, Iran roughly 11%, and Iraq nearly 10%. At the rate of production (as of 2004) in the Kingdom, Saudi Arabia exhausts its reserves in 68 years, whereas Iran's reserves last 89 years. India has just 19 years of remaining reserves.

Of course, in reality, India relies on a variety of foreign sources, and it is possible to group them together under the banner ROW. That is, ROW could be India's trading partner. Iran is chosen, however, to emphasize the complex nexus between security and trade, and test the proposition of peace through trade.

Graph 9-7
India with Free Trade



To get Iranian oil (and NG), India uses a newly constructed pipeline, which crosses Pakistani territory. Relying for some energy needs on a pipeline traversing its traditional nemesis, Pakistan, is for India both a security risk and a strategic opportunity for better relations with Pakistan.

From the U.S. perspective, stability on the Indian Subcontinent – where both India and Pakistan are armed with deliverable nuclear weapons, and fight over Kashmir – is only part of the calculus. Many among the best and brightest in America’s foreign policy elite look askance at India cozying up to Iran. They are wary of Iran’s nuclear ambitions and decry its support for extremist causes. The dreadful bilateral relations date not just to 4 November 1979, when militants seized the U.S. Embassy in Tehran (and held 52 Americans hostage for 444 days). They go at least as far back as 1953, to a U.S.-inspired *coup d’état* of Iran’s democratically elected Prime Minister, Mohammed Mossadegh (1882-1967). The U.S. maintains sanctions on the world’s only *Shi’ite* theocracy. They include a secondary boycott barring other countries from investing in Iran’s energy sector. So, trade reform in India is not just about trade.

What does India export in return for Iranian oil? The answer is pharmaceuticals, particularly generic drugs. India produces far more bottles per day than it can consume.

In contrast, Iran – which has an excess supply of oil – is more than eager to trade oil to India in exchange for medicines, which (by assumption) it needs. On the Graph, this exchange is depicted by what economists dub the “Trade Triangle,” TRD. Essentially, India exports RD units of pharmaceuticals in exchange for imports of RT units of oil.

From trade, India is better off than under autarky, as Table 9-6 shows. Specialization of production in a commodity in which India has a comparative advantage, plus a higher level of consumer satisfaction, are why India is “better off” than before. These reasons also would justify India’s interest in trade with Iran. The U.S. and its allies have political and national security motives for isolating Iran from the global economy. Those motives may be incongruous with Indian economic interests.

Consider re-calculating matters from an American perspective. Might increased trade between India and Iran enhance American national security interests? Indeed, in his *Principles of Political Economy and Taxation* (1817), Ricardo signaled the civilizing benefits of commercial intercourse:

Under a system of perfectly free commerce, each country naturally devotes its capital and labor to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labor most effectively and most economically: while, *by increasing the general mass of productions, it diffuses general benefit, and binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilized world.* It is this principle which determines that wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England....³⁶²

Put squarely, is the conflict between American politics and Indian economics a false one?

- **General Lesson**

To sum up, there are four critical points to appreciate about the Graph and Table:

1st: Production Gains from Trade

Following the Law of Comparative Advantage, India specializes in pharmaceutical production. It moves from Point M^A to Point D on its PPF, thereby expanding pharmaceutical output from just under 300 bottles per day to 400 bottles per day. It scales back oil output, from just over 4,000 barrels per day to 1,000 barrels per day. This shift reflects the TOT India faces with economic reform via trade liberalization.

³⁶² Emphasis added.

Table 9-6
Summary of Gains from Free Trade

<i>Issue</i>	<i>Oil (barrels per day)</i>	<i>Pharmaceuticals (bottles of pills per day)</i>
Production under Autarky	4,000	300
Production with Free Trade	1,000	400
Production Gain or Loss with Trade (compared to Autarky)	3,000 barrels per day less produced. Specialization out of oil, in which India lacks a comparative advantage.	100 additional bottles of pills per day produced. Specialization into pharmaceuticals, in which India has a comparative advantage. Also, Indian producers obtain a higher price for their product.
Consumption under Autarky	4,000	300
Consumption with Free Trade	9,000	330
Production (Exportable) Surplus or Consumption Deficit	Deficit of 8,000 (1,000 – 9,000)	Surplus of 70 (400 – 300)
Indo – Iranian Trade	India imports 8,000 barrels of oil per day from Iran in exchange for 70 bottles of pills per day.	India exports 70 bottles of pills per day to Iran in exchange for 8,000 barrels of oil per day.
Consumption Gain from Trade (compared to Autarky)	Indians consume an additional 5,000 additional barrels of oil per day (9,000 – 4,000). Also, Indians get oil at a lower price.	Indians consume an additional 30 bottles of pills per day (330 – 300).

The “shift” is one of a division of labor as between India and Iran. From the vantage point of free trade theory, any employment generated by their trade is of subsidiary importance. Of primary importance is the efficient allocation of factors of production, including labor, in response to comparative cost signals.

2nd: Consumption Gains from Trade

Indian consumers can achieve a higher level of material satisfaction with free trade

than under autarky. They will seek to attain a consumption level at the highest possible Societal ICs, but subject to the TOT set by the world market. At the TOT dictated by the World Market Price Line, they can reach IC². That is, they move from Point M^A to Point T on IC². At this level of material well-being, Indian consumers do not purchase all the pharmaceuticals India produces. India makes 400 bottles per day (at Point D), but its people consume 330 bottles per day, leaving 70 bottles per day of surplus. But, Indians would like more oil than India pumps and refines, as domestic demand is 9,000 barrels per day, but domestic output is just 1,000 barrels per day.

How does India rectify this situation of excess demand for oil? The answer is international trade. With the extra pharmaceutical production, India has an excess supply of that product. It ships this surplus to Iran, in exchange for the necessary oil.

3rd: World Market Price

The World Market Price Line embodies the TOT India faces with free trade. What will the TOT, a single international trade equilibrium, be? World market forces of supply and demand in the two commodity markets, oil and pharmaceuticals decide the answer. These forces are, at a human level, the decisions of millions (if not hundreds of millions) of producers and consumers in Indian, Iranian, and other markets.

Undoubtedly, the equilibrium will be an intermediate level between the autarky prices in India and Iran. Intuitively, this result makes sense. Indian pharmaceutical companies would not sell pills to Iran at a price cheaper than they could receive in India. Conversely, Iranian oil companies would not sell oil to India at a barrel price cheaper than what they could sell on their home market. Consumers in each country react in the same manner. Indian consumers would not buy oil from Iran at a higher price than they can receive domestically, and Iranian consumers would not get their medicines from India if domestic equivalents were available at a lower price.

To appreciate this point in arithmetic and graphical terms, recall the Autarky Price Line and World Market Price lines are sloped downward. Technically, their slopes are denominated by a negative number, but what matters is the absolute value and the trade-off this value represents. A smaller absolute value (such as 1 in comparison with 2), reflects a less steep slope than a larger absolute value (such as 2 in comparison with 1).

Assume, then, the TOT under autarky at Point M^A is 1. In other words, 1 barrel of oil is equal to 1 bottle of pills. Therefore, Indian pharmaceutical companies can sell in India 1 bottle of pills and receive 1 barrel of oil. As the Graph depicts, the World Market Price line is steeper than the Autarky Price Line. That steepness must be reflected in a larger number than 1. So, assume the slope is 2. The implication is that at Point D, 2 barrels of oil are equal to (*i.e.*, may be traded for) 1 bottle of pills. Therefore, Indian pharmaceutical companies can sell Iranian consumers one bottle and receive 2 barrels of oil. Clearly, the Indian pharmaceutical companies will prefer trade to autarky, because with trade their product commands a higher price than under autarky. Intuitively the result makes sense. Demand for their product rises with trade, as both Iranian and Indian consumers are buying

their product.

From the perspective of Indian consumers, trade is beneficial. Under autarky, Indians paid for one barrel of oil with one bottle of pills. With trade, at Point T, they get two barrels for a bottle of pills. Put differently, the currency with which Indian consumers pay for imports commands more goods than under autarky. Again, intuitively, this result makes sense. With trade, the oil supply available to Indian consumers expands to include Iranian output, leading to a price decline.

4th: Economic Democracy and Efficiency

There is a kind of economic democracy associated with free trade. Under autarky, the decision of what to produce, and how much, typically is dictated by central government planners. Under free trade, producers respond to free market signals. Likewise, under autarky, consumers are stuck with consumption trade-offs set by the planners. Under free trade, they adjust their consumption to world market prices. Most importantly, from an economic perspective, rational responses to such signals are efficient. To be sure, not everyone has equal access to participate in import-export transactions. Market participation is part of the evaluation of the democratic nature of trade liberalization. But, under autarky, equality is hardly assured. Indeed, history records some of the most grossly unequal – and poor – societies are ones with autarkies.

Notwithstanding these benefits from free trade, there is an important concern left out in the analysis: which country, India or Iran, gains more from trade? That is, how are the gains from trade distributed between the two countries?

The answer depends on the international equilibrium price, *i.e.*, the world market price ratio, or TOT. The closer the TOT is to the price under autarky for one country, the less the gains from trade for that country, and the greater the gains from trade for the other country. For example, if the autarky price ratio of oil to pharmaceuticals for India is 1 and Iran is 3, and the TOT is 2, then the two countries split the gain equally. But, if the TOT of oil to medicines is $1\frac{1}{2}$, then Iran captures a larger share of the gain from India. Intuitively, the reason is producers do not get a much higher price for their product with trade than under autarky, and consumers cannot buy a product at a much cheaper price with trade than under autarky, if the TOT and autarky price ratios are nearly the same.

A logical follow-up question is in what instances will the gains from trade be split relatively equally? Economists suggest a roughly 50-50 sharing occurs when countries are roughly equal in size (*e.g.*, in their economies), and their consumers have broadly the same tastes and preferences.

If countries are quite unequal in size, then the big country is likely to obtain a lesser proportion of the gain than the small country. That suggestion seems counter-intuitive, but it makes sense. The small country is unlikely to be able to satisfy the large consumption demand in a big country, much less world demand, for a particular product. As a result, the big country will continue to produce a considerable volume of that product, even though it

may lack a comparative advantage in the product. Economists dub this scenario the “importance of being unimportant,” meaning that in trade with big countries, small countries are likely to capture most of the gains from trade. This scenario has practical importance for the debate about whether, and how, developing countries and LDCs can benefit from open trade.

VIII. Exports as Price of Imports and 1990s Indian Economic Reforms³⁶³

The theoretical work of economist Paul Krugman (1953-), winner of the 2008 Nobel Prize in Economics, and the empirical experience of India, both counsel against Mercantilism. Professor Krugman writes that exports should be viewed as nothing more than the price a country must pay to obtain imports:

What a country really gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves; the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment.³⁶⁴

The story of India before and after the watershed year of 1991, when that country began implementing major market-oriented reforms, is evidence against Mercantilism. As *The Economist* explained:

... India slashed tariffs on imports from an average of 90% in 1991 to 30% in 1997. Not surprisingly, imports doubled in value over this period. But, the effects on Indian manufacturing were not what the prophets of doom had predicted: output grew by over 50%. And by looking carefully at what was imported and what it was used to make, ... researchers found that cheaper and more accessible imports gave a big boost to India’s domestic industrial growth in the 1990s.

This was because the tariff cuts meant more than Indian consumers being able to satisfy their cravings for imported chocolate (though they did that, too). It gave Indian manufacturers access to a variety of intermediate and capital goods which had earlier been too expensive. The rise in imports of intermediate goods was much higher, at 227%, than the 90% growth in consumer goods imports in the 13 years to 2000.³⁶⁵

³⁶³ See, e.g., UNITED STATES INTERNATIONAL TRADE COMMISSION, THE DYNAMIC EFFECTS OF TRADE LIBERALIZATION: AN EMPIRICAL ANALYSIS, INVESTIGATION NUMBER 332-375, PUBLICATION 3069 (October 1997); Paul Krugman, *Empirical Evidence on the New Trade Theories: The Current State of Play*, in NEW TRADE THEORIES: A LOOK AT THE EMPIRICAL EVIDENCE (Center for Economic Policy Research, Bocconi University, Milan ed. 1994); Keith E. Maskus, *Using the International Trading System to Foster Technology Transfer for Economic Development*, 2005 MICHIGAN STATE LAW REVIEW 219-241 (2005).

³⁶⁴ Quoted in *Opening the Floodgates*, THE ECONOMIST, 9 May 2009, 82. [Hereinafter, *Opening*.]

³⁶⁵ *Opening* (citing Penny Goldberg, Amit Khandelwal, Nina Pavcnik & Petia Topalova, *Multi-Product Firms and Product Turnover in the Developing World: Evidence from India*, published in the REVIEW OF ECONOMICS AND STATISTICS).

However, is the Indian experience a lesson only for relatively closed developing countries, such as Iran and Pakistan?

Consider the summary by *The Economist* of theory and practice:

Theory suggests several ways in which greater access to imports can improve domestic manufacturing. First, cheaper imports may allow firms to produce existing goods using the same inputs as before, but at lower cost. They could also open up new ways of producing existing goods, and even allow entirely new goods to be made. All this seemed to hold in India. For example, its prolific film industry [Bollywood] had continued to make some black-and-white films into the 1970s, in part because of the difficulty of importing enough suppliers of color film. ...

... [T]he data backed up the theory: lower import tariffs did lead to an expansion in product variety through access to new inputs. ... [A]bout 66% of the growth in India's imports of intermediate goods after liberalization came from goods the country had simply not bought when its trade regime was more restrictive. These new inputs caused the price of intermediate goods to fall by 4.7% per year after 1989. ... [T]he imports led to an explosion in the variety of products made by Indian manufacturers; the average firm made 1.4 products before liberalization, but by 2003, this had increased to 2.3. The increases in variety were largest for industries where the input tariffs were cut most, and these industries also saw increased spending on research and development.³⁶⁶

Is the Indian experience easily generalized to a developed economy, such as that of the U.S., where tariffs on intermediate and capital goods are low? Indian manufacturing boomed when tariffs on those goods were cut. Had they already been low, would Indian producers have fared as well from further cuts, or just faced stiffer price-competitive competition from imported finished goods (which, of course, may be salubrious)?

Query also whether government intervention in the pattern of tariff cuts is critical. Had India cut tariffs only on refined chocolate and other luxury consumer items, its experience would have been different. Finally, note the pent-up entrepreneurial drive unleashed by India's reforms. To what extent does this spirit resonate in other cultures? These questions may be some of the reasons why Mercantilism continues to lurk deeply in the hearts, and often overtly on the lips, of trade negotiators.

³⁶⁶ *Opening.*

Chapter 10

MODERN FREE TRADE THEORY³⁶⁷

I. CGE Modeling of Effects of Free Trade

While Ricardo's Law of Comparative Advantage (as well as Smith's Law of Absolute Advantage) remain the conventional wisdom among all mainstream economists, those same scholars acknowledge:

Ricardo looked at only two countries making two products, at a time when few non-tariff barriers such as safety standards existed. This renders his elegant model about as useful for analyzing contemporary free trade deals as a horse and carriage are for predicting the trajectory of an aircraft.³⁶⁸

Yet, prognostications of the economic effects of putative trade agreements cannot be ignored: they are at the heart of political debates about those deals.

In an effort to capture contemporary reality better than 19th century Ricardian model, and obtain more accurate predictions of the effects of free trade than would that model, economists use a quantitative technique known as "CGE" analysis:

CGE models are built on top of a database that seeks to describe economies in full, factoring in incomes, profits, and more. Researchers line things up so that the model yields the same outputs as a real benchmark year. Once that is achieved, they "shock" the model, adjusting trade barriers to see how outcomes shift, both immediately and over time.

... [CGE] is the only trade model broad enough to encompass services, investment, and regulations.... It also generates predictions that policymakers want: which sectors will do well, and how incomes will change.³⁶⁹

However, CGE analysis suffers from three major flaws.

First, the quality of its predictive outcomes depends on the quality of the data set used in the model:

Most [CGE models] use figures from Purdue University's Global Trade

³⁶⁷ Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

³⁶⁸ *Free Exchange – A Weighting Game*, THE ECONOMIST, 30 May 2015, 77. [Hereinafter, *Free Exchange*.] The discussion herein draws on this source.

³⁶⁹ *Free Exchange*.

Analysis Project, the best database available. But, since it was initially developed for agriculture, it is skewed. It has separate categories for raw milk and dairy products, but lumps pharmaceuticals into one overarching category for chemicals...³⁷⁰

The point about chemicals was pertinent to the debate in 2015 over *TPP*. When enhanced IP protections of *TPP* were included in a CGE model to predict *TPP* benefits, then GDP of the 12 *TPP* Parties was forecast to increase by U.S. \$285 billion, or 0.9%, by 2025.³⁷¹ Those figures cited *ad nauseum* by the Administration of President Barack H. Obama and other *TPP* proponents. They were not exactly rosy, but alternative forecasts were worse: if enhanced *TPP* IP rules were excluded from export modeling, then the collective GDP increase of *TPP* Parties was just \$74 billion by 2035 (hardly 0.21% better than baseline forecasts), and one forecast showed U.S. GDP unaffected.³⁷²

Second, a single assumption in a CGE model can radically alter the forecast from that model. For instance, the prediction of a 0.9% increase in GDP mentioned above depended on an assumption that thanks to *TPP*, more firms will become exporters. That is, the model assumed the number of exporters does not remain constant. Rather, it increases as the costs of trade (including tariff and NTBs) fall. But, whether firms, especially SMEs, respond in this way is uncertain.

Third, some assumptions premising a CGE model are debatable. Do stronger IP protections actually catalyze investment and, in turn, boost exports? The CGE model predicting a 0.9% GDP gain assumed so. But, the other model forecasting a 0.21% gain was based on the contrary view: *TPP* IP rules raise costs for consumers beyond the levels necessary to spur innovation, and they also impede the spread of technology to developing countries. So, one assumption caused over a 70% swing in the forecast. That swing had major policy implications. Under the contrary view, *TPP* would be more effective in increasing economic output if it included China, and had weaker rules on IP protection (as well as on SOEs). Excessively strict IP rules undermine potential gains from free trade. So, more important to GDP gains than those rules is the number of countries engaged in a deal.

Here again, the Asia-Pacific region was a case in point: between 1990 and 2015, the number of FTAs increased from 5 to 200 (excluding *TPP*, of course). They were not all especially ambitious in respect of disciplining tariffs and NTBs, though they did so to some degree. Because so many countries were involved, both developed, developing, and least developed, the exports of countries in the FTAs increased by an average of 50% (compared with the prior 5-year measurement period).

II. Static versus Dynamic Models

³⁷⁰ *Free Exchange*.

³⁷¹ See *Free Exchange* (citing a study by Peter Petri, Michael Plummer & Fan Zhai of the East-West Center in Honolulu, Hawaii).

³⁷² See *Free Exchange* (citing studies, respectively, by Dan Ciuriak & Jingliang Xiao of the C.D. Howe Institute in Toronto, Canada, and Inkyo Cheong of the ADB in Manila, Philippines).

Classical and Neo-Classical arguments for free trade highlight static changes. However significant net static efficiency gains are from trade liberalization, there may be equally or more impressive gains accruing over time from trade-related changes. Static gains are one-time, following from world-market price signals and factor re-allocation. For instance, trade liberalization increases long-run level of *per capita* income. But, in a static Smith-Ricardo style model, it is not possible to discern whether, to what extent, and how trade liberalization might induce growth effects, such as long-run increases in the rate of growth of *per capita* income. In such a model, growth occurs only by a transition from one *per capita* income level to the next, made possible by savings and investment. In brief, to focus only on static gains is to understate the full benefits from trade.

Consequently, in many economic models of economic growth developed since the Smith-Ricardo era, including so-called “endogenous growth models,” the spotlight is on dynamic gains from trade. Dynamic gains occur over a sustained period, and are compounded from one year to the next. In the contemporary models, effects of trade liberalization are neither transitional nor felt only on the level of *per capita* income. They are permanent, and affect the rate of growth of income. These results follow from a theoretical consideration of sources affecting growth that are not included in the classical and neo-classical models – learning by doing, human capital, and knowledge capital.

The exploration by modern economists begins with the following question: does a country that adopts policies encouraging freer trade experience more rapid rates of growth in *per capita* income than a country that does not engage in trade liberalization? This question matters because even small differences in income growth rates (*e.g.*, a few tenths of a percentage point annually), over a sustained period and compounded over time, translate into large differences in standards of living.

As a dramatic example, consider El Salvador and Japan. In the mid-1950s, the two countries had about the same level of *per capita* income. By 1993, the income of one Japanese person equaled the income of 24 Salvadorans. Why? Japan maintained over 38 years a difference of less than 9% in economic growth per person. The point is that if trade liberalization has a positive impact on growth rates, even a modest one, then it also is likely to have a positive effect on living standards.

In a static, classical model of an economy, and in neo-classical growth models, the traditional sources of economic growth, *i.e.*, of increases in *per capita* income, are long-run phenomena, namely:

- (1) savings and investment, which allow for capital accumulation;
- (2) population growth, which results in an expanded labor supply; and
- (3) technological change, which results in greater efficiency and productivity, by permitting a greater level of output per unit of inputs.

These phenomena cause an outward shift in the PPF of a country, resulting in expanded output and trade opportunities. But, in the classical model, savings, population growth, and

technological change are exogenous. That is, they are not determined by the model, but rather are assumed given and set by variables for which the model does not account.

III. Dynamic Gains from Trade Liberalization: Savings and Investment

In contemporary dynamic models of economic growth, the traditional determinants – labor, capital accumulation – play an important role. There is increasing empirical evidence that trade liberalization stimulates growth indirectly by operating on traditional factor accumulation. In particular, trade liberalization stimulates domestic savings. In 1968, the distinguished British economist Alfred Maizels (1917-2006) tested the trade-savings link using annual data from 1950-1960 for 11 countries (Australia, Burma, Iceland, India, Ireland, Jamaica, Malawi, Rhodesia, South Africa, Trinidad and Tobago, and Zambia). He asked whether export income has a higher power to explain gross domestic savings than non-export income (*i.e.*, GDP excluding exports).

The answer was “yes.” A change in exports has associated changes in domestic savings. There is a positive relationship between exports and savings rates. Maizels offers three explanations for this result: the propensity to save is higher in the export sector than other sectors; government revenues depend on tariffs on foreign trade; and sustained growth in exports raises the marginal propensity to save (MPS) in other sectors.

At least two subsequent empirical studies confirm Maizels’ overall results. In 1971, Jaymin Lee used a larger sample of data (28 countries, 20 of which were developing and 8 developed) over a longer period (15 years) than Maizels’ data set. Lee showed export income played a more significant role in determining savings than non-export GDP. Lee also demonstrated this result for both primary exporting countries and non-primary exporting countries. In 1982, P.S. Laumas confirmed the hypothesis that the MPS out of export income is greater than the MPS out of non-export income for primary exporting countries, though not for non-primary exporting countries.

However, like many debates in economics, empirical evidence exists on both sides of the trade-savings link. In 1989, a study by A.K. Lahiri showed no consistent, statistically significant relationship between savings and exports. The somewhat mixed results may reflect different model specifications (particularly with respect to the savings function), and different data sets (*e.g.*, the countries and time period investigated).

The reason a trade-savings link is so important is the further connection to investment. If trade stimulates savings, then it means the pool of funds available for investment in capital equipment enlarges. In turn, with more physical capital, an economy can grow more rapidly than before. In brief, trade may stimulate the rate of *per capita* income growth by positively impacting savings and, therefore, investment.

As a related point, there is a broad consensus among economists that trade liberalization stimulates FDI, which in turn boosts growth. The U.S. regularly receives the most FDI of any country in the world. That FDI is important to industry. Affiliates in the

U.S. of foreign multinational corporations employ (as of 2008) 13% of the entire American manufacturing workforce (over 5 million Americans), pay above-average compensation, and thereby support the middle class. The American commitment to fair, equitable, and non-discriminatory treatment of foreign investors, as manifest in the WTO *TRIMs Agreement*, bespeaks its long-standing policy of open FDI.

IV. Dynamic Gains from Trade Liberalization (continued): Additional Growth Sources

Newer models of economic growth expand the list of sources of growth to include (at least) three further independent variables. These variables are endogenous, *i.e.*, explained by the model:

- **Learning by Doing**

This variable refers to experience gained by workers in the production process. Through such experience, workers accumulate technological knowledge, and thereby become more productive. This accumulation occurs along with capital accumulation. Both lead to a social pool of knowledge on which other firms in an economy can draw. Stated differently, there are “knowledge spillover effects” among firms. Such effects help firms overcome diminishing returns to capital.

- **Human Capital Accumulation**

Production requires not only physical capital, but also human capital – that is, skilled workers. Such workers are more productive than unskilled workers. Workers become skilled in part by formal education, which is costly in that it requires investment (*i.e.*, allocations of capital and labor) in the education industry for the benefit of future workers, and the temporary withdrawal of current workers from the labor force. Workers with more human capital tend to accumulate human capital more easily than those with less human capital, which is to say skilled workers tend to learn more readily than unskilled workers. Human capital accumulation, like learning by doing, is related to the accumulation of physical capital, and leads to a pool of general knowledge on which all workers can draw. As with learning by doing, increases in human capital help counteract diminishing returns to physical capital.

- **Knowledge Capital Accumulation**

This variable also is called “R&D” capital, meaning research and development. R&D activity leads to technological advances, product differentiation, and improvements in the quality and sophistication of products. As with learning by doing and human capital accumulation, there are positive spillover effects, which help mitigate diminishing returns to capital equipment. There also are externalities, whereby an industry different from the one in which R&D occurred initially benefits from the R&D outcome.

These variables affect the dependent variable: economic growth. More experienced, smarter workers, and R&D, stimulate the rate of growth of *per capita* income. But, what is the role of international trade in contemporary growth models? Specifically, does trade liberalization increase or decrease the rate of economic growth? There is no single answer or clear theoretical prediction.

The role of trade varies, depending on the model. The channels through which trade liberalization operates may be complex. Consequently, the role of trade is a matter left for empirical testing. Overall, the effect of trade on learning by doing, human capital, and knowledge capital, is positive. Trade seems to boost economic growth by operating through these variables. But, the nexus is indirect, and ambiguities and trade-offs exist.

As for learning by doing, workers who gain experience in production can be more productive. Through trial-and-error, they develop techniques that increase output per labor hour. Trade liberalization can encourage, at least indirectly, this process, or create an incentive to learn on the job. Exactly how, why, and the extent to which this occurs depends on the country and sector in question.

Relatedly, trade liberalization leads to specialization. In turn, specialization leads to increased efficiency, lower costs, and higher income levels. For instance, greater efficiency can result in the production of a finished good by using specialized parts and machinery. As another illustration, a production process may be more efficient as a result of breaking that process down into several highly specialized tasks. Indeed, two forms of specialization – “product specialization” and “process specialization” – accompany trade liberalization. “Product specialization” refers to specializing parts and machinery in production. “Process specialization” refers to specializing the stages of the production process. Both kinds of specialization lead to greater efficiency in production. Moreover, specialization also results in increased innovation and product variety for consumers.

One interesting finding associated with the COVID-19 pandemic concerned whether longer supply chains help or hurt innovation? Intuitively, as occurred during the pandemic, shorter supply chains are more robust and resilient than longer ones: they can be sustained, *i.e.*, endure (robustness), and they can bounce back from shocks (resilience). But, might longer supply chains help spur product and/or process innovation? Yes, said an interdisciplinary researcher team in a January 2022 article, *How Production Networks Amplify Economic Growth*.³⁷³ In essence, the team “found there was more possibility of ideas-driven progress with a longer chain.”³⁷⁴

³⁷³ See James McNerney, Charles Savoie, Francesco Caravelli, Vasco M. Carvalho & J. Doyne Farmer, *How Production Networks Amplify Economic Growth*, 119 PROCEEDINGS OF THE NATIONAL ACADEMY OF SCIENCES OF THE UNITED STATES OF AMERICA, number 1 (4 January 2022), www.pnas.org/content/119/1/e2106031118.

³⁷⁴ *New Study Finds Economic Progress is Aided by Longer Supply Chains and Deeper Networks*, UNIVERSITY OF OXFORD – NEWS AND EVENTS (5 January 2022), www.ox.ac.uk/news/2022-01-05-new-study-finds-economic-progress-aided-longer-supply-chains-and-deeper-networks. [Hereinafter, *New Study Finds*.]

Doyme Farmer, Baillie Gifford Professor of Mathematics and Director of the Complexity Economics Program at Oxford University's Institute for New Economic Thinking, said, "The more steps in the process, the more opportunity there is for innovation. Industries with greater supply chains do better. We have been able to predict this over long periods. It does not explain everything that happens, but the principle can be seen operating."

Their predictions also work in terms of nation states. The team maintains the research shows close to half of China's recent economic growth is attributable to deeper supply chains.

James McNerney, Research Associate at Harvard's Growth Lab ...said, "We show that production chains accumulate the benefits of technology improvement so that long production chains facilitate faster price reduction in industries and faster GDP growth in economies.... These are latent predictions in standard models that we develop theoretically and show that they bear out in the data."

... [T]he team argues, "The predictions here suggest that, all else equal, an economy will accelerate its growth during the manufacturing stage and relax to slower growth when it becomes more developed. Our results show that the structure of a production network, taken as given, can serve as a proximate cause of growth differences across countries."

And it concludes that free trade can lead to countries' growth rates converging as they share and utilize the same supply chains.

"This suggests that trade openness induces cross-country convergence in growth rates through changes in the production network."³⁷⁵

Manifestly, these findings are counter-intuitive, and they do not incorporate the national security concerns (discussed in separate Chapters) that underlay much of the pandemic-period onshoring and regionalization of supply chains, particularly from China. That said, the underlying protectionism witnessed during that period arguably had deleterious effects on national security, including the stymying of the kind of innovation on which the above-quoted scholars focus.

With respect to human capital, trade liberalization may increase returns to human capital by increasing the efficiency of production, and by increasing the demand for goods produced by skilled workers. Indeed, there is empirical evidence that human capital has a greater effect on *per capita* income growth in open economies than in closed economies. However, this effect may vary between rich and poor countries.

In countries relatively well endowed with skilled labor, such as the U.S., trade liberalization tends to shift output toward goods that use intensively in their production

³⁷⁵ *New Study Shows.*

skilled labor. That shift creates an incentive to accumulating human capital, and higher human capital stimulates the rate of economic growth. In countries relatively well endowed with unskilled labor, such as Bangladesh, trade liberalization tends to shift output to unskilled-labor-intensive goods. Abstracting from other forces, that shift may reduce incentives to accumulate human capital, and, in turn, the rate of growth.

Finally, international trade is connected to knowledge capital accumulation, generally appearing to spur the rate of technical innovation. Trade entails commercial contacts among countries, and firms in those countries. Such contacts involve exchanges of information about products and production processes, and of technological information itself. Through FDI, technology transfer occurs across the life cycle of a product.

Under the “Product Life Cycle Hypothesis, innovations are transferred from developed to developing countries as the market for a product, in which technology is embedded, in a developed country becomes saturated and the production process becomes routine and cheap. The Austrian economist Joseph Schumpeter (1883-1950) referred to the process by which imitation and competition erodes market power, and induces new inventions, as “creative destruction.” The point is that trade facilitates the creative destruction process, and possibly shortens the life cycle of some products.

At the same time, two aspects of the international trade law regime – enhanced IP protection (*e.g.*, in terms of time length and geographic scope), and stronger enforcement of IPRs – may benefit certain countries at the expense of others. They may contribute to growth in developed countries, yet do little for some developing and least developed countries. Moreover, while trade liberalization expands market opportunities for firms to sell their products, it also increases competition among firms. If such competition erodes the retained earnings of a company, and those earnings are the main source of R&D funding for that company, then trade may be said to have had a negative effect on the knowledge capital accumulation of that company.

In sum, contemporary growth models suggest the possibility that the dynamic effects of trade liberalization may far outweigh the static effects. They consider endogenously more determinants of *per capita* income than do classical and neo-classical models. The extent of the contribution of trade liberalization to increases in growth rates is not clear, nor are the precise causal mechanisms by which trade operates through variables like learning by doing, human capital, and knowledge capital. Addressing these uncertainties has practical policy implications.

For example, suppose the contribution of trade to growth, through these 3 variables, is weak. Then, a country might choose to emphasize increases in traditional factors of production, and non-trade measures to boost Total Factor Productivity (TFP). In contrast, if trade manifestly and positively affects the three variables, which in turn boost the rate of growth, then the preferred policy would be free trade, along with the promotion of on-the-job training programs, support for education, and encouragement of R&D. Interestingly, part of the debate about how and why the post-Second World War “East Asian Miracle” occurred reflects these concerns.

Some economists argue this “Miracle” was nothing more than growth caused by increases in traditional factors like labor and capital, with TFP playing a modest contributory role. East Asian countries, they urged, did not experience rates of technological progress greater than the rates in the OECD or Latin America, and faced diminishing returns to capital, particularly insofar as labor and capital were not easily substitutable. Other economists pointed out trade-friendly policies in most East Asian countries stimulated investment rates, staved off diminishing returns to capital, and boosted *per capita* income growth. Questions also were raised about how open to trade these countries actually had been, and whether other, non-economic factors, such as good governance and low corruption, were key ingredients in the “Miracle.”

Chapter 11

QUESTIONING CAPITALIST FREE TRADE THEORY³⁷⁶

I. 20 Assumptions Underlying Comparative Advantage

Like most economic “laws,” the Law of Comparative Advantage rests on assumptions. They facilitate the analysis of the effects of trade liberalization. These assumptions also are needed for three important theorems that follow from the Law of Comparative Advantage, namely, the Factor Price Equalization Theorem, Heckscher-Ohlin Theorem (also called Factor Proportions Theorem), and Stolper-Samuelson Theorem:

(1) *Rationality*

Each economic agent, whether a producer or consumer, acts in a rational manner. Producers seek to maximize profits, and consumers seek to maximize their level of satisfaction, or “utility.”

(2) *Two Countries*

There are two countries in the world. In the examples, India and Iran are the focus. However, it is possible to group all countries other than Iran (or India) together and label them “Rest of world” (ROW).

(3) *Two Commodities*

There are two commodities in the world. In the first hypothetical, the goods are carpets and tea. However, it is possible to group all goods other than tea (or carpets) into a bundle, or basket, called “All other goods” (AOG). In the second hypothetical, the goods are oil and pharmaceuticals. Again, it is possible to substitute AOG for pharmaceuticals (or oil). A diagram called a “PPF” depicts the two commodities produced, and the trade-offs in their production.

(4) *No Money Illusion (Relative Prices)*

Economic agents do not suffer from “money illusion.” When a producer or consumer makes a decision based on a change in the price of one item, the economic agent also takes into account the prices of other items. So, if all prices rise, or if all of them fall, then a producer or consumer is not fooled by examining only one or a few prices. Rather, the agent looks for real, not just nominal, prices. In particular,

³⁷⁶

Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

the agent looks at relative prices, the relationship of one price to another.

(5) *Fixed Factor Endowments*

In each country, the endowments of factors of production are fixed in the short term (*i.e.*, during the next 1 year). The “factors of production,” or “resources,” are labor (*i.e.*, workers), land (*i.e.*, real property and fixtures), physical capital (*i.e.*, capital equipment, like machine tools), human capital (*i.e.*, knowledge), and technology (*e.g.*, computers). These factors are used to produce goods. In the medium term (2-5 years) and long term (more than 5 years), factor endowments can change.

(6) *Homogenous Factors*

Factors of production are homogeneous from one country to another. For instance, labor in one country is identical to labor in another country. Likewise, capital in the two countries is identical.

(7) *Different Factor Endowments*

The two countries do not have identical proportions of each factor of production. Rather, the relative proportionate endowments vary. One country may have relatively more labor, but relatively less capital, than the other country. Of significance is not the absolute amount of each factor in each country. Rather, what matters is the proportion of one factor to another (or all others) within a country, and the comparison of that proportion from one country to another. That is, factor endowments are measured by the ratio of one factor to another factor (or to all other factors). Thus, a country is “capital abundant” if the ratio of capital to labor (or capital to all other factors) is greater than the ratio in the other country. This abundance is “relative” in the sense of a comparison of the ratios between the two countries. A country is “labor abundant” if the ratio of labor to capital (or labor to all other factors) is greater than the ratio in the other country. This labor abundance is relative, in a proportionate sense, between the countries.

(8) *Technology Availability*

Each country has equal access to technology needed to produce each commodity. That is, the technology available to each country is the same.

(9) *Intensiveness*

As between the two commodities, one is capital intensive and the other is labor intensive. Intensiveness is a measure of the proportion of one factor of production used to make a good in relation to another factor (or all other factors). A good is “capital intensive” if the most important resource used in its production, as measured by the ratio of capital to labor (or capital to all other factors), is capital. A good is “labor intensive” if the predominant resource used to make the good,

gauged by the ratio of labor to capital (or labor to all other factors), is labor.

(10) *Perfect Competition in Commodities Markets*

In the sectors in which each of the two commodities is produced, competition among producers is perfect. There are no instances of monopoly or oligopoly. In other words, there are many buyers and sellers of the goods, so that no one purchaser or producer can control the price of either good – buyers and sellers are “price takers.” Thus, the supply of, and demand for, each commodity determines its price. Further, there are no externalities (unaccounted costs, *e.g.*, pollution, or benefits) from production of either good. Consequently, the market price of a good reflects its true social, or opportunity, cost of production. Also, the marginal cost of production (*i.e.*, the cost of making the last unit) equals the value of the resources needed to make it, plus a normal profit. In the long run, the price of a good equals the cost of production of that good.

(11) *Perfect Competition Among Factors of Production*

In the markets for factors of production, there is perfect competition. No single resource provider, be it labor, land, physical capital, human capital, or technology, can control the price at which it supplies the resource. That is, many laborers, landowners, and capitalists, and human capital and technology are readily available. Likewise, on the demand side, there are many buyers of these resources, so no one buyer can set the price. Sellers and buyers of factors of production are “price takers.” Consequently, the supply of, and demand for, each factor determines the price of that factor.

(12) *Perfect Factor Mobility Domestically*

Factors of production are perfectly mobile domestically. There are no barriers to the re-allocation of a factor from employment in one sector to another, in response to changes in prices, within a single country. Factors will move from one sector to another based on payments they receive – wages to labor and human capital, rents to owners of land and physical capital, and royalties to owners of technology. Consequently, within one country, in each of the two commodity sectors, these factor returns will be the same. For example, each industry will pay the same wage rate to workers and same rents to capital, otherwise factors would migrate until any difference is eliminated.

(13) *Factor Immobility Internationally*

Factors of production cannot move from one country to the other. For example, workers cannot migrate from one country to another, and capitalists cannot move their equipment across borders. As a result, differences in wage rates, returns to capital, and other factor payments (when measured in the same currency) can exist between the two countries, even after trade commences. Without this assumption,

the PPF of one or both countries would change (either in terms of shape or location), because of migration.

(14) *Constant Returns to Scale*

The assumption about “constant returns to scale” states a proportionate change in factors of production yields a proportionate change in output. For instance, if production of a commodity requires labor and capital, and the amount of each resource is doubled, then constant returns to scale would mean the amount of output correspondingly doubles. However, as with the first assumption, this assumption is not essential to the Law – it simply allows for a more dramatic illustration of the impact of opening a country to international trade than would be true otherwise. Typically, it is relaxed in advanced demonstrations of the Law, because in reality, diminishing returns to scale occur.

(15) *Consumer Preferences*

It is possible to represent the tastes and preferences of all consumers in a society using a diagram called an “Indifference Curve.” Moreover, consumers in each country have equal tastes and preferences. For instance, if the price of one commodity, measured in terms of the units of the other commodity, is the same in both countries, then consumers in each country consume the same proportion of each commodity.

(16) *No Trade Barriers*

There are no barriers to trade, in the form of transportation costs, other kinds of transactions costs, tariffs, or NTBs. In other words, when trade commences between the countries, it is free trade. Consequently, with international trade, there is a single world market price for each commodity.

(17) *Incomplete Specialization*

Each country continues to produce at least a small quantity of both commodities. Under autarky, both countries produce both goods. When trade occurs between the countries, neither country specializes entirely in the production of only one commodity.

(18) *Trade Balances*

In each country, exports pay for imports, hence trade is balanced. This assumption simplifies the analysis by ruling out the possibility of net flows of funds between the countries. Each country pays for its imports with what it exports.

(19) *Labor and Mix of Factors*

Some demonstrations of the Law of Comparative Advantage rely on two further assumptions. The first one is based on the Labor Theory of Value, in which classical economists believed. This assumption states the only relevant factor of production, with respect to costs of production or productivity, is labor. Put differently, the assumption is that while two (or more) resources may be used, such as labor and capital, both are used in production in the same ratio in a country – the mix of factors is the same within an industry in a particular country, though not necessarily across countries.

For instance, two workers per machine may be the ratio in one country, but the ratio could be three workers per machine in the other country). According to the Labor Theory of Value, under autarkic conditions, the amount of labor needed to make a good is the determinant of the price of that good. (Classical economists took a holistic view, including in the labor calculation the amount of labor going into making capital equipment used in production of the final good.) This assumption is obviously false, as many goods with the same price embody different quantities of labor. It is used, however, to simplify the analysis, but relaxing it does not undermine the Law of Comparative Advantage.

(20) *Constant Production Costs*

The second of two final assumptions sometimes used is about costs of production, namely, constant costs of production. This assumption means the amount of production of one commodity that a country must forego to produce an additional unit of the other commodity remains the same at all levels of production. For example, to produce 6 instead of 5 units of the second commodity, a country must sacrifice 3 units of output of the first commodity.

With constant costs, to produce 7 instead of 6 units of the second commodity (or, for that matter, 50 instead of 49 units), it must sacrifice 3 units of output of the first commodity. In brief, with constant costs of production, the opportunity cost of increasing output of one good stays the same. In contrast, if production costs decrease, then the number of units of the first commodity that must be sacrificed with increased output of the second commodity fall (*e.g.*, to 2 units, and then 1 unit). If production costs increase, then the number of units that must be sacrificed rises with higher levels of production of the second commodity (*e.g.*, 3, then 4, then 5 units and so forth).

The assumption of constant costs of production results in a PPF that is a straight line sloping downward to the right. Without constant returns to scale, the PPF is a curve concave to the origin of the graph on which it is drawn. Assuming constant costs is not essential to the demonstration of the Law of Comparative Advantage.

Finally, observe some assumptions are further from reality than others. Consider the implications for net gains from trade when one or more assumptions are relaxed.

II. New Trade Theory and Increasing Returns to Scale

The Law of Comparative Advantage rests in part on the assumption of constant returns to scale. According to this Law, international trade results from differences in factor endowments among countries, which generate comparative advantage. However, the “New Trade Theory” offers an additional, complimentary explanation of why trade occurs and may be mutually beneficial. This Theory drops the assumption of constant returns to scale. It observes that in reality, increasing returns to scale often occur.

Two contexts in which they occur are intra-industry trade and inter-industry trade. First, at the level of a firm, there may be increasing returns to scale, known as internal scale economies. Second, at the level of an economy (in a national or regional sense), there may be increasing returns to scale, called external scale economies. Intra-industry trade is observed in many markets.

For example, the U.S., EU, and Japan trade cars and watches. (To be sure, there is a debate to be had about the definition of “industry.” Is there one automobile market, and a single watch market, or is it more appropriate to consider separate markets based, for instance, on product features?) Comparative advantage does not well explain this phenomenon, yet such trade is not insignificant. About 25% of trade of industrial countries is considered intra-industry. However, the effects of economies of scale, along with monopolistic competition (*i.e.*, product differentiation to secure a niche in a market), may help explain the occurrence.

Unfortunately, at the micro (*i.e.*, plant) level, some models do not make predictions about the relationship between economies of scale and intra-industry trade. Other models suggest a negative correlation between the two variables: greater scale economies correlate with less intra-industry trade. It is possible to rationalize this suggestion by saying large plants tend to dominate industries in which the goods produced are fairly homogeneous (*e.g.*, steel). In such industries, in contrast to industries in which there is imperfect competition through differentiated products, there is little room for intra-industry trade.

At the macro (*i.e.*, national or regional) level, the evidence appears stronger than at the micro level that increasing returns to scale help explain trade (whether intra- or inter-industry). A pioneering study by business school scholar Michael Porter, *The Competitive Advantage of Nations* (1990) highlighted the importance of agglomeration. Using the case-study method, he found many instances of countries gaining a competitive advantage in an international market through a domestic cluster of firms. The concentration in Dalton, Georgia, of production of American carpets, and similarly of European carpets in Flanders, are illustrations of geographically-localized industries that appear to be driven by external economies of scale, which in turn promotes trade.

III. Questionable Assumptions

Paul Krugman (1953-), winner of the 2008 Nobel Prize in Economics, rightly

admits: “All economic theory involves *untrue* simplifying assumptions.”³⁷⁷ That is true of many explicit assumptions on which free trade theory, and in particular the Law of Comparative Advantage, rest. They are (put politely) dubious.

First, are factors of production truly homogeneous? Of course not. In groups of countries at relatively comparable developmental stages, there may be broad similarities among factors. Yet, overall, factors differ across countries. Workers seek to differentiate themselves from others in skill levels. To the extent factors are not homogeneous, the goods and services they produce may be dissimilar. (For example, is a Toyota vehicle originating in America, Japan, and Thailand?) Might that explain intra-industry trade?

Second, are factors of production immobile across borders? Again, the answer is “surely not.” Factors of production are mobile across borders – and land can be reclaimed from the sea, as in the Netherlands and Singapore. MNCs facilitate not only labor migration, but also movement of physical and human capital, and technology. Consequently, the PPF for a country may shift expeditiously, changing the nature of comparative advantages of that country. (For example, a net inward migration of unskilled or semi-skilled Central American workers into the U.S. might boost America’s manufacturing competitiveness). Might these shifts lead to changes in the pattern of trade, *i.e.*, what a country exports and imports?

Third, how realistic is it to presume a balance of trade? On the one hand, some countries, notably America, run persistent large trade imbalances. On the other hand, for many countries, exports and imports are roughly equal. Further, if an exporter receives money for merchandise shipped abroad, then it is likely the exporter will not hold those funds indefinitely. Rather, it will purchase other goods (possibly from overseas), or invest them in a financial asset.

Fourth, are transportation costs zero? Here, too, the answer is obviously “no.” In fact, if they are too high in relation to the price of a good or service, then that item will not be traded. It may be cheaper to buy mangoes in India or get a haircut in China. But, given transportation costs, a consumer in Kansas would not fly to New Delhi or Beijing solely for the reputed king of fruit or chic Asian coiffure.

Explicit assumptions are not the only problem. Underlying the Smith-Ricardo free trade paradigm is a grand but dubious implicit assumption: the source of absolute or comparative advantage is relative labor costs. That is, what determines whether a country will have an advantage in producing a particular good is whether it has a competitive advantage in low labor costs. But, labor costs are just one of many reasons why industries arise in a particular country, and why FDI is made in that country.

Among other key variables businessmen and their lawyers examine when deciding where to set up a manufacturing operation are:

³⁷⁷ *Empirical Evidence on the New Trade Theories: The Current State of Play*, in *NEW TRADE THEORIES: A LOOK AT THE EMPIRICAL EVIDENCE* 12-23 (Center for Economic Policy Research, Bocconi University, Milan ed. 1994). (Emphasis added.)

1st: Legal Risk (Rule of Law)

Are contract, property, and IPRs well-grounded in law, and are those rights enforceable through reliable, transparent judicial or arbitral mechanisms?

2nd: Political Risk

Is the country at issue stable politically? To what degree are politicians at any level corrupt?

3rd: Infrastructure Risk

Does the country at issue have a sound, reliable network of roads, ports, and telecommunication facilities?

4th: Transportation Risk (Geographic Distance)

Is it possible to respond quickly to changes in demand for the product at issue, without having to maintain a large inventory of the product (as inventory costs can be substantial)? Likewise, is it possible to consult with customers on design, quality control, and servicing?

5th: Human Capital Risk (Labor Quality)

Is there a steady supply of labor that has the requisite degree of human capital, and can function effectively in the language of international business, namely, English?

6th: Foreign Exchange Risk

Are the fiscal and monetary policies of the potential host country government responsible and transparent? Or, do they undermine the stability of the currency.

7th: War Risk

Might conflict – either cross-border or internal – involving the host country government disrupt production, distribution, and supply chains?

8th: Environmental Risk

What problems does climate change to a prospective investment in the host country?

Does China, a much vaunted manufacturing center, actually fare poorly on some of these

variables? Is there reverse offshoring from China in consequence?

IV. Infant Industry Protection

Among many arguments made against free trade over the centuries, one in which economists (though not all of them) are inclined to put some faith concerns infant industries. In his 1791 *Report on Manufactures*, Alexander Hamilton (1757-1804) urged that young American industry requires protection from experienced foreign competition. The argument is an industrialized economy has advantages over a non-industrialized one that render it difficult for the less developed economy to set up sustainable industries.

For example, it is unreasonable to expect Mali or Sri Lanka simultaneously to practice free trade in IT and spawn a computer software industry to rival Microsoft. By protecting infant industries – *i.e.*, nascent industries that poor countries seek to foster – a government gives them some time, or breathing space, to get “up to speed” and competitive. Without this time, a software start-up company in Timbuktu or Colombo would be wiped out by head-to-head competition with Microsoft. Thus, protection of an infant industry is a defensive measure. In contemporary hands, the argument has an added poignant point about hypocrisy. At various points in their history, America and other modern-day developed countries employed protection to help their infant industries. It is nakedly hypocritical to demand free trade now of struggling countries. Ought they to be able to protect their infant industries until maturity?

Compelling as the argument is, it is problematical. First, who decides what infants get protection, and thus an enhanced chance at life? Presumably the answer is industries in which a country likely will develop a comparative advantage. But, how is this probability appraised in advance? Are government officials skilled at “picking winners”?

Second, what is the right level of protection? India provided too little in its FY 2020-2021 budget to help its footwear industry:

India’s increase of customs duty is unlikely to boost local manufacturing of footwear in the world’s No. 2 producer, and is only expected to make flip flops to sneakers costlier for consumers. Finance Minister Nirmala Sitharaman, in her budget for 2020-21, raised import duties on footwear and related raw materials by 10 percent and 5 percent, respectively. While companies agreed that cheap imports of ready products and raw materials does impact the local industry, they don’t expect the increased levy to counter that.

...

India is the world’s biggest footwear producer after China with a \$9-billion market

The nation imported shoes and raw material worth \$746 million in the year ended March 2019.... More than two-thirds of that come from China.

Large manufacturers like Puma India agreed that a higher duty won't help much. "India currently doesn't have the infrastructure, capability, skill set and technology to manufacture higher-end footwear. Therefore, increasing customs duty of footwear from 25 to 35 percent may not have a significant impact on imports," [said] Abhishek Ganguly, Managing Director at the shoemaker.... Instead footwear would become costlier, he said, adding that Puma could increase prices of some of its products by 8-10 percent.

...

The government must help create infrastructure by building clusters and warehousing capacity with basic technology for such players [that is, [s]mall-time manufacturers [that] work in small, dingy areas with no proper set-up"], he [R.K. Gupta, Director of Finance and CFO of Bata India Ltd.] said. "Unless this improves, the market will not become bigger."³⁷⁸

Simply put, if the level of tariff protection is too low, then it will not generate the revenues necessary to develop a supporting infrastructure the infant industry (in India's case, higher-end footwear, and SME producer-exporters) needs to become globally competitive. But, if that level is too high, then the industry may be molycoddled. And, assuming the level of protection is rightly calibrated, government officials must invest tariff revenues wisely for the common good, not themselves.

Third, for how long will protection last? The ideal answer is "temporarily." As the philosopher John Stuart Mill (1806-1873) said, protection should be a temporary measure to test whether a country develops a comparative advantage in a protected industry. Once that test is passed, and the industry is ready for foreign competition, the protective measures should cease. Yet, in reality, protection has a nasty way of becoming rather permanent. In part, permanence follows from dependence that – again – molycoddles rather than strengthens an infant. It also follows from – again – corruption, whereby government officials are cajoled, in one form or another, into continuing the protective measures.

Fourth, how is infant industry protection delineated from strategic trade policy? In theory, protective measures for infants are defensive, whereas strategic trade policy is offensive. In practice, that line is easy to blur.

V. Revitalizing Ailing Domestic Industries

Another argument against the Law of Comparative Advantage is that operation of the Law might make it impossible for ailing industries to revitalize. A loss of comparative advantage in an industry may not be permanent. Perhaps protection would enable an industry to adjust to changed competitive circumstances, and flourish once again. Protective measures would give it time to compete effectively. The industry can adopt more efficient production processes, resulting in better, cheaper products.

³⁷⁸ Nishant Sharma, *Higher Duty On Imported Footwear Unlikely To Boost Local Industry*, BLOOMBERG QUINT (Mumbai), 2 March 2020, www.bloomberquint.com/bq-blue-exclusive/higher-duty-on-imported-footwear-unlikely-to-boost-local-industry?utm_campaign=website&utm_source=sendgrid&utm_medium=newsletter.

There is an alternative scenario, too. Protection would allow for gradual contraction of an ailing industry that cannot revitalize. Without protection, there would be a chaotic collapse, which would entail massive job losses and, possibly, social unrest. As a result, the transfer of productive resources – especially labor – to other pursuits is not so jarring. In brief, protection is needed not for revitalization, but for orderly termination.

As with the infant industry argument, serious questions must be put to the revitalization argument. First, does empirical evidence support it? Generally, the answer is “no.” A November 1986 CBO Study, *Has Trade Protection Revitalized Domestic Industries?*, assessed effects of quotas imposed to help four industries mount a comeback: automobiles; footwear; steel; and T&A. The Study showed domestic industries are not revitalized under protection. Specifically, quotas do not cause an increase in investment in the steel or T&A industries, and probably are not a factor in increased investment in the auto industry. Quotas led to more investment in the footwear industry. But, labor productivity did not grow sufficiently to close the huge gap in costs between American and foreign shoe companies. To be fair, query whether the protection was sufficient to revitalize an affected industry.

Second, is protection the correct policy tool to revitalize a domestic industry? Arguably, cost-saving measures are needed. An industry may require better capital equipment to cut expensive labor, or to improve human capital and technology to boost production efficiency. To be sure, protection might give an industry the ability to make cost-reducing investments that it could not make with free trade because of a lack of resources. But, it could equally well create complacency in the industry. Or, protection could lead to a “moral hazard” problem whereby the industry is not careful in the selection of its investments because it has the “safety net” of tariffs and NTBs.

Third, is it wise to second-guess Wall Street, *i.e.*, financial markets? If these markets function well, then why allow a government to cast doubt on professional financial judgment? Private sector analysts specialize in critiquing financial performance and prospects of companies and industries, and price credit accordingly. If a firm or industry cannot afford financing under a liberalized trade regime, then is it wise to provide funds in a sheltered environment? In brief, should politicians “pick winners”? As with the infant industry argument, the revitalization argument (or its orderly contraction version) casts them in the role of choosing what lives and what suffers. Evidently, that is not a role for which most government officials have the training or temperament. Further, it invokes a debate in political philosophy about the proper role of government.

The infant industry and revitalization arguments, as well as the scenario of orderly contraction, involve a fundamental concern – the nexus between trade liberalization, on the one hand, and jobs and wages, on the other hand. Indeed, the specter of job growth and wage gains emboldens free traders every bit as much as the specter of job loss and wage declines motivates anti-free traders. The heated rhetoric is particularly evident in the context of multilateral trade negotiations, controversial WTO rulings involving trade remedies like AD and CVDs, and FTAs. Each side hurls empirical studies – often produced

by Washington, D.C.-based think tanks with ideological sympathies on one side or the other – about the effects of jobs and wages. Unfortunately, what is lost in the shouting are economic theorems, such as Factor Price Equalization and Stolper-Samuelson, which address links among trade, jobs, and wages.

VI. Strategic Trade Policy and Managed Trade

Arguably, neither free trade nor protectionism best explains reality. Rather, strategic trade policy and managed trade do.³⁷⁹ Neither extreme, in the pure economic sense, exists. All trade occurs pursuant to some government strategy or management. Most governments try to manage trade in certain strategic or sensitive sectors.

“Strategic trade policy” is the creation through government intervention of competitive advantages for companies in which economies of scale can be realized. An “economy of scale” may be internal or external. An “internal” economy of scale means the reduction of costs per unit as output of a firm rises. It occurs via R&D, the fruits of which increase efficiency, and sheds wastage, in production. In turn, internal economies of scale can lead to an imperfectly competitive market, *i.e.*, a monopoly or oligopoly. An “external” economy of scale is where costs per unit of production depend not on the size of a company, but on that of an industry. It explains why many companies in the same industry locate near one another (*e.g.*, clusters of life sciences companies in Kansas City).

The focus of strategic trade policy is what a government can do to boost internal economies of scale in an industry. The idea is one government (*e.g.*, the EU) must act, because if it does not then another government (*e.g.*, China) will act. Because internal economies of scale may yield a monopoly or oligopoly position, once a foreign industry is at that commanding height, it is hard for domestic firms, much less new entrants, to compete. (With monopolistic competition, product differentiation may be the key to entry.) In sum, strategic trade policy is limited government industrial policy.

“Industrial policy,” in turn, is “a catchall term for government interventions in certain industries and in the broader economy.”³⁸⁰ This term was widely used in contexts

³⁷⁹ See PAUL KRUGMAN, *THE AGE OF DIMINISHED EXPECTATIONS* 110-12 (1990); Peter A.G. Van Bergeijk & Dick L. Kabel, *Strategic Trade Theories and Trade Policies*, 27 *JOURNAL OF WORLD TRADE* 176-77, 180-85 (1993).

³⁸⁰ Shannon K. O’Neil, *Protection Without Protectionism – Getting Industrial Policy Right*, 100 *FOREIGN AFFAIRS* Number 1 150, 150-160 (January/February 2020) (pointing out, on the one hand, “[e]ven governments that oversee market-based economies sometimes must intervene to overcome market failures and deal with problems that individual companies or whole industrial sectors choose to ignore,” that governments can ignite R&D with more resources, and on a longer time horizon, than the private sector, to address issues such as climate change, and “[m]ore traditional national security issues present additional reasons to expand the public sector’s role in the economy,” but, on the other hand, “[h]istory ... provides many examples of industrial policy gone wrong,” including “[s]upposedly temporary protections for infant industries or struggling economic sectors [that] often become permanent,” [and] “encouraging the development of monopolies or oligopolies,” all of which, “[o]ver time, ... impede national competitiveness, as protected corporations are less inclined to innovate,” and “[g]overnments are rarely wise or nimble enough to figure out the right amount of protection.”).

such as the Sino-American Trade War. (The term and that War are discussed in separate Chapters).³⁸¹

³⁸¹ For example, Chief Foreign Affairs Commentator for the *Financial Times*, Gideon Rachman, argued:

Old ideas are like old clothes – wait long enough and they will come back into fashion. Thirty years ago, “industrial policy” was about as fashionable as a bowler hat. But now governments all over the world, from Washington to Beijing and New Delhi to London, are rediscovering the joy of subsidies and singing the praises of economic self-reliance and “strategic” investment.

The significance of this development goes well beyond economics. The international embrace of free markets and globalization in the 1990s went hand in hand with declining geopolitical tension. The cold war was over, and governments were competing to attract investment rather than to dominate territory.

Now the resurgence of geopolitical rivalry is driving the new fashion for state intervention in the economy. As trust declines between the U.S. and China, so each has begun to see reliance on the other for any vital commodity – whether semiconductors or rare-earth minerals – as a dangerous vulnerability. Domestic production and security of supply are the new watchwords.

As the economic and industrial struggle intensifies, the U.S. has banned the exports of key technologies to China and pushed to repatriate supply chains. It is also moving towards direct state-funding of semiconductor manufacturing. For its part, China has adopted a “dual circulation” economy policy that emphasizes domestic demand and the achievement of “major breakthroughs in key technologies.” The government of Xi Jinping is also tightening state control over the tech sector.

The logic of an arms race is setting in, as each side justifies its moves towards protectionism as a response to actions by the other side. In Washington, the *U.S.-China Strategic Competition Act* [discussed in a separate Chapter], currently wending its way through Congress, accuses China of pursuing “state-led mercantilist economic policies” and industrial espionage. The announcement in 2015 of Beijing’s “Made in China 2025” [also discussed in a separate Chapter] industrial strategy is often cited as a turning point. In Beijing, by contrast, it is argued that a fading America has turned against globalization in an effort to block China’s rise. President Xi has said the backlash against globalization in the west means China must become more self-reliant.

The new emphasis on industrial strategy is not confined to the US and China. In India, Narendra Modi’s government is promoting a policy of *Atmanirbhar Bharat* (self-reliant India), which encourages domestic production of key commodities. The EU published a paper on industrial strategy last year [2020], which is seen as part of a drive towards strategic autonomy and less reliance on the outside world. Ursula von der Leyen, European Commission president, has called for Europe to have “mastery and ownership of key technologies.”

Even a Conservative administration in Britain is turning away from the *laissez-faire* economics championed by former prime minister Margaret Thatcher, and seeking to protect strategic industries. ...

Covid-19 has strengthened the fashion for industrial policy. The domestic production of vaccines is increasingly seen as a vital national interest. Even as they decry “vaccine nationalism” elsewhere, many governments have moved to restrict exports and to build up

What is the distinction between the two concepts – between strategic trade policy, and managed trade? There are common points. Both presume international trade is a zero-sum game. Both presume a consensus can be reached on the industries that a government ought to support. Both are “offensive” policies designed to stimulate an industry, not defensive policies to protect or revitalize a declining one.

However, strategic trade policy uses subsidies, rather than tariffs or quotas. Being unilateral, it does not entail, or require, trade negotiations with foreign governments. Manifestly, through government intervention to support a chosen industry, it is an activist approach. Managed trade focuses on bilateral negotiations with foreign governments to achieve market access commitments. It is a dance between two countries to regulate trade for the mutual benefit of favored industries. Numerical targets or expectations are set. That intervention aside, the government does not directly support an industry.

Are these policies sound? The answer depends on who is asked. Likewise, whether strategic trade policy works depends on who is consulted. A sizeable body of evidence points to limited effects, even in sectors a consensus agrees are strategic. Examples include commercial aircraft, semiconductors, and telecommunications equipment. Even if it “works,” there is a threshold problem of who decides what industries are “strategic.” There also is a risk of error in identifying “strategic” industries. That judgment presumes an

domestic suppliers. The lessons about national resilience learnt from the pandemic may now be applied to other areas, from energy to food supplies.

In the U.S., national security arguments for industrial policy are meshing with the wider backlash against globalisation and free trade. Joe Biden’s rhetoric is frankly protectionist. The president proclaimed to Congress: “All the investments in the American jobs plan will be guided by one principle: Buy American.”

In an article last year, Jake Sullivan, Mr Biden’s National Security Adviser, urged the security establishment to “move beyond the prevailing neoliberal economic philosophy of the past 40 years” and to accept that “industrial policy is deeply American.” [See Jennifer Harris & Jake Sullivan, *America Needs a New Economic Philosophy. Foreign Policy Experts Can Help*, FOREIGN POLICY (7 February 2020), <https://foreignpolicy.com/2020/02/07/america-needs-a-new-economic-philosophy-foreign-policy-experts-can-help/>.] The U.S., he argued, will continue to lose ground to China on key technologies such as 5G and solar panels, “if Washington continues to rely so heavily on private sector research and development.”

Many of these arguments will sound like common sense to voters. Protectionism and state intervention often does. But free-market economists are aghast. Swaminathan Aiyar, a prominent commentator in India, laments the return of the failed ideas of the past, arguing that: “Self-sufficiency was what Nehru and Indira Gandhi tried in the 1960s and 1970s. It was a horrible and terrible flop.” Adam Posen, President of the Peterson Institute for International Economics in Washington, ... decried “America’s self-defeating economic retreat”, arguing that policies aimed at propping up chosen industries or regions usually end in costly failure.

Gideon Rachman, *U.S. China Rivalry Drives the Retreat of Market Economics*, FINANCIAL TIMES, 10 May 2021, www.ft.com/content/1e749857-3cd6-453d-8cee-2c501cbfd53b?shareType=nongift.

uncanny ability to prognosticate future national security needs. Even if these problems are met, strategic trade policy in one country can be met with retaliation by others, thereby eroding the multilateral trading system.

VII. July 2020 Lighthizer Workers Matter Argument

ROBERT E. LIGHTHIZER, *HOW TO MAKE TRADE WORK FOR WORKERS, FOREIGN AFFAIRS (JULY-AUGUST 2020)*³⁸²

What should the objective of trade policy be? Some view trade through the lens of foreign policy, arguing that tariffs should be lowered or raised in order to achieve geopolitical goals. Others view trade strictly through the lens of economic efficiency, contending that the sole objective of trade policy should be to maximize overall output. But what most Americans want is something else: a trade policy that supports the kind of society they want to live in. To that end, the right policy is one that makes it possible for most citizens, including those without college educations, to access the middle class through stable, well-paying jobs.

That is precisely the approach the Trump Administration is taking. It has broken with the orthodoxies of free-trade religion at times, but contrary to what critics have charged, it has not embraced protectionism and autarky. Instead, it has sought to balance the benefits of trade liberalization with policies that prioritize the dignity of work.

... *The Limits of Interdependence*

Before World War II, tariffs were **high by contemporary standards**. From the 1820s until the late 1940s, the weighted average U.S. tariff (which measures duties collected as a percentage of total imports) rarely dipped below 20 percent. President Franklin Roosevelt and the New Deal Congress ushered in a period of relative tariff liberalization in the 1930s, but the rate remained in the mid- to high teens throughout the decade. After the war, however, both Democrats and Republicans came to champion tariff reduction as a means of preventing yet another conflict, arguing that trade fostered interdependence between nations. Trade liberalization therefore came to be seen not just as a tool of economic policy but also as a path to perpetual peace.

Subsequent events seemed to vindicate this view. Exports to U.S. consumers helped Japan and West Germany rebuild and become responsible members of the world community. The tearing down of trade barriers within Europe, starting with the establishment of the European Coal and Steel Community in 1951, surely contributed to post-war security, as well, by bringing the democracies of Western Europe closer together and setting a template for future cooperation.

But interdependence does not always lead to peace. In the United States, economic ties between the North and the South did not prevent the Civil War. Global trade grew rapidly in the years right before World War I; exports as a percentage of global GDP peaked at

³⁸² www.foreignaffairs.com. (Emphasis original.)

nearly 14 percent in 1913, a record that would hold until the 1970s. Likewise, it would be hard to argue that the rise of Germany as a major exporter in the late nineteenth century helped pacify that country in the first half of the twentieth. Japan's dependence on raw materials from the United States motivated its attack on Pearl Harbor. More recently, China's accession to the WTO in 2001 – which was supposed to make the country a model global citizen – was followed by massive investments in its military capabilities and territorial expansion in the South China Sea.

...

There may be situations when it is appropriate to make concessions on trade in order to achieve broader diplomatic aims, but one should keep in mind that such bargains can prove costly in the long run. Letting India join the General Agreement on Tariffs and Trade (the precursor to the WTO) in 1948 with nearly a third of its industrial tariffs uncapped, for example, no doubt made sense to Cold Warriors, who thought that it would help bring India into the U.S. camp. Yet the negative repercussions of that decision persist to this day, now that India has become one of the world's largest economies and, at times, a troublesome trading partner for the United States. Over the years, such concessions have piled up.

Sometimes, the tendency to view trade through the lens of diplomacy has led to excess timidity. The most vivid example is the failure of the George W. Bush and Obama administrations to meaningfully confront China's market-distorting subsidies and policy of forcing foreign companies to share their technology. ...

...

... Even with the recent tariffs imposed against China, along with efforts to rescue the domestic steel, aluminum, and solar power industries, the United States' weighted average tariff was only 2.85 percent in 2019 (and 1.3 percent for imports from countries other than China). That's slightly higher than the 1.5 percent rate that prevailed during the last year of the Obama administration but still lower than a comparable figure for the EU: the 3.0 percent weighted average rate it imposes on imports from other WTO Members.

...

The Efficiency Obsession

The other dominant school of thought in trade policy is the economist's perspective. For adherents of this faith, the sole objective of trade policy is market efficiency. Lower tariffs and nontariff barriers reduce the costs of producing and distributing goods and services; that, in turn, makes society as a whole better off.... How such policies affect the men and women who do the producing and distributing is of little or no consequence.

Rather than envisioning the type of society desired and fashioning a trade policy to fit, economists tend to do the opposite: they start from the proposition that free trade should reign and then argue that society should adapt. Most acknowledge that lowering trade barriers causes economic disruption, but very few suggest that the rules of trade should be calibrated to help society better manage those effects. On the right, libertarians deny that there is a problem, because the benefits of cheap consumer goods for the masses supposedly outweigh the costs. On the left, progressives promote trade adjustment assistance and other wealth-transfer schemes as a means of smoothing globalization's rough edges.

Neither response is satisfactory. Those obsessed with efficiency tend to see employment simply as a means of allocating resources and ensuring production. In so doing, they greatly undervalue the personal dignity that individuals derive from meaningful work. Commentators from Pope Leo XIII in the nineteenth century to Arthur Brooks and Oren Cass today have written eloquently about the central role of work in a well-ordered society. Doing honest work for a decent wage instills feelings of self-worth that come from being needed and contributing to society. Stable, remunerative employment reinforces good habits and discourages bad ones. That makes human beings better spouses, parents, neighbors, and citizens. By contrast, the loss of personal dignity that comes from the absence of stable, well-paying employment is not something that can be compensated for either by increased consumption of low-cost imported goods or by welfare checks.

None of this is to suggest that market efficiency should be irrelevant. But it should not be the sole factor in trade policy, and certainly not an object of idolatrous devotion, as some have made it. When it comes to taxes, health care, environmental regulation, and other issues, policymakers routinely balance efficiency with other competing goals. They should do the same for trade.

In recent years, however, the fixation on efficiency caused many to ignore the downsides of trade liberalization. Particularly as elites came to accept free trade as an article of faith, businesses found that they could send jobs abroad without attracting much negative publicity. ...

...

Economic groupthink also led policymakers to stop worrying about trade deficits. ... [I]n most policy circles, discussion of the trade deficit has been limited to why it supposedly doesn't matter.

...

... [L]ong-term trade deficits must be financed through asset sales, which can prove unsustainable over time. ... These persistent deficits are financed by net inflows of capital – which means that every year, the country must sell U.S. assets to foreign investors in order to sustain the gap between exports and imports.

Academic theory also cannot hide the basic fact that if a country imports goods it could produce domestically, then domestic spending is employing people abroad rather than at home. This tradeoff might be worth it if it frees up workers to move to more productive, higher-paying jobs. It might make sense, too, if reciprocal agreements for market access create new export-related jobs that replace those lost to competition from cheaper imports. ... And particularly when trade deficits are the result of currency manipulation, a lack of reciprocity in market access, unfair labor practices, or subsidies, the United States should try to change the rules of trade.

The Dark Side of Trade

Between 2000 and 2016, the United States lost nearly five million manufacturing jobs. Median household income stagnated. And in places prosperity left behind, the fabric of

society frayed. Since the mid-1990s, the United States has faced an epidemic of what the economists Anne Case and Angus Deaton have termed “deaths of despair.” They have found that among white middle-aged adults who lack a college education – a demographic that has borne much of the brunt of outsourcing – deaths from cirrhosis of the liver increased by 50 percent between 1999 and 2013, suicides increased by 78 percent, and drug and alcohol overdoses increased by 323 percent. From 2014 to 2017, the increase in deaths of despair led to the first decrease in life expectancy in the United States over a three-year period since the 1918 flu pandemic.

Trade has not been the sole cause of the recent loss of manufacturing jobs or of the attendant societal distress. Automation, productivity gains, foreign currency manipulation, and the financial crisis of 2008 have played key roles, as well. But it cannot be denied that the outsourcing of jobs from high- to low wage places has devastated communities in the American Rust Belt and elsewhere.

...

Rather than attempt to reverse these trends, some argue that mature economies should double down on services, the digital economy, and research and development. These sectors contribute greatly to the United States’ competitive edge, and the service sector employs most Americans today and will likely continue to do so for the foreseeable future. At the same time, however, it is difficult to imagine that the U.S. economy can serve the needs of working people without a thriving manufacturing sector. The technology sector, for all its virtues, simply is not a source of high-paying jobs for working people. Over half of the United States’ roughly 250 million adults lack a college diploma. Historically, manufacturing jobs have been the best source of stable, well-paying employment for this cohort. Perhaps with massive new investments in education, former autoworkers could be taught to code. But even so, there probably wouldn’t be enough jobs to employ them all. Apple, Facebook, Google, and Netflix collectively employ just over 300,000 people – less than half the number that General Motors alone employed in the 1960s.

Moreover, the service and technology jobs most accessible to working people, such as data entry and call center jobs, are themselves vulnerable to offshoring. Economists have estimated that nearly 40 million service-sector jobs in the United States could eventually be sent overseas – that’s more than three times the number of current manufacturing jobs in the country.

VIII. SUPPLY CHAIN “RESILIENCE” VERSUS “ROBUSTNESS,” AND REBUTTING LIGHIZER ARGUMENT

Martin Wolf, CBE (1946-), the Associate Editor and Chief Economics Commentator at the *Financial Times*, offers a strong counterpoint to the Lighizer argument. In a 23 June 2020 column entitled *The Dangerous War on Supply Chains*, Mr. Wolf opined:

“One of the things that this crisis has taught us, sir, is that we are dangerously overdependent on a global supply chain for our medicines, like penicillin; our medical supplies, like masks; and our medical equipment,

like ventilators.” Thus, did Peter Navarro, an influential adviser of U.S. President Donald Trump, draw lessons from the Covid-19 crisis for American trade policy.

This view is seductive to protectionists. But it is wrong. The lesson from the crisis is to be better prepared. Self-sufficiency in “essential products” would not be a good way to achieve this. On the contrary, it would be a costly error.

Attacks on cross-border supply chains should not be viewed in isolation. The latest forecasts from the World Trade Organization suggest that the collapse in trade now could be far bigger than in response to the 2008 financial crisis. It would be very damaging if policymakers responded to the steep decline in their countries’ exports by curbing imports. Yet that is what forced “reshoring” of supply chains means. It would be yet another assault on liberal trade. ...

Covid-19 brought forth a wave of export restrictions instead. The products covered by these prohibitions and restrictions vary. But most of them focused on medical supplies (face masks and shields, for example) and pharmaceuticals and medical equipment (ventilators, for example).

These restrictions are legal. But that does not make them wise. In a collection of essays on Covid-19 and Trade Policy, Richard Baldwin of the Graduate Institute in Geneva and Simon Evenett of St. Gallen ask: “Should governments react to the health, economic, and trade crises by turning inward?” The answer is: No. “Turning inward won’t help today’s fight against Covid-19 ... Trade is not the problem; it is part of the solution.”

...

Remember that *the problem was not with trade, but rather with a lack of supply. Export restrictions merely reallocate the shortages, by shifting them on to countries with the least capacity.* A natural response to this experience is for every country to try to be self-sufficient in every product that might turn out to be relevant. That is what Mr. Navarro suggests the U.S. should do.

Yet *businesses would then lose economies of scale, as global markets fragmented. Their capacity to invest in innovation would be reduced.* Only the largest and most advanced economies could plausibly seek self-sufficiency in such a wide range of technologies. For all others, this would be a dead end.

...

More relevant, *self-sufficiency is not at all a guarantee of greater security.* In his Chapter in the book edited by Profs. Baldwin and Evenett, Sébastien Miroudot of the OECD *distinguishes helpfully between “resilience” and “robustness.”* [See Richard Baldwin & Simon Evenett, COVID-19 and

Trade Policy (April 2020), <https://voxeu.org/content/covid-19-and-trade-policy-why-turning-inward-won-t-work>.] *The former refers to the ability to return to normal operations after a disruption; the latter to the ability to maintain operations during a crisis.* In a pandemic, the latter is probably the more relevant. It is necessary to have access to essential supplies in a pandemic, though it is also necessary to be able to restore production quickly if some of it is disrupted.

...

The obvious way to achieve robustness is to diversify suppliers across multiple locations. Producing in one's own country is not a guarantee of robustness. Any given location might be affected by a pandemic, hurricane, earthquake, flood, strikes, civil unrest or even war. To put every egg in one basket, even the domestic one, is risky. Robustness in supply can thus be achieved through a mixture of a multiplicity of suppliers with holding stocks of essential products. The possibility of importing increases the potential number of suppliers and possibly the access to surplus stocks, too. Protection, however, concentrates risk domestically, reduces the diversity of potential suppliers and diminishes the pressure of competition and economies of scale.

...

So what would a sensible policy look like? There would be national and global efforts to identify essential products in the event of various emergencies. There would then be monitoring of relevant supply chains and inventories, both domestic and global.

...

To achieve this, one would need respected and well-funded national and global bodies working alongside private industry. This should be viewed as a fundamental security concern. The pandemic has, after all, posed a vastly greater threat to security than the military threats governments have been spending trillions of dollars to contain.³⁸³

Certain data complemented Mr. Wolf's points. For example, in the World Competitiveness Rankings (assembled by the Institute for Management Development for 63 countries based on "hundreds of factors including employment, cost of living and government spending," and also "surveys of executives on topics such as political stability and protection of intellectual property rights"³⁸⁴), both the U.S. and China tumbled in 2020 amidst their Trade War (discussed in a separate Chapter). The U.S. fell seven places to Number 10. China fell six spots to Number 20. The Trade War had raised costs through higher tariffs, and caused uncertainty for businesses.

³⁸³ Martin Wolf, *The Dangerous War on Supply Chains*, FINANCIAL TIMES, 23 June 2020, www.ft.com/content/e27b0c0c-1893-479b-9ea3-27a81c2506c9?shareType=nongift. (Emphasis added.)

³⁸⁴ *U.S.-China Trade War Takes Toll on their Global Competitiveness*, BBC NEWS, 17 June 2020, www.bbc.com/news/business-53060436 (also reporting that India, which had largely stayed out of the Trade War, remained as the 43rd most competitive economy).

Note, however, the assumptions that underlie this rebuttal argument. First, the rebuttal maintains faith in interdependence, that a nation's security is stronger through free trade than autarky. Second, there are no bad actors with sufficient economic leverage in a market for vital goods or services that will act so self-interestedly and non-transparently as to undermine the security of other countries relying on it, *i.e.*, supply chains will not be abused. Third, the international distribution of jobs in these sectors is irrelevant; comparative advantage is what counts to bring about the greatest possible output through production specialization at the lowest possible prices to maximize consumer choice.

Ambassador Lighthizer's argument operates from fundamentally different premises, does it not? For him, trade, national security, public health, jobs, and supply chains that are both resilient and robustness are all inextricably linked – and best protected if they are onshore. Thus, Mr. Wolf fears the concentration of risk in a domestic economy, and the reduction of economies of scale, caused by protectionism. In contrast, the USTR argues that diversification of risk is itself risky, holds out the prospect of improving economies of scale in the long-run, and urges that in the short-run, Americans will accept higher costs as the trade-off for reduced dependence on foreign powers.

And, in terms of a constructivist approach to their arguments, they are based on different educational and experiential backgrounds, and subjective world views. By training at Oxford, Mr. Wolf is an Economist, he worked at the World Bank for a decade (1971-1981), and is an admirer of F.A. Hayek's *The Road to Serfdom* (1944). A lawyer from Ohio, Mr. Lighthizer spent many years in the private sector and on Capitol Hill, and points out the use of tariffs to promote U.S. industry is a theme in American history.³⁸⁵ And, Mr. Wolf is inclined to rely on economic sources, whereas the USTR invoked a founder of Catholic Social Justice Theory in respect of the dignity of work, Pope Leo XIII (1810-1903, Pope, 1878-1903) and his 1891 Encyclical, *Rerum Novarum* (literally, "Of Revolutionary Change," *i.e.*, Rights and Duties of Capital and Labor).

IX. November 2013 Papal Exhortation *Evangelii Gaudium* and New Development Model

ANDREA TORNIELLI, *CHANGING OUR MODEL FOR DEVELOPMENT BEFORE IT'S TOO LATE*, VATICAN NEWS (24 SEPTEMBER 2022)³⁸⁶

As far back as November 2013, in his exhortation *Evangelii Gaudium* that represents the "road map" of his Pontificate, Pope Francis had spoken of an economy "that kills."

"Today," he wrote, "everything comes under the laws of competition and the survival of the fittest, where the powerful feed upon the powerless. As a consequence, masses of people find themselves excluded and marginalized: without work, without possibilities, without any means of escape. Human beings are themselves considered consumer goods

³⁸⁵ See Robert E. Lighthizer, *The Venerable History of Protectionism*, THE NEW YORK TIMES, 6 March 2008, www.nytimes.com/2008/03/06/opinion/06iht-edlighthizer.1.10774536.html.

³⁸⁶ www.vaticannews.va/en/pope/news/2022-09/pope-francis-assisi-economy-francesco-editorial-development-mode.html.

to be used and then discarded. We have created a ‘throw away’ culture which is now spreading.... The excluded are not the ‘exploited’ but the outcast, the ‘leftovers.’”

These words remain as relevant as ever, even though at the time they brought upon the Pope the crude and unfounded accusation of Marxism levelled at him by commentators ignorant of the Social Doctrine of the Church [*i.e.*, Catholic Social Justice Theory, discussed in a separate Chapter].

...

And Pope Francis spoke clearly and unequivocally again from Assisi on ... [24 September 2022], addressing young people to urgently call for a change in the development model if we are to save humanity threatened by pandemics, wars, and climate change.

“An economy that inspires us with the prophetic dimension,” said the Pope to young people at the Economy of Francesco, “is expressed today in a new vision of the environment and the earth. There are many people, businesses and institutions that are making an ecological conversion. We need to go forward on this road and do more. You are doing and asking everyone to do this ‘more’. It is not enough to make cosmetic changes; we need to discuss models of development. The situation is such that we cannot just wait until the next international summit: the earth burns today, and today we must change, at all levels.”

Therefore, a few superficial actions are not enough, nor are the self-interested gimmicks of “greenwashing” enough for everything to continue as before.

We urgently need to question the development model we have embraced.

...

Pope Francis – who in his [24 May 2015] Encyclical *Laudato Si’* [*On The Care Of Our Common Home*³⁸⁷] showed how hunger, wars, migration, and climate change were interconnected – recalled in Assisi that “the cry of the poor and the cry of the earth are the same cry,” calling for preference among environmental solutions for those that “reduce misery and inequality.”

...

Our development model can only be changed with participation from below, and by governments convinced of the need for forward-looking choices to ensure a future for the earth and those who inhabit it.

APOSTOLIC EXHORTATION, *EVANGELII GAUDIUM*, OF THE HOLY FATHER FRANCIS TO THE BISHOPS, CLERGY, CONSECRATED PERSONS AND THE LAY FAITHFUL (ON THE PROCLAMATION OF THE GOSPEL IN TODAY’S WORLD) (24 NOVEMBER 2013)³⁸⁸

CHAPTER TWO AMID THE CRISIS OF COMMUNAL COMMITMENT

³⁸⁷ www.vatican.va/content/francesco/en/encyclicals/documents/papa-francesco_20150524_enciclica-laudato-si.html.

³⁸⁸ www.vatican.va/content/francesco/en/apost_exhortations/documents/papa-francesco_esortazione-ap_20131124_evangelii-gaudium.html. (Footnotes omitted.)

I. Some Challenges Of Today's World

52. In our time humanity is experiencing a turning-point in its history, as we can see from the advances being made in so many fields. We can only praise the steps being taken to improve people's welfare in areas such as health care, education, and communications. At the same time, ... the majority of our contemporaries are barely living from day to day, with dire consequences. A number of diseases are spreading. The hearts of many people are gripped by fear and desperation, even in the so-called rich countries. The joy of living frequently fades, lack of respect for others and violence are on the rise, and inequality is increasingly evident. It is a struggle to live and, often, to live with precious little dignity. This epochal change has been set in motion by the enormous qualitative, quantitative, rapid, and cumulative advances occurring in the sciences and in technology, and by their instant application in different areas of nature and of life. We are in an age of knowledge and information, which has led to new and often anonymous kinds of power.

No to an economy of exclusion

53. Just as the commandment "Thou shalt not kill" sets a clear limit in order to safeguard the value of human life, today we also have to say "thou shalt not" to an economy of exclusion and inequality. Such an economy kills. How can it be that it is not a news item when an elderly homeless person dies of exposure, but it is news when the stock market loses two points? This is a case of exclusion. Can we continue to stand by when food is thrown away while people are starving? This is a case of inequality. Today everything comes under the laws of competition and the survival of the fittest, where the powerful feed upon the powerless. As a consequence, masses of people find themselves excluded and marginalized: without work, without possibilities, without any means of escape.

Human beings are themselves considered consumer goods to be used and then discarded. We have created a "throw away" culture which is now spreading. It is no longer simply about exploitation and oppression, but something new. Exclusion ultimately has to do with what it means to be a part of the society in which we live; those excluded are no longer society's underside or its fringes or its disenfranchised – they are no longer even a part of it. The excluded are not the "exploited" but the outcast, the "leftovers."

54. In this context, some people continue to defend trickle-down theories which assume that economic growth, encouraged by a free market, will inevitably succeed in bringing about greater justice and inclusiveness in the world. This opinion, which has never been confirmed by the facts, expresses a crude and naïve trust in the goodness of those wielding economic power and in the sacralized workings of the prevailing economic system. Meanwhile, the excluded are still waiting. To sustain a lifestyle which excludes others, or to sustain enthusiasm for that selfish ideal, a globalization of indifference has developed. Almost without being aware of it, we end up being incapable of feeling compassion at the outcry of the poor, weeping for other people's pain, and feeling a need to help them, as though all this were someone else's responsibility and not our own. The culture of prosperity deadens us; we are thrilled if the market offers us something new to purchase.

In the meantime, all those lives stunted for lack of opportunity seem a mere spectacle; they fail to move us.

No to the new idolatry of money

55. One cause of this situation is found in our relationship with money, since we calmly accept its dominion over ourselves and our societies. The current financial crisis can make us overlook the fact that it originated in a profound human crisis: the denial of the primacy of the human person! We have created new idols. The worship of the ancient golden calf (*cf.* Ex 32:1-35 [Old Testament, *Book of Exodus*, Chapter 32, Verses 1-35]) has returned in a new and ruthless guise in the idolatry of money and the dictatorship of an impersonal economy lacking a truly human purpose. The worldwide crisis affecting finance and the economy lays bare their imbalances and, above all, their lack of real concern for human beings; man is reduced to one of his needs alone: consumption.

56. While the earnings of a minority are growing exponentially, so too is the gap separating the majority from the prosperity enjoyed by those happy few. This imbalance is the result of ideologies which defend the absolute autonomy of the marketplace and financial speculation. Consequently, they reject the right of states, charged with vigilance for the common good, to exercise any form of control. A new tyranny is thus born, invisible and often virtual, which unilaterally and relentlessly imposes its own laws and rules. Debt and the accumulation of interest also make it difficult for countries to realize the potential of their own economies and keep citizens from enjoying their real purchasing power. To all this we can add widespread corruption and self-serving tax evasion, which have taken on worldwide dimensions. The thirst for power and possessions knows no limits. In this system, which tends to devour everything which stands in the way of increased profits, whatever is fragile, like the environment, is defenseless before the interests of a deified market, which become the only rule.

No to a financial system which rules rather than serves

57. Behind this attitude lurks a rejection of ethics and a rejection of God. Ethics has come to be viewed with a certain scornful derision. It is seen as counterproductive, too human, because it makes money and power relative. It is felt to be a threat, since it condemns the manipulation and debasement of the person. In effect, ethics leads to a God who calls for a committed response which is outside the categories of the marketplace. When these latter are absolutized, God can only be seen as uncontrollable, unmanageable, even dangerous, since he calls human beings to their full realization and to freedom from all forms of enslavement. Ethics – a non-ideological ethics – would make it possible to bring about balance and a more humane social order. ... I encourage financial experts and political leaders to ponder the words of one of the sages of antiquity: “Not to share one’s wealth with the poor is to steal from them and to take away their livelihood. It is not our own goods which we hold, but theirs.”

58. A financial reform open to such ethical considerations would require a vigorous change of approach on the part of political leaders. I urge them to face this challenge with

determination and an eye to the future, while not ignoring, of course, the specifics of each case. Money must serve, not rule! The Pope loves everyone, rich and poor alike, but he is obliged in the name of Christ to remind all that the rich must help, respect, and promote the poor. I exhort you to generous solidarity and to the return of economics and finance to an ethical approach which favors human beings.

No to the inequality which spawns violence

59. Today in many places we hear a call for greater security. But until exclusion and inequality in society and between peoples are reversed, it will be impossible to eliminate violence. The poor and the poorer peoples are accused of violence, yet without equal opportunities the different forms of aggression and conflict will find a fertile terrain for growth and eventually explode. When a society – whether local, national, or global – is willing to leave a part of itself on the fringes, no political programs or resources spent on law enforcement or surveillance systems can indefinitely guarantee tranquility. This is not the case simply because inequality provokes a violent reaction from those excluded from the system, but because the socioeconomic system is unjust at its root. Just as goodness tends to spread, the toleration of evil, which is injustice, tends to expand its baneful influence and quietly to undermine any political and social system, no matter how solid it may appear. If every action has its consequences, an evil embedded in the structures of a society has a constant potential for disintegration and death. It is evil crystallized in unjust social structures, which cannot be the basis of hope for a better future. We are far from the so-called “end of history,” since the conditions for a sustainable and peaceful development have not yet been adequately articulated and realized.

60. Today’s economic mechanisms promote inordinate consumption, yet it is evident that unbridled consumerism combined with inequality proves doubly damaging to the social fabric. Inequality eventually engenders a violence which recourse to arms cannot and never will be able to resolve. It serves only to offer false hopes to those clamoring for heightened security, even though nowadays we know that weapons and violence, rather than providing solutions, create new and more serious conflicts. Some simply content themselves with blaming the poor and the poorer countries themselves for their troubles; indulging in unwarranted generalizations, they claim that the solution is an “education” that would tranquilize them, making them tame and harmless. All this becomes even more exasperating for the marginalized in the light of the widespread and deeply rooted corruption found in many countries – in their governments, businesses, and institutions – whatever the political ideology of their leaders.

CHAPTER FOUR

THE SOCIAL DIMENSION OF EVANGELIZATION

II. The Inclusion Of Poor In Society

...

In union with God, we hear a plea

187. Each individual Christian and every community is called to be an instrument of God for the liberation and promotion of the poor, and for enabling them to be fully a part of society. This demands that we be docile and attentive to the cry of the poor and to come to their aid. A mere glance at the Scriptures is enough to make us see how our gracious Father wants to hear the cry of the poor: “I have observed the misery of my people who are in Egypt; I have heard their cry on account of their taskmasters. Indeed, I know their sufferings, and I have come down to deliver them... so I will send you...” (*Ex* 3:7-8, 10 [Old Testament, *Exodus*, Chapter 3, Verses 7-8, 10]). We also see how he is concerned for their needs: “When the Israelites cried out to the Lord, the Lord raised up for them a deliverer” (*Jg* 3:15 Old Testament, *Judges*, Chapter 3, Verse 15]). If we, who are God’s means of hearing the poor, turn deaf ears to this plea, we oppose the Father’s will and his plan; that poor person “might cry to the Lord against you, and you would incur guilt” (*Dt* 15:9 [Old Testament, *Deuteronomy*, Chapter 15, Verse 9]). A lack of solidarity towards his or her needs will directly affect our relationship with God: “For if in bitterness of soul he calls down a curse upon you, his Creator will hear his prayer” (*Sir* 4:6 [Old Testament, *Sirach*, Chapter 4, Verse 6]). The old question always returns: “How does God’s love abide in anyone who has the world’s goods, and sees a brother or sister in need and yet refuses help?” (1 *Jn* 3:17 [New Testament, *John*, Chapter 3, Verse 17]). Let us recall also how bluntly the apostle James speaks of the cry of the oppressed: “The wages of the laborers who mowed your fields, which you kept back by fraud, cry out, and the cries of the harvesters have reached the ears of the Lord of hosts” (5:4).

188. The Church has realized that the need to heed this plea is itself born of the liberating action of grace within each of us, and thus it is not a question of a mission reserved only to a few: “The Church, guided by the Gospel of mercy and by love for mankind, hears the cry for justice and intends to respond to it with all her might.” In this context we can understand Jesus’ command to his disciples: “You yourselves give them something to eat!” (*Mk* 6:37 [New Testament, *Mark*, Chapter 6, Verse 37]): it means working to eliminate the structural causes of poverty and to promote the integral development of the poor, as well as small daily acts of solidarity in meeting the real needs which we encounter. The word “solidarity” is a little worn and at times poorly understood, but it refers to something more than a few sporadic acts of generosity. It presumes the creation of a new mindset which thinks in terms of community and the priority of the life of all over the appropriation of goods by a few.

189. Solidarity is a spontaneous reaction by those who recognize that the social function of property and the universal destination of goods are realities which come before private property. The private ownership of goods is justified by the need to protect and increase them, so that they can better serve the common good; for this reason, solidarity must be lived as the decision to restore to the poor what belongs to them. These convictions and habits of solidarity, when they are put into practice, open the way to other structural transformations and make them possible. Changing structures without generating new convictions and attitudes will only ensure that those same structures will become, sooner or later, corrupt, oppressive, and ineffectual.

190. Sometimes it is a matter of hearing the cry of entire peoples, the poorest peoples of the earth, since “peace is founded not only on respect for human rights, but also on respect

for the rights of peoples.” Sadly, even human rights can be used as a justification for an inordinate defense of individual rights or the rights of the richer peoples. With due respect for the autonomy and culture of every nation, we must never forget that the planet belongs to all mankind and is meant for all mankind; the mere fact that some people are born in places with fewer resources or less development does not justify the fact that they are living with less dignity. It must be reiterated that “the more fortunate should renounce some of their rights so as to place their goods more generously at the service of others.” To speak properly of our own rights, we need to broaden our perspective and to hear the plea of other peoples and other regions than those of our own country. We need to grow in a solidarity which “would allow all peoples to become the artisans of their destiny,” since “every person is called to self-fulfilment.”

192. ... We are not simply talking about ensuring nourishment or a “dignified sustenance” for all people, but also their “general temporal welfare and prosperity.” This means education, access to health care, and above all employment, for it is through free, creative, participatory and mutually supportive labor that human beings express and enhance the dignity of their lives. A just wage enables them to have adequate access to all the other goods which are destined for our common use.

The special place of the poor in God’s people

201. No one must say that they cannot be close to the poor because their own lifestyle demands more attention to other areas. This is an excuse commonly heard in academic, business, or professional, and even ecclesial circles. While it is quite true that the essential vocation and mission of the lay faithful is to strive that earthly realities and all human activity may be transformed by the Gospel, none of us can think we are exempt from concern for the poor and for social justice: “Spiritual conversion, the intensity of the love of God and neighbor, zeal for justice and peace, the Gospel meaning of the poor and of poverty, are required of everyone.” I fear that these words too may give rise to commentary or discussion with no real practical effect. That being said, I trust in the openness and readiness of all Christians, and I ask you to seek, as a community, creative ways of accepting this renewed call.

The economy and the distribution of income

202. The need to resolve the structural causes of poverty cannot be delayed, not only for the pragmatic reason of its urgency for the good order of society, but because society needs to be cured of a sickness which is weakening and frustrating it, and which can only lead to new crises. Welfare projects, which meet certain urgent needs, should be considered merely temporary responses. As long as the problems of the poor are not radically resolved by rejecting the absolute autonomy of markets and financial speculation and by attacking the structural causes of inequality, no solution will be found for the world’s problems or, for that matter, to any problems. Inequality is the root of social ills.

203. The dignity of each human person and the pursuit of the common good are concerns which ought to shape all economic policies. At times, however, they seem to be a mere

addendum imported from without in order to fill out a political discourse lacking in perspectives or plans for true and integral development. How many words prove irksome to this system! It is irksome when the question of ethics is raised, when global solidarity is invoked, when the distribution of goods is mentioned, when reference is made to protecting labor and defending the dignity of the powerless, when allusion is made to a God who demands a commitment to justice. At other times these issues are exploited by a rhetoric which cheapens them. Casual indifference in the face of such questions empties our lives and our words of all meaning. Business is a vocation, and a noble vocation, provided that those engaged in it see themselves challenged by a greater meaning in life; this will enable them truly to serve the common good by striving to increase the goods of this world and to make them more accessible to all.

204. We can no longer trust in the unseen forces and the invisible hand of the market. Growth in justice requires more than economic growth, while presupposing such growth: it requires decisions, programs, mechanisms, and processes specifically geared to a better distribution of income, the creation of sources of employment and an integral promotion of the poor which goes beyond a simple welfare mentality. I am far from proposing an irresponsible populism, but the economy can no longer turn to remedies that are a new poison, such as attempting to increase profits by reducing the work force and thereby adding to the ranks of the excluded.

205. I ask God to give us more politicians capable of sincere and effective dialogue aimed at healing the deepest roots – and not simply the appearances – of the evils in our world! Politics, though often denigrated, remains a lofty vocation and one of the highest forms of charity, in as much as it seeks the common good. We need to be convinced that charity “is the principle not only of micro-relationships (with friends, with family members or within small groups) but also of macro-relationships (social, economic, and political ones).” ...

206. Economy, as the very word indicates, should be the art of achieving a fitting management of our common home, which is the world as a whole. Each meaningful economic decision made in one part of the world has repercussions everywhere else; consequently, no government can act without regard for shared responsibility. Indeed, it is becoming increasingly difficult to find local solutions for enormous global problems which overwhelm local politics with difficulties to resolve. If we really want to achieve a healthy world economy, what is needed at this juncture of history is a more efficient way of interacting which, with due regard for the sovereignty of each nation, ensures the economic well-being of all countries, not just of a few.

207. Any Church community, if it thinks it can comfortably go its own way without creative concern and effective cooperation in helping the poor to live with dignity and reaching out to everyone, will also risk breaking down, however much it may talk about social issues or criticize governments. It will easily drift into a spiritual worldliness camouflaged by religious practices, unproductive meetings, and empty talk.

208. If anyone feels offended by my words, I would respond that I speak them with affection and with the best of intentions, quite apart from any personal interest or political ideology. My words are not those of a foe or an opponent. I am interested only in helping those who are in thrall to an individualistic, indifferent, and self-centered mentality to be freed from those unworthy chains and to attain a way of living and thinking which is more humane, noble, and fruitful, and which will bring dignity to their presence on this earth.

Concern for the vulnerable

...

210. It is essential to draw near to new forms of poverty and vulnerability, in which we are called to recognize the suffering Christ, even if this appears to bring us no tangible and immediate benefits. I think of the homeless, the addicted, refugees, indigenous peoples, the elderly who are increasingly isolated and abandoned, and many others. Migrants present a particular challenge for me, since I am the pastor of a Church without frontiers, a Church which considers herself mother to all. For this reason, I exhort all countries to a generous openness which, rather than fearing the loss of local identity, will prove capable of creating new forms of cultural synthesis. How beautiful are those cities which overcome paralyzing mistrust, integrate those who are different and make this very integration a new factor of development! How attractive are those cities which, even in their architectural design, are full of spaces which connect, relate, and favor the recognition of others!

211. I have always been distressed at the lot of those who are victims of various kinds of human trafficking. How I wish that all of us would hear God's cry: "Where is your brother?" (Gen 4:9 [Old Testament, *Genesis*, Chapter 4, Verse 9]). Where is your brother or sister who is enslaved? Where is the brother and sister whom you are killing each day in clandestine warehouses, in rings of prostitution, in children used for begging, in exploiting undocumented labor? Let us not look the other way. There is greater complicity than we think. The issue involves everyone! This infamous network of crime is now well established in our cities, and many people have blood on their hands as a result of their comfortable and silent complicity.

212. Doubly poor are those women who endure situations of exclusion, mistreatment, and violence, since they are frequently less able to defend their rights. Even so, we constantly witness among them impressive examples of daily heroism in defending and protecting their vulnerable families.

III. The Common Good and Peace in Society

...

218. Peace in society cannot be understood as pacification or the mere absence of violence resulting from the domination of one part of society over others. Nor does true peace act as a pretext for justifying a social structure which silences or appeases the poor, so that the more affluent can placidly support their lifestyle while others have to make do as they can. Demands involving the distribution of wealth, concern for the poor and human rights cannot be suppressed under the guise of creating a consensus on paper or a transient peace for a contented minority. The dignity of the human person and the common good

rank higher than the comfort of those who refuse to renounce their privileges. When these values are threatened, a prophetic voice must be raised.

219. Nor is peace “simply the absence of warfare, based on a precarious balance of power; it is fashioned by efforts directed day after day towards the establishment of the ordered universe willed by God, with a more perfect justice among men.” In the end, a peace which is not the result of integral development will be doomed; it will always spawn new conflicts and various forms of violence.

220. People in every nation enhance the social dimension of their lives by acting as committed and responsible citizens, not as a mob swayed by the powers that be. Let us not forget that “responsible citizenship is a virtue, and participation in political life is a moral obligation.” Yet becoming a people demands something more. It is an ongoing process in which every new generation must take part: a slow and arduous effort calling for a desire for integration and a willingness to achieve this through the growth of a peaceful and multifaceted culture of encounter.

221. Progress in building a people in peace, justice, and fraternity depends on four principles related to constant tensions present in every social reality. These derive from the pillars of the Church’s social doctrine, which serve as “primary and fundamental parameters of reference for interpreting and evaluating social phenomena.” In their light I would now like to set forth these four specific principles which can guide the development of life in society and the building of a people where differences are harmonized within a shared pursuit. I do so out of the conviction that their application can be a genuine path to peace within each nation and in the entire world.

...

Realities are more important than ideas

231. There also exists a constant tension between ideas and realities. Realities simply are, whereas ideas are worked out. There has to be continuous dialogue between the two, lest ideas become detached from realities. It is dangerous to dwell in the realm of words alone, of images and rhetoric. So, a third principle comes into play: realities are greater than ideas. This calls for rejecting the various means of masking reality: angelic forms of purity, dictatorships of relativism, empty rhetoric, objectives more ideal than real, brands of ahistorical fundamentalism, ethical systems bereft of kindness, intellectual discourse bereft of wisdom.

232. Ideas – conceptual elaborations – are at the service of communication, understanding, and praxis. Ideas disconnected from realities give rise to ineffectual forms of idealism and nominalism, capable at most of classifying and defining, but certainly not calling to action. What calls us to action are realities illuminated by reason. Formal nominalism has to give way to harmonious objectivity. Otherwise, the truth is manipulated, cosmetics take the place of real care for our bodies. We have politicians – and even religious leaders – who wonder why people do not understand and follow them, since their proposals are so clear and logical. Perhaps it is because they are stuck in the realm of pure

ideas and end up reducing politics or faith to rhetoric. Others have left simplicity behind and have imported a rationality foreign to most people.

233. Realities are greater than ideas. This principle has to do with incarnation of the word and its being put into practice: “By this you know the Spirit of God: every spirit that confesses that Jesus Christ is come in the flesh is from God” (1 Jn 4:2 [New Testament, *First Epistle of John*, Chapter 4, Verse 2]). The principle of reality, of a word already made flesh and constantly striving to take flesh anew, is essential to evangelization. It helps us to see that the Church’s history is a history of salvation, to be mindful of those saints who inculturated the Gospel in the life of our peoples and to reap the fruits of the Church’s rich bimillennial tradition, without pretending to come up with a system of thought detached from this treasury, as if we wanted to reinvent the Gospel. At the same time, this principle impels us to put the word into practice, to perform works of justice and charity which make that word fruitful. Not to put the word into practice, not to make it reality, is to build on sand, to remain in the realm of pure ideas and to end up in a lifeless and unfruitful self-centeredness, and gnosticism.

...
IV. Social Dialogue as a Contribution to Peace

238. Evangelization also involves the path of dialogue. For the Church today, three areas of dialogue stand out where she needs to be present in order to promote full human development and to pursue the common good: dialogue with states, dialogue with society – including dialogue with cultures and the sciences – and dialogue with other believers who are not part of the Catholic Church. In each case, “the Church speaks from the light which faith offers,” contributing her two-thousand-year experience and keeping ever in mind the life and sufferings of human beings. This light transcends human reason, yet it can also prove meaningful and enriching to those who are not believers, and it stimulates reason to broaden its perspectives.

239. ... In a culture which privileges dialogue as a form of encounter, it is time to devise a means for building consensus and agreement while seeking the goal of a just, responsive, and inclusive society. The principal author, the historic subject of this process, is the people as a whole and their culture, and not a single class, minority, group or elite. We do not need plans drawn up by a few for the few, or an enlightened or outspoken minority which claims to speak for everyone. It is about agreeing to live together, a social and cultural pact.

240. It is the responsibility of the State to safeguard and promote the common good of society. Based on the principles of subsidiarity and solidarity, and fully committed to political dialogue and consensus building, it plays a fundamental role, one which cannot be delegated, in working for the integral development of all. This role, at present, calls for profound social humility.

241. In her dialogue with the State and with society, the Church does not have solutions for every particular issue. Together with the various sectors of society, she supports those programs which best respond to the dignity of each person and the common good. In doing

this, she proposes in a clear way the fundamental values of human life and convictions which can then find expression in political activity.

Dialogue between faith, reason, and science

242. Dialogue between science and faith also belongs to the work of evangelization at the service of peace. Whereas positivism and scientism “refuse to admit the validity of forms of knowledge other than those of the positive sciences,” the Church proposes another path, which calls for a synthesis between the responsible use of methods proper to the empirical sciences and other areas of knowledge such as philosophy, theology, as well as faith itself, which elevates us to the mystery transcending nature and human intelligence. Faith is not fearful of reason; on the contrary, it seeks and trusts reason, since “the light of reason and the light of faith both come from God” and cannot contradict each other. Evangelization is attentive to scientific advances and wishes to shed on them the light of faith and the natural law so that they will remain respectful of the centrality and supreme value of the human person at every stage of life. All of society can be enriched thanks to this dialogue, which opens up new horizons for thought and expands the possibilities of reason. This too is a path of harmony and peace.

243. The Church has no wish to hold back the marvelous progress of science. On the contrary, she rejoices and even delights in acknowledging the enormous potential that God has given to the human mind. Whenever the sciences – rigorously focused on their specific field of inquiry – arrive at a conclusion which reason cannot refute, faith does not contradict it. Neither can believers claim that a scientific opinion which is attractive but not sufficiently verified has the same weight as a dogma of faith. At times some scientists have exceeded the limits of their scientific competence by making certain statements or claims. But here the problem is not with reason itself, but with the promotion of a particular ideology which blocks the path to authentic, serene, and productive dialogue.

Inter-Religious dialogue

250. An attitude of openness in truth and in love must characterize the dialogue with the followers of non-Christian religions, in spite of various obstacles and difficulties, especially forms of fundamentalism on both sides. Interreligious dialogue is a necessary condition for peace in the world, and so it is a duty for Christians as well as other religious communities. This dialogue is in first place a conversation about human existence or simply, as the bishops of India have put it, a matter of “being open to them, sharing their joys and sorrows.” In this way we learn to accept others and their different ways of living, thinking and speaking. We can then join one another in taking up the duty of serving justice and peace, which should become a basic principle of all our exchanges. A dialogue which seeks social peace and justice is in itself, beyond all merely practical considerations, an ethical commitment which brings about a new social situation. Efforts made in dealing with a specific theme can become a process in which, by mutual listening, both parts can be purified and enriched. These efforts, therefore, can also express love for truth.

251. In this dialog, ever friendly and sincere, attention must always be paid to the essential bond between dialogue and proclamation, which leads the Church to maintain and intensify her relationship with non-Christians. A facile syncretism would ultimately be a totalitarian gesture on the part of those who would ignore greater values of which they are not the masters. True openness involves remaining steadfast in one's deepest convictions, clear and joyful in one's own identity, while at the same time being "open to understanding those of the other party" and "knowing that dialogue can enrich each side." What is not helpful is a diplomatic openness which says "yes" to everything in order to avoid problems, for this would be a way of deceiving others and denying them the good which we have been given to share generously with others. Evangelization and interreligious dialogue, far from being opposed, mutually support, and nourish one another.

Chapter 12

COMMUNIST TRADE THEORY³⁸⁹

I. Marxist-Leninist Critique of Free Trade

It is all too easy to read the term “Marxism” in a pejorative sense, especially given the human rights violations committed across the 20th and early 21st centuries professing to adhere to this “-ism.” It is all too easy to think Marxism is a bankrupt ideology in light of the collapse of Communism virtually everywhere. (In several countries where Communism has not yet collapsed, such as Laos and Vietnam, there is a growing “disconnect” between official state ideology and everyday reality in the marketplace. Into that gap the interests of the poor often tumble.)

Just as it is bad lawyering to underestimate the opposition, it is bad scholarship to dismiss prematurely an entire paradigm that still yields some provocative insights. As historian Niall Ferguson (1964-), observes in London’s *Financial Times*:

As a prophet Marx was, of course, a washout. He was also a class traitor, taking the side of the proletariat when he himself was the quintessential 19th century bourgeois. His socialist utopia turned out to be a corrupt tyranny, which expropriated the wealth of the middle class only in order to enrich a new class of apparatchiks.

Even so, Marx’s insights into Capitalism can still illuminate. ...

This may read like heresy, especially in the pages of the *Financial Times*. But a little reflection on the current crisis of Capitalism will show otherwise. ...

...

For Marx, the defining characteristics of Capitalism in his own time included “the centralization of capital,” “the expropriation of the mass of the people by a few usurpers,” and “the entanglement of all peoples in the net of the world-market, and with this, the international character of the Capitalistic regime” [quoting chapter 32 in volume I of *Das Kapital* (1867)]. In other words, *widening inequality and globalization*.

Forget Marx’s utopian prophecy that Capitalism would be succeeded by socialism, with all property redistributed according to the

³⁸⁹ Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

workers' needs. *The real point is that many of the defects he identified in 19th century Capitalism are again evident today.*³⁹⁰

Many lawyers who toil away in multinational law firms for long hours at highly specialized and repetitive tasks, not receiving the full value of their labor input, and feeling alienated from clients, might be surprised at just how many passages from the works of Karl Marx (1818-1883) or Vladimir I. Lenin (1870-1924) correctly capture their work life.

Likewise, Communism has experienced somewhat of a renaissance in contemporary China:

Chinese university graduates are struggling to find work in the country's worst labor market in years – unless they have degrees in Marxism.

Despite being China's ruling ideology, Marxism has for decades been an obscure major for students. But it is enjoying a revival under President Xi Jinping [1953-, President, 2012-], who has urged Chinese Communist party cadres to “remember the original mission” as he prepares to begin an unprecedented third term in power this year [2022].

According to *Yingjiesheng*, a leading job search website for university graduates, there has been a 20 per cent increase in openings that require a Marxism degree in the second quarter – the peak hiring season – compared with the same period last year [2021]. Marxism experts are being sought by employers ranging from government departments to private conglomerates.

Analysts said the popularity of Marxism graduates underscored Xi's efforts to strengthen ideological education as China's rivalry with the U.S. intensified [discussed in separate Chapters], with the powers taking radically different approaches to everything from Russia's invasion of Ukraine to coronavirus pandemic management.

“The purpose of the major is to train thought police to brainwash the entire population,” said Ming Xia, a Political Science Professor at the City University of New York.

Chinese universities offering Marxism degrees inculcate students in the philosophy developed by Karl Marx as interpreted by Xi and his revolutionary idol, Mao Zedong [1893-1976, CCP Chairman, 1943-1976].

A curriculum for a three-year Master's program in Marxism at a university in central Henan Province includes a module on the “principle and methods of thought education” and 18 hours of study of Xi's speeches on education.

³⁹⁰ Niall Ferguson, *Full Marx*, FINANCIAL TIMES, August 17-18, 2002, at Weekend I. (Emphasis added.) See also LEO XIII, ENCYCLICAL LETTER, RERUM NOVARUM (“On the Condition of the Working Classes”) ¶¶ 1-6 (15 May 1891).

Prior to Xi's rise to power in late 2012, Marxism courses struggled to gain traction in a country that emphasized economic prosperity over ideological correctness during the three-decade reform era launched by Deng Xiaoping [1904-1997, Chairman, 1982-1987] in 1978.

Under Deng, the party popularized catchphrases such as "it is glorious to get rich" and assured entrepreneurs that it was acceptable for "some people to get rich first." Deng's successor as leader, Jiang Zemin, formally invited private sector businessmen and women to join the Party.

Xi, however, has made it clear that he intends to preside over an ideologically stricter "new era" that will prioritize "common prosperity," tighter regulation of private sector conglomerates and a less stark rich-poor divide in what is one of the world's most unequal societies.

Xi's government has cracked down on young people who apply Marxist analysis too critically to abuses of labor allowed under China's system of state Capitalism. But it has boosted demand for Marxism teachers, who now play a critical role in educating the public about why China's communist regime is superior to the West.³⁹¹

In brief, whether lawyers toiling away in Capitalist economies or cadres working their way up the CCP are right or wrong, and whether one agrees with them or not, neither of these groups can be dismissed as either "stupid" or "irrelevant."

Monstrous in its practical effects hideously documented across the 20th and early 21st centuries? Yes, Communism is that. Inane as an intellectual critique? No. Now consigned to history's dustbin? No. Marxist-Leninist ideology may have little of appeal to offer in terms of practical policy prescriptions in free-enterprise jurisdictions as diverse as the Australia, Canada, EU, India, Japan, New Zealand, U.S., and U.K. But that ideology holds considerable sway in its diagnosis of the underside of Capitalism and free trade.

II. Step 1: Competition, Exploitation, and Surplus

Do the wealthy countries talk like free traders, but at the negotiating table behave like mercantilists, with the goal of maximizing market access for their own MNCs? Never mind that investment by MNCs tends rather strongly to occur among developed countries – Africa, for example, captures less than 0.7% of global FDI. In the Marxist paradigm, the answer is a resolute "yes."

In 1867, Karl Marx published the first volume of *Das Kapital*. Before then, he had written about various aspects of the nature of Capitalism in *Economic and Philosophical*

³⁹¹ Sun Yu, *China's Marxism Majors Prosper Amid Labor Market Woes*, FINANCIAL TIMES, 28 June 2022, www.ft.com/content/36d34b2f-7f69-4224-8322-87d99a820f64?shareType=nongift.

Manuscripts of 1844. Between these two dates, he (sometimes co-authoring with Friedrich Engels (1820-1895)) produced a large body of work in which he developed his critique. One of Marx's works that clearly and concisely expresses his ideas is *Wage Labor and Capital*. This essay began as a series of lectures Marx delivered in Brussels in December 1847, which were published in 1849.

The basic story line in Marx's classic critique of Capitalism is clear enough: competition among capitalists ultimately dooms their economic system. The chain of causation, said Marx, was inevitable – historically determined, as it were. Marx urged in that process, capitalists exploit rather mercilessly not only workers in their own countries, but also workers in poor countries, and indeed the poor countries themselves. In this story line, perhaps, lie the origins of contemporary claims that the rules of international trade are adverse to the interests of poor countries.

Marx's critique of Capitalism posits two key factors of production: labor and capital. "Labor," of course, refers principally to workers on a factory assembly line. "Capital" means physical capital, such as machine tools on that line. The model does not ascribe much importance to other factors, such as land or human capital. In the model, "capitalists" are the class of businessmen who own the capital, and who employ labor to work with the capital in the production of goods. The goal of capitalists – as free-market economists champion in their classical and neo-classical models – is to maximize profits. In Marxist terminology, this equates to a relentless drive for "surplus labor."

Occasionally, Marx is rather imprecise in some of his terminology, and here we happen upon an example. He speaks of "surplus," which at least in a loose sense we can equate as conceptually the same thing as "profits" and "returns to capital." How so?

Every capitalist must pay his workers. Likewise, every capitalist must invest money "up front" in a machine. The capitalist wants to generate as much money over and above the wages he must pay his workers, and over and above previous investment expenditures in machines. That is, every capitalist is motivated to maximize "profit," *i.e.*, the amount earned from selling products made by labor and capital, less the amount he must pay to workers and for the machines. Put in the language of modern-day economic theory, every capitalist wants to maximize profits, which occurs by maximizing gross revenues from sales, and minimizing variable and fixed costs of production.

However, capitalists do not have much control over sales revenues. In the long run, they cannot generate higher returns to capital by raising prices. So, said Marx, there is cut-throat competition. (A renowned Marxist famously remarked that when it comes time to hang capitalism, the capitalists will compete to sell you the rope!) The point is that in their competition with one another, capitalists ineluctably over-produce. That is, capitalists tend to saturate – and eventually super-saturate – the markets in which they sell their goods. The inevitable result is a decline in prices for those goods.

The way out of this spiral of over-production and price declines is to expand the size of the market. But, the market in any one country is only so large (particularly in the

short- and medium-term, and where population size is not growing rapidly). So, capitalists seek to expand their markets by finding new ones overseas. Here, then, is where capitalists become imperialists.

The more intense the competition in their domestic markets, the more voracious their appetite to find new consumers in foreign markets. They may unite on one point – entry into an unholy alliance with their governments and military to force open foreign markets. Of course, that unity breaks down when the military-industrial complexes of the great powers fight among themselves over the spoils from newly-opened foreign markets.

It is precisely on this point that V.I. Lenin expounds in his 1916 classic, *Imperialism: The Highest Stage of Capitalism*.³⁹²

The building of railways seems to be a simple, natural, democratic, cultural, and civilizing enterprise; that is what it is in the opinion of bourgeois professors, who are paid to depict Capitalist slavery in bright colors, and in the opinion of petit-bourgeois philistines. But as a matter of fact the Capitalist threads, which in thousands of different inter-crossings bind these enterprises with private property in the means of production in general, have converted this work of construction into an instrument for oppressing *a thousand million* people (in the colonies and semi-colonies), that is, more than half the population of the globe, which inhabits the subject countries, as well as the wage slaves of Capitalism in the lands of “civilization.”

Private property based on the labor of the small proprietor, free competition, democracy, *i.e.*, all the catchwords with which the capitalists and their press deceive the workers and the peasants – are things of the past. Capitalism has grown into a world system of colonial oppression and of the financial strangulation of the overwhelming majority of the people of the world by a handful of “advanced” countries. And this “booty” is shared between two or three powerful world marauders armed to the teeth (America, Great Britain, Japan), who involve the whole world in *their* war [the First World War] over the sharing of *their* booty.³⁹³

With a few changes in words – *e.g.*, from “building of railways” to “forging of international trade routes” – it is easy (though, again, perhaps not correct normatively) to translate Lenin’s classic into a modern critique of the WTO and international trade law.

Thus, for example, in Marxist-Leninist terms, what the accession to the WTO of new Members from the Third World is all about is market access. Market access for whom? Not so much for China and other developing countries, Marx would reply, as for the hegemonic trade powers that already are in the club. China is a case in point. Even the

³⁹² V.I. LENIN, *IMPERIALISM: THE HIGHEST STATE OF CAPITALISM* (1916, Junius Publications Ltd. ed. 1996). (Emphasis original.) [Hereinafter, LENIN.]

³⁹³ LENIN, 4-5 (Preface to the French and German editions).

American President could not help but admit that the 15 November 1999 bilateral concession agreement between the America and China was the most lopsided trade deal in history. American MNCs won nearly everything. American producers subject (or potentially subject) to competition from like or directly competitive products from China gave little. All that was left was for China to implement its WTO commitments. As this task proved quite controversial in some sectors of keen interest to American enterprise (*e.g.*, banking and IP), the U.S. insists in accession negotiations that would-be WTO Members demonstrably enact and enforce their commitments before their accession. Subsequent accession negotiations with Saudi Arabia and Russia were cases in point.

In any event, there remains a small conceptual leap from the concept of surplus and the need to open markets overseas, on the one hand, and Lenin’s conclusion quoted above, on the other hand. The bridge between the two sides is Marx’s proposition that the capitalists’ “surplus” is formed from accumulated labor. In the Marxian paradigm, capitalists might not have much control over the cost of capital. They have to buy machines for the factory assembly lines at whatever price prevails, and eventually they must recoup that investment if they are to avoid insolvency. Thus, says Marx, the essential source of surplus (*i.e.*, profits) is labor. Specifically, he means a capitalist’s profit really is a surplus generated by accumulated labor. What does this proposition mean?

To maximize profit, the capitalist minimizes the one variable over which he has some control – wages. The capitalist produces more and more, and endeavors to raise the productivity of capital, through greater division of labor. Laborers work on ever-narrower, and thus ever-less satisfying, tasks. They use machinery that enables them to produce more in a defined time period, so the scale of production expands (hence the consequences of over-production and price depression). As the workers’ tasks are divided, they are, by definition, simplified.

Marx argues that as workers compete with one another for employment that is monotonous, wage rates in this repulsively unskilled labor market inevitably fall. The capitalist is only too eager to pay workers only subsistence wage, or as near thereto as possible. That way, the “return on capital” – another way of describing “surplus” or “profit” – is larger. (The meaning of “return on capital,” or “return to capital,” in the Marxian paradigm is a bit different from that in the modern-day Capitalist sense. Whereas Marx was rather imprecise in this terminology, the Wall Street analyst would consider it to be the rate of return an owner of machine gets from funds he invested to buy the machine. That is, it is the return on invested capital, which is a narrower concept than “profits.”) From a Marxist-Leninist perspective, neither the WTO nor international trade law does enough to protect the rights of workers in developing countries.

Marx argues the source of surplus is “accumulated” labor. What does the adjective “accumulated” mean? It refers to Marx’s famous labor theory of value, which the following example illustrates. Suppose a worker at IBM requires 10 hours to produce a PC. IBM sells the computer for \$2,000, a price that reflects ruthless competition in the PC market among a number of producers. Is the worker paid \$2,000 (or anywhere near that amount)?

Of course not, urges Marx. Marx says that IBM will pay a wage that is the minimum amount necessary for the worker to survive – a subsistence wage. Suppose that amount is \$100. It ought to be quite apparent why Marx sneers that “[t]o be a productive laborer is, therefore, not a piece of luck, but a misfortune.”

So far, this analysis is all quite familiar to students of Classical and Neo-Classical economics. The caveat to add is Marx assumed there is a large pool of labor – a reserve army of the unemployed – that ensures (along with the division of labor) that wage rates are kept low. As soon as workers lobby for a wage increase, they will be met with the rebuttal from capitalists that there are many outside the factory gates willing to take their jobs. The machinery the capitalists employ in the production process is their ally: it dispenses with the need for muscular power, thereby expanding the pool of eligible workers to include weaker men, plus women and children.

Foreign market access ensures the reserved army of the unemployed is a global one. Workers in one country can take the positions of those in other countries, if capital is mobile, *i.e.*, if factories and the equipment in them can be closed in one country, shipped to another, and re-opened therein. The T&A industry is a case in point. In 1990, 900,000 Americans worked in the clothing sector.³⁹⁴ In 2013, employment in the U.S. T&A industry was 150,000. Why the drop? Competition from cheap garments from Bangladesh, China, India, Mexico, and other developing countries and LDCs.

To be sure, on occasion, there might be an excess demand for workers, based on labor shortages. Marx would reply that such a situation would not endure, that sooner or later, the Capitalist business cycle would turn. The tendency of capitalists to over-produce when in competition with one another might lead them, at some point, to cut back temporarily on production. In turn, they would lay off workers, and the redundant workers would staff the reserve army of the unemployed.

At this point, Marx’s argument takes a U-turn. He re-visits the production process, and posits the PC (in the present example) embodies 10 hours of labor. That is, the value of the PC is based on the 10 hours of labor. Yes, that value also reflects other factors of production – capital and land, for instance. Yet, Marx dwells on the labor input, hence the name for his theory of the valuation of goods – the labor theory of value. Moreover, the surplus (*i.e.*, profit) of capitalists is derived from the deliberate failure of capitalists to return to the worker all 10 hours of value embodied in the PC. In the example, the worker toiled for 10 hours, but received only \$100. For Marx, that \$100 is not anywhere near the full labor value embodied in the product. It might translate into, say, 4 hours’ worth of work, assuming a subsistence wage of \$25 per hour (and assuming the worker were paid the time value of her labor). The capitalist obtained a surplus from the worker of 6 hours.

Here, then, is the explanation for the statement that the surplus generated by capitalists is “accumulated” labor. For every PC IBM sells, it accumulates 6 hours of labor in the sense that it does not return this portion of the value of the product to the worker

³⁹⁴ See Arvind Subramanian, *The Curious Case of the Protectionist Dog that Has Not Barked*, FINANCIAL TIMES, 11 July 2013, 9.

who made it. The repeated phenomenon of paying workers less than the labor value embodied in their work is accumulated surplus. As Marx writes in *Das Kapital*:

The value of a commodity is, in itself, of no interest to the capitalist. What alone interests him, is the surplus-value that dwells in it, and is realizable by sale.

The shortening of the working-day is, therefore, by no means what is aimed at, in Capitalist production, when labor is economized by increasing its productiveness. It is only the shortening of the labor-time, necessary for the production of a definite quantity of commodities, that is aimed at. The fact that the workman, when the productiveness of his labor has been increased, produces, say 10 times as many commodities as before, and thus spends one-tenth as much labor-time on each, by no means prevents him from continuing to work 12 hours as before, nor from producing in those 12 hours 1,200 articles instead of 120. Nay, more, his working-day may be prolonged at the same time, so as to make him produce, say 1,400 articles in 14 hours. The object of all development of the productiveness of labor, within the limits of Capitalist production, is to shorten that part of the working-day, during which the workman must labor for his own benefit, and by that very shortening, to lengthen the other part of the day, during which he is at liberty to work *gratis* for the capitalist. ...

...
The directing motive, the end and aim of Capitalist production, is to extract the greatest possible amount of surplus-value, and consequently to exploit labor-power to the greatest possible extent.³⁹⁵

This fact, urges Marx, makes Capitalism innately exploitative. The conditions in which this fact is manifest alienate the worker from the fruits of her labor. Altering a few words in the above-quoted passage suffice to make it appear to be a contemporary attack on global production and trade, the evils of which are felt by workers in poor countries, yet which are effectively protected in good measure (so the claim goes) by the WTO and its rules.

Marx takes the point one step further, saying capital itself is accumulated surplus. His point is capitalists may re-invest the accumulated surplus generated by the difference between the labor value of a product (in the above example, 10 hours), on the one hand, and the return to labor (in the above example, 4 hours), on the other hand. Specifically, they re-invest in physical capital, buying more machines and building more assembly lines. In fact, capitalists need to re-invest the surplus to expand production, and thereby become larger and stronger in their competition with one another. Hence, for Marx, the source of not only profit, but also of capital, is accumulated surplus from labor.

III. Step 2: Search for New Markets

³⁹⁵ MARX, DAS KAPITAL, in THE MARX-ENGELS READER 383-85 (Robert C. Tucker ed., 2nd ed. 1978). [Hereinafter, MARX-ENGELS READER.]

What does the Marxist-Leninist argument have to do with trade in the modern-day multilateral trading system? How is it the starting point for the now-fashionable proposition that developed countries block full and fair participation in this system? The answer is Marx and Lenin offer three key points about trade that remain relevant.

First, in their never-ending efforts to maximize surplus in the face of intense competition in exhausted domestic markets, capitalists inevitably look for new markets overseas. Marx makes this point in various works, including *The German Ideology*:

With the advent of manufacture the various nations entered into competitive relations, a commercial struggle, which was fought out in wars, protective duties and prohibitions, whereas earlier the nations, insofar as they were connected at all, had carried on an inoffensive exchange with each other. Trade had from now on a political significance.

...

In spite of these protective measures large-scale industry universalized competition ..., established means of communication and the modern world market, [and] subordinated trade to itself.... By universal competition it forced all individuals to strain their energy to the utmost. It destroyed as far as possible ideology, religion, morality, etc., and, where it could not do this, made them into a palpable lie. It produced world history for the first time, insofar as it made all civilized nations and every individual member of them dependent for the satisfaction of their wants on the whole world, thus destroying the former natural exclusiveness of separate nations.³⁹⁶

It seems quite apparent that Mr. Marx is commenting on globalization and its pernicious effects long before the critics of the WTO and international trade law.

In the 18th, 19th and early 20th centuries, the search for new markets led to overt colonialism. The expression “trade followed the flag” meant that a colonial power could open up new trading markets by sending in its navy first. In fact, English historian Lawrence James’ (1943-) examination of the colonial era suggests the opposite occurred in many instances – the flag followed trade in order to secure and reinforce trade routes that merchants had pioneered. Even Marx suggested the possibility of a few salutary effects, however unintended they may have been, of British colonialism in India, namely, the destruction of the age-old and oppressive village system that was the foundation of Oriental despotism. But, these debates are for another time and place.

In the late 20th and early 21st centuries, it is not uncommon to hear it said businesses from developed countries are the new agents of colonialism, and International Trade Law is written to serve MNC interests. Critics point out bargaining power to open up new markets is asymmetric. That is, except where a developing country is large and powerful – Brazil, China, Mexico, or India, for instance – corporations (or their official representatives, such as the USTR) are largely able to dictate terms of market access.

³⁹⁶ THE GERMAN IDEOLOGY, in THE MARX-ENGELS READER, 77, 81.

IV. Step 3: Extracting Surplus

The second key point in the Marxist-Leninist trade argument is about labor surplus. As capitalists open new markets overseas, they locate production facilities there, especially in colonies or former colonies – FDI, in modern parlance). Why not make goods in these Third World countries, in which labor costs are relatively lower than in home countries of the MNCs? Then, returns to labor are minimized, and profits maximized. In so doing, capitalists extract surplus from Third World laborers – a colonial, or neo-colonial, surplus.

This extractive process, Marx argued, is inherently exploitative. Developing countries need the surplus to re-invest in their own economies (*e.g.*, in new production facilities). Precisely because they are poor countries, they lack a large endowment of resources to use as a basis for industrialization. Draining what surplus they do have from their workers makes their growth process all the more difficult.

Unfortunately for poor countries, the principal source of investment comes from abroad: FDI. FDI generates accumulated surpluses that MNCs repatriate to bank accounts of capitalists that run these firms from plush developed country offices. (From time to time, workers in the home countries of MNCs tire of their exploitation and threaten industrial action. Then, capitalists can take some of the labor surplus extracted from developing countries and use it to increase the wages of the restless workers. The increase would be the minimum amount necessary to stave off the threatened action.) The result is a continued, indeed ever-growing, gap between rich and poor countries:

Of the former European colonies, many have experienced some development, but only a tiny handful have joined the developed world. A considerable number in Africa have experienced not progress but catastrophic decline, with steep falls in living standards and services, and in some cases the complete collapse of the state.

...

Latin America is a particularly striking example of the triumph of hope over experience. Several states have achieved very real progress, and are of course vastly richer than they were a century ago. But very few indeed have achieved western standards of living and levels of democracy. Argentina was probably closer to such a breakthrough a century ago than it is today. ...

...

Objectively, the centers of successful Capitalism remain today what they were 100 years ago: western Europe, its overseas white colonies and its immediate European periphery; and Japan. Since 1945, to this group have been added two former Japanese colonies already developed under Japanese rule – South Korea and Taiwan – and a handful of international *entrepôts* such as Singapore.³⁹⁷

³⁹⁷ Anatol Lieven, *The Road to Riches Discredited*, FINANCIAL TIMES, 12 August 2002, 11.

Contemporary critics of the multilateral trading system would add simply WTO rules – such as the WTO *TRIMs Agreement* – protect (or reinforce) this exploitative process.

**V. Step 4:
Unholy Alliances**

The third key insight into world trade offered by Marx and Lenin concerns the relationship between politics and economics in both rich and poor countries. As the argument goes, capitalists advocate free trade policies *vis-à-vis* developing countries. They push for open markets overseas as an outlet, or vent, for their excess production. Simultaneously, they lobby their governments for protection from imports, to avoid exacerbating competitive pressures in domestic markets. Here is a double standard that amounts not to pure free trade, but rather mercantilism in new garments.

Worse yet, there is nothing in the logic of Capitalism to put an end to the hypocrisy. Marx and his adherents observed the declining rates of return to capital in developed country markets, caused by over-production and ferocious competition, coupled with cheap labor overseas, mandate a push to pry open Third World markets. Yet, independent of this mandate is another: natural resources. Some Third World countries have minerals and raw materials to fuel the engines of capitalist production.

Accordingly, so goes the Marxist critique, capitalists push to secure these sources of supply for their factories. For the Third World country, the result is over-investment in its natural resource sector. Rather than focus on giving birth to, and nurturing, infant industries, the country is “encouraged” by MNCs and their governments to pursue a free trade policy that allows foreigners to invest in this sector, and assures them of a steady source of supply from it. Depending on the geographic location and political structure of a particular Third World country, it may be impossible to safeguard these sources and trade routes without military help. Hence, now as in the avowedly colonial era of the past, an unholy military – industrial alliance is established.

A particularly intriguing feature of this alliance is identified by a formerly famous development economist of the mid-20th century – Paul Baran (1926-2011). In his 1957 classic, *The Political Economy of Growth*, Baran inquires why workers in developed countries generally decline to unite with their cohorts in less developed countries, and why they tend not to protest against the exploitation by a military-industrial complex. Baran’s argument is workers in a developed country often benefit from the alliance.

Suppose the supply of natural resources from developed countries were restricted or cut off, and re-directed to infant industries in the Third World. Would the developed country workers be better off? Hardly, says Baran. They would lose their jobs, because absent this supply of natural resources, which were essential inputs in the goods they made, their factories would have no option but to close. The most obvious example of the clash of interests was between workers in defense industries in developed countries, on the one hand, and workers in emerging industries in the Third World, on the other hand. It was no

small clash, given the economic importance and political prominence of defense and defense-related industries in developed countries.

In sum, the third link is this: developed countries hamper integration of developing countries into the multilateral trading system by nearly dictating free trade policies to them, yet limiting their access to developed country markets. They are unable to grow into robust players, because the playing field is unlevel, *i.e.*, skewed against them. They cannot protect their infant industries. Their agricultural and industrial sectors are exposed to stiff foreign competition in their own domestic markets, and they have few overseas opportunities. Even small producers and local industries – from handicrafts to textiles – are destroyed.

Worse yet, goes the Marxist-influenced argument, in some developing countries the power elite (rulers and their families, the land-owning aristocracy, and well-connected businessmen) connive with foreign powers against the interests of the poor. This elite class enjoys luxury items made and exported by foreign MNCs. Cars and washing machines are examples. Members of the elite class also are quite happy to see the MNCs produce luxury goods locally, which they could afford.

Thus, wrote the renowned Brazilian development economist, Celso Furtado (1920-2004), serious income inequality within a Third World country can, and does, lead to an alignment of interests between local elites and foreign capitalists. Why would these elites advocate a more level playing field for multilateral trade, if that would entail (1) limiting luxury goods imports (in order to preserve precious foreign exchange reserves for imports essential to the poor, or to emerging industries), (2) a re-orientation of domestic production away from luxury goods consumed by local elites and toward basic goods in which there was a broader societal interest, and (3) maybe even formal income redistribution? Conversely, why would foreign capitalists seek radical change, when (1) they profit from exporting luxury items to a power elite in developing countries, and (2) their own home markets spilling over with excess production? To the contrary, the local power elite and foreign capitalists have every incentive to maintain extant trade patterns.

Not surprisingly, therefore, after winning independence from their former colonial masters, and particularly after the Second World War when a number of development theories arose that condoned one form or another of protectionism to assist in the growth process, many Third World countries turned inward. Chinese and Indian Socialist policies (different in nature and severity, to be sure), and much of Latin America's import substitution policies, are examples. Some theories were rather pessimistic about the possibility of ever achieving a level playing field within a Capitalist paradigm. They called for a restructuring of economic and social relationships, along non-Capitalist lines, and these calls found outlets in various U.N. declarations.

Chapter 13

INDUSTRIAL POLICY³⁹⁸

I. What is “Industrial Policy”?

Neo-classical free trade theory (discussed in a separate Chapter), namely, the Law of Absolute Advantage of Adam Smith (1723-1790), and Law of Comparative Advantage of David Ricardo (1772-1823), “never imagined a world in which subsidized manufacturing by foreign states would leave domestic consumers unable to absorb domestic production.”³⁹⁹ Their 18th and 19th century worlds were ones of “trading cloth for wine.”⁴⁰⁰ Yet, the 21st century reality is different.

Through both strategic trade policy and managed trade (discussed in a separate Chapter) government seek to boost industrial output, employment, and wages, highlight new technologies that industry can use to enhance its competitiveness, identify industries that deserve priority sponsorship from government, and develop strategies to repatriate jobs lost overseas. Such efforts fall under the rubric “industrial policy,” which is a national manufacturing strategy, but for which there is no single definition. The concept is hardly foreign to America: it has existed “in loud and quiet cycles, peaking during periods when one power is afraid of losing out to the others,” with “[t]he U.S. space race against Soviet Russia ... [during the Cold War being] a prime example, as well as American consternation over Japan’s ascendancies in the 1980s.”⁴⁰¹ Further, consider these 2011 Council on Foreign Relations *Report* recommendations:

... Over the course of the decade [2001-2011], as Americans witnessed dramatic turns of global economic fortune and stagnant or declining wages and benefits at home, their traditional wariness has cooled to near antipathy.

The trend is cause for real concern, because global trade has, in fact, brought enormous economic benefit to the United States and rest of the world. In the coming decades, the booming markets in Asia, Latin America, and Africa will be among the world’s most important economic engines,

³⁹⁸ Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

³⁹⁹ Rana Foroohar, *The Global Trade System is in Desperate Need of an Overhaul*, FINANCIAL TIMES, 25 February 2025, www.ft.com/content/416671be-4d0d-4a43-8119-b3638589c6b9?shareType=nongift. [Hereinafter, *The Global Trade System is in Desperate.*]

⁴⁰⁰ *The Global Trade System is in Desperate.*

⁴⁰¹ Yuan Yang, *We Need an Honest East-West Discussion about Industrial Policy*, FINANCIAL TIMES, 9 December 2022, www.ft.com/content/2a0c60bc-b1d4-49b5-b0b2-fea2a9030d2a?shareType=nongift.

and exporting to them will be crucial to creating the high-wage jobs America needs.

Moreover, trade has been and remains a strategic instrument of American foreign policy. It binds together countries in a broad and deep network that constitutes a bulwark against conflict; it is also a fundamental mechanism of development that contributes to growth and works against state failure.

[This] *Report* of this bipartisan Independent Task Force calls on the U.S. Administration and Congress to adopt trade and investment policies that maximize the benefits to the American people and U.S. foreign policy from global economic engagement.

The trade agenda outlined in this *Report* stands on seven pillars: an ambitious trade negotiation strategy to open markets for the most competitive U.S. sectors, especially within emerging markets; the implementation of a National Investment Initiative to coordinate investment policy and attract good jobs to the United States; a renewed effort to bolster trade enforcement; increased government promotion of American exports; the expansion of trade to foster development in the world's poorest countries; comprehensive worker adjustment and retraining programs; and the establishment of a Presidential mandate to negotiate trade-opening agreements with an assurance of timely Congressional action. ...⁴⁰²

The Independent Task Force making these recommendations euphemistically titled its publication *U.S. Trade and Investment Policy*. But were they strategic trade policy, or did they sum up to (albeit rather light-handedly) “industrial policy”?

There is no standard meaning of “industrial policy.” Across time and countries, there are countless instances of (1) protectionist trade measures, (2) subsidies for specific enterprises, and (3) public (or public-private) R&D. But any one of these three, without them operating in tandem with a common purpose, seems insufficient to be called “industrial policy.” Rather, it is the combination of two or all three of them – trade policy, targeted government financing, and public funding – that yields something properly called a coordinated national strategy. Likewise, comparing and contrasting legal and policy initiatives, not only in the post-Second World War experiences of China and India, but also of Japan, Malaysia, and the Four Tigers (Hong Kong, Korea, Singapore, and Taiwan), and synthesizing them into a definition, is fraught with difficulty. The clue to start is what became all the rage since President Donald J. Trump (1946-, President, 2017-2021) launched Section 201, 232, and 301 actions (discussed in separate Chapters): supply chain management.

⁴⁰² Andrew H. Card, Thomas A. Daschele, Edward Alden & Matthew J. Slaughter, *U.S. Trade and Investment Policy*, Council on Foreign Relations, Independent Task Force Number 67 ix-x (Washington, D.C.: Council on Foreign Relations, 2011).

Aside from growth and development (including infant industry protection⁴⁰³), the economic purpose of industrial policy is reliable supply chain management. “Reliable,” which refers to ensuring sources of vital merchandise and its inputs, has two dimensions. Sources should be robust (consistent and sustained), and resilient (capable of absorbing exogenous shocks without severe or prolonged disruption).⁴⁰⁴ For industrial policy to

⁴⁰³ Professor Ricardo Haussman, of Harvard’s Kennedy School of Government, writes:

industrial policies “have existed since the dawn of the Industrial Revolution. In recent decades, however, economists have questioned their usefulness. Governments should not be picking winners, the argument goes, but rather let the market allocate resources across industries in a way that reflects consumer preferences and technological possibilities. By the same logic, policymakers should intervene in the market only when they have sufficient information that some externality is causing the market to malfunction. And even then, the detractors would say, governments might make matters worse by adding their own failures – for example, policy capture by rent-seeking players – to those of the market. With the Reagan-Thatcher revolution and the emergence of the so-called Washington Consensus in the 1980s, these arguments became enshrined in a new orthodoxy.

But economic theorists have since come around to recognizing the value of industrial policies. ... [T]here are many cases where government intervention is justified. The question, then, is not whether industrial policies should exist, but how they should be managed.

For example, learning by doing was seen as a large and important phenomenon that required policy interventions long before economists caught on. There is ample evidence that many firms and industries improve over time as they accumulate production experience. In 1936, the aeronautical engineer Theodore Wright formulated what is now known as Wright’s Law, which states that costs decline exponentially with accumulated production. During World War II, the U.S. Army used this law in its procurement contracts to reap the cost savings. But the idea entered economics only with a paper by Kenneth Arrow published in [January] 1962 [*Economic Welfare and the Allocation of Resources for Invention*, NATIONAL BUREAU OF ECONOMIC RESEARCH, www.nber.org/books-and-chapters/rate-and-direction-inventive-activity-economic-and-social-factors/economic-welfare-and-allocation-resources-invention]. *It has since been used to justify infant-industry protection, advanced market commitments, and subsidies...*

(Emphasis added.) See Ricardo Haussman, *Why Industrial Policy is Back*, PROJECT SYNDICATE, (26 January 2023), www.project-syndicate.org/commentary/why-economists-have-rediscovered-industrial-policy-by-ricardo-hausmann-2023-01. However, this ordering is questionable. Does industrial policy justify infant industry protection, or is it the need to protect infant industry that motivates industrial policy?

⁴⁰⁴ On the limitations of FTAs in fostering supply chain resilience, see U.S. General Accountability Office, *Supply Chain Resilience – Agencies Are Taking Steps to Expand Diplomatic Engagement and Coordinate with International Partners*, GAO-23-105534 (Feb. 2023), www.gao.gov/assets/gao-23-105534.pdf. GAO explained:

According to USTR officials, current U.S. trade agreements generally were not designed to address supply chain disruptions or build resiliency. ... U.S. trade agreements historically focused on trade liberalization and maximizing economic efficiency. ... [T]rade agreements and trade preference programs can serve as tools for addressing supply chain resiliency concerns, but this may require renegotiating current agreements, negotiating new agreements, or modifying trade preference programs. In addition, ... for long-term resilience, the U.S. will need policies that incentivize allies and partners to work with the U.S. to build resilient supply chains.

succeed in fostering robustness and resilience, conditions are necessary: the public sector must make clear what is expected of the private sector to receive financial benefits.

That is because, “[w]ithout conditions, the public money flowing into industrial strategies [*e.g.*, in the form of subsidies or tax breaks] will dissipate into company and shareholder profits with only marginal public gain,” hence “[g]etting these investments right should be a priority for governments everywhere.”⁴⁰⁵ For example, if the goal of an industrial policy is to create reliable supply chains that are “green,” or free of forced labor, then there should be clear criteria concerning, respectively, de-carbonization and ILO standards (both discussed in separate Chapters). Industrial policy, therefore, is more than merely a public-private partnership; it also is public leadership of the private sector. How voluntary or coercive that leadership is depends on a range of factors, including the country and its officials, and the policy and its importance.

Underlying both dimensions is skepticism of interdependence, particularly the theory countries with diverse political economies (*e.g.*, America, China, India, and Russia) will gravitate to peaceful relations through comparative-advantage driven commercial intercourse governed by multilateral legal regimes (*e.g.*, GATT-WTO) the hallmark of which is non-discriminatory trade.

For example, the officials pointed to the 2017 *TFA* [discussed in a separate Chapter] as an initiative that provides a multilateral opportunity for reducing supply chain bottlenecks abroad. USTR officials stated that they believe the trade facilitation measures included in the *TFA* can help alleviate some supply chain disruptions. In 2020, USTR supported accelerating the implementation of the *TFA* to address critical pandemic supply chain disruptions. However, ... in 2017, USTR unsuccessfully attempted to include a provision in the *TFA* to eliminate the requirement in some countries for in-person consulate visits to obtain permission to import. ... [T]his requirement contributes to supply chain bottlenecks by hindering the ability of both U.S. and foreign businesses to import goods.

USTR officials said that future trade negotiations could also address supply chain resilience. As an example, “rules of origin” could serve as a mechanism in free trade agreements for the U.S. government to promote supply chain resilience with trading partners, according to the officials. ... [T]hese rules specify what percentage of a good’s components must be produced within the agreement partners’ countries to qualify for the lower tariffs offered by an agreement.³² [Per Footnote 32, GAO observed: “For example, under the 2020 *United States-Mexico-Canada Agreement* “rules of origin” for passenger vehicles and light or heavy trucks, seventy percent of a vehicle producer’s purchases of both steel and aluminum, during a specified time period, must be for goods that originate in North America to qualify for the lower tariff offered by the agreement.” This and other *USMCA* ROOs are discussed in separate Chapters.] ... [T]he U.S. government might use free trade agreement rules of origin to incentivize supply in partner countries and promote resilience that will benefit U.S. consumers. However, ... rules of origin are negotiated when free trade agreements are first established, meaning USTR must either renegotiate the rules of origin in existing agreements to specifically address supply chain resilience or wait until they negotiate new agreements.

Id., 19. Query whether these limitations, in respect of FTAs, necessitate a shift to industrial policy.

⁴⁰⁵ Mariana Mazzucato, *Industrial Strategy Demands a New Deal with the Private Sector*, FINANCIAL TIMES, 27 November 2022, www.ft.com/content/7a4e07e0-deb3-4ba9-b6ae-f75f961ad001?shareType=nongift.

Why the skepticism? Because the adoption of interventionist planning by some countries un-levels the playing field, and results in global overcapacity in some industries.⁴⁰⁶ Trade negotiations and litigation cannot make the world flat. Those countries are frozen in a historical narrative partly of their own making. Their egos are inseparable from their righting the wrongs of centuries of colonialism and neo-colonialism. Following rules crafted by hegemon powers is less important than evolving into a larger role in the world trading system.

Nationalist stories in erstwhile peripheral countries beget nationalist stories in center ones. That is, supposedly declining powers need to respond with their own interventionist planning to preserve a *status quo* that still, on balance, favors them. And thus, America joins China and India in the Great Game of Industrial Policy, all jostling for reliable supply chains in pursuit of national security.

In sum, the economic purpose of industrial policy (whether it is called by that name) is steady supply chain management. “Steady” in reference to ensuring a source of vital merchandise, and the inputs for that merchandise, has two dimensions. The source should be robust (consistent and sustained), and it should be resilient (capable of absorbing exogenous shocks without severe or prolonged disruption). Underlying both dimensions is a concern about economic independence, which is directly or indirectly linked with national security. Small wonder why so much of the 21st century debate about supply chain management has come in the context of the Sino-American Trade War (discussed in a separate Chapter) and the process of “decoupling” from China.⁴⁰⁷

⁴⁰⁶ For a critique of modern U.S. industrial policy, see Gary Clyde Hufbauer & Euijin Jung, *Scoring 50 Years of U.S. Industrial Policy, 1970-2020*, Peterson Institute for International Economics (PIIE), Briefings 21-5 (November 2021), www.piie.com/publications/piie-briefings/scoring-50-years-us-industrial-policy-1970-2020 (contending “U.S. consumers and taxpayers are currently paying more than \$900,000 a year for every job saved by [President Donald J.] Trump’s steel tariffs, extended by [President Joseph R.] Biden,” examining “18 U.S. industrial policy episodes,” dividing them into “cases where trade measures blocked the U.S. market or opened foreign markets, cases where federal or state subsidies were targeted to specific firms, and cases where public and private R&D was funded to advance technology,” but failing to define “industrial policy” in a conceptual sense and thus being over-inclusive in calling all of the episodes as such).

⁴⁰⁷ See, e.g., Leo Lewis, *The U.S. and China are Decoupling, But Not as Fast as You Think*, FINANCIAL TIMES, 6 August 2022, www.ft.com/content/6673622f-14a5-4644-9391-fe9b589d201c?shareType=nongift. Mr. Lewis argues:

Decoupling has a credible ring. There is already visible political momentum for it on both sides. There is nothing to suggest greater closeness is in prospect, and plenty that foreshadows the divergence expanding well beyond the two central players – including Chinese missiles landing in Japan’s exclusive economic zone for the first time. The decoupling narrative, though, is one with hard limits of both time and scale and they should not be overlooked because of the events of the past week.

Proponents of the more rapid decoupling thesis have a fair stack of evidence on their side. The *Made in China 2025* program is all about technological self-containedness and the Biden Administration has so far done little to reduce the tone of hawkishness on China established by its immediate predecessor.

... [I]n a decoupling milestone [discussed above], the U.S. President ... sign[ed] the *Chips and Science Act* passed by Congress in late July. This dangles more than \$50 bn in federal

grants to companies building advanced semiconductor manufacturing in the U.S., while requiring any recipients of that funding not to upgrade any China-based factories for a decade. Non-American companies are included and the decoupling lure for South Korean chipmakers could prove decisive. Japan, which could soon confront efforts by Beijing to force its high-tech companies to design certain products in China, may also feel stronger decoupling pressure building.

The narrative may also be gaining traction outside the U.S. and its closest Asian allies. In a note to clients last week, analysts at Gavekal Dragonomics identified a deepening consensus within the EU to treat China as both an economic and a security threat. ...

For now, at least, there are three significant constraints on the accelerated decoupling story. The first is that the U.S. ability to bring others along with the program may be more fragile than it looks, even with a close ally such as Japan. As decoupling is increasingly pushed through legislation or regulation, questions over the underlying intention will intensify. Efforts to protect national and economic security are fine; deliberate hobbling of the Chinese economy will win fewer converts.

The second is that, on both the Chinese and U.S. sides, corporate resistance to accelerated decoupling will be quietly substantial, however noisy the politics becomes. The business relationships, investments and supply chains are not trivial ties that can be quickly unwound, and the Chinese market is still the most attractive long-term growth bet. Chinese companies cannot yet afford a cliff-edge exit of foreign technology and a sudden break in their learning curve.

The third issue is time. In late July, the U.S. Senate proposed a new bill that could in theory create tax incentives that would draw the electric vehicle battery production chain out of China (which dominates in all key areas) and into the U.S. This is logical stuff, given where electric vehicle markets are heading. The bill would superficially fit the rapid decoupling story. The reality, according to analysts at Goldman Sachs, is a rather more sedate process that would involve lead times of between four and seven years for each of the six principal points in the supply chain.

However, all three of these constraints may not be as significant as suggested, hence decoupling associated with “industrial policy” of one flavor or another could accelerate. As to the first constraint, converts are won partly in proportion to the actual or perceived belligerence of CCP behavior (*e.g.*, with respect to Hong Kong and Taiwan) by other countries. The second constraint could be offset by corporate support from firms well positioned to benefit from decoupling. The third constraint seems to underestimate the ability of American capitalists to pivot quickly based on political and economic incentives – they are not inefficient SOEs.

Indeed, in October 2022, the Biden Administration used one lever at its disposal, namely, subsidies (in the form of grants) to stimulate U.S.-based EV battery production and domestic sourcing of their mineral inputs:

The Biden Administration said ... it is awarding \$2.8 billion in grants to boost U.S. production of electric vehicle batteries and the minerals used to build them, part of a bid to wean the country off supplies from China.

“By undercutting U.S. manufacturers with their unfair subsidies and trade practices, China seized a significant portion of the market,” President Joe Biden said ... in announcing the awards. “Today we’re stepping up... to take it back, not all of it, but bold goals.”

Albemarle Corp ... is among the 20 manufacturing and processing companies receiving U.S. Energy Department grants to domestically mine lithium, graphite, and nickel, build

To be sure, supply chain management need not be part of an industrial policy. Private companies as diverse as auto producers, book publishers, grocery stores, pharmaceutical suppliers, and sports apparel brands routinely engage in such management, with no over-arching national economic plan. Even when they manage sourcing to rid their supply chains of terrorist threats (as under the post-9/11 border security measures, discussed in a separate Chapter) or forced labor (as under *UFLPA*, also discussed in a separate Chapter), their behavior is tantamount to industrial policy. But, when a central authority suggests guidelines or imposes rules for sourcing, investment, production, and distribution, then the supply chain management of those same companies operates under an industrial policy umbrella. In other words, not all supply chain management is within an industrial policy framework, but all industrial policy entails supply chain management.

II. Export Controls as Industrial Policy and Biden Administration Limits on Semiconductors to China

the first large-scale U.S. lithium processing facility, construct facilities to build cathodes and other battery parts, and expand battery recycling.

The grants, which are going to projects across at least 12 states, mark the latest push by the Biden Administration to help reduce the country's dependence on China and other nations for the building blocks of the green energy revolution.

The funding recipients ... were chosen by a White House steering committee and coordinated by the Energy Department with support from the Interior Department.

...

By 2030, Biden wants 50% of all new vehicles sold in the United States to be electric or plug-in hybrid electric models along with 500,000 new EV charging stations. He has not endorsed the phasing-out of new gasoline-powered vehicle sales by 2030.

Legislation tied to the program that Biden signed in August sets new strict battery component and sourcing requirements for \$7,500 consumer EV tax credits. A separate \$1 trillion infrastructure law signed in November 2021 allocates \$7 billion to ensure U.S. manufacturers can access critical minerals and other components to manufacture the batteries.

The White House said that the United States and allies do not produce enough of the critical minerals and materials used in EV batteries.

“China currently controls much of the critical mineral supply chain and the lack of mining, processing, and recycling capacity in the U.S. could hinder electric vehicle development and adoption, leaving the U.S. dependent on unreliable foreign supply chains,” the White House said.

In March [2022], Biden invoked the *Defense Production Act* [discussed in a separate Chapter] to support the production and processing of minerals and materials used for EV batteries.

David Shepardson & Ernest Scheyder, *Biden Awards \$2.8 Billion to Boost U.S. Minerals Output for EV Batteries*, REUTERS, 19 October 2022, www.reuters.com/markets/us/us-awards-28-billion-ev-battery-grid-projects-2022-10-19/. At the very least, the grants were yet more evidence of American-style industrial policy in one among several economic sectors.

- **September-October 2022 Controls**

Industrial policy may be implemented by several measures, including trade sanctions and/or export controls. This reality was well exemplified amidst the Sino-American Trade War in September-October 2022, when the U.S. announced a tightening of export restrictions on China. (The specifics of these restrictions, and the Trade War, are discussed in separate Chapters.) The Biden Administration said semiconductors (ICs) used for AI, or as tools to make chips of less than 14 nm, could not be shipped to China. (“As a general guide in chip manufacturing, the smaller the number of nanometers indicates more advanced capabilities.”⁴⁰⁸)

Interestingly, America’s approach was incremental, targeting specific U.S. producer-exporters:

The Commerce Department intends to publish new regulations based on restrictions communicated in letters earlier this year to three U.S. companies – KLA Corp. ..., Lam Research Corp. ..., and Applied Materials Inc.

The letters, which the companies publicly acknowledged, forbade them from exporting chipmaking equipment to Chinese factories that produce advanced semiconductors with sub-14 nanometer processes unless the sellers obtain Commerce Department licenses.

The rules would also codify restrictions in Commerce Department letters sent to Nvidia Corp. ... and Advanced Micro Devices ... last month [August 2022] instructing them to halt shipments of several artificial intelligence computing chips to China unless they obtain licenses.

...

So-called “is informed” letters allow the Commerce Department to bypass lengthy rule-writing processes to put controls in place quickly, but the letters only apply to the companies that receive them.

Turning the letters into rules would broaden their reach and could subject other U.S. companies producing similar technology to the restrictions. The regulations could potentially apply to companies trying to challenge Nvidia and AMD’s dominance in artificial intelligence chips.

...

the rules could also impose license requirements on shipments to China of products that contain the targeted chips. Dell Technologies ..., Hewlett Packard Enterprise ..., and Super Micro Computer ... make data center servers that contain Nvidia’s A100 chip.

⁴⁰⁸ Jenny Leonard, Ian King & Eric Martin, *U.S. to Announce New Limits on Chip Technology Exports to China*, BLOOMBERG, 3 October 2022, www.bloomberg.com/news/articles/2022-10-03/us-to-announce-new-limits-on-chip-technology-exports-to-china?sref=7sxn9Sxl. [Hereinafter, *U.S. to Announce New Limits*.]

...
A senior Commerce official ... said: “As a general rule, we look to codify any restrictions that are in is-informed letters with a regulatory change.”

A spokesperson for the Commerce Department ... reiterated that it is “taking a comprehensive approach to implement additional actions ... to protect U.S. national security and foreign policy interests,” including to keep China from acquiring U.S. technology applicable to military modernization.

...
The planned action comes as the President Joe Biden’s Administration has sought to thwart China’s advances by targeting technologies where the United States still maintains dominance.

“The strategy is to choke off China and they have discovered that chips are a choke point. They can’t make this stuff, they can’t make the manufacturing equipment,” said Jim Lewis a technology expert at the Center for Strategic and International Studies. “That will change.”⁴⁰⁹

Query, however, what changes are possible via an incremental approach?

One possibility is the transformation of is-informed letters to regulations broadens and deepens export controls on dual civilian-military use items. Yet, the efficacy of such regulations relies on America’s coordination with its Allies, and also on their collective defenses against industrial espionage and cybertheft. Another possibility is America moves closer to full-scale industrial policy, by identifying (first) individual companies and issuing them an is-informed letter, and then generalizes those letters to sector-wide regulations.

The possibilities are not mutually exclusive. In fact, both seemed to be realized in October 2022, when the Biden Administration published some of the most severe export controls ever,⁴¹⁰ a “raft of measures [that] could amount to the biggest shift in U.S. policy toward shipping technology to China since the 1990s,” which “[i]f effective, ... could hobble China’s chip manufacturing industry by forcing American and foreign companies that use U.S. technology to cut off support for some of China’s leading factories and chip

⁴⁰⁹ Karen Freifeld & Alexandra Alper, *Exclusive: Biden to Hit China with Broader Curbs on U.S. Chip and Tool Exports*, REUTERS, 11 September 2022, www.reuters.com/business/exclusive-biden-hit-china-with-broader-curbs-us-chip-tool-exports-sources-2022-09-11/.

Notably, in October 2022, the Biden Administration formalized the above-described export controls “on technology to produce chips that are designated as 14-nanometer or better..., [and] expand[ed] the so-called Foreign Direct Product rule on more Chinese entities....” *U.S. to Announce New Limits*.

⁴¹⁰ See U.S. Department of Commerce, Bureau of Industry and Security, *Implementation of Additional Export Controls: Certain Advanced Computing and Semiconductor Manufacturing Items; Supercomputer and Semiconductor End Use; Entity List Modification*, 87 Federal Register number 197, 62186-62215 (13 October 2022), www.govinfo.gov/content/pkg/FR-2022-10-13/pdf/2022-21658.pdf; U.S. Department of Commerce, Bureau of Industry and Security, *Revisions to the Unverified List; Clarifications to Activities and Criteria That May Lead to Additions to the Entity List*, 87 Federal Register number 197, 61971-61977 (13 October 2022), www.govinfo.gov/content/pkg/FR-2022-10-13/pdf/2022-21714.pdf.

designers.”⁴¹¹ The “measure[s] ... cut China off from certain semiconductor chips made anywhere in the world with U.S. equipment.”⁴¹² In particular:

(1) Banned Shipments:

The U.S. forbade all “shipments of equipment to wholly Chinese-owned factories producing advanced logic chips.”⁴¹³ This semiconductor chip manufacturing equipment, which was “chip-making gear,” covered (a) “[l]ogic chips using so-called non-planar transistors made with 16-nanometer technology or anything more advanced than that,” (b) 18-nanometer dynamic random access memory chips, and (c) “Nand-style flash memory chips with 128 layers or more.”⁴¹⁴

Significantly, in fashioning prohibition (a), the U.S. broadened the range of what it previously defined as an “advanced” chip from ones with a circuit width of 10 nm or less to ones with widths between 14-16 nm or less used for arithmetic calculations.⁴¹⁵ The smaller the chip, the more advanced the technology, so in enlarging the size of chips subject to the export ban, America was expanding what it deemed to be advanced – that is, sensitive – technology.

Export controls also were cast in terms of the data transfer rate (that is, the rate at which a chip can transfer data, which is especially important with respect to AI), and maximum processing speed of the chip at issue (as faster speeds obviously mean a higher-end chip). The Biden Administration set a limit of 600 gigabytes per second, *i.e.*, chips faster than this limit were barred from exports to China.⁴¹⁶

Likewise, with respect to chips used in AI and supercomputing, the U.S. “block[ed] shipments of a broad array of chips for use in Chinese

⁴¹¹ Stephen Nellis, Karen Freifeld & Alexandra Alper, *U.S. Tries to Hobble China Chip Industry with New Export Rules*, REUTERS, 7 October 2022, www.reuters.com/technology/us-aims-hobble-chinas-chip-industry-with-sweeping-new-export-rules-2022-10-07/. [Hereinafter, *U.S. Tries to Hobble China*.]

⁴¹² *U.S. Tries to Hobble China*.

⁴¹³ *U.S. Tries to Hobble China*. See also Ian King, *China Says Biden’s New Chip Technology Curbs Will Harm Recovery*, BLOOMBERG, 7 October 2022, www.bloomberg.com/news/articles/2022-10-07/white-house-announces-new-restrictions-on-chip-exports-to-china?sref=7sxx9Sxl. (reporting: under the new rules, “it will be harder for providers of chips used in Chinese supercomputers and related gear to get permission to fill orders. They should presume requests will be denied, according to senior Commerce Department officials.”) [Hereinafter, *China Says Biden’s New*.]

⁴¹⁴ *China Says Biden’s New*.

⁴¹⁵ Kazuyuki Okudaira, Kotaro Hosokawa & Ryosuke Eguchi, *U.S. Companies Caught in Crossfire of China Chip Crackdown*, NIKKEI ASIA, 16 October 2022, <https://asia.nikkei.com/Politics/International-relations/US-China-tensions/US.-companies-caught-in-crossfire-of-China-chip-crackdown#>.

⁴¹⁶ See Richard Waters & Qianer Lu, *Why China Remains Hungry for AI Chips Despite U.S. Restrictions*, FINANCIAL TIMES, 21 August 2023, www.ft.com/content/47f7aefc-3ec0-4f66-80a1-24dcc551a845?shareType=nongift.

supercomputing systems.”⁴¹⁷ The U.S. defined “supercomputer” as “any system with more than 100 petaflops of computing power within a floor space of 6,400 square feet,” hence the export bans “could also hit some commercial data centers at Chinese tech giants.”⁴¹⁸

(2) The Foreign Direct Product (FDP) Rule:

The U.S. broadened the FDP Rule,⁴¹⁹ “to make it harder for China to develop and maintain supercomputers and AI technology.” This Rule “was first used by the Administration of Donald Trump against Chinese technology group Huawei ... bars any U.S. or non-U.S. company from supplying targeted Chinese entities with hardware or software whose supply chain contains American technology.”⁴²⁰

(3) Direct or Indirect Support:

The U.S. “prohibit[ed] ‘U.S. persons’ – American citizens and companies – from providing direct or indirect support to Chinese companies involved in advanced chip manufacturing.”⁴²¹ This “U.S. persons” prohibition was “novel,” and the “most significant and expansive” element of the measures, “because it threatened a form of sanctions even if the underlying technology was not subject to existing export controls.”⁴²²

(3) Entity List:

Additional Chinese companies were added to target lists, such as IFLYTEK, Dahua Technology, and Megvii Technology; such companies had been put on the Entity List in 2019 over allegations they aided the Chinese government in the suppression of Uyghurs.⁴²³ American producer-exporters thus had to take care when engaging in any transactions with them.

(4) Unverified List:

Chinese companies the U.S. could not inspect were put on the “unverified list,” including “China’s top memory chipmaker, YMTC [Yangtze Memory Technologies Co.], and 30 other Chinese entities,” because U.S. officials “cannot inspect,” that is, “cannot complete on-site visits to determine if they

⁴¹⁷ *China Says Biden’s New.*

⁴¹⁸ *U.S. Tries to Hobble China.*

⁴¹⁹ *U.S. Tries to Hobble China.*

⁴²⁰ Demetri Sevastopulo & Kathrin Hill, *U.S. Hits China with Sweeping Tech Export Controls*, FINANCIAL TIMES, 7 October 2022, www.ft.com/content/6825bee4-52a7-4c86-b1aa-31c100708c3e?shareType=nongift. [Hereinafter, *U.S. Hits China with Sweeping*.]

⁴²¹ *U.S. Hits China with Sweeping.*

⁴²² *U.S. Hits China with Sweeping.*

⁴²³ *U.S. Tries to Hobble China.*

can be trusted to receive sensitive U.S. technology.”⁴²⁴ The U.S. said that “if a government prevents U.S. officials from conducting site checks at companies placed on the unverified list, U.S. authorities will start the process for adding them to the entity list after 60 days.”⁴²⁵ Here again, U.S. producer-exporters has to beware of dealing with such entities.

All told, the measures sought “to stop China’s drive to develop its own chip industry and advance its military capabilities,” that is, “to ensure that Chinese companies don’t transfer technology to the country’s military and that chipmakers in China don’t develop the capability to make advanced semiconductors themselves.”⁴²⁶ The military applications were ominous, ranging “from modelling nuclear weapons to developing hypersonic weapons.”⁴²⁷

Reactions from U.S. analysts bespoke the breathtaking nature (and divisive) nature of the measures. For instance:

“This will set the Chinese back years,” said Jim Lewis, a technology and cybersecurity expert at the Center for Strategic and International Studies (CSIS), a Washington D.C.-based think tank, who said the policies harken back to the tough regulations of the height of the Cold War.

“China isn’t going to give up on chipmaking ... but this will really slow them (down).”⁴²⁸

Indeed, “[t]he controls mark[ed] a new attempt to decouple China from the U.S. in cutting-edge technologies:”

Paul Triolo, a China and tech expert at Albright Stonebridge, a consultancy, said the action was a “major watershed” in U.S.-China relations and in the increasingly intense technology competition between the two countries.

“The U.S. has essentially declared war on China’s ability to advance the country’s use of high-performance computing for economic and security gains,” said Triolo.

...

One chip industry executive said the U.S. was attacking China “from all angles.”

⁴²⁴ *U.S. Tries to Hobble China. See also China Says Biden’s New* (reporting: YMTC “is widely regarded as being the best bet China has of breaking through into the front ranks of the industry and has made progress with advanced products for chip-based storage.”); FT (reporting: “The Administration’s strategy is to deny China the capability to indigenize its semiconductor industry. If the U.S. is successful, this causes a huge problem for Beijing’s strategy to be a world-class player,” said Martijn Rasser, a security and technology expert at the Center for a New American Security, a think-tank.”).

⁴²⁵ *U.S. Tries to Hobble China.*

⁴²⁶ *China Says Biden’s New.*

⁴²⁷ *U.S. Hits China with Sweeping.*

⁴²⁸ *U.S. Tries to Hobble China.*

“The stunning thing about this move is that they have assembled a whole array of tools,” the executive said. “They are not just targeting military applications, they are trying to block the development of China’s technology power by any means.”⁴²⁹

Vitality, there was an extraterritorial dimension to these measures, because they “were aimed at preventing foreign firms from selling advanced chips to China or supplying Chinese firms with tools to make their own advanced chips.”⁴³⁰ As the *Financial Times* observed:

The new restrictions are not confined to the export of high-end U.S. semiconductor chips. They extend to any advanced chips made with U.S. equipment. This incorporates almost every non-Chinese high-end exporter, whether based in Taiwan, South Korea, or the Netherlands. The ban also extends to “U.S. persons,” which includes green card holders as well as U.S. citizens. That presents a binary choice between America or China. Most will choose the U.S. But there are tens of thousands of Chinese green card holders who will now be inclined to believe Beijing’s claim that there can be no such thing as divided loyalty.⁴³¹

In other words, the measures were unilaterally imposed by the U.S., but their efficacy ultimately would depend on the extent to which all of America’s Allies would participate.⁴³²

For good reason, the Allies (let alone third countries) were not happy:

Sweeping U.S. curbs ... on the sale of semiconductors and chipmaking equipment to China mark a step change in the Biden Administration’s approach to its chief geopolitical rival. That’s not just a challenge to Beijing, but also asks tough questions of allies – and presents Washington with a dilemma over how far it’s willing to squeeze them to comply.

...

⁴²⁹ *U.S. Hits China with Sweeping.*

⁴³⁰ *U.S. Tries to Hobble China.*

⁴³¹ Edward Luce, *Containing China is Biden’s Explicit Goal*, FINANCIAL TIMES, 19 October 2022, www.ft.com/content/398f0d4e-906e-479b-a9a7-e4023c298f39?shareType=nongift.

⁴³² See *China Says Biden’s New* (reporting: “While there will be more latitude for overseas companies needing technology for their own operations in China – or for parties that can prove they’re making things there for immediate export elsewhere – Commerce said it will enforce the rules and also cut off support for existing deployments of machinery covered by the restrictions. While the U.S. is home to the biggest block of companies that design vital electronic components and provide the complex machinery to manufacture them, other regions have capabilities that could undermine some of the government’s efforts. Commerce Department officials acknowledged that overseas cooperation is necessary to avoid hampering the initiatives and said there are talks with other parties underway around the world on the topic.”); *U.S. Hits China with Sweeping* (reporting: “in an effort to reduce supply chain disruptions, the administration will carve out an exception for chipmaking facilities in China owned by companies from the U.S. or Allied countries that are exporting chips.”)

... [T]he chip controls are ... causing friction with key allies.

In the Netherlands, home of ASML Holding NV, which has a virtual monopoly on a type of machine needed to make the most advanced chips, people familiar with the ... [discussions about the export controls] described the U.S. as acting like a bully. ...

The mood in Japan's government ... was said ... to be one of bemusement that its sovereignty could be so disregarded. ...

“This package is replete with unilateral measures with very big assumptions that partners will follow the U.S.’s lead,” said Reva Goujon, Director of China corporate advisory at Rhodium Group. The “game changer” controls send an unmistakable signal of intent to Beijing while containing an implicit threat for partners, she said, since “the U.S. is willing to go extra-territorial if they consider it important enough.”

The new export controls leave American chip companies at the mercy of the U.S. Commerce Department's Bureau of Industry and Security to grant a license to sell certain advanced products in China. Since early October [2022], *American officials have repeatedly said that if allies do not align with Washington on the latest rules, they could ban sales of foreign chip equipment that contains even the smallest amount of U.S. technology.*

...

The real test for the U.S. is whether its allies and security partners around the globe will play along ... – and that kind of acquiescence isn't guaranteed....

U.S. officials have repeatedly said export control rules will lose their effectiveness over time if partners don't join in, but by effectively forcing governments to comply or face potential penalties, the U.S. is alienating swing nations in Europe and Asia that are less willing to confront Beijing, whether for political or economic reasons. ...

...

Aside from actual chips, five companies dominate the global market for the equipment needed to produce them: Applied Materials Inc., Lam Research Corp. and KLA Corp., all of the U.S.; Japan's Tokyo Electron Ltd.; and ASML.⁴³³

To be sure, the U.S. came close to a deal, under the *Wassenaar Arrangement* (discussed in a separate Chapter), but it backed away when it decided the threshold dimension of chips

⁴³³ *Biden's Chip Curbs Outdo Trump in Forcing World to Align on China*, BLOOMBERG, 13 November 2022, www.bloomberg.com/news/articles/2022-11-13/biden-s-chip-curbs-outdo-trump-in-forcing-world-to-align-on-china?sref=7sxn9Sxl. [Hereinafter, *Biden's Chip Curbs Outdo Trump*.]

whose shipment would be barred – 5 nm – was too small.⁴³⁴ The American view was a larger diameter was needed to prevent China from gaining ground in the race to dominate AI. The fight among friends, then, literally was a matter of nanometers. With minimal consultation and no consensus, the U.S. foisted *fait accompli* an “us-versus-them” choice on other countries.⁴³⁵

The deal came, in a different form, following a September 2022 speech by U.S. National Security Advisor Jake Sullivan. His speech “signalled a significant change in policy,” namely, that America “should abandon its ‘sliding scale’ approach of trying to stay two generations of chips ahead, and instead ‘maintain as large as a lead as possible.’”⁴³⁶ By January 2023, the two most important advanced chip-producing allies,

⁴³⁴ *Biden’s Chip Curbs Outdo Trump* (reporting: “... early this year [2022] Washington almost got allies to agree to a deal, albeit with looser restrictions than were announced last month, only for Dutch and Japanese officials to walk away. Japan and the Netherlands were ready to formalize multilateral controls through the so-called *Wassenaar Arrangement* that would ban China’s access to equipment capable of making 5-nanometer chips, or one generation behind the current most advanced technologies, but the U.S. then wanted to raise that threshold to more mature technologies that would lead to a bigger impact on chip companies’ China sales. That’s when talks collapsed.”)

⁴³⁵ In June 2023, the Biden Administration contemplated tightening DOC’s export control restrictions, specifically with respect to chips used for AI:

The update ... to sweeping export controls introduced in October [2022] could make it harder for companies such as Nvidia and Advanced Micro Devices to sell advanced chips to China....

The move would have a significant effect on Nvidia, which responded to the October 7 controls by designing graphics processing unit chips called the A800 and H800 to replace more advanced chips that were restricted under the new rules.

...

While the A800 and H800 are slower than the chips they replaced, they are still the most important technology powering AI research and development for China’s tech giants.

Tencent, Alibaba, Baidu, ByteDance, and other Chinese groups placed additional orders for Nvidia chips when the generative AI wave exploded in China this year....

...

The new export controls would mark the latest effort by President Joe Biden to make it harder for China to obtain advanced technologies, including AI chips that can be used for everything from the research and development of hypersonic weapons to nuclear weapons modelling.

Demetri Sevastopulo, *U.S. Weighs Tougher Restrictions on AI Chip Exports to China*, FINANCIAL TIMES, 28 June 2023, www.ft.com/content/a6c6b769-349e-440f-a55b-c92371d00dd9?shareType=nongift.

⁴³⁶ *Quoted in Demetri Sevastopulo & Sam Fleming, Netherlands and Japan Join U.S. in Restricting Chip Exports to China*, FINANCIAL TIMES, 27 January 2023, www.ft.com/content/baa27f42-0557-4377-839b-a4f4524cfa20?shareType=nongift (reporting: “Japan and the Netherlands will restrict exports of chip manufacturing tools to China after reaching a deal with the U.S. designed to make it harder for the Chinese military to develop advanced weapons. ... The accord comes three months after Washington imposed unilateral export controls that barred U.S. companies from selling advanced chipmaking equipment to Chinese groups. ... [T]he deal marks a significant milestone in U.S. efforts to work with allies to hinder Chinese efforts to develop its semiconductor industry.”). [Hereinafter, *Netherlands and Japan Join U.S.*] See also Jenny Leonard and Cagan Koc, *Biden Nears Win as Japan, Dutch Back China Chip Controls*, BLOOMBERG, 26 January 2023, www.bloomberg.com/news/articles/2023-01-27/japan-netherlands-to-join

Japan and the Netherlands, agreed with the change.⁴³⁷ They joined the U.S. in restricting chip exports to China.⁴³⁸ Why they did, and exactly what the tripartite arrangement said,

us-in-chip-export-controls-on-china?sref=7sxxw9Sxl (reporting: “Japan and the Netherlands are poised to join the U.S. in limiting China’s access to advanced semiconductor machinery, forging a powerful alliance that will undercut Beijing’s ambitions to build its own domestic chip capabilities.... The Netherlands will expand restrictions on ASML Holding NV, which will prevent it from selling at least some of its so-called deep ultraviolet lithography machines – crucial to making some types of advanced chips and without which attempts to set up production lines may be impossible. Japan will set similar limits on Nikon Corp. ... The three countries are home to the most important companies that produce equipment for manufacturing chips, including ASML, Japan’s Tokyo Electron Ltd., and the U.S.’s Applied Materials Inc.”). [Hereinafter, *Biden Nears Win as Japan, Dutch.*]

⁴³⁷ *Netherlands and Japan Join U.S.*

⁴³⁸ Thus, for example, in March 2023, without expressly mentioning China:

Japan’s government says it plans to put restrictions on some computer chip-making exports, following similar moves by the U.S. and the Netherlands.

The measures will apply to 23 types of semiconductor manufacturing equipment.

...

Japan’s restrictions will apply to equipment supplied by major technology companies including Tokyo Electron and Nikon.

They will affect exports ranging from tools which are used to clean silicon wafers to immersion lithography machines.

Lithography machines use lasers to print miniscule patterns on silicon as part of the manufacturing process of microchips.

Annabelle Liang, *U.S.-China Chip War: Japan Plans to Restrict Some Equipment Exports*, BBC NEWS, www.bbc.com/news/business-65134017. Likewise:

The Netherlands, home to the world’s most valuable chip tool maker ASML, ... followed Japan and the U.S. in unveiling details of new export control rules that could deal a further blow to China’s semiconductor ambitions.

The new regulation, which the Dutch government first announced it would introduce on March 8, would prevent ASML from exporting its advanced chip production tools without licenses.

ASML is the world’s biggest provider of machines used in lithography – a key part of chipmaking in which chip designs are printed on wafers. The machines are crucial for making everything from processors to memory chips.

ASML said two types of its machines fall under the scope of the export control rules and would thus need licenses for export, namely its advanced immersive deep ultraviolet lithography systems (DUV). The machines are part of the TWINSCAN NXT:2000i and later immersion systems....

The advanced immersive DUV systems are capable of building chips that are on the 16-nanometer level or more advanced....

...

The export controls will take effect on Sept. 1 [, 2023] – later than Japan’s rules, which ... [were effective in late July].

remained confidential. Nevertheless, the deal was a big deal, because it met objections from “U.S. equipment makers,” which had “complained that the unilateral action by the Biden Administration allowed overseas competitors to continue to operate in one of the biggest markets for their products and undermined the aim of restricting China’s military advancements.” Simply put, thanks to the deal, American industry would not be at a competitive disadvantage relative to their Japanese and Dutch counterparts.

Or did it? There was evidence U.S. companies were satisfied with the tripartite agreement, and did not wish to see it expanded:

... American chip companies have pushed back with a blunt warning: Cutting sales to China would gut their businesses and derail the administration’s plan to build new semiconductor factories in the United States.

Since July [2023], Nvidia, Intel, and Qualcomm, three of the world’s largest chip makers, have pressed their case that cracking down on China would have unintended consequences. ...

The companies have warned that a U.S. pullback could accelerate China’s development of an independent chip industry, paving the way to a world dominated by Chinese-created chips rather than American-designed chips.

“What you risk is spurring the development of an ecosystem that’s led by competitors,” said Tim Teter, Nvidia’s General Counsel....

...

The warnings from the companies speak to the tension between national security concerns and commercial interests and highlight an unavoidable quandary for the Biden administration: The economic interdependence of the United States and China, which has roots stretching back decades,

ASML’s advanced immersive DUV systems are widely used by global chipmakers, including China’s chipmaking champion Semiconductor Manufacturing International Co., memory chipmaker YMTC, and top Chinese DRAM memory chipmaker ChangXin Memory Technologies.

...

The Dutch government’s new regulation also involves atomic layer deposition production tools – known as ALD – another key process in advanced chipmaking, in which Dutch company ASM International has the highest market share. ...

The Dutch government has blocked shipments of ASML’s most cutting-edge chip production tool, the extreme ultraviolet system (EUV), to China since 2019 due to U.S. pressure.... The immersive DUV systems covered in the latest regulations are less advanced than EUV, but the Dutch government considers immersive DUV to be “dual-use” technology, meaning it can be used for both commercial and military purposes.

Cheng Ting-Fang, Lauly Li & Rhyannon Imadegawa-Bartlett, *Netherlands Unveils Chip Tool Export Curbs in Fresh Blow to China*, NIKKEI ASIA, 30 June 2023, <https://asia.nikkei.com/Business/Tech/Semiconductors/Netherlands-unveils-chip-tool-export-curbs-in-fresh-blow-to-China#>.

means that any action by Washington to confront Beijing risks causing harm at home.

China accounts for about a third of the global semiconductor market and more than \$50 billion in combined annual revenue for Nvidia, Intel and Qualcomm. The companies have cautioned that losing that revenue could force cuts in technology development, jobs, and spending on semiconductor factories in Arizona, Ohio, and New York.⁴³⁹

Succinctly put, no matter how justified export controls on chips seemed to be from a short-term national security perspective, domestic companies continued to make the arguments they always had against them: in the long run, such controls would prove self-defeating, as they would spur semiconductor industry growth in China, while eroding the Chinese-sourced sales those companies needed to re-invest in America.⁴⁴⁰

⁴³⁹ Tripp Mickle, David McCabe & Ana Swanson, *How the Big Chip Makers Are Pushing Back on Biden's China Agenda*, THE NEW YORK TIMES, 5 October 2023, www.nytimes.com/2023/10/05/technology/chip-makers-china-lobbying.html?smid=nytcore-ios-share&referringSource=articleShare.

⁴⁴⁰ Moreover, the efficacy of U.S. export controls was in question, as it always had been:

Several Taiwanese technology companies are helping [Huawei Technologies Co.](#) build infrastructure for an [under-the-radar network](#) of chip plants across southern China, an unusual collaboration that risks inflaming sentiment on a democratic island grappling with Beijing's growing belligerence.

...

At a time when China threatens Taiwan regularly with military action for even contemplating independence, it's unusual that members of the island's most important industry may be helping U.S.-sanctioned Huawei develop semiconductors to effectively break an American blockade. Those sanctions were called into question after Huawei unveiled a smartphone in late August [2023] with an advanced made-in-China chip, spurring alarm in Washington and calls to completely cut off Huawei and its Shanghai-based chipmaker Semiconductor Manufacturing International Corp. [This incident is discussed below.]

...

... National Security Council spokesman John Kirby said it was no surprise that Huawei would look to "continue illicit production of semiconductors."

"We're confident in the export controls that we have in place, that they will be helpful in terms of protecting the supply chain for semiconductors here in the United States," Kirby said. "We're going to constantly look at the regime and if it needs to be changed or adjusted, we'll absolutely do that in the future."

"The chips from these plants built with Taiwanese companies' help could eventually be used on Chinese missiles aimed at Taiwan," said Li Jung-Shian, Professor of Electrical Engineering at Tainan, Taiwan-based National Cheng Kung University. ...

It's unclear whether the Taiwanese companies' potential involvement violates American sanctions, in part because U.S. curbs are designed to curtail the export of American-origin technology to Huawei rather than blocking all business relationships. Kevin Wolf, a Partner at Akin Gump who specializes in trade policy, says it's impossible to know whether these firms are violating US regulations without more detailed information. Because of the

Nevertheless, the Biden Administration persisted. In October it warned China that more, and tighter, export controls were in the offing.⁴⁴¹

- **October 2023 Tightening**

And, so they were. The additional American export controls supplemented the extant “sweeping U.S. restrictions on shipments of advanced chips and chipmaking equipment to China unveiled last October [2022].”⁴⁴² The supplement was 92 pages of rules that took effect on 17 November 2023, including changing the definition of covered chips, broadening controls to prevent circumvention, controlling more equipment, and adding more Chinese entities to the Entity List.⁴⁴³ As with the original measures, the supplement focused on advanced semi-conductors, related manufacturing equipment, and items that support supercomputing applications to arms embargoed countries such as China (without specifically targeting the Mainland).

At least one incident led to this expansion of measures:

Last year [2022], government restrictions kept Nvidia . . . , the world’s most valuable chipmaker, from shipping two of its most advanced AI chips to Chinese customers, chips that have become the industry standard for developing chatbots and other AI systems.

But Nvidia soon released new variants for the Chinese market that were less sophisticated and got around the U.S. export controls. One, named the H800, has as much computing power at some settings used in AI work as

complexity of US sanctions against Huawei, it can be difficult to determine such violations without knowing exactly what technologies and equipment suppliers are using.

Key Taiwan Tech Firms Helping Huawei With China Chip Plants, BLOOMBERG, 2 October 2023, www.bloomberg.com/news/articles/2023-10-03/taiwan-tech-companies-are-helping-huawei-build-a-secret-network-of-chip-plants?sref=7sxw9Sxl.

⁴⁴¹ See Karen Freifeld & Alexanandra Alper, *Exclusive: U.S. Warned China to Expect Updated Export Curbs in October – U.S. Official*, REUTERS, 2 October 2023, www.reuters.com/technology/us-warned-china-expect-updated-export-curbs-october-us-official-2023-10-02/.

⁴⁴² Karen Freifeld, *Exclusive: U.S. Tackles Loopholes in Curbs on AI Chip Exports to China*, REUTERS, www.reuters.com/technology/upcoming-us-rules-ai-chip-exports-aim-stop-workarounds-us-official-2023-10-15/. [Hereinafter, *Exclusive: U.S. Tackles Loopholes*.]

⁴⁴³ See U.S. Department of Commerce, Bureau of Industry and Security, *Export Controls on Semiconductor Manufacturing Items*, 88 Federal Register number 205, 73424-73455 (25 October 2023), www.govinfo.gov/content/pkg/FR-2023-10-25/pdf/2023-23049.pdf?utm_campaign=subscription+mailing+list&utm_medium=email&utm_source=federalregister.gov; U.S. Department of Commerce, Bureau of Industry and Security, *Implementation of Additional Export Controls: Certain Advanced Computing Items; Supercomputer and Semiconductor End Use; Updates and Corrections*, 88 Federal Register number 205, 73458-73517 (25 October 2023), www.govinfo.gov/content/pkg/FR-2023-10-25/pdf/2023-23055.pdf?utm_campaign=subscription+mailing+list&utm_medium=email&utm_source=federalregister.gov.

the company’s more powerful but blocked H100 chip. Still, some key performance aspects are limited....⁴⁴⁴

(Nvidia made “the most popular AI accelerators, processors that help sophisticated algorithms handle massive amounts of data.”⁴⁴⁵) So, the U.S. closed multiple loopholes by limiting “certain advanced data center AI chips” the existing regime failed to capture.

Specifically, the expanded measures entailed (1) enhanced reporting requirements to monitor so-called “gray zone” activity in the dual-use space of merchandise with commercial and military use, (2) elimination of the two triggers (the bandwidth parameter) necessary for an export ban, and (3) addition of a new trigger (the performance parameter) for a ban:

Chips meant for consumer products like laptops [as well as EVs, gaming devices, and smartphones] ... [were] exempt from the new curbs.... But companies ... need[ed] to tell the Commerce Department when they are filling orders for the most powerful consumer chips to make sure they are not being used in ways that threaten national security....

In order to keep AI chips the U.S. views as too powerful from China, ... the U.S. ... stop[ped] taking into account one of the parameters – the “bandwidth parameter” – it ha[d] been using to determine which types of AI data center chips to restrict. A bandwidth, or interconnect, parameter is a measure of how fast chips talk to each other.

Under the current thresholds, a chip had to exceed both a performance speed and a bandwidth threshold to be restricted. By removing the bandwidth parameter, a chip will soon be restricted if it exceeds a certain performance speed alone – in other words, how powerful each chip is.

It will also be restricted if it exceeds another measurement, a certain “performance density,” to help prevent future workarounds....

...

The updated rules also ... cover[ed] AI chips as technology evolves. ... [C]ompanies [had] to notify the government about semiconductors whose performance is just below the guidelines before they are shipped to China.... The government ... [would] decide on a case-by-case basis whether they pose[d] a national security risk, but they can be shipped unless the chipmaker is told otherwise.⁴⁴⁶

⁴⁴⁴ *Exclusive: U.S. Tackles Loopholes.*

⁴⁴⁵ *U.S. Restricts Nvidia Made-for China Chips.*

⁴⁴⁶ *Exclusive: U.S. Tackles Loopholes.* On reporting requirements, see also *U.S. Restricts Nvidia Made-for China Chips* (noting: “The new rules also require companies to notify the U.S. government before selling chips that fall below the controlled threshold.... Top-of-the-line chips are best for powering artificial intelligence models, a[n] [unnamed] senior [Biden] Administration official said.

As a fourth measure, the updates to the October 2022 rules ... “close[d] a loophole that ... gave Chinese companies access to American artificial intelligence chips through Chinese units located overseas....”⁴⁴⁷ Specifically, the U.S. prohibited “chips ... from being sent to units of firms located anywhere in the world, if their parent companies are headquartered in China, Macau and other arms embargoed countries.”⁴⁴⁸ This move aimed to “keep the chips from being illegally smuggled into China or remotely accessed by Chinese parent companies.”⁴⁴⁹ The expanded export controls indeed did hit Nvidia’s A800 and H800 chips.⁴⁵⁰ They did not, however, cover cloud computing services by American or Allied providers.⁴⁵¹

In essence, these four new measures “block[ed] some AI chips that ... [fell] just under current technical parameters [of the extant controls,] while demanding companies report shipments of others....”⁴⁵² But that was not all.

The expanded export controls on advanced chips and chip-making tools entailed four further measures, on top of the four aforementioned ones: (5) expanded intermediary country targets; (6) blacklisting; (7) toughened licensing rules; and (8) limits chip-manufacturing equipment using DUV technology. The targets summed to over 40 additional countries, including Iran and Russia “that present[ed] risks of diversion to China and are subject to U.S. arms embargoes.”⁴⁵³ The blacklisted entities were “Chinese chip designers Moore Threads [Intelligent Technology Beijing Co.] and [Shanghai] Biren [Intelligent Technology Co.],” which were “Chinese startups founded by former Nvidia employees and aim[ed] to compete with the U.S. AI chip giant.”⁴⁵⁴ As for licensing, they affected Moore Thread and Biren: their U.S. suppliers would have difficulty getting permission to ship products to them or their subsidiaries.⁴⁵⁵ And, licensing was obligatory for proposed shipments of chipmaking tools to 21 countries (in addition to China).⁴⁵⁶ Finally, the U.S. “added to the list of equipment restricted from going to that country to include some deep ultraviolet (DUV) lithography systems, going beyond recent Dutch regulations to keep the Netherlands’ ASML from sending older DUV models and spare parts to some advanced Chinese chip factories....”⁴⁵⁷ This eighth measure was significant

But with a lot of money and a little jury-rigging, a whole class of slightly inferior chips could also be used for AI and supercomputing and therefore pose a national security risk, the official said.”).

⁴⁴⁷ *Exclusive: U.S. Tackles Loopholes.*

⁴⁴⁸ Alexandra Alper, Karen Freifeld & Stephen Neillis, *Biden to Cut China Off from More Nvidia Chips, Expand Curbs to Dozens of Countries*, REUTERS, 17 October 2023, www.reuters.com/technology/biden-cut-china-off-more-nvidia-chips-expand-curbs-more-countries-2023-10-17/. [Hereinafter, *Biden to Cut China Off*.]

⁴⁴⁹ *Biden to Cut China Off.*

⁴⁵⁰ *See Biden to Cut China Off.*

⁴⁵¹ *U.S. Restricts Nvidia Made-for China Chips; Exclusive: U.S. Tackles Loopholes.*

⁴⁵² *Exclusive: U.S. Tackles Loopholes.*

⁴⁵³ *Biden to Cut China Off.*

⁴⁵⁴ *Biden to Cut China Off.*

⁴⁵⁵ *U.S. Restricts Nvidia Made-for China Chips.*

⁴⁵⁶ *See Biden to Cut China Off.*

⁴⁵⁷ *Biden to Cut China Off.*

because although “DUV is less advanced chipmaking equipment than state-of-the art extreme ultraviolet equipment (EUV), which has already been withheld from China,” DUV “can make chips nearly as advanced at greater cost.”⁴⁵⁸

All told, the expanded regime “marked a historic shift in U.S.-China tech policy.”⁴⁵⁹ U.S. Commerce Secretary Gina Raimondo intoned the policy goal was “to limit China’s access to ‘advanced semiconductors that could fuel breakthroughs in artificial intelligence and sophisticated computers that are critical to (Chinese) military applications....’”⁴⁶⁰ Yet, query whether the U.S. was playing a game of “whack a mole.” Each technological innovation, which surely America wanted to incentivize, came with the possible disincentive of a new export restriction. Indeed, consider the fact:

The previous [October 2022] rules imposed a two-pronged test that measured both a chip’s computing performance and its ability to communicate with other chips, an important measure in AI supercomputers where thousands of chips are strung together to chew through huge amounts of data.

Nvidia and Intel created special chips for the Chinese market that retained the powerful computing capabilities but limited communications speeds to stay inside the previous rules.

The new rules impose limits on how much computing power a chip packs into a certain size, a measure designed to prevent workarounds using new

In December 2023, ASML cancelled shipments of advanced semiconductor manufacturing equipment, under pressure from the Biden Administration. *See* Cagan Koc & Jennifer Jacobs, *U.S. Pressured Netherlands to Block China-Bound Chip Machinery*, BLOOMBERG, 1 January 2024, www.bloomberg.com/news/articles/2024-01-01/us-pushed-asml-to-block-chinese-sales-before-january-deadline?sref=7sxn9Sxl. Technically, ASML “had licenses to ship three top-of-the-line [immersion] deep ultraviolet lithography machines to Chinese firms until January [2024,] when new Dutch restrictions [against such shipments] ... [took] full effect.” But, ASML acquiesced to the Administration’s request “to immediately halt pre-scheduled shipments of some of the machines to Chinese customers....” *Id.*

ASML’s acquiescence did not stop a surge in exports to China in advance of the U.S. export ban taking effect. *See* Cagan Koc, Ian King & Diederik Baazil, *ASML’s China Sales Surged Despite Secret Dutch Deal With U.S.*, BLOOMBERG, 25 January 2024, www.bloomberg.com/news/articles/2024-01-25/asml-s-china-sales-surged-despite-secret-dutch-deal-with-us?sref=7sxn9Sxl (reporting: “A secret agreement between the U.S. and the Netherlands last year [2023] to limit ASML Holding NV’s deliveries to China didn’t stop a surge in sales of its sensitive chipmaking equipment. The deal ... stumbled as ASML turned to Beijing to compensate for weak demand elsewhere. The Dutch government permitted more shipments, allowing China to stock up on the gear before new U.S.-brokered export restrictions came into force this month [January 2024]. Originally intended as a stopgap before those restrictions took effect, the agreement was meant to give priority to shipments of the company’s immersion deep ultraviolet lithography machines to markets outside of China.... But the global downturn pushed ASML to successfully lobby The Hague for export licenses to China of critical semiconductor manufacturing kit, dashing U.S. officials’ expectations that the deal would limit deliveries.... Instead, China became ASML’s biggest market last year [2023], as companies there rushed to buy equipment before the impending export ban. ... ASML didn’t violate the letter of the agreement, despite the poor optics....”).

⁴⁵⁸ *Biden to Cut China Off.*

⁴⁵⁹ *Exclusive: U.S. Tackles Loopholes.*

⁴⁶⁰ *Quoted in Biden to Cut China Off.*

“chiplet” technology that China has said will be central to its semiconductor industry’s future.⁴⁶¹

Surely the likes of Nvidia and Intel would develop a workaround for the new performance density criterion. Consider also the fact that defining the gray zone amidst technological change is fraught with difficulty:

“It’s difficult to draw a bright line between military and commercial technology,” U.S. Commerce Secretary Gina Raimondo ... [said]. “There are often dual-use technologies — and the same technologies that fuel commercial exchange, unfortunately, sometimes can also allow our competitors to modernize their military, surveil their citizens and solidify oppression.”⁴⁶²

Put generally, is there an inherent, ironic tension between industrial policy and national security, perhaps one that increases with the degree of technological sophistication of the good or service that is at once promoted by industrial policy and restricted by export controls?

The Commerce Secretary “stress[ed] the Administration was not seeking to hurt Beijing economically.”⁴⁶³ Not true, said China, in what had become a familiar counter-narrative. The expanded export controls. China accused America of trying to “suppress Chinese companies.”⁴⁶⁴ “The U.S. needs to stop politicizing and weaponizing trade and tech issues and stop destabilizing global industrial and supply chains,” China’s Foreign Ministry spokesperson Mao Ning said....⁴⁶⁵

The Biden Administration also faced criticism from its right flank. In its Annual Report – a 741-page document issued in November 2023 – the U.S. China Economic and Security Review Commission slammed the Administration’s October 2022 export restrictions as having failed to keep Chinese companies from getting U.S. semiconductor-making tools for the manufacture of advanced chips at the 14 nanometer or less node. (The Commission was established in 2000 to weigh the national security ramifications of Sino-American economic ties.):

With the Commerce Department using the 14-nanometer restriction limit, “importers are often able to purchase the equipment if they claim it is being used on an older production line, and with limited capacity for end-use inspections, it is difficult to verify the equipment is not being used to produce more advanced chips,” the Report stated.

⁴⁶¹ *Biden to Cut China Off.*

⁴⁶² *Quoted in U.S. Restricts Nvidia Made-for China Chips.*

⁴⁶³ *Quoted in Biden to Cut China Off.*

⁴⁶⁴ *Exclusive: U.S. Tackles Loopholes.*

⁴⁶⁵ *Quoted in Exclusive: U.S. Tackles Loopholes.*

The finding comes as the United States scrambles to figure out how Chinese telecoms giant Huawei was able to produce an advanced 7 nanometer chip to power its Mate 60 Pro smartphone at China's top chipmaker SMIC, despite the export curbs announced last year [October 2022].

Huawei and SMIC were also added to a trade restriction list in 2019 and 2020, which in theory bars U.S. suppliers from shipping certain technology to the companies.

...

The United States managed to plug a key loophole in its efforts to stymie China's access to advanced chipmaking tools by convincing allies Japan and the Netherlands, with similarly robust chipmaking equipment industries, to announce their own restrictions on exports of the coveted technology.

But China stockpiled equipment by taking advantage of the lag time between the United States' October 2022 rules, and Japan and the Netherlands' similar moves in July and September of 2023 respectively....

According to the ... [Report], between January and August 2023, China imported \$3.2 billion (*RMB* 23.5 billion) worth of semiconductor manufacturing machines from the Netherlands, a 96.1% increase over the \$1.7 billion (*RMB* 12 billion) recorded over the same period in 2022. China's imports of semiconductor equipment from all countries totaled \$13.8 billion (*RMB* 100 billion) over the first eight months of 2023....⁴⁶⁶

Manifestly, unless they are (1) comprehensive, in the sense of all relevant supplier countries participating, and (2) unforeseeable, so that target countries cannot plan for them, export controls are leaky. Even with these parameters met, arguably the long-term impact of such controls is to drive up costs and delay production times in the target countries.⁴⁶⁷

⁴⁶⁶ Alexandra Alper, *China Receives U.S. Equipment to Make Advanced Chips Despite New Rules – Report*, REUTERS, 14 November 2023, www.reuters.com/technology/china-receives-us-equipment-make-advanced-chips-despite-new-rules-report-2023-11-14/.

⁴⁶⁷ For example, as *Nikkei Asia* points out:

What will the new restrictions likely mean for China's AI ambitions?

Simply put: higher costs and longer development times.

For example, it will cost up to 50% more to train AI servers, and more than twice as much to implement those results without access to the most advanced chips.... This is because companies will need more chips to obtain an equivalent amount of computing power, which also means less energy efficiency.

Being added to the U.S. trade blacklist will make it harder for Chinese AI chip startups Biren Technology and Moore Threads to work with leading global chipmakers like TSMC, Samsung, GlobalFoundries, and Intel.

Satisfying these parameters proved difficult, as became evident in January 2024. *Reuters* analyzed over 100 tender offers for the NVIDIA A100 chip, and dozens of tenders for the NVIDIA A800 chip,⁴⁶⁸ plus tenders for NVIDIA’s H100 chip (which is more powerful than the A100), and its H800 (which, like the A800, is slower than the A100 and H100). Chinese government entities (including the PLA, and a laboratory run by the Ministry of Industry and Information Technology) and bodies related to the government (that is, SOEs), as well as prominent academic institutions (such as Tsinghua University and Chongqing University), issued these tenders.⁴⁶⁹ Even entities involved with China’s military that were on U.S. sanctions lists – such as the Harbin Institute of Technology and University of Electronic Science and Technology of China – were among the buyers. All of them were able to procure the A100 and A800 models, even after the September 2022 U.S. ban on A100 and H100 exports to China and Hong Kong, and after October 2023 U.S. export ban on the A800 and H800 models.⁴⁷⁰

Typically, the Chinese procurers used the chips for AI (thus, the chips were “graphic processing units,” which were highly efficient at “process[ing] huge amounts of data needed for machine-learning tasks”), though the volume of their purchases remained too small “to build a sophisticated AI large language model from scratch,” because that would require over 30,000 A100 cards (*e.g.*, to construct OpenAI’s GPT).⁴⁷¹ Yet, the tenders sometimes obliged the chip suppliers to deliver and install the chips before they would be paid, and insisted on new – not used or disassembled – chips.

Who were the suppliers? It was neither NVIDIA nor its approved retailers; NVIDIA avowed it followed all export control rules and, if it learned a customer unlawfully re-sold a chip to a third party, would take appropriate action. Some of them may have been “units of Chinese companies located outside China,” though DOC vowed to close this loophole.⁴⁷² Another possibility was an emerging underground market for advanced chips, which had been established. Chinese vendors in this black market imported chips from companies incorporated in India, Singapore, and/or Taiwan, and/or “snatch[ed] up excess stock that finds its way to the market after NVIDIA ships large quantities to big U.S. firms.”⁴⁷³ Then, they delivered the chips to Chinese procurers – lawfully, because “[b]uying or selling high-end U.S. chips is not illegal in China.”⁴⁷⁴ Thus, as Professor Chris

More broadly, the U.S. is making it harder for global contract chipmakers to serve Chinese clients if their chips are deemed too advanced. For instance, the computing power of the Hanguang 800 AI chip developed by Alibaba may exceed the new U.S. threshold.

Cheng Ting-Fang, *China Faces New U.S. Chip Rules: 5 Things to Know*, NIKKEI ASIA, 6 November 2023, <https://asia.nikkei.com/Business/Technology/China-faces-new-U.S.-chip-rules-5-things-to-know#>.

⁴⁶⁸ See Eduardo Baptista, *China’s Military and Government Acquire NVIDIA Chips Despite U.S. Ban*, REUTERS, 15 January 2024, www.reuters.com/technology/chinas-military-government-acquire-nvidia-chips-despite-us-ban-2024-01-14/. [Hereinafter, *China’s Military and Government Acquire*.]

⁴⁶⁹ See *China’s Military and Government Acquire*.

⁴⁷⁰ See *China’s Military and Government Acquire*.

⁴⁷¹ *China’s Military and Government Acquire*.

⁴⁷² *China’s Military and Government Acquire*.

⁴⁷³ *China’s Military and Government Acquire*.

⁴⁷⁴ *China’s Military and Government Acquire*.

Miller (author of *Chip War: The Fight for the World's Most Critical Technology* (2022)) explained, American export restriction could not be “watertight, given that chips are small and can be easily smuggled.”⁴⁷⁵ Rather, the best the U.S. could do was “‘to throw sand in the gears of China’s AI development’ by making it difficult to build large clusters of advanced chips capable of training AI systems.”⁴⁷⁶

U.S. DEPARTMENT OF COMMERCE, BUREAU OF INDUSTRY AND SECURITY, PRESS RELEASE, *COMMERCE STRENGTHENS RESTRICTIONS ON ADVANCED COMPUTING SEMICONDUCTORS, SEMICONDUCTOR MANUFACTURING EQUIPMENT, AND SUPERCOMPUTING ITEMS TO COUNTRIES OF CONCERN* (17 OCTOBER 2023)⁴⁷⁷

Updates to Modify and Reinforce Restrictions Initially Released on October 7, 2022, to Address National Security Concerns Posed by PRC Military Modernization

... [T]he U.S. Department of Commerce’s ... BIS released a package of rules [which make changes to the *EAR*] designed to update export controls on advanced computing semiconductors and semiconductor manufacturing equipment, as well as items that support supercomputing applications and end-uses, to arms embargoed countries, including the PRC, and to place additional related entities in the PRC on the Entity List.

“Today’s updated rules will increase effectiveness of our controls and further shut off pathways to evade our restrictions. These controls maintain our clear focus on military applications and confront the threats to our national security posed by the PRC Government’s military-civil fusion strategy,” said Secretary of Commerce Gina M. Raimondo. “As we implement these restrictions, we will keep working to protect our national security by restricting access to critical technologies, vigilantly enforcing our rules, while minimizing any unintended impact on trade flows.”

“Export controls are a powerful national security tool, and the updates released today build on our ongoing assessment of the U.S. national security and foreign policy concerns that the PRC’s military-civil fusion and military modernization present,” said Under Secretary of Commerce for Industry and Security Alan F. Estevez.

...

Today’s rules reinforce the October 7, 2022, controls to restrict the PRC’s ability to both purchase and manufacture certain high-end chips critical for military advantage. These updates are necessary to maintain the effectiveness of these controls, close loopholes, and ensure they remain durable.

These controls were strategically crafted to address, among other concerns, the PRC’s efforts to obtain semiconductor manufacturing equipment essential to producing advanced integrated circuits needed for the next generation of advanced weapon systems, as well as

⁴⁷⁵ *China’s Military and Government Acquire.*

⁴⁷⁶ *Quoted in China’s Military and Government Acquire.*

⁴⁷⁷ www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3355-2023-10-17-bis-press-release-acs-and-sme-rules-final-js/file.

high-end advanced computing semiconductors necessary to enable the development and production of technologies such as artificial intelligence (AI) used in military applications. Advanced AI capabilities – facilitated by supercomputing, built on advanced semiconductors – present U.S. national security concerns because they can be used to improve the speed and accuracy of military decision making, planning, and logistics. They can also be used for cognitive electronic warfare, radar, signals intelligence, and jamming. These capabilities can also create concerns when they are used to support facial recognition surveillance systems for human rights violations and abuses.

The three rules ... are summarized briefly below. ...

Advanced Computing Chips Rule ... :

...
The ... [Advanced Computing Chips Rule] retains the stringent PRC-wide licensing requirements imposed in the October 7, 2022, rule and makes two categories of updates:

- First, adjusting the parameters that determine whether an advanced computing chip is restricted;
- Second, imposing new measures to address risks of circumvention of the controls.

Part 1: Parameter Changes:

Based on public comments, recent technological developments, and analysis of the prior rule’s national security impact, the ... [Advanced Computing Chips Rule] removes “interconnect bandwidth” as a parameter for identifying restricted chips. The rule also:

- Restricts the export of chips if they exceed either of two parameters:
 - (1) The preexisting performance threshold set in the October 7 rule; or
 - (2) A new “performance density threshold,” which is designed to preempt future workarounds.
- Requires a notification for the export of certain additional chips with performance just below the restricted threshold. Under new “License Exception Notified Advanced Computing...,” following receipt of notification for exports and reexport to Macau and destinations identified as subject to a U.S. arms embargo (including the PRC), the U.S. government will determine within 25 days whether the transaction may proceed under the license exception or instead require a license.

As part of these updates, we are also introducing an exemption that will permit the export of chips for consumer applications.

Part 2: Circumvention Prevention:

Establishes a worldwide licensing requirement for export of controlled chips to any company that is headquartered in any destination subject to a U.S. arms embargo (including the PRC) or Macau, or whose ultimate parent company is headquartered in those countries,

to prevent firms from countries of concern from securing controlled chips through their foreign subsidiaries and branches.

- Creates new red flags and additional due diligence requirements to help foundries identify restricted chip designs from countries of concern. This will make it easier for foundries to assess whether foreign parties are attempting to circumvent the controls by illicitly fabbing restricted chips.
- Expands licensing requirements for export of advanced chips, with a presumption of denial, to all 22 countries to which the United States maintains an arms embargo (including the PRC) and Macau.
- Imposes license requirements for export of advanced chips, with a presumption of approval, to these same additional countries, in response to reporting that countries of concern have used third countries to divert or access restricted items. This will provide greater visibility for compliance monitoring and enforcement.
- Creates a notification requirement for a small number of high-end gaming chips to increase visibility into shipments and prevent their misuse to undermine U.S. national security.
- Includes a request for public comments on multiple topics, including risks associated with infrastructure as a service ... providers, the application of controls on deemed exports and deemed reexports, additional compliance guidance that could be provided to foundries receiving chip designs, and how to more precisely define key terms and parameters in the regulation.

Expansion of Export Controls on Semiconductor Manufacturing Items ... Rule ...:

...

Key changes made from the October 7, 2022, rule include:

- Imposes controls on additional types of semiconductor manufacturing equipment.
- Refines and better focuses the U.S. persons restrictions while codifying previously existing agency guidance, to ensure U.S. companies cannot provide support to advanced PRC semiconductor manufacturing while avoiding unintended impacts.
- Expanding license requirements for semiconductor manufacturing equipment to apply to additional countries beyond the PRC and Macau, to 21 other countries for which the U.S. maintains an arms embargo.

Additions to the Entity List:

...

- BIS is adding to the Entity List two PRC entities and their subsidiaries (a total of 13 entities) involved in the development of advanced computing chips that have been found to be engaged in activities contrary to U.S. national security and foreign policy interests. These entities will also be subject to restrictions on foreign-produced items made with U.S. technology.
- Foundries producing chips for these listed parties will need a BIS license before the foundries may send such chips to these entities or parties acting on behalf of these entities as a result of applying the “Footnote 4” Entity List foreign direct product rule designation.

Additional Background:

BIS's actions ... were taken under the authority of the *Export Control Reform Act of 2018* and its implementing regulations, the *EAR*.

Under these authorities, BIS possesses a variety of tools to control the export of U.S.-origin and certain foreign-produced commodities, software, and technology as well as specific activities of U.S. persons, for national security and foreign policy reasons. These tools include issuing federal regulations, as well as using the licensing and regulatory process to take party-specific actions.

III. Who Practices “Industrial Policy”?

Both non-market and market economies may employ industrial policy strategies. China, for example, has 5- and 10-year plans for the development of its manufacturing sector, as does India and several other countries. The *Made in China 2025* and *Make in India* programs (discussed in other Chapters) are examples.⁴⁷⁸ Thus, industrial policy does not fit easily into a Communist (or Socialist) or Capitalist paradigm – but in either one, linkages to national security are visible. In India, for example, on 15 August 1947, in his Red Fort Speech commemorating the 75th anniversary of Partition, Prime Minister Narendra Modi (1950, PM, 2014-) boasted of India's strategy for a home-grown defense industry:

the BJP government has pushed for more self-reliance in defense. It has:

- (1) raised the cap on foreign investment in the defense sector;
- (2) set up special programs to promote home-produced manufacture;
[and]
- (3) simplified procedures for companies wanting to bid for defense contracts.⁴⁷⁹

⁴⁷⁸ The *Made in China 2025* industrial policy was part of the PRC's 13th Five Year Plan, which covered 2016-2020. For an overview of China's *Made in China 2025* industrial policy, which identified China's 10 industrial priority sectors and issues for Congress, see Karen M. Sutter, Congressional Research Service, “*Made in China 2025*” *Industrial Policies: Issues for Congress* (10 March 2023), <https://sgp.fas.org/crs/row/IF10964.pdf>.

Alarming, a think tank called the “Urban China Initiative,” which was led by the American-based management consultancy, “advised China to deepen co-operation between business and the military and push foreign companies out of sensitive industries as part of a project for the central government in 2015,” and helped shape the *Made in China 2025* industrial policy, making “61 recommendations across 14 different technologies.” See Stephen Foley and Sun Yu, *McKinsey-led Think-Tank Advised China on Policy that Fed U.S. Tensions*, FINANCIAL TIMES, 22 February 2024, www.ft.com/content/15a3e8d9-6c57-422a-8eb8-35a3c24a50e3?shareType=nongift. McKinsey downplayed its role, but the episode was relevant of the Lenin-esque insight that capitalists will compete with each other to sell the rope to hang capitalism.

⁴⁷⁹ Reality Check Team, *Independence Day Speech: Prime Minister Modi's Speech Fact-Checked*, BBC NEWS, 16 August 2022, www.bbc.com/news/62550609. [Hereinafter, *Independence Day Speech*.]

The PM was concerned India was “still one of the world’s biggest buyers of arms from abroad,” “account[ing] for 11% of all global major arms imports from 2017 to 2021.”⁴⁸⁰

There is no single industrial policy that defines linkages to national security. Each country has its own formula, given its geopolitical context and economic system. So, there are many shades of that policy, which incline it more to one or the other extreme of Communism and Capitalism.

For example, an industrial policy associated with public ownership of the means of production (the defining feature of Communism) would rightly fit in the non-market economy paradigm. Conversely, an industrial policy associated with private ownership of the factors of production (the hallmark of Capitalism) would be distinctly market-based. The first scenario would entail centralized, command-based directives to producers and exporters to implement the policy, while the second scenario would rely on decentralized decision-making, incentives (such as tax breaks and subsidies), and price signals to encourage agents to follow the policy.

IV. Three Styles of “Industrial Policy”

Succinctly put, there is Chinese-, Indian-, and American-style industrial policy. Table 13-1 summarizes them. The tools of that policy differ, which is to be expected given the different relationships of government to factors of production. But at least one policy instrument is the same: the financial contribution of benefits conferred by a government or government-like authority to specific enterprises of industries.

At some point, when that instrument – subsidies – is manifest so openly, in coordination with the other tools, the non-traditional planned economy, which had long prided itself on free markets, becomes an industrial policy ecosystem. International trade becomes about framing supply chain management within that policy.

In command (Communist/Socialist) economies (China), where there is public ownership of the means of production (land, labor, human capital, physical capital, and technology) through the government (Chinese Communist Party), the policies include centralized input-output planning, wage and foreign exchange rate management, and sectors designated as restricted or off limits to foreign direct investment (FDI). Tariff and non-tariff barriers are high in keeping with import substitution. State owned enterprises are commonplace, some of which are national champions. Direct and indirect subsidies are pervasive. Even in private sector spaces, governmental influence is exercised through, for example, placement of officials on boards of directors or in the ranks of senior management.

In mixed (Socialist/Mixed) economies (India), the government occupies the commanding heights of manufacturing and service supply, not so much through outright

⁴⁸⁰ *Independence Day Speech* (also noting the 11% figure had “come down from previous years, when it was even higher,” and that encouragement from the U.S. and its Allies that India lessens its dependence on Russian-origin arms, amidst the war in Ukraine, was a factor motivating India’s policy).

state-owned enterprises (many of the SOEs have been privatized since the 1980s), but through long-standing plutocratic networks of policymakers and industrialists. National champions predominate certain markets. Five-year plans are centrally produced. They are accompanied by FDI equity limits. Import substitution is favored through high tariffs and NTBs (including for India's post-Partition history until the 1991 First Generation Reforms, licensing requirements), and supervision of foreign exchange markets. Direct and indirect subsidies are commonplace.

These dimensions of Indian industrial policy have not necessarily served the country well. As the *Financial Times* summarized:

Multinationals wanting to reduce their geopolitical vulnerability are on the hunt for the “plus one” in a “China plus one” production strategy – or increasingly, as tensions rise between Washington and Beijing, a “China plus one, minus China.”

India, especially given last year's [2022] big expansion in high-end Apple iPhone production, is an obvious contender. It's low-cost, English-speaking and has a substantial domestic market. Prime Minister Narendra Modi presents himself as an enthusiastic globalizer, and has signed or is negotiating bilateral trade deals with the UAE, Australia, the U.K. and the EU. His “Make in India” strategy, launched in 2014, aims to replicate the success of multiple east Asian countries creating globally competitive manufacturing and lifting millions out of poverty.

The reality is less impressive. India has already had a decade of opportunity to scoop up the industrial production leaving China. It has performed poorly, and its trade and investment policy is regressing towards unhelpful Indian traditions of protectionism and import substitution.

...

... [U]nhelpfully, India is more concerned about the competitive threat from China than it is enticed by the possibilities of taking a bigger role in the Asian supply network. ...

India, whose industrial lobby was concerned about being hollowed out by Chinese competition, considered but ultimately balked at joining *RCEP*. It preferred instead to imagine it could create supply chains within India for export to rich markets, especially Europe. To that end, the Modi government adopted a philosophy of *Atmanirbhar Bharat* (“self-reliant India”). It reached into the familiar tool bag of Indian industrial policy and pulled out a series of domestic subsidies to favored industries, including telecoms, electronics and pharmaceuticals, plus higher tariffs to give companies protection from foreign competition.

India's attempts to build competitive manufacturing have not inspired confidence. Arvind Subramanian, ... former Chief Economic Adviser to the

Indian government, points out that well before the Trump-Biden trade conflict with Beijing, rising Chinese costs and wages were pricing out labor-intensive manufacturing and creating opportunities for other countries.

Subramanian calculates that in the decade or so since the global financial crisis, China gave up about \$150 bn of global market share in labor-intensive goods, of which India attracted no more than 10 per cent. Unlike fellow lower-middle-income countries Vietnam and Bangladesh, and even upper-middle-income Turkey, whose export-oriented electronics and garment industries have expanded hugely, the share of manufacturing in the Indian economy actually declined over that period.

Clothing and shoes, ceramics, leather goods, furniture – these are all mass-employment, labor-intensive manufacturing industries in which India ought to specialize. But raising tariffs to deter imported inputs means it struggles to be competitive in global supply networks. When China and Vietnam began their textiles and clothing export booms, respectively in the mid-1990s and the mid-2010s, foreign inputs made up more than 40 per cent of their exports. For India in 2015 the equivalent number was just 16 per cent.

India tries to do too much at home, which means it's not sufficiently competitive to sell enough abroad. ...⁴⁸¹

In other words, query whether India has forged an industrial policy that position the country well to take advantage of MNCs decoupling from China amidst the Sino-American Trade War. Is India's industrial policy altogether too insular?

⁴⁸¹ Alan Beattie, *Insular India's Exporters Will Struggle to Fill Chinese Shoes*, FINANCIAL TIMES, 1 March 2023, www.ft.com/content/6b5cee30-3e30-4208-a5ed-fabf27a25cce?shareType=nongift.

Table 13-1
Chinese-, Indian-, and American-Style Industrial Policy

	<i>China</i>	<i>India</i>	<i>U.S.</i>
<i>Nature of Economy</i>	Command Communist/Socialist	Mixed Socialist/Market	Private Capitalist
<i>Ownership of Means of Production (Land, Labor, Physical Capital, Human Capital, and Technology)</i>	Public	Public/Private	Private
<i>Is “Industrial Policy” Declared Explicitly?</i>	Yes	Yes	No
<i>Distinctive Interventionist Policies</i>	Central input-output planning SOEs Government officials participate on private entity boards or in senior management Wage management	Central planning SOEs Plutocratic networks of policymakers and private sector officials exist	Private sector advisory committees and public-private partnerships Government procurement, contracting to military-industrial complex companies Favoritism of domestic national champions
<i>Common Interventionist Policies</i>	Subsidies Foreign equity caps on certain types of FDI High tariffs and non-tariff barriers Foreign exchange management Price and wage management	Subsidies Foreign equity caps on certain types of FDI High tariffs and non-tariff barriers Foreign exchange management	Subsidies Review of proposed foreign equity investments in certain sectors Export controls

The common framework means governments of Capitalist economies (*e.g.*, U.S.) seek what those of other types of economies want: reliable supply chains on strategic goods and services. Geopolitical tensions (*e.g.*, Kashmir, Senkaku Islands, South China Sea, Taiwan) plus public health emergencies (*e.g.*, COVID) convince these governments supply chains that lie too far offshore are unreliable.

Hence, Capitalist governments become more legislatively aggressive, and draw on more Executive branch powers, to onshore supply, or at least friend-source it (*e.g.*, in Mexico and Vietnam), and decouple it from elsewhere (*e.g.*, China and Russia). The just-announced U.S.-Taiwan “21st Century Trade Initiative” negotiations is a case in point of deepening mutual trade and investment ties, and promoting sound labor and environmental practices, which inevitably will decouple the two long-time friends further from China (which “firmly opposes” the deal) and facilitate enforcement of another Biden bill that could have been Trump’s, the *Uyghur Forced Labor Prevention Act* (discussed in a separate Chapter).

However, as distinct from the first type of economy, here the private sector space is relatively larger and enjoys room for decentralized decision-making. Hence, interventionist measures are not economy-wide, but targeted to infrastructure (*e.g.*, especially energy, and transportation), strategic industries (*e.g.*, steel) and services (*e.g.*, banking and telecommunications).

In these first two types of economies, the term “industrial policy” is not foul language. In the third type – Capitalist – it is among conservative politicians in some of them (U.S.), but not generally in the political class of others (Canada, EU).

And yet, across Capitalist economies, where the means of production are privately owned, there are FDI equity limits in strategic sectors and/or review of proposed FDIs in those sectors. Though tariffs and NTBs are low, export controls are pervasive with respect not only military goods, but also dual civilian-military use items. Private sector advisory boards advise the government, and public-private partnerships collaborate, on trade-related topics. Government procurement is directed toward favored military-industrial complex companies, which results in the creation an/or affirmation of domestic national champions. That direct and indirect subsidies are commonplace is evidenced from the legal reality that the governments of these countries frequently sue (in the WTO) each other over them, just as they do against the first two categories.

V. 2022 U.S. IRA and EU Response

The U.S. *Inflation Reduction Act (IRA)* is a case in point of America’s use of subsidies that triggered a potentially adversarial response from the EU.⁴⁸² Signed by President Biden in August 2022, the IRA (*inter alia*) was the “most aggressive action on

⁴⁸² See H.R. 5376 – *Inflation Reduction Act of 2022*, 117th Congress (2021-2022), Public Law 117-169, 136 Stat. 1818-2090, (16 August 2022), www.congress.gov/bill/117th-congress/house-bill/5376/text and www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

tackling the climate crisis in American history.”⁴⁸³ It aimed to “lift up American workers and create good-paying, union jobs across the country ... to help reduce emissions across every sector of” the American economy.⁴⁸⁴ The specific measures – Energy Security and Climate Change Programs totaling \$369 billion – to do so included:

Create Clean Energy Jobs:

Incentivize prevailing wages. The expanded tax credits for energy efficient commercial buildings, new energy efficient homes, and electric vehicle (EV) charging infrastructure will include bonus credits for businesses that pay prevailing wages and hire registered apprentices, ensuring local wages are not undercut by low-road contractors.

Stop companies from ripping off workers. It will penalize companies that promise to pay prevailing wages but don’t follow through, and workers who are owed prevailing wages will receive the difference, plus interest.

Make it in America. For the first time ever, the *Inflation Reduction Act* establishes Make it in America provisions for the use of American-made equipment for clean energy production. The law provides expanded clean energy tax credits for wind, solar, nuclear, clean hydrogen, clean fuels, and carbon capture, including bonus credits for businesses that pay workers a prevailing wage and use registered apprenticeship programs.

...

Revitalize American Manufacturing:

Build American clean energy supply chains, by incentivizing domestic production in clean energy technologies like solar, wind, carbon capture, and clean hydrogen.

Support American workers with targeted tax incentives aimed at manufacturing U.S.-sourced products such as batteries, solar, and offshore wind components, and technologies for carbon capture systems.

Strengthen America’s manufacturing base. The *Inflation Reduction Act* promotes domestic sourcing and American jobs. For example, clean energy tax credits are increased if the amount of American steel used in wind projects meets the domestic content threshold, and bonus credits apply to employers who use of prevailing wages and apprenticeships, ensuring that federal tax policy supports good-paying, high-skilled jobs.

⁴⁸³ The White House, *Fact Sheet: The Inflation Reduction Act Supports Workers and Families* (19 August 2022), www.whitehouse.gov/briefing-room/statements-releases/2022/08/19/fact-sheet-the-inflation-reduction-act-supports-workers-and-families/. [Hereinafter, August 2022 *IRA Fact Sheet*.]

⁴⁸⁴ August 2022 *IRA Fact Sheet*.

Create good-paying union jobs in energy communities. Clean energy tax credits will be increased by 10% if the clean energy projects are established in communities that have previously relied upon the extraction, processing, transport, or storage of coal, oil, or natural gas as a significant source of employment, creating jobs and economic development in the communities that have powered America for generations.⁴⁸⁵

It was not the *IRA* aim of fighting climate change that attracted the ire of the EU; it was relieved America finally had enacted legislation to meet its internationally agreed commitments (discussed in a separate Chapter) to fight climate change.

Rather, it was the bald-faced, America First favoritism of the above-listed Energy Security and Climate Change Programs that the EU criticized. So, in response:

[the] EU relaxed state aid measures, allowing member states to match subsidies if there is a risk of investment being diverted from the bloc.

The U.S.’s *Inflation Reduction Act*, ... includes \$369 bn worth of tax credits, loans and grants designed to stimulate clean technology investment and meet President Joe Biden’s goal of halving U.S. carbon emissions by 2030.

But the scale of subsidies has prompted fears of a new trade war, with President Emmanuel Macron of France warning that the *IRA* threatened to “fragment the west.”

Europeans have also been alarmed by what they perceive to be an aggressive push by U.S. States to lure investment from the EU, including hefty subsidies for companies moving manufacturing to the country.⁴⁸⁶

The EU’s legal position was the *IRA* ran afoul of the national treatment commitments under GATT, and its measures were Red and/or Yellow Light subsidies under the *SCM Agreement*. Because these violations were so severe, they risked a Trans-Atlantic subsidies war when, as a policy matter, the U.S. and EU should collaborate to develop climate change adaptation and mitigation measures.

However, with a deeply polarized Congress, how else could the Biden Administration enact controversial legislation without promising jobs in key districts? Early evidence indicated the promise – in effect, a “new industrial revolution” – might be fulfilled.⁴⁸⁷ By March 2023, companies had “committed more than \$200 bn to U.S.

⁴⁸⁵ August 2022 *IRA Fact Sheet*. (Emphasis original.)

⁴⁸⁶ Derek Brower, *U.S. Energy Secretary Offers Olive Branch to EU in Green Subsidies Row*, FINANCIAL TIMES, 10 March 2023, www.ft.com/content/22f83d2b-4f91-4012-99a1-638ff6dedbeb?shareType=nongift.

⁴⁸⁷ Amanda Chu & Oliver Roeder, *U.S. Manufacturing Commitments Double after Biden Subsidies Launched*, FINANCIAL TIMES, 16 April 2023, www.ft.com/content/b1079606-5543-4fc5-acae-2c6c84b3a49f?shareType=nongift. [Hereinafter, *U.S. Manufacturing Commitments Double*.]

manufacturing projects,” with “investment in semiconductor and clean tech investments ... almost double the commitments made in the same sectors in the whole of 2021, and nearly 20 times the amount in 2019...,” before the *IRA* and *CHIPS Act* were passed.⁴⁸⁸ Notably, though two-thirds of the commitments came from U.S. companies, one-third of them came from firms with headquartered overseas (especially, Japan, Korea, and Taiwan).⁴⁸⁹ That suggested a trade and FDI diversion effect of the legislation – and possibly legal friction with some other traditional Allies, such as the EU, worried about that effect.

VI. Is “Industrial Policy” a Pejorative Term?

The American business community, and some politicians they support, tend to be chary of “industrial policy.” Central planning, they fear, smacks of Socialist or Communist central planning. China is a case in point, with a 2014 plan to boost its semiconductor industry and reduce dependence on American imports.⁴⁹⁰ Semiconductors are part of the infrastructure of a modern economy, as they are needed (*inter alia*) for cell phones, self-driving cars, and defense goods. Its measures include subsidies for investment, jawboning customers to buy from Chinese suppliers, and even compelling semiconductor technology transfer from foreign companies in exchange for permission to enter the Chinese market. Stealing trade secrets also allegedly occurs, and indeed is one of the claims the U.S. made in its 2018 Section 301 case against China (discussed in a separate Chapter).

U.S. companies and conservative policymakers prefer legislative reform of factors that undermine the global competitiveness of American industrial producers, such as high corporate tax rates, excessive regulation, and increased health care and pension costs. Yet, Germany and Japan have integrated manufacturing strategies, neither is a Socialist country, both are home to globally competitive industries (*e.g.*, Germany is a world leader in solar panel production), and both enjoy a more balanced trade relationship with China than the U.S. can claim.

VII. 2021 *USICA* and 2022 *CHIPS Act* Overview

● Legislative Efforts

Still another dimension of industrial policy is targeting support for strategic sectors in competition with adversaries. Semiconductors and China, respectively, are a case in point. Consider the following facts about 2021 legislative efforts to respond to China amidst great power competition (discussed in a separate Chapter).⁴⁹¹ Many proposals smacked of “industrial policy,” though several legislators avoided the term:

⁴⁸⁸ *U.S. Manufacturing Commitments Double.*

⁴⁸⁹ *U.S. Manufacturing Commitments Double.*

⁴⁹⁰ See Executive Office of the President, President’s Council of Advisors on Science and Technology (PCAST), Report to the President – Ensuring Long Term Leadership in U.S. Semiconductors (January 2017), www.whitehouse.gov/sites/default/files/microsites/ostp/PCAST/pcast_ensuring_long-term_us_leadership_in_semiconductors.pdf.

⁴⁹¹ For a discussion of semiconductor subsidies, WTO rules, and efforts to discipline such subsidies, see Ambassador Alan Wm. Wolff, *International Cooperation in the Semiconductor Sector During a Period of Intensified Official Support – A Presentation to Representatives of the Governments and Authorities of*

Faced with an urgent competitive threat from China, the Senate is poised to pass the most expansive industrial policy legislation in U.S. history [the *USICA*, which it approved in June 2021], blowing past partisan divisions over government support for private industry to embrace a nearly quarter-trillion-dollar investment in building up America's manufacturing and technological edge.

...

It is an especially striking shift for Republicans, who are following the lead of former President Donald J. Trump and casting aside what was once their party's staunch opposition to government intervention in the economy. Now, both parties are embracing an enormous investment in semiconductor manufacturing, artificial intelligence research, robotics, quantum computing and a range of other technologies.

And while the bill's sponsors are selling it in part as a jobs plan, the debate over its passage has been laced with Cold War references and warnings that a failure to act would leave the United States perilously dependent on its biggest geopolitical adversary.

Around the globe, authoritarian governments smell blood in the water," Senator Chuck Schumer, Democrat of New York and the majority leader, warned in a recent speech on the Senate floor. "They believe that squabbling democracies like ours can't come together and invest in national priorities the way a top-down, centralized and authoritarian government can. They are rooting for us to fail so they can grab the mantle of global economic leadership and own the innovations."

Mr. Schumer and the bill's other sponsors have steered clear of the phrase "industrial policy," knowing that would revive a 30-year-old debate about whether the government was picking winners and losers, or championing certain industries over others. That argument goes back to the days of the Reagan Administration, when the biggest threat to America's semiconductor and auto industries seemed to be Japan, and the federal government started some small-scale initiatives, including one called Sematech, to reinvigorate the semiconductor industry. (The Federal government's participation in Sematech ended a quarter-century ago.)

In an interview on Friday, Mr. Schumer pushed back on the idea that the United States was seeking to back industrial champions, as China does.

China, Chinese Taipei, the European Union, Japan, Korea and the United States, and of Their Respective Semiconductor Industries at The Governments and Authorities Meeting on Semiconductors (GAMS) and the World Semiconductor Council (WSC) and its Joint Steering Committee (JSTC), Peterson Institute for International Economics (PIIE) (Nagano, Japan, 18 October 2022), www.piie.com/sites/default/files/2022-10/2022-10-18-wolff.pdf.

“Industrial policy means we’re going to pick Ford and give them money,” he said.

“This means we’re going to invest in quantum computing or A.I. or biomedical research, or storage, and then let the private sector take that knowledge and create jobs,” Mr. Schumer said, adding later: “These are the areas of dominance that we need research in, and these are the areas of potential industrial growth; great job growth.”

One difference from the debate in the 1980s is that Japan is both an industrial competitor and a military ally. China, of course, is a rising geopolitical rival, and that has changed the nature of the debate. No one argued in the 1980s that Japan would use its largest companies as a tool for surveillance or a potential weapon of war; that is exactly the concern about China.

...

What is most striking about the legislation is the degree to which the projects that the bill funds closely parallel those in China’s “Made in China 2025” program, which funnels huge government spending into technologies where the country is seeking to be independent of outside suppliers. The Chinese government announced its initiative six years ago.

...

While some Republicans have balked at the bill’s costs – a \$52 billion subsidy program for the country’s semiconductor firms and another \$195 billion in scientific research and development – most are still signing on. And that has created concerns that the legislation, a classic Washington mash-up of other bills that has grown to more than 2,400 pages, may be longer on cash than real strategy.

Mr. Schumer rejected that contention in the interview.

“When the government invests in pure forms of research, down the road it creates millions of jobs,” he said, citing investments in the National Institutes of Health and the National Science Foundation.

His Republican co-sponsor, Senator Todd Young of Indiana, argues that the ideological orthodoxies of his party have been swept away by the realities of how China funds its “national champions” like Huawei, the telecommunications giant that is wiring nations around the world with 5G networks capable of directing traffic back to Beijing.

“We can’t be wedded to old doctrines and shibboleths,” Mr. Young said in an interview. “The world has changed. Our economy has changed. The needs of our country have changed.”

...

The bill is gaining support after years in which the United States has objected to government subsidies for private industry – whether it was Airbus in France or Huawei in China.

“We’re making an attempt to punish China and their bad industrial policies,” said Sage Chandler, the vice president of international trade at the Consumer Technology Association, a trade group. “But rather ironically, we punish them and then start to copy exactly what they’re doing in a number of ways.”

...

Some of the funding in the bill would go toward persuading foreign semiconductor manufacturers to open facilities in the United States – and approach similar to one taken by China, but in which it has made comparatively little progress.⁴⁹²

Simply put, there was bipartisan support to adopt big-money measures to respond to economic, political, and military challenges posed by China, bipartisan support that the Federal government be significantly involved in planning and implementing these measures, and bipartisan denial of what the measures represented.

The high-tech sector, and particularly semiconductors, were particularly targeted for this support, given not only the widespread use of chips in military and dual-use items, but also the diminution in America’s comparative advantage in them: in 2022, the U.S. held a 12% share of global semiconductor production, a drop of 25 percentage points across the previous 30 years.⁴⁹³ So, consider the nuanced verdict by Bloomberg that *USICA* was:

... a major breakthrough in American economic policy. China has succeeded where many economists and policymakers have failed: It convinced an ideologically paralyzed Washington that the state can play a positive role in economic progress. U.S. politicians used to believe that. Taxpayer cash helped build the Transcontinental Railroad, the Interstate Highway System, and the U.S. semiconductor industry. But since the Reagan Revolution, metaphysical certitude in the free market has dominated policymaking, and state investment in the economy has withered. Anyone who has recently navigated the crumbling New Jersey

⁴⁹² David E. Sanger, Catie Edmondson, David McCabe & Thomas Kaplan, *Senate Poised to Pass Huge Industrial Policy Bill to Counter China*, THE NEW YORK TIMES, 7 June 2021, www.nytimes.com/2021/06/07/us/politics/senate-china-semiconductors.html?referringSource=articleShare. The specific legislation referenced above is discussed in a separate Chapter. See also Daniel Flatley, *Senate Passes Sweeping Bill to Help U.S. Compete With China*, Bloomberg, 8 June 2021, www.bloomberg.com/news/articles/2021-06-08/senate-passes-sweeping-bill-to-help-u-s-compete-with-china?sref=7sxn9Sxl (quoting Senator Pat Toomey (Republican-Pennsylvania), who voted against the *USICA*: “Maintaining our technological superiority over China requires punishing bad Chinese behavior and relying on the natural innovative entrepreneurship of America’s market economy, not by imitating Chinese central planning.”).

⁴⁹³ Kosuke Shimizu, *CHIPS Act Will Help Boost Semiconductor Investment in Mexico: Official*, NIKKEI ASIA, 14 August 2022, <https://asia.nikkei.com/Editor-s-Picks/Interview/CHIPS-Act-will-help-boost-semiconductor-investment-in-Mexico-official>. [Hereinafter, *CHIPS Act Will Help Boost*.]

Turnpike understands the consequences. Yet despite these obvious detriments, many politicians have insisted that every and any economic problem can be solved with a tax break.

Now the state is back. ... Such lofty, state-promoted goals represent a significant shift from the notion that man cannot outthink the market. Some diehard conservatives may squirm, but thanks to China, the ideological tide is turning against them.

This shift in U.S. policy reveals China's growing influence in the global economy. Its power has already been felt in trade and technology; now it is entering the critical realm of ideas. For much of the past two centuries, China has borrowed them from the Western powers – everything from constitutions to dating habits. Modern China is built to a great degree on the imported philosophies of Marxism and Capitalism. When China opened to the world in the 1980s and introduced free-market reforms, its policymakers were heavily influenced by Western economists and economic theory.

Now the flow is beginning to reverse. President Xi Jinping's administration has generally spurned calls for deeper market liberalization in favor of greater state control. Policymakers around the world, meanwhile, have watched China's astronomical ascent and figured Beijing has concocted some kind of special sauce to promote prosperity – a recipe worth copying. The Senate bill is a result.

Although China has reminded the U.S. that government action isn't all bad, its example also warns against too much of it. The free-market guys are right that state intervention can distort as well as develop. Despite persistent American fascination with Asian state-led industrial policies going back to the 1970s, their beneficial effects have often been exaggerated.

In Japan, where government ministries tried to “pick winners” and nurture them with protection and financing, the record is, at best, spotty, with a long list of failures as well as successes. ...

China's extensive state programs also expose the deep downside to intrusive bureaucrats. Government support may have accelerated the development of certain industries, such as solar panels and electric cars, but it also generated tremendous excess capacity and waste, and produced uncompetitive companies. ... Many of the country's most severe economic problems – its high debt, low productivity, property bubbles, and endemic corruption – can be traced to the overly heavy hand of the Chinese state. And the verdict is still out on its current batch of industrial policies. It's not at all clear that expensive efforts to create world-beating technologies will

succeed. Despite much energy and many billions, China remains as dependent on imported chips as ever.

A better approach for the U.S. is to avoid the penchant of Chinese technocrats to target certain industries and national champions in favor of setting broad goals that can reshape the economy and its direction. ... Perhaps we should thank China twice over, for alerting us not only to the potential economic benefits of state intervention but also to its dangers. As Clyde Prestowitz, author of the book *The World Turned Upside Down: America, China, and the Struggle for Global Leadership*, wrote ...: “It is a case of the Chinese putting too much faith in the state and the U.S. too little.” Both sides have a lot to learn.⁴⁹⁴

Likewise, consider the pronouncements of the *Financial Times*:

[A] Hamilton Center on Industrial Strategy ... index tallied national change in global share of output in seven key industries (pharmaceuticals, chemicals, electrical equipment, machinery, cars, other transport, computers and electronics, and information technology) across 10 countries between 1995 and 2018 (the last year for which OECD data were available). It found that *while America remained strong in areas such as pharma, software, and non-auto transport (which was mostly about Boeing), its performance in the other sectors was “weak and declining” when measured by both global market share and the size-adjusted global average. The U.S. now ranks 6 per cent below that average.*

This is a huge problem since these types of advanced manufacturing industries make up the majority of business R&D and also drive national productivity growth and investment. No wonder other countries, from Germany (which has a share of advanced industry 74 per cent above the global average), to Japan (43 per cent above), China (34 per cent), South Korea and Taiwan have all opted to protect such industries in ways the U.S. does not. They have done this not with wasteful subsidies or failed policies such as, say, import substitution, but by putting the laser focus of both the public and private sectors on high-growth industries at crucial times, in ways that the markets (which look for short-term gains, particularly in countries such as the U.S. and U.K.) aren't always incentivized to do.

It can, for example, take \$20 bn to build a single new semiconductor fabrication plant, with the cost doubling every two to four years across new product generations. No single private actor is likely to take on such a cost. Most countries that care about advanced manufacturing subsidize 40 to 50 per cent of upfront costs for the companies that are ready to make

⁴⁹⁴ Michael Schuman, *Thank Beijing for Overdue Changes to U.S. Economic Policy*, BLOOMBERG, 15 June 2021, www.bloomberg.com/news/articles/2021-06-16/u-s-senate-china-bill-addresses-overdue-economic-policy-changes?sref=7sxn9Sxl.

investments of that length and magnitude.... But in the U.S., Congress has yet to pass and fully fund a bill to underwrite semiconductor production, itself a high-growth strategic industry that fuels all the others. Why would this be, given the fragilities in the market system illuminated in recent years?

One reason is there are still some conservatives that believe the state should have no role in the market. As Rob Atkinson, head of the International Technology and Innovation Foundation, which publishes the Hamilton index, puts it, they are afraid to “cross the Rubicon of acknowledging that markets aren’t working as well as they should – once you do that, you are in a whole new world.” Some neoliberal economists likewise want to go back to using lower consumer prices as the sole measure of economic policy success.

But among most Democrats and even some Republicans there is a sense that the government does have a role to play in supporting national competitiveness and resiliency. The question is how. Should it focus mainly on skill building? Should it expand the ways in which federal budgets are used to support domestic demand? Should it use fiscal policies to smooth price volatility? ...

Certainly, the supply chain disruptions of the past few years have added to the debate. “When you look at the origin of manufacturing value added in final demand, the U.S. is more reliant on overseas inputs than, say, China,” says Eric Chewning, a McKinsey Partner who says the U.S. has plenty of room to grow its domestic sourcing. He points out that *the U.S. meets just 71 per cent of its final demand with regional goods; in Germany, the number is 83 per cent, Japan stands at 86 per cent and China at 89 per cent.*

Achieving parity could add \$400 bn to U.S. gross domestic product, even before considering the market opportunities of products such as electric vehicles or advanced biotech innovations like, say, gene therapy. ...⁴⁹⁵

In sum, does government have “a still bigger role to play” through *USICA*-like legislation? And, notwithstanding any political allergy to the term “industrial policy,” is the breadth and depth of market intervention, as Shakespeare would put it, a rose by any other name, still a rose – industrial policy – with the caveat that not all roses are the same color?

The answer to these questions would seem to be “yes.” That answer is further confirmed by excerpts below from two superb summaries of the *CHIPS Act*. Through financial incentives to a restricted class of beneficiaries, the *CHIPS Act* aimed to boost investment in America’s semiconductor industry, while also protecting its national security. (DOC began accepting applications for assistance on 31 March 2023 for leading-

⁴⁹⁵ Rana Foroohar, *America Must Do More In The Trade Tug of War*, FINANCIAL TIMES, 12 June 2022, www.ft.com/content/72309a1a-9ca6-4547-afe8-34f35aeefa7?shareType=nongift. (Emphasis added.)

edge manufacturing facilities, and on 26 June 2023 for current-generation, mature-node, or back-end manufacturing facilities.)

- **Five Points**

In perusing the summaries, note the following five key points:⁴⁹⁶

(1) Levels of Support:

Overall, *CHIPS Act* support was significant: \$39 billion in direct funding, plus \$75 billion in loans and loan guarantees that could be used for (a) construction, expansion, or modernization of a domestic semiconductor manufacturing facility equipment therein, (b) workforce development for a domestic semiconductor manufacturing facility, and (c) reasonable operating expenses for a domestic semiconductor manufacturing facility.

(2) National Security Guardrails:

To protect U.S. national security the *CHIPS Act* imposed two restrictions on beneficiaries of funding. First, beneficiaries were forbidden from investing in advanced semiconductor manufacturing in foreign countries of concern for 10 years. Second, they could not “engage in national security-adjacent joint research or technology licensing efforts with a foreign entity of concern.”⁴⁹⁷

The first restriction ensured investments were located in the U.S., and thus domestic companies and workers benefitted from the funding. The second restriction aimed to prevent leakage of technology to suspect foreign parties.

To enforce both restrictions, the *CHIPS Act* contained a “claw back” rule: the DOC could take (claw) back the full amount of the funds that had been bestowed to the beneficiary, plus interest.

(3) Clarifying Ambiguities

The *CHIPS Act* legislation did not define certain key terms; rather, it left to DOC the task of articulating them. Indeed, it was up to DOC to determine precisely “which semiconductor technologies are critical to national security and cannot be exported to foreign companies of concern by program participants.”⁴⁹⁸ Among the

⁴⁹⁶ See Maria Alejandra (Jana) del-Cerro, Jeremy Iloulian, Byron R. Brown & Kelsey Clinton, Crowell & Moring LLP, *Proposed Rule from Commerce on National Security Guardrails for CHIPS Act Funding: Restrictions on China and other Countries of Concern*, Alerts & Newsletters, (29 March 2023), www.crowell.com/NewsEvents/AlertsNewsletters/all/Proposed-Rule-from-Commerce-on-National-Security-Guardrails-for-CHIPS-Act-Funding-Restrictions-on-China-and-other-Countries-of-Concern. [Hereinafter, *Proposed Rule from Commerce on National Security Guardrails*.]

⁴⁹⁷ *Proposed Rule from Commerce on National Security Guardrails*.

⁴⁹⁸ *Proposed Rule from Commerce on National Security Guardrails*.

knotty questions was how to deal with an applicant for funding that had operations or affiliated companies in China, because the *CHIPS Act* prohibited:

funding recipients or their “affiliates” from engaging in “significant transactions” involving the “material expansion” of “semiconductor manufacturing capacity” in a foreign country of concern (*i.e.*, China, Russia, Iran, or North Korea) for 10 years, once the funding agreement is finalized.⁴⁹⁹

So, in its March 2023 Proposed Rule, DOC scripted the undefined parameters.⁵⁰⁰ For example, DOC said:

“Affiliate” means any direct or indirect subsidiary, parent, or affiliate (it shares a common parent of the funding recipient) of the funding recipient. Each is determined based on a 50% voting ownership threshold.

“Significant transaction” means transactions with an aggregate monetary value of \$100,000 or more. This can include mergers, acquisitions, or takeovers (*e.g.*, or consolidations, joint ventures, long-term leases) or any other investments (*e.g.*, capital expenditures, formations of subsidiaries).

“Material Expansion” means when the significant transaction has either the purpose or the effect of expanding an existing facility’s production capacity, in the aggregate, by more than five (5) percent, compared to that facility’s product when the funding agreement was finalized.

“Semiconductor Manufacturing Capacity” means semiconductor fabrication and/or packaging, and includes both front-end fabrication as well as back-end manufacturing (assembly, testing, and packaging of semiconductors).⁵⁰¹

Also, by way of example, with respect to the national security guardrail concerning “joint research” and “technology licensing” with a “foreign entity of concern,” DOC proposed the following definitions:

“Joint Research” means any research and development undertaken by two or more persons.

⁴⁹⁹ *Proposed Rule from Commerce on National Security Guardrails.*

⁵⁰⁰ See U.S. Department of Commerce, National Institute of Standards and Technology, *Preventing the Improper Use of CHIPS Act Funding*, 88 Federal Register number 56, 17439-17450 (23 March 2023), www.govinfo.gov/content/pkg/FR-2023-03-23/pdf/2023-05869.pdf.

⁵⁰¹ *Proposed Rule from Commerce on National Security Guardrails.*

“Technology Licensing” means an agreement to make patents, trade secrets, or know-how available to another party.

“Foreign Entity of Concern.” This term was already defined to include “foreign entities” (i) on the SDN List administered by Treasury, (ii) designated foreign terror organizations, (iii) having been convicted under a number of U.S. espionage, export control, and sanctions laws, or (iv) owned by, controlled by, or subject to the jurisdiction or direction of the Chinese, Russian, Iranian, or North Korean governments or political parties.

... [P]ersons described in (iv) include persons that are (a) citizens, nationals or residents of that country; (b) persons organized under the laws or has its principal place of business in that country; (c) at least 25% of that person’s voting interest is held by that government or political party.

[Also included in the definition of “foreign entity of concern” were]: persons on Commerce’s Entity List, Treasury’s Chinese Military Industrial Complex Companies (“CMIC”) List [discussed separately herein], and persons on the FCC’s *Trusted Communications Network Act*.

“Technology or Product that Raises National Security Concerns” means any “semiconductors critical to national security” ..., or any item in Category 3 of the Commerce Control List that are controlled for “National Security” or “Regional Security reasons.” [The CCL is discussed in a separate Chapter.]

Manifestly, the definitions are intricate as they aim to exclude (*inter alia*) the transfer of benefits to any legal or natural person connected with the governments of China, Iran, North Korea, or Russia. Query, however, whether any of the terms could be over-inclusive, under-inclusive, or both?

(4) Exceptions

The *CHIPS Act* also gave DOC discretion to carve out certain exceptions to the national security guardrails. In its March 2023 Proposed Rule, DOC did so – one for limited investments in existing facilities, and one for new facilities that make legacy semiconductors.

Interestingly, to qualify for the legacy exception, the chips would have to “predominately serve[] the market,” “meaning 85% of the output (or more) of that facility will be incorporated into final products for use in China, Russia, Iran, or

North Korea.”⁵⁰² At the time of the Proposed Rule, the U.S. listed two types of semiconductors that qualified as “legacy:”

- (a) A digital or analog logic semiconductor that is of the 28-nanometer generation or older (*i.e.*, has a gate length of 28 nanometers or more for a planar transistor); and
 - (b) A memory semiconductor with a half-pitch greater than 18 nanometers for Dynamic Random Access Memory (DRAM) or less than 128 layers for Not AND (NAND) flash that does not utilize emerging memory technologies, such as transition metal oxides, phase-change memory, perovskites, or ferromagnetics relevant to advanced memory fabrication.⁵⁰³
- (5) Differences between subsidies and export controls:

On the one hand, *CHIPS Act* support is for less advanced logic semiconductors, namely, chips of 28 nm or larger in diameter. On the other hand, DOC’s October 2022 export controls (discussed earlier) govern chips of 14-16 nm. But, for both sets of measures, the parameters as to the performance of the chips are similar. Accordingly, subsidies and export controls work in tandem as tools of industrial policy.

W. SCOTT DOUGLAS, STEPHANIE L. CRAWFORD, LYNDASAY A. GORTON & BYRON R. BROWN, CROWELL & MORING LLP, *THE CHIPS ARE DOWN AND INCENTIVES FLOW AS CONGRESS ATTEMPTS TO VITALIZE THE U.S. SEMICONDUCTOR INDUSTRY, ALERTS & NEWSLETTERS (3 AUGUST 2022)*⁵⁰⁴

... [T]he United States Congress passed the \$280 billion *CHIPS and Science Act of 2022 (CHIPS Act)* [H.R. 4346] to bolster domestic semiconductor and microchip manufacturing in the United States. The bipartisan legislation will facilitate federal investments in the form of grants, loans, and loan guarantees to eligible entities and create significant business opportunities for companies in the U.S. The legislation also provides funding and new programs to boost advanced workforce training and research and development in a range of scientific and technology areas. ...

The legislation seeks to reverse the decades-long decline in U.S. microchip and semiconductor manufacturing and counter the rise of China as a source for technologically advanced manufacturing processes and products. By boosting domestic manufacturing and supply chains, the legislation also aims to relieve the global semiconductor shortage that has plagued manufacturers of a diverse set of products – everything from automobiles to

⁵⁰² Proposed Rule from Commerce on National Security Guardrails.

⁵⁰³ Proposed Rule from Commerce on National Security Guardrails.

⁵⁰⁴ www.crowell.com/NewsEvents/AlertsNewsletters/all/The-CHIPS-Are-Down-and-Incentives-Flow-as-Congress-Attempts-to-Vitalize-the-US-Semiconductor-Industry. (Footnotes omitted.)

children's toys – and has contributed to the nation's supply chain woes for more than two years.

The cornerstone of the legislation is \$52 billion that will be allocated to the U.S. Department of Commerce semiconductor initiative to develop and expand domestic manufacturing capacity. Implementation of that program was already underway at the Department of Commerce, following Congressional authorization in the Fiscal Year 2021 *National Defense Authorization Act* (FY21 *NDAA*), and the legislation [*i.e.*, *CHIPS Act*] ... provides the critical funding needed to commence direct federal incentives for the construction, expansion, or modernization of semiconductor manufacturing facilities.

Other features of the *CHIPS Act* include:

- (1) **Advanced Manufacturing Investment Credit:** U.S. semiconductor companies will also benefit from a new 25 percent tax credit for their investments in new and expanded domestic manufacturing of semiconductors, including costs of manufacturing specialized tooling equipment. Those credits will be provided for property placed into service after December 31, 2022, and for which construction begins before January 1, 2027. ... [The details of this credit are explained below.]
- (2) ... **GAO Semiconductor Reporting** [*CHIPS Act*, § 105]: The bill specifically enhances GAO's semiconductor reporting requirement established in the FY21 *NDAA* to (1) include an evaluation of potential government steps to avoid semiconductor shortages; (2) describe efforts taken to hire individuals from disadvantaged populations into the semiconductor workforce; and (3) detail how funded projects support critical infrastructure industries.
- (3) **Public Wireless Supply Chain Innovation Fund** [*CHIPS Act*, § 106]: The legislation provides another \$1.5 billion for the Department of Commerce to assist with 5G wireless deployment through its Public Wireless Supply Chain Innovation Fund, also created in the FY21 *NDAA*. That program seeks to provide 5G market access to additional U.S. vendors to diversify the domestic supply chain and decrease dependence on foreign supplies.
- (4) **Allocations for Identified Research Projects** [*CHIPS Act*, scattered Sections]: The legislation also authorizes investments of more than \$150 billion at the National Science Foundation (NSF), the Department of Commerce, the Department of Energy, and the National Institute of Standards and Technology (NIST) to bolster identified scientific research and programs.
- (5) **New NIST Authorities and Requirements** [*CHIPS Act*, Division B, Title II, Subtitle C]: The bill grants NIST new authorities but also tasks it with expanding or creating guidance and programs related to issues such as the lifecycle of software, artificial intelligence-enabled defense research,

biometrics identification, and sustainable chemistry, among other things. It also grants NIST other transactions authority allowing the agency to engage in more flexible contracting relationships with the private sector.

- (6) Supply Chain Database [*CHIPS Act*, § 10253]: The legislation tasks NSF with establishing a voluntary National Supply Chain Database, which is intended to assist the federal government and industry sectors in minimizing supply chain disruptions by having an assessment of U.S. manufacturers' capabilities.
- (7) Research Security [*CHIPS Act*, Division B, Title III, Subtitle D, Division B, Title VI, Subtitle D]: The bill provides for a new Office of Research Security and Policy and new Chief of Research Security at NSF. It further requires NSF to engage in various reporting, analyses, research, and mitigation of security risks to research, including establishing a university foreign funding reporting process with a reporting threshold of \$50,000 or more.
- (8) Clean Energy Incubator Program: The legislation establishes a competitive grant program within the Department of Energy to provide funding to support the commercialization of clean energy technology, a program to help coordinate technology transfers between entrepreneurs and DOE programs, and a program to provide entrepreneurs access to resources of DOE national laboratories.

Key Takeaways:

The *CHIPS Act* funds programs for research and development, manufacturing, and industry development in an effort to reduce supply chain vulnerabilities and foreign reliance. ...

IRINA PISAREVA, CROWELL & MORING LLP, *THE CHIPS BILL INTRODUCES NEW TAX CREDIT TO INCENTIVIZE U.S. SEMICONDUCTOR INDUSTRY, ALERTS & NEWSLETTERS (3 AUGUST 2022)*⁵⁰⁵

Background and Expected Impact: ... In furtherance of the broad goal of reducing U.S. reliance on foreign suppliers of semiconductor chips, the *Bill* [*CHIPS Act*] will add the Advanced Manufacturing Investment Credit (the “AMI Credit”) to the *Internal Revenue Code* (the “Code”).

The *CHIPS Bill* could produce more than \$20 billion in AMI Credit for the semiconductor industry. However, its expected value could be significantly reduced if the minimum corporate tax on book earnings [discussed in a separate Chapter] ... is enacted.

⁵⁰⁵ www.crowell.com/NewsEvents/AlertsNewsletters/all/The-CHIPS-Bill-Introduces-New-Tax-Credit-to-Incentivize-US-Semiconductor-Industry. (Emphasis added.)

General Explanation of Provisions: ... The AMI Credit for any taxable year is an amount equal to 25 percent of the qualified investment for such taxable year with respect to any advanced manufacturing facility of an eligible taxpayer. The AMI Credit is refundable; if a taxpayer elects in any taxable year, it will be treated as having made a payment against its income tax liability equal to the amount of the AMI Credit on the later of the due date of the return (determined without regard to the extensions), or the date on which the return is filed. This election is made on a year-by-year basis, and, once made for a taxable year, is irrevocable.

“Qualified investment” with respect to any advanced manufacturing facility is the basis of any qualified property placed in service by the taxpayer during the taxable year which is part of an advanced manufacturing facility.

“Qualified property” is defined as property which is tangible property with respect to which depreciation (or amortization in lieu of depreciation) is allowable, which is constructed, reconstructed, or erected by the taxpayer, or acquired by the taxpayer if the original use of such property commences with the taxpayer, and which is integral to the operation of the advanced manufacturing facility. Qualified property includes any building or its structural components which otherwise satisfy the above requirements with the exception of buildings or portions of buildings used for offices, administrative services, or other functions unrelated to manufacturing. The credit allowed under this section applies only to property the construction of which begins before December 31, 2026.

“Advanced manufacturing facility” is a facility with the primary purpose of manufacturing semiconductors or semiconductor manufacturing equipment.

“*Eligible taxpayer*” is any taxpayer which is not a foreign entity of concern as defined in section 9901(6) of the [FY21 NDAA] ..., and has not made an applicable transaction (as defined in Section 50(a) [of the Code]) during the taxable year. Under the [NDAA] ..., foreign entities of concern include entities:

- (1) designated as a foreign terrorist organization [FTO] by the Secretary of State under section 219 of the *Immigration and Nationality Act* (8 U.S.C. 1189);
- (2) included on the list of specially designated nationals and blocked persons maintained by the Office of Foreign Assets Control [OFAC]....;
- (3) *owned by, controlled by, or subject to the jurisdiction or direction of a government of China, North Korea, Russia, and Iran;*
- (4) alleged by the Attorney General to have been involved in espionage, economic espionage, and certain other criminal activities for which a conviction was obtained; or

- (5) determined by the Secretary of Commerce, in consultation with the Secretary of Defense and the Director of National Intelligence, to be engaged in unauthorized conduct that is detrimental to the national security or foreign policy of the United States under this [CHIPS] Act.

...

Basis reduction and recapture: The basis of qualified property will be reduced by the amount of AMI Credit claimed with respect to such property under the rules similar to the rules provided in Section 50(c) of the *Code*.

The claimed AMI Credit is subject to recapture in case the qualified property is sold or otherwise disposed of. The recapture provisions are based on the investment tax credit recapture rules of Section 50 [of the *Code*]. The *CHIPS Bill* also includes new recapture rules for certain expansions of advanced manufacturing facilities. *The new recapture provisions apply if a taxpayer, having claimed AMI Credit, materially expands semiconductor manufacturing capacity to China, North Korea, Russia, Iran, or other non-aligned countries identified as countries of concern under the [NDAA]....* This recapture provision would not apply if the taxpayer demonstrates to the satisfaction of the IRS that it ceased or abandoned the recapture-triggering transaction within 45 days of a determination and notice by the IRS.

...

Penalties: In the case of any AMI Credit payment amount treated as excessive, the tax imposed on such taxpayer for the taxable year in which such determination is made shall be increased by an amount equal to the sum of the amount of such excessive payment, plus an amount equal to 20 percent of such excessive payment. The penalty does not apply if the taxpayer demonstrates to the satisfaction of the IRS that the excessive payment resulted from reasonable cause.

...

[The DOC proceeded to issue two sets of rules – the first were export controls on sensitive chip technology, and the second were restrictions on recipients of *CHIPS Act* subsidies. Specifically, in September 2022, the DOC unveiled *CHIPS Act* guidelines that stated any U.S. company that received federal funding would “be barred from building ‘advanced technology’ facilities in China for 10 years.⁵⁰⁶ That is, under DOC regulations, “[c]hipmakers must agree not to expand capacity in China for a decade if they are to receive money from a \$39 billion federal fund designed to build a leading-edge U.S. semiconductor industry....”⁵⁰⁷ *CHIPS Act*-funded companies could “expand their mature node factories in China to serve the Chinese market,” but otherwise not use monies to invest in China and thereby develop leading-edge technologies in China, as doing so would compromise U.S. national security.⁵⁰⁸ In March 2023, DOC issued proposed rules “to prevent \$52 billion in

⁵⁰⁶ Monica Miller, *U.S. Bars “Advanced Tech” Firms from Building China Factories for 10 Years*, BBC NEWS, 7 September 2022, www.bbc.com/news/62803224. [Hereinafter, *U.S. Bars “Advanced Tech” Firms.*]

⁵⁰⁷ *U.S. CHIPS Act Fund Bars Chipmakers from China Expansion for 10 Years*, NIKKEI ASIA, 28 February 2023, <https://asia.nikkei.com/Politics/International-relations/US-China-tensions/U.S.-CHIPS-Act-fund-bars-chipmakers-from-China-expansion-for-10-years>.

⁵⁰⁸ *U.S. Bars “Advanced Tech” Firms* (quoting U.S. Secretary of Commerce Gina Raimondo). See also, The White House, *Press Briefing by Press Secretary Karine Jean-Pierre and Commerce Secretary Gina Raimondo*, 6 September 2022, www.whitehouse.gov/briefing-room/press-briefings/2022/09/06/press-

semiconductor manufacturing and research funding from being used by China and other countries deemed of concern.”⁵⁰⁹ The regulation prohibits recipients of U.S. incentive funds from (1) “investing in the expansion of semiconductor manufacturing in foreign countries of concern such as China and Russia,” and (2) “engaging in joint research or technology licensing efforts with a foreign entity of concern.”⁵¹⁰ Additionally, the regulation “classifies some semiconductors as critical to national security – defining these chips as not considered to be a legacy chip and, therefore, subject to tighter restrictions, namely, “chips ‘including current-generation and mature-node chips used for quantum computing, in radiation-intensive environments, and for other specialized military capabilities.’”⁵¹¹]

- **Overview of 2022 CHIPS Act DOC Guardrail Regulations**

On 25 September 2023, with effect on 24 November, DOC published its Final Rule on “*Preventing the Improper Use of CHIPS Act Funding*.”⁵¹² Predictably, this Rule:

... prohibit[ed] funding recipients from significantly expanding semiconductor manufacturing capacity in foreign countries of concern for 10 years. It also restrict[ed] recipients from some joint research or technology licensing efforts with foreign entities of concern, but allow[ed]

[briefing-by-press-secretary-karine-jean-pierre-and-commerce-secretary-gina-raimondo/](#) (in which Secretary Raimondo states: “Today, the United States consumes more than 25 percent of the world’s leading-edge chips and produces zero of those chips. ... [W]e want to build a sufficient and stable supply of mature node semiconductors. We consume 30 percent, produce 13 percent. We need to fix that. ... To achieve these goals, *CHIPS for America* will support three distinct initiatives. Two of those initiatives, which total \$39 billion, will make investments in domestic chip manufacturing here in the United States. First, we will make large-scale investments in leading-edge manufacturing. *CHIPS for America* will target approximately \$28 billion in manufacturing incentives to establish domestic production of leading-edge logic and memory chips that require the most sophisticated processes available today. Second, we will invest about \$10 billion in new manufacturing capacity for mature or current-generation semiconductors. This will help us increase domestic production across a range of chips, including the chips that are used in cars, medical devices, communication technology. And third and finally, we’re going to make historic investments to strengthen America’s research and innovation leadership. Eleven billion dollars ... this is not as talked about; we always focus on the incentives for the companies, but in many ways, this could be the most exciting piece of what we’re doing. Eleven billion dollars will go to research and development programs, including the creation of a National Semiconductor Technology Center. In terms of timeline, we expect to be in a position to receive application from companies no later than February of 2023. ... This is not a blank check for companies. ... There are clear guardrails on this money, and the Department of Commerce intends to be vigilant and aggressive in protecting taxpayers. ... We’re ... going to be implementing the guardrails to ensure those who receive *CHIPS* funds cannot compromise national security by – they’re not allowed to use this money to invest in China, they can’t develop leading-edge technologies in China, they can’t send latest technology overseas. ... Companies who receive *CHIP* funds can’t build leading-edge or advanced technology facilities in China for a period of 10 years. Companies who [*sic*] receive the money can only expand their mature node factories in China to serve the Chinese market.”).

⁵⁰⁹ David Shepardson, *U.S. Seeks to Prevent China from Benefiting from \$52 Billion Chips Funding*, REUTERS, 21 March 2023, www.reuters.com/technology/us-seeks-prevent-china-benefiting-52-billion-chips-funding-2023-03-21/. [Hereinafter, *U.S. Seeks to Prevent China from Benefiting*.]

⁵¹⁰ *U.S. Seeks to Prevent China from Benefiting*.

⁵¹¹ *U.S. Seeks to Prevent China from Benefiting*.

⁵¹² See 88 Federal Register number 184, 65600-65620 (25 September 2023), www.govinfo.gov/content/pkg/FR-2023-09-25/pdf/2023-20471.pdf.

for international standards, patent licensing, and utilizing foundry and packaging services.

The Final Rule[] prohibit[ed] material expansion of semiconductor manufacturing capacity for leading-edge and advanced facilities in foreign countries of concern for 10 years. It also clarifie[ed] wafer production is included within semiconductor manufacturing.

The Final Rule tie[d] expanded semiconductor manufacturing capacity to adding clean room or other physical space, defining material expansions as increasing production capacity by more than 5%.

The Rule prohibit[ed] recipients from adding new clean room space or production lines that result in expanding a facility’s production capacity beyond 10%.

The Rule also classifie[d] some semiconductors as critical to national security, triggering tighter restrictions, including quantum computing current-generation and mature-node chips, in radiation-intensive environments, and for other specialized military capabilities.⁵¹³

As explained (below) in detail by two distinguished practitioners, the Final Rule – as distinct from DOC’s March 2023 Proposed Rule – bore three hallmarks: (1) specific guardrails could be subject to negotiation; (2) the guardrails were broader than the *EAR*; and (3) the guardrails applied to a narrow group of affiliates under a common control.

So, first, the Final Rule allowed for negotiations between DOC and *CHIPS Act* funding recipients, thus creating the possibility of regulations specific to projects. Second, the guardrails – though overlapping to some degree with export controls – were separate and distinct, and intentionally crafted to be broader than those controls. Of course, funding recipients were obliged to adhere to both regimes. Third, the Final Rule did not require the guardrails apply to all affiliates (*e.g.*, subsidiaries and branches) under common control with the funding recipient. Rather, the so-called “Expansion Clawback” standard applies to a narrow group of affiliates. However, the precise scope of application of the “Technology Clawback” remained unclear.

In end-March 2024, DOC began the first disbursements of *CHIPS Act* subsidies from the \$39 billion pot of available direct support. Approximately 12 entities were recipients in 2024, including Intel (for a planned expansion to its Ohio semiconductor manufacturing facility, which would make it the largest such factory in the world), TSMC

⁵¹³ U.S. Finalizes Rules to Keep China from Cashing in on Chip Funding, Nikkei Asia, 23 September 2023, <https://asia.nikkei.com/Business/Tech/Semiconductors/U.S.-finalizes-rules-to-keep-China-from-cashing-in-on-chip-funding#>.

(for U.S. facilities), and Samsung (also for U.S. facilities).⁵¹⁴ The awards took the form of “grants, loans, and loan guarantees ... [that] cover[ed] up to 15% of project costs.”⁵¹⁵ The awards mattered, because a chip-making facility “can cost as much as \$30 billion and yet be obsolete within a decade.”⁵¹⁶ Hence, “semiconductor companies ... pledged to invest more than \$230 billion in the U.S. in recent years, *many on the explicit condition that they receive government support.*”⁵¹⁷ Per the discussion (later in this Chapter) this condition, and the government’s willingness to step in to incentivize the private sector to act in a way different from how it would behave under purely market-based signals, surely was industrial policy.

MARIA ALEJANDRA (JANA) DEL-CERRO & JEREMY ILOULIAN, CROWELL & MORING LLP, *FINAL RULE FROM COMMERCE ON NATIONAL SECURITY GUARDRAILS FOR CHIPS ACT FUNDING: RESTRICTIONS ON CHINA AND OTHER COUNTRIES OF CONCERN (27 SEPTEMBER 2023)*⁵¹⁸

Background:

The *CHIPS Act* authorizes the provision of nearly \$39 billion in direct funding and \$75 billion in loans and loan guarantees to (1) support the construction, expansion, or modernization of a domestic semiconductor manufacturing facility, or equipment for that facility; (2) support workforce development for a domestic semiconductor manufacturing facility; or (3) pay reasonable operating expenses for a domestic semiconductor manufacturing facility. Commerce began accepting applications on a rolling basis on March 31, 2023, for leading-edge manufacturing facilities, and on June 26, 2023 for current-generation, mature-node, or back-end manufacturing facilities. Commerce will begin to accept applications on a rolling basis, beginning October 23, 2023, for semiconductor materials and manufacturing equipment facilities.

The Clawbacks:

⁵¹⁴ See Ian King & Mackenzie Hawkins, *U.S. Aims to Announce Big Grants for Chip Plants by End of March*, BLOOMBERG, 27 January 2024, www.bloomberg.com/news/articles/2024-01-27/us-set-to-announce-big-grants-for-chip-factories-by-end-of-march?sref=7sxw9Sxl. [Hereinafter, *U.S. Aims to Announce.*]

⁵¹⁵ *U.S. Aims to Announce.*

⁵¹⁶ *U.S. Aims to Announce.*

⁵¹⁷ *U.S. Aims to Announce.* (Emphasis added.) See also Josh Boak, *Biden Admin Providing \$1.5 Billion to GlobalFoundries to Make computer Chips in New York and Vermont*, ASSOCIATED PRESS, 19 February 2024,

<https://apnews.com/article/computer-chips-biden-new-york-schumer-globalfoundries-fe69bb214354695769dd615de4f9c221> (reporting: “The Biden Administration said ... [on 19 February 2024] that the government intends to provide \$1.5 billion to the computer chip company GlobalFoundries to expand its domestic production in New York and Vermont. The announcement is the third award of direct financial support for a semiconductor company under the 2022 *CHIPS and Science Act* ..., [which] enables the government to invest more than \$52 billion to revitalize the manufacturing of computer chips in the United States as well as advance research and development.”).

⁵¹⁸ www.crowell.com/en/insights/client-alerts/final-rule-from-commerce-on-national-security-guardrails-for-chips-act-funding-restrictions-on-china-and-other-countries-of-concern.

The *CHIPS Act* imposes two main national security restrictions on any funding recipients: the “Expansion Clawback” and the “Technology Clawback.”

- (1) **Expansion Clawback:** Recipients are restricted from engaging in transactions involving the “*material expansion*” of “*semiconductor manufacturing capacity*” in a “foreign country of concern” (*e.g.*, China, Russia, Iran, or North Korea) for 10 years, once the funding agreement is finalized, except for:

“*Existing facilities*” for producing “*legacy semiconductors*,” and,

Facilities for producing legacy semiconductors that “*predominantly serve the domestic market*” of the foreign country of concern.

- (2) **Technology Clawback:** Recipients may not engage in “*joint research*” or “*technology licensing*” efforts with a “*foreign entity of concern*” related to a “*technology or product that raises national security concerns*.”

If funding recipients violate either of these prohibitions, they are subject to a “clawback” of the full funding amount (plus interest).

...

Changes in the Final Rule:

The Final Rule made a handful of notable changes to the Expansion and Technology Clawbacks, including:

Removal of the term “Affiliates:”

Previously, the Expansion and Technology Clawbacks could apply if either an entity accepting funding (“covered entity”) or any “affiliate” (*i.e.*, a parent, subsidiary, or an entity under common control based on a 50% voting ownership threshold) engaged in prohibited behavior. Commerce has now removed the reference to “affiliates.”

- (1) Expansion Clawback: The expansion clawback now applies to covered entities and any members of an “*affiliated group*” that engages in a prohibited activity. The term “*affiliated group*” still applies to parents, subsidiaries, and entities under a common parent, but the voting ownership threshold is now 80% and companies that are not “*includible corporations*” are exempt (*e.g.*, certain non-profits, regulated investment companies).
- (2) Joint Research and Technology: The technology clawback now *only* applies to covered entities engaging in a prohibited activity. However, Commerce explained it “*may take appropriate remedial measures*,” which includes imposing mitigation agreements or recovering the full amount back, if a “*related entity*” undertakes activity that the covered entity could not itself undertake.

...

Expansion Clawback-Specific Changes:

- (1) **Manufacturing Expansion Limitation Up to Negotiation:** Previously, only “*significant transactions*” (e.g., any activity for \$100,000 or more) were prohibited. That limit has been removed, and the limit for each agreement will be negotiated and included in the contract, where Commerce will consider the total funding size, among other factors.
- (2) **Legacy Semiconductors:** Commerce added another “*legacy semiconductor*,” specifically a semiconductor that does not use advanced three-dimensional (3D) integration packaging (for the purposes of a semiconductor packaging facility), such as by directly attaching one or more die or wafer, through silicon vias, through mold vias, or other advanced methods.
- (3) **Material Expansion Clarification:** Material expansions of semiconductor fabrication facilities can be prohibited under the expansion clawback. Commerce noted this term does not include equipment and efficiency upgrades in existing cleanrooms, only the addition of cleanroom space.

Technology Clawback-Specific Changes:

- (1) **Foreign Entity of Concern:** Who is considered a foreign entity of concern was slightly modified to note that, with respect to entities that are caught due to ownership by a Chinese, Russian, Iranian, or North Korean national, that national must be located in one of those countries as well. For example, if a Chinese national located in Singapore owned an entity, that entity would not be considered a “*foreign entity of concern*” solely due to the Chinese national’s ownership (but it could be caught due to another provision, e.g., if the entity is incorporated or has a principal place of business in one of the aforementioned countries).
- (2) **Exemptions from Both Joint Research and Technology Licensing:** The Final Rule allowed for exceptions to the definitions of “*joint research*” and “*technology licensing*,” even if it involves “*technologies or products that raise national security concerns*.” This includes any activities related to (i) “*standards-related activities*” (as defined in the *EAR*); (ii) research and development between employees of a funding recipient and any related entities; and (iii) any historic activities that occurred prior to publication of the Final Rule (though Commerce can require those activities are halted as a condition of funding).
- (3) **Exemptions from Only Technology Licensing:** In addition to the above listed exceptions, the Final Rule excepted “*published information*” and patent agreements (where only published information, as opposed to

proprietary information, is shared) from the definition of “technology licensing.” These exceptions mirror those in the *EAR* (and ... *ITAR*). Neither of these exceptions apply for joint research, and so any joint research involving this type of information or agreement, would still be subject to the Technology Clawback.

...

Technology Clawback Applies to Items Not Subject to the U.S. Export Administration Regulations ...:

- (1) **Items Not Subject to the *EAR* Still Caught:** Commerce explained that it would not limit its scope to only items subject to the *EAR* and that these controls were intended to be broader than the jurisdiction of the *EAR*.
- (2) **Fundamental Research:** Additionally, unlike in the *EAR* and ... *ITAR*, Commerce determined that it would not provide any exception for fundamental research (for the definition of joint research) as Commerce has concerns that any additional advancements in the technology or its use may be made through such research efforts to the benefit of the foreign entity of concern. Interestingly, Commerce did not speak to whether fundamental research is or is not excepted under technology licensing.

[Note DOC retained in the Final Rule from its Proposed Rule its explanation that an entity that engages in “significant renovations” of an “existing facility” for “legacy semiconductors” no longer can be considered an “existing facility.”]

- **2022 *CHIPS Act* as American Industrial Policy**

The CHIPS and Science Act of 2022, H.R. 2022, which both chambers of Congress passed overwhelmingly, and which President Joseph R. Biden (1942-, President, 2021-) signed on 9 August 2022, seemed a clear instance of American “industrial policy:”

The Senate ... passed an expansive \$280 billion bill aimed at building up America’s manufacturing and technological edge to counter China, embracing in an overwhelming bipartisan vote the most significant government intervention in industrial policy in decades.

The legislation reflected a remarkable and rare consensus in a polarized Congress in favor of forging a long-term strategy to address the nation’s intensifying geopolitical rivalry with Beijing. The plan is centered around investing Federal money into cutting-edge technologies and innovations to bolster the nation’s industrial, technological, and military strength.

The measure passed 64 to 33, with 17 Republicans voting in favor. The bipartisan support illustrated how commercial and military competition with Beijing – as well as the promise of thousands of new American jobs – has dramatically shifted longstanding party orthodoxies, generating

agreement among Republicans who once had eschewed government intervention in the markets and Democrats who had resisted showering big companies with federal largess.

“No country’s government – even a strong country like ours – can afford to sit on the sidelines,” Senator Chuck Schumer, Democrat of New York and the majority leader who helped to spearhead the measure, said in an interview. “I think it’s a sea change that will stay.”

...

The bill, a convergence of economic and national security policy, would provide \$52 billion in subsidies and additional tax credits to companies that manufacture chips in the United States. It also would add \$200 billion for scientific research, especially into artificial intelligence, robotics, quantum computing and a variety of other technologies.

The bill calls for pouring \$10 billion into the Department of Commerce – which would also dole out the chips subsidies to companies that apply – to create 20 “regional technology hubs” across the country. The brainchild of Senator Todd Young, Republican of Indiana, and Mr. Schumer, the hubs would aim to link together research universities with private industry in an effort to create Silicon Valley-like centers for technology innovation in areas hollowed out by globalization.

The legislation would steer billions to the Department of Energy and the National Science Foundation to promote both basic research and research and development into advanced semiconductor manufacturing, as well as work force development programs, in an effort to build a labor pipeline for a slew of emerging industries.

The effort has marked a foray into industrial policy that has had little precedent in recent American history, raising myriad questions about how the Biden Administration and Congress would implement and oversee a major initiative involving hundreds of billions of taxpayer dollars.

...

Many Senators, including Republicans, saw the legislation as a critical step to strengthen America’s semiconductor manufacturing abilities as the nation has become perilously reliant on foreign countries – especially an increasingly vulnerable Taiwan – for advanced chips.

...

The legislation, which was known in Washington by an ever-changing carousel of lofty-sounding names, has defied easy definition. At more than 1,000 pages long, it is at once a research and development bill, a near-term and long-term jobs bill, a manufacturing bill and a semiconductors bill.

Its initial version, written by Mr. Schumer and Mr. Young, was known as the *Endless Frontier Act*, a reference to the 1945 landmark report

commissioned by President Franklin D. Roosevelt asking how the federal government could promote scientific progress and manpower.

“New frontiers of the mind are before us, and if they are pioneered with the same vision, boldness, and drive with which we have waged this war,” Mr. Roosevelt wrote at the time, “we can create a fuller and more fruitful employment and a fuller and more fruitful life.”

Enactment of the legislation is considered a critical step to strengthening America’s semiconductor abilities when the share of modern manufacturing capacity in the United States has plummeted to 12 percent. That has left the nation increasingly reliant on foreign countries amid a chip shortage that has sent shock waves through the global supply chain.

The subsidies for chip companies were expected to produce, in the short term, tens of thousands of jobs, with manufacturers pledging to build new factories or expand existing plants in Ohio, Texas, Arizona, Idaho, and New York. While chip companies will not immediately receive the federal money, several of them had said they would make business decisions in the coming weeks based on whether they received assurances that the money would soon be coming.

The bill also seeks to create research and development and manufacturing jobs in the long run. It includes provisions aimed at building up pipelines of workers – through work force development grants and other programs – concentrated in once-booming industrial hubs hollowed out by corporate offshoring.

... Mr. Young described the legislation as an effort to equip American workers hurt by globalization with jobs in cutting-edge fields that would also help reduce the nation’s dependence on China.

“These technologies are key to our national security,” Mr. Young said. “We’re actually giving rank-and-file Americans an opportunity, as it relates to chip manufacturing, for example, to play a meaningful role, not only in supporting their families, but also harnessing our creativity, talents, and hard work, to win the 21st century.”

The bill is expected to pave the way for the construction of factories across the country and, along with that, an estimated tens of thousands of jobs.

Chip manufacturers lobbied heavily, and often shamelessly, for the subsidies, in recent months threatening to plunge their resources into building plants in foreign countries such as Germany or Singapore if Congress didn’t quickly agree to shower them with federal money to stay in the United States.

The legislation also stipulates that chip manufacturers that take the federal funds and tax subsidies provided by the legislation cannot expand existing factories or build new ones in countries including China and Russia, in an effort to curtail advanced chip manufacturing in nations that present a national security concern.

The Department of Commerce would claw back the funds provided by the bill if companies do not abide by those restrictions....⁵¹⁹

The next day, 28 July, the House passed the *CHIPS Act* by a 243-187 margin.⁵²⁰ These margins clearly indicated that across Congress, the legislation enjoyed widespread bipartisan support.

Query whether Senator Schumer (quoted above) was right. That is, did America have a choice not to engage in “industrial policy” when faced with a determined competitor/adversary, such as China and its CCP, which intervenes pervasively in most sectors of its economy to achieve its national security and foreign policy goals? Consider the fact China had (as of August 2022) 340 reactors’ worth of solar plants in its pipeline.⁵²¹ Does that kind of production capacity inventory indicate the U.S. had to intervene?

⁵¹⁹ Catie Edmondson, *Senate Passes \$280 Billion Industrial Policy Bill to Counter China*, THE NEW YORK TIMES, 27 July 2022, www.nytimes.com/2022/07/27/us/politics/senate-chips-china.html?referringSource=articleShare. For the text and summary of this *Act*, see U.S. Committee on Science, Commerce, and Transportation, *View the CHIPS+ Act Legislation, H. R. 4346 – The CHIPS and Science Act of 2022*, Press Releases, 27 July 2022, www.commerce.senate.gov/2022/7/view-the-chips-legislation.

⁵²⁰ See Jack Stone Truitt, *U.S. Congress Passes CHIPS Act to Boost Semiconductor Sector*, NIKKEI ASIA, 29 July 2022, <https://asia.nikkei.com/Politics/U.S.-Congress-passes-CHIPS-Act-to-boost-semiconductor-sector> (also reporting on the national security and economic impulses behind the *Act* in the context of Sino-American strategic competition: “By making more semiconductors in the United States, this bill will increase domestic manufacturing and lower costs for families,” [President] Biden said in a statement. “And, it will strengthen our national security by making us less dependent on foreign sources of semiconductors.”).

⁵²¹ Noriyuki Doi, *China Has 340 Reactors’ Worth of Solar Cell Plants in the Pipeline*, NIKKEI ASIA, 23 August 2023, <https://asia.nikkei.com/Spotlight/Environment/Climate-Change/China-has-340-reactors-worth-of-solar-cell-plants-in-the-pipeline> (reporting: “Chinese solar panel manufacturers are building or planning new production facilities that will add combined annual output capacity equivalent to 340 nuclear reactors, buoyed by strong global demand and new mass-production technology. ‘We’ll double our shipments every year,’ said Tang Jun, president of Changzhou EGING Photovoltaic Technology. Last year, the midsized player delivered 2.6 gigawatts’ worth of solar panels, with the figure expected to rise to 5 GW this year and 10 GW in 2023. One gigawatt is the power output of a typical reactor, so from next year its solar cell deliveries would be equivalent to EGING installing 10 nuclear facilities each year. Solar cell manufacturing is driven by capacity. As bigger production volumes drive down the cost per unit, all players pursue economies of scale. There is also a technological factor. Up until last year, so-called p-type cells were the mainstream due to their superior cost competitiveness. But n-type cells, which generate electricity more efficiently than p-types, are being mass produced at a lower cost this year. Anticipating that clients will switch to n-types, solar panel makers are ramping up capital investments to stay ahead of the curve.”).

Indeed, one feature of the *CHIPS Act* that made it appear to fit squarely within “industrial policy” was its direction not only of what is to be manufactured (chips), but also where (in the U.S.) and by whom (non-Chinese companies):

As the U.S. Congress passed an historic \$52 billion federal program to boost domestic chipmaking capabilities, it included one significant caveat: *Companies that receive the funding have to promise not to increase their production of advanced chips in China.*

It’s a condition that will certainly add to escalating tensions between Washington and Beijing. The curbs will hit companies like Intel Corp. and Taiwan Semiconductor Manufacturing Co., leading chipmakers that have tried to build their businesses in China. TSMC won’t be able to substantially upgrade or expand its existing facilities, effectively losing some growth opportunities in the world’s biggest semiconductor market.

Specifically, the Chips and Science Act bars companies that get Federal funding from materially expanding production of chips more advanced than 28-nanometers in China – or a country of concern like Russia – for 10 years. While 28-nanometer chips are several generations behind the most cutting-edge semiconductors available now, they are still used in a wide range of products including cars and smartphones. The ban covers both logic and memory chips.

An exception can be made if the chipmakers concerned are adding production of 28-nanometer semiconductors or older generations to serve the China market predominately or the foreign country of concern involved. *Recipients who violate the restrictions and fail to remedy the breach may need to pay back the federal subsidies in full.*

...

While China’s chipmaking champion Semiconductor Manufacturing International Corp. can make chips that are more advanced than 28 nanometers, its technology is still at least six years behind industry leader TSMC.

SMIC has been facing virtually insurmountable challenges in catching up with TSMC after the Trump Administration pressured the Dutch government to prevent ASML from selling its most cutting-edge extreme ultraviolet lithography systems to China. The Chinese chip industry encountered a further setback ... as Washington had quietly tightened China’s access to relatively advanced chip equipment....

A large chunk of the Federal grant is expected to go to Intel, TSMC and South Korea’s Samsung Electronics Co., all of which are now building new chip fabrication facilities worth tens of billions in the U.S.

Among potential recipients of the Federal grant, only TSMC is making relatively advanced chips in China.... Its facility in the southern Chinese city of Nanjing makes 28-nanometer and more advanced 16-nanometer chips, roughly the equivalent of the most sophisticated product SMIC can make.⁵²²

Several points (explained below) about the ban on FDI destined for China, which help articulate the dimensions of “industrial policy.”

VIII. Dimensions of American Industrial Policy

The *CHIPS Act* is a case study of the multi-dimensional and interdisciplinary nature of industrial policy as practiced in the U.S. amidst a long-term confrontation between the world’s two largest economies, America and China. First, the *CHIPS Act* ban was highly specific to certain types of investments. Only logic and memory chips of a certain size or smaller, measured in nanometers, were implicated. The rationale is chips of a certain size (28 nanometers) are widely used in vital merchandise (*e.g.*, cars, household appliances, and smartphones),⁵²³ and chips smaller (*e.g.*, 16 nanometers) than that size entail sensitive IP technology the U.S. did not wish to lose to China.

Second, the ban also implicated inputs into chips. That was evident from the reaction of one non-Chinese foreign company to the *CHIPS Act*:

Japan’s Mitsubishi Gas Chemical plans to nearly triple U.S. production of a chipmaking chemical over the next decade..., as Washington’s drive to bring semiconductor manufacturing onshore spurs suppliers to follow.

The company will invest around 50 billion *yen* (\$372 million) to boost production capacity for super-pure hydrogen peroxide, which is used in making high-performance chips. Production lines will be added at a facility in Oregon, and a new plant is on the table as well.

The fresh investment in the U.S. comes as chipmakers like Intel and Samsung Electronics lay out plans for new plants there. Japan's Showa

⁵²² Debby Wu, Daniel Flatley, & Jenny Leonard, *U.S. to Stop TSMC, Intel From Adding Advanced Chip Fabs in China*, BLOOMBERG, 1 August 2022, www.bloomberg.com/news/articles/2022-08-02/us-to-stop-tsmc-intel-from-adding-advanced-chip-fabs-in-china?sref=7sxw9Sxl. (Emphasis added.)

⁵²³ See, *e.g.*, The White House, *Remarks by President Biden Marking the Signing of Governor Whitmer’s Executive Directive to Implement the CHIPS and Science Act of 2022*, 2 August 2022, www.whitehouse.gov/briefing-room/speeches-remarks/2022/08/02/remarks-by-president-biden-marking-the-signing-of-governor-whitmers-executive-directive-to-implement-the-chips-and-science-act-of-2022/ (in which President Biden observed: “The bill [*CHIPS Act*] will supercharge our efforts to make semiconductors here in America. And, you know, these tiny little computer chips, the size of a – of a fingertip that are building the – are the building blocks for the modern economy. They power everything from smartphones, to dishwashers, automobiles, and so much more. In fact, the vehicles that the UAW makes in Michigan use as many as – the vehicles use as many as 3,000 semiconductors per vehicle.”).

Denko and South Korea's SK Group are also considering U.S. investments in chipmaking gas production.

The U.S. Congress recently passed the bipartisan *CHIPS Act*, earmarking \$52 billion in subsidies for the industry, as Washington competes with China for tech superiority while seeking a more secure supply of essential components.

...

Super-pure hydrogen peroxide is used to clean microscopic debris from chips without damaging their minute structures. It is also used in polishing and circuit etching.

Mitsubishi Gas Chemical controls half the global market for super-pure hydrogen peroxide, with production facilities in the U.S., Japan, South Korea, and Taiwan. It can now produce 140,000 tons a year in the U.S. alone.

The company spent around 7 billion *yen* on two new U.S. peroxide manufacturing facilities in 2017 but still expects rising demand.⁵²⁴

Mitsubishi's expectation surely was fueled by the certainty more chip producers would produce more chips in America, thanks to the *CHIPS Act*, and they would need more super-pure hydrogen peroxide. In essence, then, the almost predictably behavior of Mitsubishi Gas, based on the subsidy incentives the *CHIPS Act* created, illustrates the link running from industrial policy to supply chain management, right through to the sourcing of energy inputs used to make semiconductors.

Third, the *CHIPS Act* effort to secure semiconductor supply chains for America, and protect IPRs held by American companies, relied on export controls:

... the United States is considering limiting shipments of American chipmaking equipment to memory chip producers in China that make advanced semiconductors used in everything from smartphones to data centers.

The curbs would stop chipmakers like South Korean giants Samsung Electronics ... and SK Hynix ... from shipping new technology tools to factories they operate in China, preventing them from upgrading plants that serve customers around the world.

Samsung and SK Hynix, which control more than half of the global NAND [NOT-AND digital electronic logic gate] flash memory chip market, have invested heavily in China in recent decades to produce chips that are vital

⁵²⁴ Yui Usui, *After CHIPS Act, Japanese Supplier to Triple U.S. Semiconductor Chemical Output*, NIKKEI ASIA, 4 August 2022, <https://asia.nikkei.com/Business/Materials/After-CHIPS-Act-Japanese-supplier-to-triple-U.S.-semiconductor-chemical-output>. [Hereinafter, *After CHIPS Act, Japanese.*]

to customers including tech giants Apple ..., Amazon ..., Facebook owner Meta ..., and Google.... As well as computers and phones, the chips are used in products like electric vehicles that require digital data storage.

“Samsung’s China production alone accounts for more than 15% of global NAND flash production.... If there’s any production disruption, it will make chip prices surge,” said Lee Min-hee, analyst at BNK Securities.⁵²⁵

Of course, such price surges were the short-term consequence of a long-term pursuit, namely, re-orienting supply chains out of China.

Note the implication of export controls for MNCs invested in China was to make their Chinese production assets less valuable through diminishing returns:

The deepening tensions could leave Samsung and SK Hynix having to review strategies on China investments....

“Until now, companies tended to invest in countries like China, where costs were cheap,” said Kim Yang-jae, analyst at Daol Investment & Securities.

“That’s no longer going to be the only consideration. The biggest change these potential limits will bring will be where the next chip factories are built.”

They could also face potentially diminishing returns from their multi-billion-dollar China plants, which could be stuck making older-technology, less lucrative chips.

SK Hynix has not been able to upgrade its DRAM memory chip production facilities in Wuxi, China with the latest extreme ultraviolet lithography (EUV) chipmaking machines made by Dutch firm ASML ..., as U.S. officials do not want advanced equipment used in the process to enter the country.

The EUV machines are used to make more advanced and smaller chips that are used in high-end devices such as smartphones.⁵²⁶

To be sure, strictly enforced export controls (discussed in a separate Chapter) create incentives for unscrupulous, even illegal, behavior: forced technology transfer, cybertheft, and espionage. Such behavior, in turn, incentivizes, even necessitates, ever-stricter enforcement measures. The cycle, which was obvious in the Sino-American War and with

⁵²⁵ Joyce Lee, *As U.S. Eyes New China Chip Curbs, Turmoil Looms for Global Market*, REUTERS, 3 August 2022, www.reuters.com/technology/us-eyes-new-china-chip-curbs-turmoil-looms-global-market-2022-08-03/. [Hereinafter, *As U.S. Eyes New China*.]

⁵²⁶ *As U.S. Eyes New China*.

respect to Russia sanctions (both discussed in separate Chapters), was hard to broke. Each step in it reduced confidence between the sanctioning and target countries.

Fourth, industrial policy is triggered by a perception of a threat to economic and/or national security. Obviously, chips are essential to civilian, dual use, and military items – the list is almost endless, from cars to mobile phones, and refrigerators to satelites, almost every aspect of modern life requires them. In 1990, America accounted for nearly 40% of global computer chip production. By July 2023, that figure had plummeted to about 10%.⁵²⁷ The *CHIPS Act* premise was that threat was excessive American reliance on foreign semiconductors, particularly from Taiwan, coupled with the possibility of a disruption in the supply of Taiwanese chips because of Chinese military action against Taiwan: “Most of the world’s high-performance chips come from Taiwan, and a geopolitical crisis there could put that supply at risk.”⁵²⁸ If the CCP opted to reunify Taiwan by force, say through a naval quarantine or blockade, or an outright amphibious assault, then chip exports from Taiwan would be disrupted indefinitely.

Fifth, “friend-shoring” was permissible under the *CHIPS Act*. So, for example, Mexico hoped to benefit from increased semi-conductor investments.⁵²⁹ Vietnam, too, was positioned for friend-shoring, with Apple shifting Apple Watch and MacBook production to it from China.⁵³⁰ So was Taiwan, with which (in August 2022) the U.S. launched

⁵²⁷ See Annabelle Liang, *TSMC: Chip Giant Delays Arizona Production in Blow to Biden*, BBC NEWS, 21 July 2023, www.bbc.com/news/business-66264392.

⁵²⁸ After *CHIPS Act*, *Japanese*.

⁵²⁹ See *CHIPS Act Will Help Boost* (but noting estimates showed *CHIPS Act* subsidies might increase America’s share of global semiconductor production, which had fallen 25 percentage points across 30 years to 12% as of 2022, by just 1-2 percentage points, which if true, would limit the potential benefits for Mexico.).

⁵³⁰ Specifically:

Apple is in talks to make Apple Watches and MacBooks in Vietnam for the first time, marking a further win for the Southeast Asian country as the U.S. tech giant looks to diversify production away from China.

Apple suppliers Luxshare Precision Industry and Foxconn have started test production of the Apple Watch in northern Vietnam with the aim of producing the device outside of China for the very first time....

Vietnam is already Apple’s most important production hub outside of China, producing a wide range of flagship products for the American company, including iPad tablets and AirPods earphones.

The Apple Watch is even more sophisticated, according to industry experts, who say that squeezing so many components into such a small case requires a high degree of technological skill. Producing the device would be a win for Vietnam as the country attempts to further upgrade its tech manufacturing sector.

Apple has also continued to shift iPad production to Vietnam after COVID-related lockdowns in Shanghai caused massive supply chain disruptions. ...

On the MacBook front, Apple has asked suppliers to set up a test production line in Vietnam.... However, progress in moving mass production to the country has been slow, partly due to pandemic-related disruptions but also because notebook computer production

negotiations on a so-called “21st Century Trade Initiative” (discussed in a separate Chapter) to deepen their mutual trade and a forum for governments and companies to discuss and co-ordinate policies on supply chain security, workforce development, R&D and subsidies.⁵³¹ Cutting-edge chip technology was very much a part of the plan to deepen these linkages, given “Taiwan’s position as the world’s leading supplier of semiconductors,” making it “a linchpin of its economic relationship with the U.S., China, and other nations.”⁵³² America was Taiwan’s third largest trading partner (in 2021), and China and Hong Kong combined accounted for 40% of Taiwan’s exports.⁵³³ Without expressly saying so, to enhance the national security of America and Taiwan, the *Initiative* aimed to boost the first number, and cut the second one.

This said, friend sourcing was not necessarily easy. America launched (in March 2021) a CHIP 4 alliance, consisting of itself along with Japan, Korea, and Taiwan. Its purpose was to serve as a “forum for governments and companies to discuss and co-ordinate policies on supply chain security, workforce development, R&D, and

involves a larger supply chain.... That network is currently centered on China and very cost-competitive, they added.

“AirPods, Apple Watch, HomePod, and more ... Apple has big plans in Vietnam, apart from iPhone manufacturing,” one of the people with direct knowledge of the situation said. “The components for MacBooks have become more modularized than in the past, which makes it easier to produce the laptops outside of China. But how to make it cost-competitive is another challenge.”

Apple’s diversification to Vietnam started with AirPods, which went into mass production there in 2020. The earphones were among the first Apple products whose assembly was shifted out of China after a trade war between Washington and Beijing broke out under former U.S. President Donald Trump.

The move signaled a change of approach for Apple, which had depended on China for almost all of its production needs for decades.

For Vietnam, Apple’s shift – and the U.S.-China tensions more broadly – have been a boon. The number of Apple suppliers with facilities in the country has increased to at least 22 from 14 in 2018.... Many other major electronics manufacturers like Google, Dell, and Amazon have also set up production in Vietnam to diversify beyond China....

Cheng Ting-Fang & Lauly Li, *Vietnam to Make Apple Watch and MacBook for First Time Ever*, NIKKEI ASIA, 17 August 2022, <https://asia.nikkei.com/Business/Technology/Vietnam-to-make-Apple-Watch-and-MacBook-for-first-time-ever>.

⁵³¹ See Office of the United States Trade Representative, *United States and Taiwan Commence Formal Negotiations on U.S. – Taiwan Initiative on 21st Century Trade*, Press Release, 17 August 2022, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2022/august/united-states-and-taiwan-commence-formal-negotiations-us-taiwan-initiative-21st-century-trade>; Office of the United States Trade Representative, *U.S.-Taiwan Initiative on 21st Century Trade: Negotiating Mandate*, 17 August 2022, [https://ustr.gov/sites/default/files/2022-08/US-Taiwan%20Negotiating%20Mandate%20\(Final\).pdf](https://ustr.gov/sites/default/files/2022-08/US-Taiwan%20Negotiating%20Mandate%20(Final).pdf).

⁵³² *U.S.-Taiwan Trade Talks Kick Off in Long-Planned Counter to China*, BLOOMBERG, 17 August 2022, www.bloomberg.com/news/articles/2022-08-18/us-and-taiwan-begin-formal-negotiations-on-trade-initiative?sref=7sxw9SxI. [Hereinafter, *U.S.-Taiwan Trade Talks Kick Off*.]

⁵³³ See *U.S.-Taiwan Trade Talks Kick Off*.

subsidies.”⁵³⁴ Yet, CHIP 4 struggled to mobilize itself into a credible, self-contained source for chips and chips policies. A hodgepodge of idiosyncratic reasons was the culprit.⁵³⁵ Some were historical. For example, Japan and Korea debated unresolved controversies from the Second World War. Others were economic. For instance, Taiwan could not easily extricate itself from supply chains running through the Mainland. Still others involved national security. The need for South Korea to maintain good relations with China insofar as China could influence North Korea was an illustration.

Per the above details as to entities and transactions ineligible for benefits, obviously the *CHIPS Act* incentivized investments in the U.S. But, the *Act* did not technically forbid foreign MNCs from FDI in a friendly country:

Companies face a rapid shift in mindset. In the post-Cold War era, and after Beijing’s 2001 accession to the World Trade Organization when the belief persisted that deepening commerce with the west could pull China into the liberal world order, businesses grew used to operating in a largely benign global environment. Purely economic considerations – where it made most commercial sense to build a factory or source supplies – could take priority.

With Beijing’s emergence as a geopolitical rival, security considerations again trump economic ones. Western governments now view it as vital to build supply chains that rely less on potential foes such as China and are instead based around strategic allies – so-called friend-shoring.

...

The pressure to pull out of Russia after its assault on Ukraine has now forced nearly every U.S. company to confront the question of what it would do if China invaded Taiwan. ... Western companies have understood a crisis over Taiwan could similarly lead to investments being stranded, unwound, or written off and throw supply chains into chaos, but on a vastly larger scale.

Unlike Russia, China, together with Taiwan – which makes 90 per cent of the world’s most advanced semiconductors – is both a crucial production hub and a vast market. Anything that forced western business to freeze or withdraw from operations there would be a punishing double blow.⁵³⁶

⁵³⁴ Christian Davies, Song Jung-a, Kana Inagaki & Richard Waters, *U.S. Struggles to Mobilize its Asian CHIP 4 Alliance*, FINANCIAL TIMES, 13 September 2022, www.ft.com/content/98f22615-ee7e-4431-ab98-fb6e3f9de032?shareType=nongift. [Hereinafter, *U.S. Struggles to Mobilize*.]

⁵³⁵ *U.S. Struggles to Mobilize*.

⁵³⁶ The Editorial Board, *Western Companies Wake Up to China Risk*, FINANCIAL TIMES, 11 August 2022, www.ft.com/content/0a03a58c-01ed-4b7e-8891-c9267f2dd7e6?shareType=nongift.

See Jim Tankersley, *Biden Incentives for Foreign Investment Are Benefiting Factories*, THE NEW YORK TIMES, 23 August 2023, www.nytimes.com/2023/08/23/us/politics/biden-foreign-investment-factories.html?smid=nytcare-ios-share&referringSource=articleShare. Of course, the White House touted the data. See The White House, *Early Signs That Bidenomics is Attracting New Foreign Investment in U.S. Manufacturing* (23 August 2023), www.whitehouse.gov/cea/written-materials/2023/08/23/early-signs-that-bidenomics-is-attracting-new-foreign-investment-in-u-s-manufacturing/.

That is exactly the blow the *CHIPS Act* dealt. But, the *Act* accommodated the reality a variety of supply chain management considerations, including cost, may make an investment in, say, Taiwan appealing. And, of course, such friend-shoring would not cause the entities or transactions at issue to run afoul of U.S. export control laws.

Sixth, what costs did U.S. export controls on chips and chip-making equipment bound for China impose on Americans? The answer, which the *Financial Times* proffered, is they were non-*diminimis*, in the short- and long-terms:

The advice “dig two graves, before you set out” applies to anyone bent on revenge. An old aphorism is hardly going to divert the U.S. from its mission to restrict Chinese access to its world-beating technology, slowing the progress of its rival towards self-sufficiency in high-performance chips.

However, American policymakers are unlikely to have fully appreciated the corollary of splitting the world semiconductor supply chain in two: far higher costs for western manufacturers and their customers.

Advanced chips and the factories making them have become a substitute for arms and armies in the east-west stand-off because they are a critical component of our modern lives. They are central to mobile devices, electric cars, and gaming consoles. They are also the foundation of next-generation technology from self-driving cars and 5G internet to cloud services and artificial intelligence.

Any country without stable access to large amounts of these chips risks falling behind technologically. That is exactly what the U.S. hopes its new technology export ban will achieve.

...

Washington’s new rules bar China from accessing technology essential for producing advanced chips. The sale of those chips and the equipment needed to make them to Chinese companies without a licence are also banned.

...

These sweeping new rules could have unintended consequences that are just as far reaching. Governments around the world are grappling with inflation. Longer term, the U.S. ban on Chinese tech will raise prices for all sorts of chips. That bill will be picked up by businesses and consumers on both sides of the Great Silicon Divide springing up between east and west.

...

Nanometers – a unit of length equal to one ten-thousandth the diameter of a human hair – are used to measure the width between individual transistors on a chip. The smaller this size, the more transistors – basic building blocks that conduct electrical signals and power – can be squeezed on to a single silicon chip, making the chip more powerful.

That means the lower numbered chips have more transistors densely packed on the same surface area, offering higher processing speed. That is why the size of a chip has not changed significantly in recent years, yet each new generation packs in much more functionality.

Semiconductors labelled as using 7 nm and smaller processes are critical for the latest consumer products. Apple iPhones, MacBooks, and Samsung Galaxy phones use the 5 nm chips, Sony Play Stations use 6 nm.

Only two countries, Taiwan, and South Korea, have the cutting-edge technology to make these high-end chips. As a result, they have about half the world's semiconductor market. The rest mostly consists of older, so-called legacy chips. The U.S. holds 12 per cent of the global chip market but local companies are not able to produce the high-end chips at scale.⁵³⁷

Indeed, perhaps the U.S. was right to act precisely when it did: it “retain[ed] outsized influence on the supply of the world's chips,” “[m]ny stages of the semiconductor production process – spanning chip design, research, development, fabrication and testing – depend on technologies that originated in the U.S.,” and America still was “home to the three of the biggest chip gear makers – Lam Research, KLA, and Applied Materials.”⁵³⁸

Seventh, ultimately, did America's semiconductor-focused industrial policy work? That is, did it succeed in reconfiguring supply chains from Taiwan and China back to the U.S.? Early anecdotal evidence suggested the answer was “yes:”

⁵³⁷ June Yoon, Lex in-Depth: *The Cost of America's Ban on Chinese Chips*, FINANCIAL TIMES, 23 November 2022, www.ft.com/content/d3935b9a-a203-435d-b1a9-a22bcc9d79e7?shareType=nongift. [Hereinafter, *The Cost of America's Ban*.]

By September 2023, Huawei had used in its Mate 60 Pro smartphone a 7 nm chip, the Kirin 9000, made by SMIC, China's top chip producer. See Vlad Savov & Debby Wu, Huawei Teardown Shows Chip Breakthrough in Blow to U.S. Sanctions, BLOOMBERG, 4 September 2023, www.bloomberg.com/news/features/2023-09-04/look-inside-hua-wei-mate-60-pro-phone-powered-by-made-in-china-chip?ref=7sxxw9Sxl. That suggested (1) early CCP success in building a domestic, advanced chip ecosystem, consistent with its Made in China 2025 industrial policy market share targets, (2) there were limits to the extraterritorial efficacy of U.S. export controls, because BIS put on the Entity List Huawei in May 2019 and SMIC in December 2020, and apparently neither had obtained a special license required of companies on that List to receive lawfully advanced chips; and (3) SMIC may have violated the FDP rule, which bars any company anywhere in the world from using certain inputs to make chips for Huawei. See id.; Stephen Nellis, U.S. Lawmaker Calls for Ending Huawei, SMIC Exports After Chip Breakthrough, REUTERS, 6 September 2023, www.reuters.com/technology/us-lawmaker-calls-ending-huawei-smic-exports-after-chip-breakthrough-2023-09-06/. Notably, Apple used a 4 nm chip in its iPhone 14, with its iPhone 15 powered by a 3 nm chip, but was the gap with Huawei ineluctably narrowing? See id.; Eleanor Olcott, U.S. to Investigate Chips Used in Huawei's “Made in China” Smartphone, FINANCIAL TIMES, 6 September 2023, www.ft.com/content/44f833a0-dc74-47be-833c-cb94a9d9e856?shareType=nongift. That question was all the more poignant when, in an apparent tit-for-tat measure, China initially clamped down on the use by its central government officials of iPhones, and soon expanded the restriction to local government and SOE officials. See Shunsuke Tabeta, *China Expands iPhone Ban to Local Governments, State-Owned Firms*, NIKKEI ASIA, 8 September 2023, <https://asia.nikkei.com/Politics/International-relations/US-China-tensions/China-expands-iPhone-ban-to-local-governments-state-owned-firms#>.

⁵³⁸ *The Cost of America's Ban*.

Samsung Electronics and SK Hynix are re-evaluating their investments in China as leading Korean chipmakers respond to incoming U.S. restrictions on the production of advanced semiconductors.

The *Chips and Science Act* passed by Congress..., which envisages \$52 bn in grants to support advanced chip manufacturing in the U.S., also contains qualified “guardrails” prohibiting recipients of federal funds from expanding or upgrading their advanced chip capacity in China for 10 years.

The provisions have led Samsung and SK Hynix to rethink their exposure to China....

A senior Korean official added that over time, several Korean investments in chip manufacturing in China were likely to be “abandoned.” “If China is unhappy, they will have to take it up with the U.S.,” said the official.

The moves suggested that Washington’s efforts to encourage leading chipmakers to pivot away from China and towards the U.S. were bearing fruit.

“The guardrails against China will accelerate Korean chipmakers’ shift to the U.S. from China,” said Kim Young-woo, Head of Research at SK Securities in Seoul and an adviser to the Korean government on semiconductor policy.

“They have been rethinking their strategies because of the U.S.-China technology war and they are now tilting further towards the U.S. because of geopolitical risks.”

Kim added that Korean groups such as Samsung and SK Hynix “will build more U.S. plants because they cannot mass-produce cutting-edge chips without U.S. equipment and technology. If they have to make a choice between the U.S. and China, they have no choice but to opt for the U.S.”

...

Yeo Han-koo, a former Korean economic official who served as South Korea’s Trade Minister until May [2022], said that the “recalibration” of Korean chipmakers’ strategy *vis-à-vis* the U.S. and China had already begun.

...

“This new economic order is still being formulated, and the companies are re-evaluating and recalibrating their strategy accordingly,” said Yeo.

Lee Jae-min, a Law Professor at Seoul National University..., said the U.S. was using subsidies to “lure” Korean chipmakers into its regulatory orbit.

“Once they receive U.S. subsidies, they will come under stronger U.S. control for their decision-making and business activities, which will restrict their investment and production in China,” said Lee.

“Chipmakers like Samsung and SK Hynix have to constantly upgrade their plants to produce cutting-edge chips, but it is difficult to upgrade their Chinese facilities without introducing high-tech equipment.”⁵³⁹

What are the determinants of this “recalibration,” *i.e.*, of America’s success in this “new economic order”? Do they include the relative size of the American economy, its rule of law framework, and its generally sound infrastructure? Could, for example, India – a more populous country but one with a smaller economy – onshore the production of critical merchandise in the same manner? Consider how successful India’s *Make in India* campaign has been?

Sixth, reaction from China to the *CHIPS Act* was not surprising:

Two Chinese trade associations ... slammed the *CHIPS and Science Act*, arguing that the newly signed U.S. law to promote domestic chipmaking will hurt the industry elsewhere in the world.

The law will “intensify geopolitical competition in the semiconductor industry and hinder the global economic recovery and the growth of technological innovation,” said the groups, the China Council for the Promotion of International Trade, and the China Chamber of International Commerce.

The legislation’s goal of encouraging construction of new plants in the U.S. “discriminates against some foreign companies, uses state power to forcibly change the international division of labor in the semiconductor industry and harms the interests of companies around the world, including in China and the U.S.,” the associations said.

The groups urged the international business community to come together to “eliminate the adverse impact” of the legislation.

Chinese Foreign Ministry spokesperson Wang Wenbin criticized the U.S. legislation ... as an example of American “economic coercion.”⁵⁴⁰

That was not the only reaction from the Mainland. In March 2023, China:

⁵³⁹ Christian Davies & Song Jung-a, *Samsung and SK Hynix Rethink China Exposure Following U.S. Chips Act*, FINANCIAL TIMES, 2 August 2022, www.ft.com/content/0b997942-93bd-4a67-9784-928af2641738?shareType=nongift.

⁵⁴⁰ Takashi Kawakami, *China Trade Groups Blast U.S. CHIPS Act as Hindering Innovation*, NIKKEI ASIA, 11 August 2022, <https://asia.nikkei.com/Business/Tech/Semiconductors/China-trade-groups-blast-U.S.-CHIPS-Act-as-hindering-innovation>.

went on the offensive, with the Cyberspace Administration of China announcing an investigation on national security grounds into Idaho-based memory chip manufacturer Micron Technology. The CAC said it would review imports of Micron’s products to ensure the security of its information infrastructure.

... Micron, which generates 11 per cent of its revenue in mainland China and another 5 per cent in Hong Kong, was an obvious first target for Beijing, because its tech would be more easily replaced with competitors’ chips if China ultimately decided to ban it. The U.S. group had also been downsizing some of its operations on the mainland while increasing investment in the U.S.⁵⁴¹

However, were such reactions hypocritical? China had its own *Made in China 2015* industrial policy, which had been a *casus belli* (justification for war) in the Sino-American Trade War. Perhaps the CCP was miffed the U.S. – finally – was matching tit-for-tat China in industrial policy?

Consider also whether this reaction stemmed from China’s understanding that forging a home-grown, world-class semiconductor industry would be all the more difficult with the *CHIPS Act* and tighter export curbs in place. There were two schools of thought:

Fresh restrictions on exports of U.S. chip technology to Chinese companies have provoked an angry reaction from Beijing, but beyond the rhetoric, China is expected to unleash a new wave of funding to boost domestic production of semiconductors.

...

China’s Foreign Ministry accused the U.S. ... of attempting to impose a “technological blockade” on China to maintain its tech “hegemony” and said it was stretching the concept of national security. The US has said it fears its tech will be adapted for military purposes.

Unable to break such a “blockade”, “the restrictions will turbocharge China to find local replacements,” said one senior executive at a Chinese chipmaker.

The government has already poured vast sums of money into the chip sector, with state-owned investment funds targeting chip start-ups that promise to replace foreign rivals. The largesse has prompted accusations of waste, corruption, and mismanagement. Chipmaker Tsinghua Unigroup defaulted on its bonds in 2020 despite receiving tens of billions of dollars in government support.

⁵⁴¹ Eleanor Olcott & Richard Waters, *Beijing Chooses Targets Carefully as it Goes on Offensive in U.S. Chip Wars*, FINANCIAL TIMES, 9 April 2023, www.ft.com/content/7f3f3636-9639-4d45-8366-c12a982513c6?shareType=nongift.

Analysts believe a string of high-profile failures will not deter Beijing in its quest for chip self-sufficiency, as Washington accelerates the encirclement of China's tech sector with ever-tighter controls.

...

In July [2022], the U.S. Congress approved \$52.7bn in grants to build chip facilities in the US for those companies agreeing not to fund high-end semi production in China, under the landmark *U.S. Chips and Science Act*.

Randy Abrams, head of Asia Semiconductors research at Credit Suisse, wrote in a note that the ban on investing in advanced fab production in China would "further limit access to overseas talent and investment to build up China's domestic semis industry."

...

... [Some analysts] disagree that China can strike out on its own. Stephen Ezell, a Director at the Information Technology and Innovation Foundation in Washington, said China's efforts to develop a "closed loop semiconductor ecosystem" had failed.

"It is self-defeating for a country in a high-tech industry to try and do everything by itself," he said.

The devastating impact of Washington's sanctions on Huawei, which barred the Chinese telecoms behemoth from all chips using U.S. tech in 2020, underscores the interconnected nature of the global chip supply chain. The move crippled the company's smartphone business.⁵⁴²

In other words, American industrial policy compelled China to double down on its own industrial policy by boosting subsidies. But, China lacked the open society, which incubates high-tech entrepreneurial innovations, to succeed through autarky.

Finally, query why politicians cling to euphemisms and avoid accurate labels? If the *CHIPS Act* indeed was "industrial policy," then why cover that up by emphasizing its job-creation benefits? In truth, are they welcome, but secondary, to the primary goal of the policy? Finally, query whether any aspects of "industrial policy" amount to "corporate welfare"? Is that epithet a desperate, libertarian-based one that is utterly naïve in a world with challenges from China?

⁵⁴² Eleanor Olcott & Anna Gross, *U.S. "Blockade" Set to Turbocharge Chinese Chip Development*, FINANCIAL TIMES, 3 September 2022, www.ft.com/content/ebcac5e4-f45d-418f-a617-95f1a944bc73?shareType=nongift.

Chapter 14

TRADE PATTERNS⁵⁴³

I. Studying Trade Patterns

Classical and contemporary arguments for free trade, while often put to the test empirically, are grand in scope. They ask whether trade liberalization is a “good thing” in a general sense. The logic is deductive: reasoning from general principles, arguments are built. But, economists are (for the most part) a savvy lot. They appreciate the importance of inductive logic, of reasoning from the specific to the general. Ask the proverbial “average person in the street” whether free trade is a good thing, mostly the responses hinge on that person’s perception of how free trade affects her.

Economists spend a good deal of time pondering the effects of free trade on variables such as patterns, infant industries, labor, the environment, and even national security and sovereignty. The expectation (or hope) is these effects will yield a few generalizations about free trade. The reality is that their studies hardly resolve the issue. Debate between free traders and protectionists continues as an epic intellectual struggle.

If trade liberalization occurs, then what is the effect on the pattern of trade? That is, what determines whether a country imports or exports a particular product? The traditional answer is based on Ricardo’s Law of Comparative Advantage. If a country has a comparative advantage, in terms of cost, in producing a good, then it will export that good. If not, then it will import the good. Yet, this answer fails to account for shifts in an endowment of factors of production. There are changes in land (*e.g.*, through land reclamation, desertification, or soil erosion), labor (*e.g.*, through population growth or immigration), physical capital (*e.g.*, through investment), human capital (*e.g.*, through education), and technology (*e.g.*, through research and development).

II. Heckscher-Ohlin Theorem

In the 1930s, the Swedish economists Eli Heckscher (1879-1952) and Bertil Ohlin (1899-1979) attempted to rectify this defect in the Classical model and devised what is known as the Heckscher-Ohlin Theorem. It is set forth in Ohlin’s 1935 classic, *Interregional and International Trade*. (Ohlin was awarded the 1977 Nobel Prize in Economics.) Heckscher and Ohlin agreed with Ricardo; international trade is based on differences in comparative costs. But, they sought to uncover the reasons for cost differentials – a point Ricardo largely ignored.

Their answer? Factor endowments. Heckscher and Ohlin predicted international

⁵⁴³ Documents References:
 (1) *Havana Charter Preamble*, Articles 1-10
 (2) *GATT Preamble*
 (3) *WTO Agreement Preamble*

trade is based on – indeed, caused by – differences in factor abundance across countries. Succinctly stated, the Heckscher-Ohlin Theorem is this: A country will specialize in the production of, and export, the good that uses intensively in its production the factor (of production, *i.e.*, labor, land, human capital, physical capital, or technology) with which the country is relatively well endowed.

Thus, for example, a country would export labor-intensive goods if it has an abundance of labor. (By “intensity,” economists mean a higher proportion of labor than of capital will be used in production. This definition depends on the ratio of factors used in production, not on the ratio of the overall availability of factors. Of course, the Theorem links the two ratios.) In contrast, a country relatively better endowed with land will specialize in the production and export of primary products.

Why? Differences in relative factor endowments mean differences in comparative production costs, the focus of Ricardo’s attention. A labor-abundant country can produce labor-intensive goods cheaply, and a land-abundant country can produce land-intensive goods cheaply. Think China and Canada, respectively, to see the importance of plentiful versus scarce factors for the price of goods that use intensively in their production those factors and, in turn, on pattern of inter-industry trade.

To reach their result, Heckscher and Ohlin needed to make several simplifying assumptions, two of which were particularly critical. First, countries differ in their factor endowments. Some countries have plenty of labor (*e.g.*, China and India), some have an abundance of land (*e.g.*, Australia, Canada, and Russia). Others have a surplus of capital (*e.g.*, Japan and the U.S.). Still others concentrate on human capital (*e.g.*, Singapore) and technology (*e.g.*, Germany, UAE).

Second, production functions for different goods make use of factors of production in different proportions. (A production function is a microeconomic mathematical relationship between factors of production, which are the independent variables, and output of a particular product, which is the dependent variable. There is a coefficient associated with each independent variable that represents the importance of its contribution in the production process.) For example, more labor is used in the production of Persian carpets than in growing wheat, but more land is used in harvesting wheat than weaving carpets.

However, third, Heckscher and Ohlin assumed that for any particular good (*e.g.*, carpets or wheat), the production function was the same in every country in which that good was produced. Thus, the production function for Persian carpets was the same in Iran, Turkey, and Pakistan, and the production function for wheat was the same in the U.S., Canada, and Australia. Another way to put this assumption is that each country has the same production technology for a particular good.

Despite mixed empirical evidence for the Heckscher-Ohlin Theorem, it remains a celebrated predictive tool for the effects of trade liberalization on trade patterns. For good reason. It is logically compelling, *i.e.*, it makes good common sense. Stated succinctly, the Theorem posits a country will specialize in the export of goods whose production uses

intensively the factors with which the country is relatively well endowed. The country will import those goods that use intensively in their production the factors with which the country is not relatively well endowed. Professor Krauss puts it nicely:

The fundamental idea is that, both for the world as a whole and its constituent nations, it is more efficient for each country to concentrate on the commodity that uses its relatively abundant factor intensively in its production and to import the other good than for each country to attempt to produce large amounts of both goods. The labor-abundant country should concentrate its production on the labor-intensive good and import the land-intensive good, and *vice versa* for the land-abundant country. In other words, the gains from international trade result from the correct matching of land-intensive and labor-intensive production technologies of goods with different factor supply or endowment ratios between countries.⁵⁴⁴

To follow up on Professor Krauss' rendition, assume the U.S. has relatively more physical capital than China, while China has relatively more labor than the U.S. The Heckscher-Ohlin Theorem predicts the U.S. will export capital-intensive goods to China, and China will export labor-intensive goods to the U.S. Sometimes, the Theorem is called the "Factor Proportions Theory." The logic of that appellation now is clear: the Theorem emphasizes the interplay of (1) proportions of different factors of production in each country, and (2) proportions in which each factor is used to make different goods.

As intimated earlier, the intuitive reasoning behind this prediction is simple and harkens back to Ricardo. Differences in the relative prices of goods are the consequence of differences in relative factor endowments. In a capital-abundant country, capital will be relatively cheaper than labor, and in a labor-rich country, labor will be relatively cheaper than capital. Because capital is cheaper than labor in the capital-abundant country, that country can produce a capital-intensive good more cheaply than the labor-rich country. Thus, because the U.S. has an abundance of capital relative to China, it can produce capital-intensive goods more cheaply than China. With trade liberalization, the U.S. will do so, and export them to China. As for China, because it is better endowed with labor than the U.S., China can make labor-intensive goods more cheaply than the U.S. Trade liberalization will cause China to do just that, and export these goods to the U.S. in return for capital-intensive goods made in America.

Or, consider the U.S. and Japan. Obviously, the U.S. has far more agricultural land available than Japan. (Roughly 60-70% of Japan is mountainous or otherwise not arable.) If free trade in agricultural products were to exist between the two countries, the Heckscher-Ohlin Theorem would predict America would be a net exporter of fruits, vegetables, and meats to Japan. What would the Japanese export in return, assuming free market access? Herein lies a small knot in the Theorem. Both countries are well endowed with labor, physical capital, human capital, and technology. The Theorem would appear to predict two-way trade in goods that use intensively in their production these factors. Japan would, therefore, export manufactured and high-tech goods to the U.S., but so too would

⁵⁴⁴ MELVIN KRAUSS, THE NEW PROTECTIONISM 5 (1978).

the U.S. to Japan. It is difficult to say, however, precisely which manufactured or high-tech goods would be traded in which direction.

III. Leontief Paradox and Empirical Tests of Heckscher-Ohlin Theorem

Unfortunately, empirical tests of the Heckscher-Ohlin Theorem have not always lent solid support. In 1953, Russian-born economist Wassily Leontief (1906-1999) used input-output analysis to test the Theorem. In this methodology, an input-output table is constructed that details the sales of every industry to all other industries in an economy. The result is a giant spreadsheet of rows and columns, or, in mathematical terms, of linear algebraic equations. Communist planners used such tables to develop central plans. Professor Leontief developed the methodology (which won him the 1973 Nobel Prize). Using data from 200 American industries for the year 1947, Professor Leontief concluded America exported labor-intensive goods and imported capital-intensive goods.

The conclusion was startling. The U.S. in 1947 was capital abundant. Thus, the Heckscher-Ohlin Theorem would predict America's export industries would be capital-intensive, and its import-competing industries would be labor intensive. Fittingly, the conclusion is memorialized as the "Leontief Paradox."

Some economists suggest the test was the most famous one in the history of economic thought, and its findings among the most puzzling and troubling ever produced by an economist. Economists had thought they had the explanation for trade patterns in the Heckscher-Ohlin Theorem, and since its development in the early 1930s, the Theorem had become one of the most revered in all of economics. Now, it appeared the Theorem could not even explain the ostensibly clear case of the U.S. To make matters worse, when Professor Leontief repeated his test with data from 1951, the Paradox remained. Professor Robert Baldwin looked at data for 1962, and again found the Paradox. Leontief-like tests for Japan using data from the 1950s, Canada, and India all showed the Paradox.

Even Professor Leontief was worried. He tried immediately to resurrect the Heckscher-Ohlin Theorem. He suggested the importance of American labor was understated in his model because U.S. workers are three times as productive as foreign workers. If their superior productivity was included in the calculation – *i.e.*, if each unit of labor were multiplied by three – then the U.S. would come out as a labor-abundant country. The pattern of labor-intensive exports would be consistent with the Theorem.

It was a nice try. But, the sad truth is the productivity of American workers is not as superior as Professor Leontief would have it. Possibly, Professor Leontief did not include natural resources or human capital in his calculations. Indeed, in accounting for these missing factors, studies by two economists, Jaroslav Vaněk (1930-2017) and Donald Keasing (1933-2004), are particularly renowned. In 1959, Professor Vaněk called attention to the importance of non-agricultural land – *i.e.*, raw materials – in American imports. He argued physical capital and land are complementary factors with respect to the production of raw materials. (As a simple example, coal mining is made possible by both land and proper equipment.) Professor Leontief had urged America's import-competing industries

were capital-intensive. But, because his model posited two factors of production – physical capital and labor – it was unrealistic. Maybe there was more than just “capital” in his capital factor. Maybe a third factor, non-agricultural land, was embedded in it as well. That is, Professor Vaněk suggested the apparent importance of capital-intensive output in America’s import-competing industries might reflect the land-intensive nature of that production. Professor Leontief had too simplistic a model, and had not sufficiently dis-aggregated the data, to capture this effect.

In 1966, Professor Donald Keesing argued it is misleading to treat labor as a single factor. Professor Keesing’s analysis of the Leontief Paradox is similar to that of Professor Vanek, but concerns a different variable. Whereas Professor Vanek focused on capital, Professor Keesing focused on labor, but both said the Paradox resulted from an all-too-simple model with insufficiently dis-aggregated data. Professor Keesing divided the American labor force according to skill levels, and found that export production is more skill-intensive than import-competing production. Accordingly, the U.S. should be seen as a skill-, *i.e.*, human-capital, abundant country. When Professor Keesing examined the data in this way, the Paradox was reversed: the U.S. exported capital-intensive goods.

Whatever the reason for the Paradox, it has not spelled the end for the Heckscher-Ohlin Theorem. That Theorem renders a fairly accurate account for some inter-industry trade among LDCs. It also is correct in respect of the pattern of trade in manufactured goods between developed countries, on the one hand, and NICs and LDCs, on the other hand. For instance, the U.S. tends to export skill-intensive products to Thailand, a NIC, which tends to export low-value added products to the U.S. In comparison with Thailand, the U.S. is relatively well-endowed with skilled labor, so this pattern of trade is consistent with the Theorem. Of course, trade between developed and developing countries accounts for a small (albeit growing) percentage of world trade, thus resurrecting the Theorem solely on the basis of this trade is not sufficient.

What about the mixed empirical results? Perhaps some can be explained. Consider the test for Japan using data from the 1950s. At that time, Japan was labor abundant, yet the test showed Japan to be exporting capital-intensive goods and importing labor-intensive goods. But, on closer inspection, Japan was capital-intensive relative to many of its trading partners, especially those in Asia. Likewise, the test for Indian exports to the U.S. showed them to be more capital-intensive than Indian imports from the U.S. Yet, the same test also showed that, overall, Indian exports tended to be labor-intensive – a conclusion clearly consistent with the Heckscher-Ohlin Theorem.

What about Leontief’s original test for the pattern of American exports? In his 1984 book *Sources of International Comparative Advantage: Theory and Evidence*, Edward E. Leamer (1944-) argued Leontief had taken an insufficiently comprehensive view of America’s factor endowments. Professor Leamer argued the Heckscher-Ohlin Theorem cannot be tested on a country-by-country basis, nor will it do to guess about the position of a particular country. Rather, it is necessary to examine many countries simultaneously, and actually measure their relative factor endowments. Professor Leamer reasoned it would be right to call the U.S. capital rich only if it has a larger share of the world’s capital stock

than of other factors of production. Therefore, he collected data on a large number of countries, examining each country's factor endowments in comparison with the world stock of those factors. While his results are complex, among them is a finding that countries with large shares of the world's capital stock tend to be net exporters of capital-intensive goods (as long as statistical adjustments are made for the relative abundance in those countries of natural resources and skilled labor).

What is the bottom line? The most appropriate view of the Heckscher-Ohlin Theorem probably is a balanced one: use it with care and realize its limitations. It remains the – or, at least, one of the – most logically tight economic explanations of trade patterns. Yet, the Leontief Paradox nags. Moreover, the Theorem fails to explain or predict much of the intra-industry trade (such as the exchange of manufactured goods for other manufactured goods) among industrialized countries. Contemporary trade relations in the U.S.-Japan are a case in point.

Most importantly, the bottom line is the Heckscher-Ohlin is a starting point, not the finishing line, for explanations of the effect of free trade on the patterns of trade. Economists are seeking ways to re-cast the Heckscher-Ohlin Theorem. In particular, they are dropping the grossly simplifying assumption of the Theorem that each country uses the same production technology. Economists know that with a given set of inputs, some countries can produce more output than others. The different outcomes are a result of “factor augmentation” – factors like labor are helped in some countries by better technology, whereas other countries lack that technology. The result is one American worker may be worth five Portuguese workers, and eight Bangladeshi workers, in terms of output per labor-hour, simply because the American worker has access to state-of-the-art technology. (Imagine writing a research paper without a computer to underscore the point.) Much empirical testing remains to be done along these lines. So far, when economists examine differences in factor endowments without assuming identical technologies, but instead adjusting for factor augmentation, they seem to account quite accurately for the observed pattern of world trade.

IV. Theory of Monopolistic Competition

The mixed – some might say disappointing – empirical results from tests of the Heckscher-Ohlin Theorem catalyzed a search for alternative explanations of trade patterns. In fact, one such explanation pre-dates the Theorem. Recall the Heckscher-Ohlin Theorem cannot account for intra-industry trade, that is, trade in the same item between two countries. Such trade has expanded rapidly since the Second World War. Why, for example, do the U.S. and Europe export automobiles to each other? One explanation might be differentiated consumer preferences. Many Americans prefer imported cars. They perceive the imports to be of superior quality, and they have a snob appeal to boot. The English economist, Edward H. Chamberlin (1899-1967), offered a different reason – monopolistic competition – in the early 20th century.

The Neo-Classical theory of perfect competition relies on the assumption competing firms produce identical products that may be substituted for one another. In his

classic 1933 book, *The Theory of Monopolistic Competition: A Reorientation of the Theory of Value*, Chamberlin points out this assumption is sheer folly. In reality, firms compete by attempting to differentiate their products. Through product differentiation, firms gain monopoly power, and imperfect or “monopolistic” competition results. For instance, the cars America imports from Europe are different from those it exports to Europe.

Finally, the Heckscher-Ohlin Theorem says nothing about two other post-Second World War phenomena: intra-firm and inter-firm trade. The former refers to trade within different constituent parts of a single multinational corporation. The latter concerns trade within several firms cooperating in a JV or sub-contracting relationship. To explain such trade, it is necessary to study the rise of multinational oligopolies, as well as the globalization of production through FDI.

V. Product Life Cycle Hypothesis

A business school theory of international trade patterns that seems to accord more accurately with reality than the Heckscher-Ohlin Theorem is the Product Life Cycle Hypothesis. Professor Raymond Vernon (1913-1999) put it forth in 1966. The U.S. (and other developed countries) often change from being a net exporter to a net importer of a particular good when production of that good becomes standardized. Radios, TVs, VCRs and semi-conductors are examples of this phenomenon. How does this transformation occur? Professor Vernon studied the process by which a product is invented, and subsequently becomes standardized as consumers and producers alike become acquainted with the features of the product.

A technologically advanced product is introduced by a company (or companies) in the U.S. primarily for domestic consumption. In this early stage of product development and marketing, it is important for the producer to be close to the market in order to receive feedback about the product from consumers, and make necessary modifications to the product based on this feedback. The market niche may consist of relatively high-income consumers. The producer is concerned more with perfecting the product than profits, market share, or export opportunities.

Soon, however, product development stabilizes, and production costs correspondingly level off or even decline owing to economies of scale. The product is mass-marketed, and profitable export opportunities are investigated and seized. In particular, consumers in NICs and LDCs develop a taste for the product as a result of marketing efforts made by the American producer. Soon the product is exported from the U.S. to meet burgeoning demand in these countries – assuming, of course, there are no barriers to trade in that product market. At this early juncture in the life cycle, the country in which the product is invented – here, the U.S. – has the comparative advantage in making and exporting it.

However, as time passes, the product and production technology become even more standardized and labor intensive. Companies in highly-populated NICs and LDCs realize they can make the same or a similar product more cheaply than the American producer –

in part because of relatively lower wage levels in those countries – and they begin to do so. Hence, the American producer becomes less successful in competing with these low-cost foreign producers. Alternatively, the American producer may decide to close production facilities in the U.S. and open them in the low-wage countries. Plainly, the comparative advantage starts shifting to these countries.

As a result, producers in NICs and LDCs mass produce the product. They market it not only to domestic consumers, but also to consumers in developed countries such as the U.S. Eventually (again assuming no trade barriers), the U.S. becomes a net importer of the good. The shift from net exporter to net importer status often is accompanied by a transfer of production technology from the American producer to producers in the NICs and LDCs. At this point, the product has gone through its complete life cycle, and comparative advantage has shifted completely. The American producer must invent a new product, or develop a significant variation of the mature product, to remain competitive. So, a critical concern of the American producer is sure to be its ability to protect its IPRs.

Three points are worth noting about the Product Life Cycle Hypothesis. First, its applicability is limited to trade in the manufacturing sector, or more accurately, in certain types of products. There must be a degree of technical sophistication – invention, followed by design, followed by development – in the product for it to have a life cycle.

Second, the Hypothesis does not explain trade patterns in all sophisticated products. The U.S. has not surrendered its comparative advantage in advanced products like aircraft, medical instruments, and some computer equipment and pharmaceuticals. These are mature products, yet the U.S. remains the world leader in their production. The problem, then, is the Hypothesis is of limited generalizability. It cannot predict well either (1) when or (2) to what products the location of comparative advantage will shift.

Third, the Hypothesis can be used to explain (in part) the Leontief Paradox. The U.S. is an innovative country, creating many new products a year. By definition, production of newly designed products is not yet standardized and, therefore, is quite labor-intensive. Businesses prefer not to invest in physical capital equipment for a new product until its features are settled, the exact market identified, and the best way to automate production determined. Until production is standardized, exports of the product will be labor-intensive. Perhaps Professor Leontief's data reflected this phenomenon.

Chapter 15

TRADE AND FACTORS OF PRODUCTION⁵⁴⁵

I. Links among Trade, Jobs, and Wages

- **Political and Humanitarian Concerns**

One of the most hotly debated topics in international trade policy is the effect of trade liberalization on jobs and wages. Never mind the theory of free trade, which stresses efficient international division of labor over employment generation. In 2014, Gary Clyde Hufbauer (1939-) of the PIIE estimated *NAFTA* made each American richer by \$400, thanks to cheaper imported products, increased exports, and higher-paying export-oriented jobs. It also was clear every dollar of imports into the U.S. from Mexico contained 40 cents of value added in the U.S., *i.e.*, there was 40 cents worth of American content in every dollar of Mexican exports to the U.S. That was because *NAFTA* had brought about an integration of supply chains. Yet, as the November 2016 election to the Presidency of Donald J. Trump (1946-, President, 2017-2021) illustrates, many Americans either do not know or neglect these facts. They believe *NAFTA* caused job and income loss, and a massive bilateral trade imbalance, so they targeted free trade, and ignored the need to boost TAA to help adjust to free trade.

Not only as a political matter, but also as a humanitarian concern, jobs and wages are and should matter. Whether existing trade liberalization obligations are met, and whether new free trade deals are passed by a legislature, depends on whether key constituencies believe those accords are a proxy to transfer jobs overseas and depress incomes at home. Those constituencies can as easily be white-collar, upper middle-class service professionals as well as blue-collar industrial workers or agricultural laborers.

- **Krugman-Batra Debate**

One of the most outspoken commentators on the subject is Professor Paul Krugman (1953-). In *Pop Internationalism* (1996), he says stagnation in American wages after 1973 (that is, the decline in real earnings of blue-collar workers in most years since 1973) is not due to free trade. He takes head on the thesis of another prominent economist, Ravi Batra (1943-), who in *The Myth of Free Trade* (1993) puts the blame for post-1973 earning and employment loss squarely on free trade. Professor Batra points out in 1973, the trade/GNP ratio (the ratio of imports plus exports as a percentage of GNP) took off, soaring soon thereafter about 20% and never to fall below that threshold again. Professor Batra argues 1973 was the year when the carnage in manufacturing jobs and real wages began. He urges that the phenomenon cannot be explained by a fall in the productivity of the American

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Documents References:

- (1) *Havana Charter Preamble*, Articles 1-10
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

worker. To the contrary, productivity rose steadily in the post-1973 period (albeit at a declining rate of growth).

How does Professor Krugman proceed with, and defend, his counter-argument? First, he points out compensation for highly educated workers has risen. He also points out that wages of the average American worker more than doubled between 1945 and 1973. Thus, the phenomenon of wage stagnation labor union leaders are fond of recalling every time a new trade liberalization bill is proposed is really a discrete one, both in terms of the sector affected and the duration of the effect.

Second, he debunks the conventional wisdom post-1973 blue-collar wage stagnation is due to a decline in the competitiveness of the American worker, that somehow foreign products have eroded the American manufacturing base, resulting in mass lay-offs in manufacturing industries, particularly among less skilled workers. It is wrong, he says, to blame the imports made by huge reserves of unskilled labor in the Third World for the problem. The truth is, international trade has only a small role to play in causing America's manufacturing difficulties. It is simply a mistake in logic to construct a causal relationship between a rise in imports and shrinkage of the industrial sector. After all, during the 1970-1990 period, when manufacturing imports rose, so too did manufacturing exports. Many American industrial companies may have laid off workers, but many added employees to produce for new overseas market opportunities.

Put differently, a dollar's worth of imports of manufactured goods may displace a dollar of sales of a like domestic product. But, a dollar of manufactured exports obviously is a dollar of sales revenue to a U.S. exporter. The question, as Professor Krugman points out, is the net effect of a simultaneous growth in manufactured exports and imports – has the trade deficit in manufactured goods been increasing as a percentage of GDP? In 1970, the U.S. had a trade surplus in manufactured goods. Measured as a percentage of GDP, manufactured exports exceeded manufactured imports by 0.2%. Since then, the U.S. has had a manufacturing trade deficit. In 1986, it reached a peak: manufacturing imports minus manufacturing exports, divided by GDP, equaled 3.1% of GDP. But, by 1990 the trade deficit in manufacturing had fallen to just 1.3% of GDP.

Even more significantly, says Professor Krugman, are statistics on the decline in the U.S. trade position in manufactured goods compared with the fall in the share of those goods in GDP. Between 1970-1990, the share of manufacturing in GDP fell by 6.6%. By how much did the manufacturing trade position as a percentage of GDP decline during that same 20 years? Just 1.5%. By correcting for the manufacturing trade deficit thusly (*i.e.*, seeing it in the context of the broader manufacturing story), the bottom line is obvious: “if trade in manufactured goods had been balanced from 1970 to 1990, the downward trend in the size of the manufacturing sector would not have been as steep as it actually was, but most of the de-industrialization would still have taken place.”⁵⁴⁶ In sum, even if between 1970-1990 the U.S. had not been importing more manufactured goods than it had exported, the decline in manufacturing still would have occurred.

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PAUL KRUGMAN, *POP INTERNATIONALISM* 38 (1996). [Hereinafter, KRUGMAN.]

What, then, explains this ineluctable de-industrialization if not international trade? Professor Krugman says the immediate reason is a change in the composition in domestic spending. Americans simply do not buy as many manufactured goods as they once did. In 1970, 46% of American consumption went on goods that were manufactured, grown, or mined, and 54% on services. By 1991, those shares had changed to 40.7 and 59.3%, respectively. What had Americans decided to spend more money on? Health care, travel, entertainment, legal services, restaurants, etc. Small wonder, intones Professor Krugman, that manufacturing is less important in the American economy.

But, this explanation leads to another question. Why did (and are) Americans spending less income on manufactured goods? Professor Krugman's answer is these goods are cheaper, relative to the price of services. During 1970-1990, the price of goods relative to services fell 22.9%. Why are manufactured goods cheaper? Because productivity has grown faster in the manufacturing than in the services sector. This growth translates into lower consumer prices. Herein is an irony: it is the productivity of American labor that contributes to the declining importance of the manufacturing sector.

Does this irony suggest we should wish for slower productivity growth?

... [C]onsider a world in which productivity (output per worker-hour) increases by the same amount in every nation around the world – say, 3 percent a year. Under these conditions, all other things remaining equal, workers' real earnings in all countries would tend to rise by 3 percent annually as well. Similarly, if productivity grew at 1 percent a year, so would earnings. (The relation between productivity growth and earnings growth holds regardless of the absolute level of productivity in each nation; only the rate of increase is significant.)

Concerns about international competitiveness, as opposed to low productivity growth, correspond to a situation in which productivity growth in the U.S. falls to 1 percent annually while elsewhere it continues to grow at 3 percent. If real earnings in the U.S. then grow at 1 percent a year, the U.S. does not have anything we could reasonably call a competitive problem, even though it would lag other nations. The rate of earnings growth is exactly the same as it would be if other countries were doing as badly as we are.

The fact that other countries are doing better may hurt U.S. pride, but it does not by itself affect domestic standards. It makes sense to talk of a competitive problem only to the extent that earnings growth falls by more than the decline in productivity growth.⁵⁴⁷

In other words, focus on whether earnings growth keeps pace with productivity growth.

⁵⁴⁷ KRUGMAN, 41-42.

What about the blue-collar earnings carnage said to result from foreign competition? As an empirical matter, Professor Krugman estimates wage loss in 1990 from de-industrialization caused by foreign competition at less than 0.07% of national income. He concedes this competition can affect adversely TOT: the burgeoning supply of foreign manufactured goods can provoke a decline in prices of like domestic products. This effect works through the exchange rate, as the dollar depreciates relative to foreign currencies, and the price of imports rises. In the end, real earnings in the U.S. can fall, because Americans must sell their manufacturing output more cheaply, and they must pay more for manufactured imports. He concedes between 1970 and 1990, the U.S. TOT deteriorated, as the ratio export to import prices fell by over 20%. (Put equivalently, Americans had to export 20% more to pay for the same import quantity.) But, he eschews ascribing too much blame to foreign competition. Professor Krugman points out during the 1970s and 1980s, real earnings grew roughly 6%. Suppose U.S. TOT had not deteriorated in those decades – would earnings have grown faster? His answer is yes, but the growth rate would have been only about 8%.

As persuasive as Professor Krugman’s analysis may be, it strikes some as cold. Surely less-educated workers in the U.S. are not helped by cheap foreign competition. As he acknowledges, this view is grounded on

... a familiar concept in the theory of international trade: factor price equalization. When a rich country, where skilled labor is abundant (and where the premium for skill is therefore small), trades with a poor country, where skilled workers are scarce and unskilled workers abundant, the wage rates tend to converge. The pay of skilled workers rises in the rich country and falls in the poor one; that of unskilled workers falls in the rich country and rises in the poor nation.

Given the rapid growth of exports from nations such as China and Indonesia, it seems reasonable to suppose that factor price equalization has been a major reason for the growing gap in earnings between skilled and unskilled workers in the U.S.⁵⁴⁸

However, Professor Krugman rejects this Factor Price Equalization (FPE) Theorem rationale. In a telling sentence, he writes: “We have found that increased wage inequality, like the decline of manufacturing and the slowdown in real income growth, is overwhelmingly the consequence of domestic causes.”⁵⁴⁹

How could Professor Krugman reject so powerful a Theorem? He returns to the:

underlying logic of factor price equalization, first explained in a classic 1941 paper by Wolfgang F. Stolper [1912-2002] and Paul A. Samuelson [1915-2009]. The principle of comparative advantage suggests that a rich country trading with a poor one will

⁵⁴⁸ KRUGMAN, 43-44.

⁵⁴⁹ KRUGMAN, 44.

export skill-intensive goods (because it has a comparative abundance of skilled workers) and import labor-intensive products. As a result of this trade, production in the rich country will shift toward skill-intensive sectors and away from labor-intensive ones. That shift, however, raises the demand for skilled workers and reduces that for unskilled workers. If wages are free to rise and fall with changes in the demand for different kinds of labor (as they do for the most part in the U.S.), the real wages of skilled workers will rise, and those of unskilled workers will decline. In a poor country, the opposite will occur.

All other things being equal, the rising wage differential will lead firms in the rich country to cut back on the proportion of skilled workers that they employ and to increase that of unskilled ones. That decision, in turn, mitigates the increased demand for skilled workers. When the dust settles, the wage differential has risen just enough to offset the effects of the change in the industry mix on overall demand for labor. Total employment of both types of labor remains unchanged.

According to Stolper and Samuelson's analysis, a rising relative wage for skilled workers leads all industries to employ a lower ratio of skilled to unskilled workers. Indeed, this reduction is the only way the economy can shift production toward skill-intensive sectors while keeping the overall mix of workers constant.

This analysis carries two clear empirical implications. First, if growing international trade is the main force driving increased wage inequality, the ratio of skilled to unskilled employment should decline in most U.S. industries. Second, employment should increase more rapidly in skill-intensive industries than in those that employ more unskilled labor.⁵⁵⁰

Here lies the rub. The empirical implications of the Stolper-Samuelson Theorem are not borne out:

... Between 1979 and 1989 the real compensation of white-collar workers rose, whereas that of blue-collar workers fell. Nevertheless, nearly all industries employed an increasing proportion of white-collar workers. Moreover, skill-intensive industries showed at best a slight tendency to grow faster than those in which blue-collar employment was high. ...

Thus, the evidence suggests that factor price equalization was not the driving force behind the growing wage gap. The rise in demand for skilled workers was overwhelmingly caused by changes in demand *within* each industrial sector, not by a shift of the U.S.'s industrial mix in response

⁵⁵⁰ KRUGMAN, 45-46.

to trade.⁵⁵¹

It is folly to blame manufactured goods from developing countries. The fact, says Professor Krugman, is the bulk of America's imports of these products comes from developed, not developing, countries. Workers in those countries have similar skill levels, and are paid comparable (and in some instances higher) wages, as American workers.

II. Technological Change

What is the reason for declining relative demand for less skilled workers? Here, Professor Krugman admits uncertainty. Echoing Lester Thurow's (1938-2016) analysis in *The Future of Capitalism* (1996), Professor Krugman blames technological change. Less skilled workers are left behind by the digital economy, *i.e.*, the digital divide is a real.

The share of manufacturing in GDP is declining because people are buying relatively fewer goods; manufacturing employment is falling because companies are replacing workers with machines and making more efficient use of those they retain. Wages have stagnated because the rate of productivity growth in the economy as a whole has slowed, and less skilled workers in particular are suffering because a high-technology economy has less and less demand for their services.⁵⁵²

In its 2017 *World Trade Report*, the WTO reinforced the Thurow-Krugman view of the primacy of technological change over trade as a cause for job loss and income decline:

A number of factors other than import competition have contributed to rising disparities across regions. Automation is a key factor, as illustrated by the increased use of industrial robots. The available empirical evidence suggests that *trade can explain up to 20 per cent or 25 per cent of the recent decline in U.S. manufacturing jobs*. This implies that *factors other than trade, such as technological change, may explain up to 80 per cent or more of the decline in manufacturing jobs in the United States*.

There has been a lot of debate around the impact of China's economic rise. There is evidence for the United States, for example, that in regions less exposed to direct import competition, employment developed favorably compared to employment in more exposed regions. Yet the debate over the labor market effects of import competition needs to encompass other issues.

In the United States, for example, there is no conclusive evidence of nationwide job losses from import competition. Indeed, when researchers take into account that, while some manufacturing jobs may be lost in a given region or a city, other jobs may be created in other regions or other cities or in the services sector, their findings suggest positive overall effects of trade on

⁵⁵¹ KRUGMAN, 46-47.

⁵⁵² KRUGMAN, 48.

employment.⁵⁵³

The key point is all of the dislocations, to one degree or another, would have happened with or without international trade.⁵⁵⁴

III. AI and T&A

The T&A sector is one among many excellent examples of the proposition that AI is more to blame than trade for job loss. Consider the implications of the demise of “fast fashion:”

In Tuntex’s sprawling factory on the outskirts of Jakarta, self-guided

⁵⁵³ WORLD TRADE ORGANIZATION, WORLD TRADE REPORT 2017 – TRADE, TECHNOLOGY, AND JOBS 9, www.wto.org/english/res_e/booksp_e/world_trade_report17_e.pdf. (Emphasis added.)

⁵⁵⁴ A distinct but related question to the effects of trade on labor is the effects of technology on labor. Summarized, the theory and evidence are:

Throughout history, technological change has been a source of anxiety for many workers. Labor-saving technologies, such as mechanization in agriculture, industrial robots in manufacturing, and automation in services, which has eliminated occupations such as elevator operators, have affected all sectors.

Labor-replacing technological change reduces the demand for labor. At the same time, however, it also reduces the cost of production and stimulates production, which in turn tends to increase labor demand. As a result of this and other factors such as local demand spill-overs (i.e., when new jobs generate additional demand in the local economy), the overall effect of labor-replacing technological change on labor demand is ambiguous.

The effects of labor-augmenting technologies on labor demand are also ambiguous, as they depend on how product demand responds to changes in relative prices induced by technological change. Whether technological change increases or decreases overall labor demand is, therefore, an empirical question.

The empirical literature has generally found small and possibly even positive effects of technological change on aggregate labor demand and employment. There are, however, a few relevant exceptions, with some studies showing the negative effects on labor demand generated by technological change. A common theme in the literature is that, *in developed and developing countries alike, the most relevant effects are on the structure, rather than on the level, of employment.*

...

The rapid diffusion of information and communication technologies (ICTs) in the workplace is consistent with an increase in the (relative) demand for skilled workers because ICTs and skills are complementary.

There seems to be a consensus that technological change has been skill-biased over the past few decades in developed and in developing countries. For the United States, it has recently been estimated that *computerization is the central force driving changes in the levels of wages between different education groups, accounting for 60 per cent of the rise in the skill premium.*

WORLD TRADE ORGANIZATION, WORLD TRADE REPORT 2017 – TRADE, TECHNOLOGY, AND JOBS 6-7, www.wto.org/english/res_e/booksp_e/world_trade_report17_e.pdf. (Emphasis added.)

vehicles trundle across the shop floor, carrying materials between auto-cutting stations – which churn out jigsaw pieces of fabric – and semi-automated sewing machines, where more than 1,000 workers oversee the construction of finished garments.

Tuntex, which supplies Adidas, Nike, Puma, and other global clothing brands, has always had to be fast, turning around product lines quicker than its rivals to compete in the relentless cycles of the fast fashion market. Today, though, the pressure is growing on them to be ever quicker, ever more reactive.

“The average lead time went from 120 days to 90 days about four years ago, and now it’s 60 days. ... Some manufacturers are even doing much shorter,” said Stanley Kang, Tuntex’s deputy general manager. “Automation and digitalization are changing everything, and when things change, we have to change. Whoever can respond faster will win.”

...

Tuntex, like many others in the supply chain of the \$1.4 trillion garments industry, is investing millions of dollars per year in new technology and new processes, as shifts in consumer demand reshape the sector. The days of stack-them-high, sell-them-cheap “fast fashion” are coming to an end, replaced by a new model which favors speed, precision, traceability and adaptability over bulk.

To adjust, suppliers are moving their centers of production across borders to be closer to infrastructure, raw materials and their eventual markets, allowing them to shave precious days off their turnaround times. They are also investing heavily in automation and digitization, as the technology becomes more advanced and competitive with the cheap labor that has sustained the industry.

The changing economics of the industry could profoundly impact those countries in South and Southeast Asia that have positioned themselves as hubs for the most basic elements of the garment supply chains. And it potentially ends a seven-decade-long global race to the bottom on wages, as full automation drastically changes how the industry turns a profit, and threatens to displace millions of low-skilled workers around the world.

...

The voracious demand for speed has begun to overturn the supply chains that apparel companies spent the past few decades building. On a relentless drive to cut costs, suppliers restlessly shifted their manufacturing bases within and between Asian nations in a continual search for lower wages and cheaper land. That stretched their supply chains over huge geographic distances: Thousands of kilometers divide fabric mills from sewing factories, themselves weeks away from their final destination by ship. The journey of an Adidas or Nike garment produced by Tuntex in Indonesia, for

instance, can begin almost 4,000 km away in the company's textile plant in Taiwan. The fabrics can take nearly a week to reach the sewing factories.

The model worked well enough when retail stores dictated trends and operated in clearly delineated seasons. But when clothing retailers need to react to a sudden trend driven by Instagram, it creates a daunting barrier. Some, such as Inditex, have solved the problem by moving production closer to their consumers – a process known as “reshoring” or “nearshoring.” Factories in Europe are now increasingly serving Europe.

...

That tightening of production cycles creates new competitive challenges for companies like Tuntex, which have tracked the development of the global textiles and garments industry over the past seven decades.

Beginning with a single mill in Taiwan in 1954, Tuntex today employs about 16,000 people in 17 factories across Asia....

The manufacture of textiles and clothing has long been a forerunner of globalization. East Asian production hubs, including Taiwan, were among the first to benefit from the industry's offshoring of production, and they leveraged their low wages to build a manufacturing base that gradually developed into higher value sectors. As salaries rose, so did costs, and the industry migrated into countries where wages were lower – notably, mainland China, which from the late 1990s was opening up to foreign trade, and Vietnam....

...

Other countries have also ridden the wave. Bangladesh, in particular, has specialized in producing very basic garments for international businesses, and is now second only to China as an exporter.

The garment trade has helped countries to develop their industrial bases, sometimes from scratch – apparel makes up more than 80% of Bangladesh's total exports. From there, some countries have been able to move up the value chains, from basic assembly of garments into more capital- and technology-intensive products, such as electronics or automobiles.

Vietnam is an example of this, building on a foundation of simple manufacturing to eventually attract factories producing automobiles and high-tech goods – such that garment makers say that they are now struggling to find affordable labor.

The search for cheap workforces, though, has had a human cost. Poor wages and working conditions have long been a blight on the garment supply chains, and have occasionally surfaced into the consciousness of consumers. High-profile campaigns against child labor and “sweatshops” in Nike's supply chains in the 1990s prompted a flurry of action among major

brands. Later, many of those same concerns re-emerged; notably, in April, 2013, when the Rana Plaza factory complex [discussed in a separate Chapter] near Bangladesh’s capital of Dhaka collapsed, killing more than 1,000 workers.⁵⁵⁵

This case study shows as outdated the characterization that FDI decisions are driven by a race-to-the-bottom with respect to labor standards. In that characterization workers in developed countries are rendered redundant, losing their jobs to exploited workers in developing countries and LDCs.

Those decisions depend, as they always did, on cost control. But, cost control in the 21st century depends on AI, *i.e.*, it is not about finding the cheapest labor, but rather about digitized design, automated production, careful calibration of small-batch output to match demand, and proximity to markets.

So-called “Sewbots,” for instance, are robots that “can produce a T-shirt in 22 seconds or a shoe upper in 26 seconds.”⁵⁵⁶ Likewise, knitting machines can make a sweater in less than one hour, laser cutting is replacing hand-cutting of fabric, and 3D printers with robotic arms are making shoes. T&A factories thus need fewer laborers, and more industrial engineers and managers. Indeed, in a 2019 report, the ILO estimated “as many as 80% of the more than 60 million jobs in the sector could be at risk as automated cutting and sewing robots take over factory floors,” with the speed of those losses contingent “on the pace of adoption of new technologies.”⁵⁵⁷ Consequently, blaming import-export patterns for job loss may fail to account for what in reality is a more dynamic, complex process.

Without doubt, that process of replacing human labor with a high-tech substitute occurs across many economic sectors of the American and other economies, and is accelerating. In the U.S., in 2015, 176 robots were installed for every 10,000 workers. In 2022, 274 robots were installed – 40,000 in total – for every 10,000 workers.

... The automotive industry was the biggest driver of the expansion [of robots], with U.S. installations in the sector jumping 47% in 2022. Factories have also been on a human hiring spree: Roughly 13 million people were employed in the U.S. manufacturing sector as of August [2023].... That’s the highest level since 2008, but a mere 1.3% increase from the same month in 2019.

...

Automation is frequently painted as the enemy of labor; the reality can be more complicated. ... A shortage of skilled workers was a key motivation

⁵⁵⁵ Gwen Robinson, Marrian Zhou & Erwida Maulia, *How the Death of Fast Fashion is Transforming Asia’s Garment Industry*, NIKKEI ASIAN REVIEW, 20 November 2019, <https://asia.nikkei.com/Spotlight/Cover-Story/How-the-death-of-fast-fashion-is-transforming-Asia-s-garment-industry>. [Hereinafter, *How the Death*.]

⁵⁵⁶ *How the Death*.

⁵⁵⁷ *How the Death*.

for companies that accelerated automation investments in the wake of the pandemic, including trash-hauler Waste Management Inc., air-conditioner maker Carrier Global Corp. and Howmet Aerospace Inc., a supplier of fasteners and other metal parts for aircraft.

Howmet recently finalized a five-year agreement with the UAW for its plant in Whitehall, Michigan, which makes engine airfoils. ... Certain work functions at the plant that previously required four people now require only one.... Indeed, “much of the heavy lifting is automated, including the dipping of the waxed forms into casting slurry to form the shell, movement of the forms between stages, and melting of the alloys in the furnaces and cooling,” Vertical Research Partners analysts ... [reported]. The company is also using artificial intelligence and machine learning to assist in inspection and recognition of defects, with the technology improving through repetition and human correction.

... Howmet representatives noted that “the union is generally on board with increased automation as that drives product and volume growth necessary to support the organization,” according to the Vertical Research report. With Boeing ... and Airbus ... pushing to ramp production of top-selling jets ever higher and lingering difficulties in attracting skilled labor, many aerospace suppliers need to invest in automation simply to keep up....

... Globally, factories installed around 553,000 industrial robots in 2022, with more than half the expansion taking place in China....⁵⁵⁸

In brief, foreign import competition generally, or a “China effect” (discussed below) in particular, are easy-to-blame for job losses, but the reality is more nuanced. Labor shortages are a key cause for “hiring” robots. China itself needs robots to replacing its labor pool, which is shrinking thanks to a population aging-out of the work force.

Note also the linkage of robots-substituting-for-people to the quality as well as quantity of human capital. Per the above-quoted passage, a skilled labor shortage afflicts some industries. Why? Are degraded public education systems to blame for failing to graduate creative, clever skilled workers?

IV. Factor Price Equalization Theorem

Economists are not blind to the effects of trade liberalization on wage rates. Indeed, for some time they have offered two theorems concerning these effects. Like most economic theorems, they are not always borne out by empirical testing. Nevertheless, the logic – indeed, simple common sense – behind the theorems makes them compelling. It

⁵⁵⁸ Brooke Sutherland, *Robots Versus Workers is No Zero-Sum Game*, BLOOMBERG, 29 September 2023, www.bloomberg.com/opinion/articles/2023-09-29/industrial-strength-robots-versus-workers-is-no-zero-sum-game-ln4yacbq?sref=7sxx9Sxl.

might even be argued the failure of trade policy makers and legislators to come to grips with these theorems – for example, through a meaningful TAA program is a major reason for widespread resistance to, and persistent anxiety about, trade liberalization.

Consider the U.S., a capital-abundant country, and Mexico, a labor-abundant country. They are Parties to an FTA, *NAFTA* (both *NAFTA* 1.0, which entered into force on 1 January 1994, and thereafter to *NAFTA* 2.0, or *USMCA*, which took effect on 1 July 2020 and substituted for *NAFTA* 1.0). Assume, however, factors of production could not flow freely across the U.S.-Mexican border: capital in the U.S., and labor in Mexico, stayed put. No matter. The free trade occurring between these countries is a substitute for the free mobility of factors of production.

How so? First, consider an autarkic scenario. In the absence of any trade, wage rates in the U.S. will be high, because labor is scarce, and the U.S. is not efficient at producing labor-intensive goods. However, physical capital is cheap, because it is in abundance, and thus so also are capital-intensive goods. Conversely, in Mexico, the returns to capital are extraordinary, because capital is scarce in Mexico and, therefore, commands a high price. But, labor is cheap because it is abundant, and goods that are labor-intensive can be purchased for a bargain.

Now, along comes *NAFTA*. Recall the Heckscher-Ohlin Theorem predicts a country will specialize in the production of, and export, that good which uses intensively in its production the factor with which the country is relatively well endowed. Thus, the Theorem predicts the U.S. will export capital-intensive goods to Mexico (*e.g.*, cars and medical instruments), and Mexico will export labor-intensive goods to the U.S. (*e.g.*, low-value added products like brooms, ceramics, or simple shoes and toys). Consider, then, the impact on the factor markets in each country. In the U.S., demand for capital will rise, and demand for labor will fall. Factor resources, specifically, capital, shift to the advantaged export sector. After all, in response to demand from Mexico, businesses will make more capital-intensive goods. Thus, U.S. businesses will need more machine tools, and less labor. Returns to capital will rise, but the price of labor (*i.e.*, wages) will fall.

In Mexico, the opposite reactions will occur. Factor resources, in particular, labor, shifts to the advantaged labor-intensive export sector. After all, in response to demand from the U.S., Mexican businesses will concentrate on producing and exporting labor-intensive goods. Their demand for labor will rise, causing an increase in wages, but the demand for capital will fall, causing a drop in the return to capital.

Observe the Heckscher-Ohlin Theorem does not require complete specialization. Quite the contrary. Incomplete specialization is most likely. Each country continues to produce some of each good. The U.S. still makes some labor-intensive goods, and Mexico still produces some capital-intensive goods. Specialization, then, is a focus or emphasis, but not an all-or-nothing proposition. Why not?

Because of increasing opportunity costs. Production in the advantaged industry continues to increase as long as the relative cost of this expansion is lower than, or just

equal to, the relative price. But, eventually, the relative cost of producing a product begins to exceed the relative price obtained from selling that product, thus making further increases in output in the favored industry economically irrational. Ultimately, even in the advantaged sector, the law of diminishing returns must apply. At some point, adding more and more of the abundant factor of production will yield less-than-proportional increases in output, suggesting that the additions of the input are not paying off. Better to keep those inputs in the other industry. Hence, the other industry will survive, in a diminished state, and still compete with imports. There would be complete specialization only in the highly unusual case where the price of a country's exported good rises to such a high level that all of that country's factors are attracted to producing exportables.

Now, juxtapose the pre- and post-*NAFTA* scenarios. Before *NAFTA*, labor commanded a premium in the U.S., whereas capital did not. After *NAFTA*, American wage rates fell, but owners of capital enjoyed higher returns. In Mexico, the opposite events occurred. The end result is a convergence – ultimately, an equalization – of factor prices. Mexican wages rise, while American wages fall, and the two eventually equalize. Returns to capital in the U.S. rise, while in Mexico they fall, and eventually move to the same level. This is factor price equalization: in the absence of free mobility of factors of production across geo-political boundaries, free trade causes a long-run convergence in the incomes of each factor of production. In each country, the price of the abundant factor goes up, and the price of the scarce factor falls, because free trade impels each country to use its abundant factor all the more. Or, to put it concisely: free trade is a perfect substitute for factor mobility and leads to the equivalence of factor prices.

Why is it justified to say that factor incomes will *equalize*? Why not just stop with the less strong proposition that they will *tend* to converge? The answer is that free trade ought to result in a common world-market price for a product. In every country, the American-made, capital-intensive good will cost the same, and likewise, there will be a single, world-wide price for the Mexican-made, labor-intensive good. (Observe the critical hidden assumptions here necessary for this result: an absence of trade barriers, perfectly competitive markets, use of the same production technology, and identical products.) Because each country continues to produce some of each good (*i.e.*, there is incomplete specialization), and because each good is produced at the same cost using the same technology, returns to each factor should equalize.

Another way of explaining the justification for equalization is to consider what the goods exported by each country embody. The answer is the abundant factor of production. When the U.S. exports capital-intensive goods to Mexico, it is exporting some of its abundance of capital. The Americans are letting the Mexicans have use of some of their abundant factor – not by selling it directly, but by exporting the good that is produced with a high ratio of capital to labor. Conversely, when Mexico exports labor-intensive goods to the U.S., it is exporting some of its abundance of labor. The Mexicans are letting the Americans use some of their generous endowment – again, not by direct sales, but by exports of the good that uses labor intensively in the production process. In brief, when countries trade, they do more than exchange goods. They exchange the factors of production embodied in those goods.

Thus, if the U.S. is “exporting” some of its capital to Mexico, through the embodiment of capital in the capital-intensive good, then it is reasonable to expect the return to capital in Mexico to fall. In effect, the “supply of capital” in Mexico increases, but demand for capital has not picked up – indeed, it has fallen with trade liberalization. The income earned by Mexican owners of capital must, therefore, fall. Likewise, if Mexico is “exporting” some of its labor to the U.S., through the embodiment of labor in the labor-intensive good, then wages in the U.S. must fall. The practical effect is that the “supply of labor” in the U.S. increases. Given that demand for labor in the U.S. falls with trade liberalization, American wages are sure to drop.

Interestingly, there is some empirical evidence to support the Factor Price Equalization Theorem. In 1993, Professor Dan Ben-David published the results of his analysis of the effects of lowering trade barriers in Western Europe following the creation of the EU. He found a dramatic reduction in the dispersion of incomes across countries.

As another example, before 1970, many developing countries exported raw materials to the U.S. and EU. But, since 1970, some developing countries have exported manufactured goods to America and Europe that use unskilled labor intensively in the production processes. These exporting countries are NICs such as Brazil, India, Mexico, Korea, and their exports include T&A, and shoes. In return, America and Europe have exported products that are skill-intensive, capital-intensive, such as chemical and aircraft. What has the effect of this NIC-developed country trade pattern been on wages of highly skilled and unskilled workers in developed countries?

The answer is wages of highly skilled workers have risen, but wages of unskilled workers have fallen. For instance, from 1970-1989, the real wage of American male workers in the 90th percentile (*i.e.*, those earning more than the bottom 90%) rose by 15%, but the real wage of American male workers in the 10th percentile fell by 25%. This fact is what the Factor Price Equalization Theorem predicts. NICs export less-skill-intensive manufactured goods, because they are abundant in unskilled workers. The Theorem forecasts the wages of unskilled workers in the U.S. and EU (workers employed in import-competing industries) will fall. In contrast, the U.S. and EU export high-skill-intensive goods, because they are abundant in human capital. The Theorem says demand and, hence, wages, of highly skilled U.S. and EU workers will rise.

Still, complete factor price equalization has not occurred in the U.S. or EU. Nor has it occurred as a result of *NAFTA*, much less as a result of the Uruguay Round agreements. A particular interesting fact is that the growing wage inequality between skilled and unskilled workers in the U.S. and EU also is occurring in NICs. Skilled workers in China, for instance, are doing very well, yet the Factor Price Equalization Theorem would predict a drop in their wages. Why have factor prices not equalized?

One obvious answer is trade between NICs and developed countries is insufficiently large in volume to influence income distribution. Most trade occurs among developed countries. Another possibility is that the explanation has nothing to do with

trade. The reason for growing wage inequality, at least, is technology: workers who know how to use it win, those who do not are left behind.

However, part of the answer must lie in the assumptions underlying the Factor Price Equalization Theorem. They simply do not hold as true in reality as economists might like. First, complete free trade is needed. After all, if prices of goods cannot equalize, then factor returns cannot equalize. However, this assumption is patently false. Tariff and non-tariff barriers remain the world over, and even when they fall, remedial actions often are taken to re-impose barriers. Even so-called FTAs, like *NAFTA*, have their share of barriers. Preferential ROOs are a case in point.

Second, there must be no transport costs (or, at least, they must be negligible). That assumption remains a shipper's dream. Most of world trade moves by ocean freight. Depending on trade volumes and routes, freight charges vary. During and after the 1997-1999 Asian economic crisis, when currencies were devaluated, and depreciated, relative to the U.S. dollar, exports from the Far East to America surged. Freight charges and container rates were cheap on voyages from the U.S. back to the Far East. However, during oil price shocks, wars, or other civil unrest, these costs can skyrocket. The point is, transport costs are rarely, if ever, negligible.

Third, there must be no factor reversals, *i.e.*, there must be no differences in the rankings of countries with respect to the factor requirements needed for a particular good. For example, suppose that in the U.S., producing cars is capital intensive and growing soybean is land intensive. A factor reversal would exist if, in another country that also made cars and soybeans, cars were less capital-intensive than soybeans. If the U.S. exported soybeans, and the other country exported cars, both countries would appear to be specializing in a non-capital-intensive product. It would, then, be impossible to draw any general conclusions about trade patterns from the data of these two countries.

However, whether this assumption is true is an empirical question. It depends on the countries involved and, more specifically, on their technologies of production. The Factor Price Equalization Theorem assumes that production technologies are the same. That is not true in all instances, particularly if factors are substitutable in the production process of a good. For instance, Californian farmers use considerable machinery to grow rice, whereas Thai and Vietnamese farmers use a labor-intensive process.

Fourth, the Theorem relies on the assumption that relative factor endowments across countries are not wildly different. If they were, then either or both countries might produce only one good. Suppose the U.S. had a huge amount of capital and very little labor, and Mexico had an enormous population size but no capital. The U.S. might produce only capital-intensive goods, and Mexico might produce only labor-intensive goods. When the countries traded, the issue of the equalization of factor prices would have no practical importance. In fact, there are cases where factor endowments are not at all close. India and Russia, with vast differences in labor and land, or Burma and Singapore, with vast differences in natural resources and human capital, are examples.

All of this is not to say the Factor Price Equalization Theorem is either utterly quixotic or a mere intellectual curiosity. It is useful, if for no other reason than it lends insight into what might happen if the economist's dream of real trade liberalization came true. In turn, it should catalyze thought as to how to handle adjustment costs that might arise after a free trade deal is signed.

V. Stolper-Samuelson Theorem

The Theorem published in 1941 by Professors Stolper and Samuelson, and later named after them, is about the income distribution effects of trade liberalization. In political terms, it is about winners and losers from free trade. As such, it helps predict and explain why certain groups support, and others oppose, free trade. The Stolper-Samuelson Theorem follows logically from the Factor Price Equalization Theorem, just as the Factor Price Equalization Theorem emerges straight from the Heckscher-Ohlin Theorem. Like the other Theorems, the Stolper-Samuelson Theorem focuses on inter-industry, not intra-industry, trade.

The question Professors Stolper and Samuelson began with is this: If free trade occurs, what is the effect on the price of the scarce factor of production? Their answer: that price must fall. The intuitive reasoning is simple.

In the example of U.S. and Mexico, America is accurately assumed to be blessed with plenty of capital, but a scarcity of labor, relative to Mexico. Mexico faces the opposite situation. When trade liberalization occurs because of *NAFTA*, Mexicans demand capital-intensive goods from the U.S. Professors Stolper and Samuelson knew the U.S. has a comparative cost advantage, based on relative factor endowments, in these goods. They also knew Americans seek labor-intensive goods from Mexico, because Mexico produces these more cheaply than the U.S., given Mexico's abundance of labor.

The result is captains of American industry stock up on physical capital, but not labor. They buy more of the factor with which their country is relatively well endowed. Demand for capital-intensive goods, which Mexico fuels, is increasing. Given this export demand, the price of capital-intensive goods must rise, and thus so too must returns to capital. After all, an increase in the price of capital-intensive goods must lead to an increase in the income of the factor used intensively in the production of that good.

As for American wage rates – the returns to the scarce factor of production – they will tumble. The captains of American industry know better than to try and compete with Mexico in the production of a labor-intensive good, *i.e.*, a good in which America lacks a comparative cost advantage, given the differences in relative factor endowments. In contrast, in Mexico, businesses hire workers, knowing America has an appetite for Mexican labor-intensive goods. Given this export demand, the price of Mexico's labor-intensive goods inevitably rises. There is a concomitant increase in the returns to the factor used intensively in producing those goods – Mexican labor, *i.e.*, Mexican wages must rise. But, Mexican businesses do not increase their demand for capital. Returns to capital – Mexico's scarce factor of production – thus tumble.

Complete specialization does not occur in reality. Even with free trade between the U.S. and Mexico, there are some American businesses hiring labor for labor-intensive goods. And, some Mexican businesses employ capital for capital-intensive goods. What is the long-term fate of these enterprises? Not good, if free market forces operate.

American workers making labor-intensive goods will face stiff import competition, as will Mexican capital that produces capital-intensive goods. Neither of these groups will be able to exploit their “scarcity power” in their respective countries if they are forced to compete with their cohorts across the border. Not surprisingly, American labor and Mexican capital will oppose free trade. They may demand protection, and they may get it if they have sufficient lobbying clout or if they happen to be making a product deemed strategic. At the least, American labor and Mexican capital may demand adjustment assistance packages to cope with vicissitudes.

Here, then, is the Stolper-Samuelson Theorem. Trade liberalization leads to an increase in the relative price of labor in the labor-abundant country (*e.g.*, Mexico), and a decrease in the relative price of labor in the capital-abundant country (*e.g.*, U.S.). These results occur because of the effect of trade liberalization on the relative demand for factor inputs. In the labor-abundant country, demand for labor rises, and demand for capital falls. Conversely, in the capital-abundant country, demand for capital rises, and demand for labor falls. In brief, free trade helps the abundant factor and harms the scarce factor. It increases the income of a country’s plentiful factor, because it is used intensively in the export sector, but it lowers the income of the country’s scarce factor, which is used by domestic producers that compete with imports.

One clear implication of the Stolper-Samuelson Theorem is the share of each factor of production in a country’s national income accounts will change. In the example, the share of Mexico’s GDP accounted for by labor will rise, while the share accounted for by capital will fall. In the U.S., the share of capital in national income will rise, whereas the share of labor will fall. Another implication of the Theorem is that it can be applied within a specific factor, for example, labor, to evaluate the effects of trade liberalization on high-skilled versus less-skilled workers:

Trade can lead to a reallocation of economic activity and therefore can lead to *changes in a country’s employment structure* at the level of tasks, occupations, firms or sectors.

In advanced economies, trade increases the relative demand for high-skilled workers, especially in non-routine occupations. It thus behaves in a similar manner to skill-biased technological change. The main channels appear to be specialization in skill-intensive activities, the offshoring of routine tasks and increased innovative activity as a response to competition from low-cost exporters. Trade also leads to a higher demand for high-skilled workers in developing economies, mainly because of technology diffusion through imports of capital goods, intermediate inputs and know-how.

The increased demand for skills often translates not only into an increased share of skilled workers in employment, but also into a higher *skill premium*, that is, an increase in the nominal wages of high-skilled workers relative to low-skilled workers. [The “skill premium” is the ratio between the wages of skilled and unskilled workers.]

...

There is evidence in developing countries that it is not only the wages of skilled workers, but also the wages of unskilled workers, that increase thanks to trade.

Furthermore, trade increases the purchasing power of poor, low-skilled workers more by enabling them to purchase cheaper imported products, and therefore its impact on the relative real wage can be favorable to the poorer.⁵⁵⁹

What, then, are obvious lessons to draw from the Stolper-Samuelson Theorem?

Legal counsel to a scarce factor of production – American labor, and especially low-skilled labor, for example – should demand protection. A tariff on Mexican labor-intensive goods would raise the cost of those goods, and allow American businesses producing labor-intensive goods to raise their prices to the higher level resulting from the tariff. When the price of their product rises, American workers will realize higher wages. But, counsel for a plentiful factor of production – Mexican labor, for example – should lobby for free trade. Avoid tariffs and other protective measures that interfere with market-based income distribution outcomes.

While those lessons are “obvious,” they are not exclusive. To make the case for free trade to representatives of the scarce factor of production (*e.g.*, U.S. unions) then come up with a mechanism for helping them weather nasty effects of free trade. Fiscal compensation from the government, in the form of TAA is the conventional mechanism.

Recall the central insight of Ricardo’s Classical Model: free trade results in a net (not gross) gain to the countries involved, because each country specializes in the production of what it can produce most efficiently (cheaply), and each country consumes a bundle of goods that is unattainable under autarky. Therefore, it ought to be possible for the winners from free trade to transfer some of their gain to the losers as compensation. Still a bolder proposal to make the world safe for free trade and yet retain a compassionate disposition to the losers might be to focus on human capital development. What better way to cope with the vicissitudes of the global economy than to re-conceptualize education as a life-long process, and for the government to provide (directly or indirectly) subsidized training? After all, better to give workers a fishing pole for life than a fish for today.

VI. World Bank, WTO, ILO, and OECD Empirical Research

⁵⁵⁹ WORLD TRADE ORGANIZATION, WORLD TRADE REPORT 2017 – TRADE, TECHNOLOGY, AND JOBS 9, www.wto.org/english/res_e/booksp_e/world_trade_report17_e.pdf. (Emphasis added.)

Prominent IOs contribute to the debate embodied by Professors Krugman and Batra and evaluate the real-world application of the Heckscher-Ohlin, Factor Price Equalization, and Stolper-Samuelson Theorems. To be sure, these IOs generally favor open trade, so their studies support trade liberalization as a nearly universally desirable policy goal. And, economists debate about how best to measure “openness” to trade, and thus argue about which countries qualify as open trading nations. In fact, under any metric, countries are “open” or “closed” at different points in their history. Still, emerging from IO research are four fundamental points worth of consideration.⁵⁶⁰

- **1st: Openness Leads to Faster Economic Growth**

According to the World Bank, the GDP growth rate (as of 2012) of countries with open trade policies is triple that of countries with closed trade policies. Faster relative growth also is observed in *per capita* GDP. The proof lies not only in empirical evidence, but also in negation of this proposition: autarky leads to slower economic growth. The proof is by counterexample: Burma (from 1962-2012) and North Korea (for its entire history). China before its 1979 reforms led by Deng Xiaoping (1904-1997), and India before its 1991 liberalization led by Manmohan Singh (1932-), also are counterexamples.

- **2nd: Trade is an Engine of Growth**

Open trade and economic growth are increasingly closely correlated. Trade is an ever-more important source of growth. The proof is by example. In the U.S. in 1949, exports contributed 0.42% to American GDP growth. In 2010-2011, exports added 1.08% to GDP growth. So, in 6 decades, the significance of trade as an engine of growth trebled.

- **3rd: Trade Creates Jobs and Boosts Incomes**

As a 2012 joint WTO-ILO study indicates, the efficiency gains caused by trade generate two positive employment effects: trade boosts the number of jobs, and the level of wages. For example, the U.S. is an open trading nation, and Minnesota is headquarters to many globally competitive multinational corporations. In the U.S. (as of April 2012), jobs tied to exports pay 6% better on average than those not related to exports. In Minnesota, the figure is 18%.

- **4th: Import Penetration and Unemployment are Weakly Correlated**

As a 2012 OECD study states, the link between import penetration and unemployment is tenuous. The OECD surveyed 23 countries and computed their average unemployment rate in 1970 as 3%. In that year, their import penetration ratio was slightly in excess of 10%. By 2012, their import penetration ratio had leaped to 45%. But, unemployment was 8%, partly due to the aftermath of the global economic slump.

⁵⁶⁰ “Trade Improves the Lives of People,” Speech of Pascal Lamy, WTO Director General, to Minnesota Economic Club, Minneapolis, 17 April 2012, www.wto.org.

VII. “China Effect”?

Overall, the number of Americans employed in manufacturing fell from one in five in 1980 to one in 12 in 2015.⁵⁶¹ Across developed countries, industrial jobs as a share of employment had declined for 40 years. China acceded to the WTO on 11 December 2001. Was its accession a culprit for post-2001 job losses?

Initially, economists thought automation, along with sluggish growth in demand for manufactured goods, were to blame. Japan seemed to be a case in point: its trade regime was less open than those of other developed countries, so economists inferred increased mechanization and sluggish consumer demand were the culprits for industrial job loss across four decades in Japan.

Federal Reserve data showed that between 1970-2010, output per factory worker rose by more than four times, as companies replaced humans with machines to enhance efficiency. That mirrored a development earlier in American history, when agriculture became mechanized, and jobs shifted to factories. So, for instance, dockworkers in American ports could move 1.7 tons of cargo per hour before those ports used large cranes and cargo containers; five years after they started using cranes and containers, dockworkers moved 30 tons per hour.⁵⁶² Fewer dockworkers were needed, and the remaining ones had sophisticated human capital training. Yet, regardless of job loss through production specialization, economists insisted the middle class and poor were better off by free trade, because of the wider availability of cheaper goods.

But, was there a “China effect” to blame for the loss of U.S. industrial sector jobs? Multiple studies indicate the consequence of its WTO Membership on American manufacturing jobs was negative – but how negative, and why, is uncertain.

First, in 2013, MIT economist David Autor estimated that between 2000 and 2007, 982,000 American manufacturing jobs were lost because of import competition from China. The Autor study traced (1) industries in which Chinese exports burgeoned to (2) American competitors. (That economists were not doing surely was befuddling to International Trade Lawyers, who appreciate the importance of matching foreign exports with “like,” “directly competitive,” or “substitutable” domestic products.) The result was a “powerful correspondence between where China had surged and where U.S. manufacturing employment had collapsed.”⁵⁶³ Autor reasoned that, in contrast to the Smith-Ricardo Classical Theory of free trade, “[i]n reality, ... labor fails to migrate smoothly from dying industries to growth sectors,” and “[w]orkers with lower education, skills and income tend to suffer the most under these conditions.”⁵⁶⁴ Indeed:

⁵⁶¹ See Peter Gosselin & Mike Dorning, *After Doubts, Economists Find China Kills Well-Paying U.S. Factory Jobs*, 32 International Trade Reporter (BNA) 1150 (25 June 2015). [Hereinafter, *After Doubts*.]

⁵⁶² *After Doubts* (discussing a study by McKinsey & Co.).

⁵⁶³ *After Doubts* (quoting Autor).

⁵⁶⁴ Hiroyuki Kotake, *Biden and Trump Both Exaggerate Pain from Trade with China*, NIKKEI ASIA, 10 July 2023, <https://asia.nikkei.com/Spotlight/Comment/Biden-and-Trump-both-exaggerate-pain-from-trade-with-China#>. [Hereinafter, *Biden and Trump Both Exaggerate*.]

The economic development of China after its 2001 accession to the World Trade Organization was a particularly striking example [of this suffering], producing unemployment and downward pressure on wages in areas of the U.S. affected by the surge in imports.

Autor and his colleagues estimate[d] that this led to the loss of nearly 1 million manufacturing jobs, and between 2 million and 2.4 million jobs overall, between 1999 and 2011.

And although the impact of the so-called China shock peaked around 2010, it continued to reverberate throughout the U.S., according to this analysis. The latest estimate indicates that rising imports from China accounted for roughly 60% of all manufacturing jobs lost between 2001 and 2019.⁵⁶⁵

But was trade liberalization a zero-sum game, as the Autor research suggested? Not necessarily:

... Research accumulated on the topic [of the China shock and its effects] not only ties the phenomenon to a reduction in jobs and income from slow adjustments in the labor market, but also to lower home prices, declining marriage rates, technological stagnation, and the rise of populism.

...[S]ome experts warn against focusing exclusively on the blows dealt by the China shock. Increased trade with China and other countries came with positives that helped offset many of the negatives, including benefits to consumers, new export opportunities and turnover in stagnant industries.

[Keio University Associate Professor Akira Sasahara] is one of them. While an Assistant Professor at the University of Idaho, he co-wrote a paper arguing that the increase in U.S. goods exports to the rest of the world, including China, relative to U.S. imports from China produced 1.7 million jobs between 1995 and 2011.

“Changes caused by the IT revolution may have had a greater effect on manufacturing jobs,” said Senshu University Professor Hideo Ohashi. Many economists worldwide continue to hold similar views.⁵⁶⁶

Succinctly put, the magnitude of a China shock, and the extent to which factors other than Chinese-origin import competition are causes of the shock, is empirically unsettled. That is apparent from the next two points.

Second, in 2015, economists Justin Pierce of the Federal Reserve and Peter Schott of Yale said of the five million American factory jobs lost since 2000, at least one million, and possibly more than two million, were thanks to China’s WTO accession. The biggest

⁵⁶⁵ *Biden and Trump Both Exaggerate.*

⁵⁶⁶ *Biden and Trump Both Exaggerate.*

drops in manufacturing were connected to the biggest surges in imports. In turn, those surges were in products in which China had obtained the biggest tariff reductions in its WTO accession deals. The products included apparel, leather goods, medical and surgical equipment, and plastic plumbing fixtures.

Third, in 2017, Gary Hufbauer and Lucy Lu of the PIIE found that “156,250 manufacturing sector jobs were lost annually over the past 13 years,” due to globalization.⁵⁶⁷ But that figure “represent[ed] less than a percent of the number of people involuntary separated from their jobs each year.”⁵⁶⁸ Likewise, “between 2001 and 2015 – a period that covers the ‘China shock’ – expanding imports hurt about 312,000 workers a year on average.”⁵⁶⁹ Yet, that number “represent[ed] under 2 percent of the total number of periods of involuntary unemployment experienced by workers during those years,” and was “an upper bound based on the assumption that every dollar spent on imports comes at the expense of purchases of American products and credit should be given for a significant offsetting increase in employment as a result of increased exports.”⁵⁷⁰

So, what is the “bottom line”? Perhaps it is best summarized as follows:

*Almost 6 million manufacturing jobs were lost in the United States between 2000 and 2010. This loss was overwhelmingly caused by two recessions as well as relatively faster productivity growth, but trade did play a role. Autor, Dorn, and Hanson (2021) estimate that 1 million jobs in manufacturing were lost to the China shock, one-sixth of total job losses at the time. The coincidence of the shocks gave trade a greater political resonance than this estimate suggests.*⁵⁷¹

In other words, was there a China effect? Yes. Was it the primary causal factor of America’s manufacturing problems? No. Could the U.S. government through TAA (discussed in separate Chapters) to help dislocated American workers? Yes.

⁵⁶⁷ See Gary Clyde Hufbauer & and Zhiyao (Lucy) Lu, *The Payoff to America from Globalization: A Fresh Look with a Focus on Costs to Workers*, Peterson Institute for International Economics (PIIE), Policy Brief 17-16 (May 2017), www.piie.com/publications/policy-briefs/payoff-america-globalization-fresh-look-focus-costs-workers. [Hereinafter, *The Payoff to America*.]

⁵⁶⁸ *The Payoff to America*.

⁵⁶⁹ Alan Wm. Wolff, Robert Z. Lawrence & Gary Clyde Hufbauer, *Have Trade Agreements Been Bad for America?*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS (PIIE) POLICY BRIEF 22-17, 10 (December 2022), www.piie.com/sites/default/files/2022-12/pb22-17.pdf. [Hereinafter, *Have Trade Agreements*.]

⁵⁷⁰ *Have Trade Agreements*.

⁵⁷¹ *Have Trade Agreements*, 10-11. (Emphasis added.) The referenced empirical analysis is David Autor, David Dorn & Gordon Hanson, *On the Persistence of the China Shock*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY (Fall 2021), www.brookings.edu/wp-content/uploads/2021/09/15985-BPEA-BPEA-FA21_WEB_Autor-et-al-Online-Appendix.pdf.

Chapter 16

ECONOMICS OF PROTECTION⁵⁷²

I. Defining “Trade Barriers”

The generic term “trade barrier” embraces both tariffs and NTBs, both of which provide protection from import competition for domestic producers of a good or suppliers of a service. NTBs take a variety of forms, from quotas and other QRs to qualitative restrictions (*e.g.*, SPS or TBT measures for goods, or licensing requirements for professional services). Tariffs, too, take a variety of forms, and are manifest not only in the context of normal trade relations (such as MFN rates), but also when trade remedies (such as AD duties or CVDs) are applied.

All such forms of protection – that is, all trade barriers – are departures from free trade. Many may be used to manage trade, others may be used to close off trade all together. The costs and benefits of all such protective (dare it be said, protectionist) tools are susceptible to economic analysis.

II. Three Tariff Types

A tariff is a tax on the importation of a good or service. It is distinct from a so-called “direct” tax, which is a tax on income. The accrual of income triggers the application of an income tax. A tariff also is distinct from a so-called “indirect,” or “internal,” tax, which is a levy on a particular economic transaction other than the cross-border provision of a good or service or the accrual of income. For example, a tax may be imposed on the sale of a product, known as a “sales” or “consumption” tax, or on the addition of value to a product, known as a VAT. A tariff, then, is triggered by transfer of a good or service across an international boundary.

Tariffs come in one of three types: *ad valorem*; specific; or hybrid. As the Latin term suggests, an “*ad valorem*” tariff is a charge on the value of the imported good or service. The charge is expressed as a set percentage of the price of a good or service. For example, levies of 2.5% of the value of a car, or 25% of the value of a truck, are *ad valorem* tariffs. A specific duty is an assessment based not on the value, but the volume, of the good or service imported. The volume is expressed in terms of the physical units by which industry custom and practice measures the good or service. A charge of \$1.23 per bushel of wheat, or \$4.56 per ton of steel, would be specific duties. Finally, a hybrid tariff combines both *ad valorem* and specific duty features. A charge of 5% plus 78 cents per dozen eggs would be a hybrid tariff.

⁵⁷²

Documents References:

- (1) *Havana Charter* Articles 1-10
- (2) GATT Preamble, Articles I-II, XI
- (3) *WTO Agreement* Preamble

Implicit in cataloging of tariff types is the importance of customs valuation. Tariff liability, that is, the amount of tariff owed on a good or service by the importer of record of that good or service, depends on two variables: the tariff amount, and the value or weight of the product. If the tariff is an *ad valorem* rate, then for any given rate, tariff the higher the value, the higher the tariff liability. If the tariff is a specific duty, then for any given level of duty, the larger the volume by weight imported, the higher the liability.

In truth, tariff liability depends on a third variable – customs classification, which is a decision implicit in the tripartite catalogue of tariffs. How do customs officials and the importer of record know the correct tariff to apply to a good or service? The answer is customs classification. Imported merchandise must be classified properly according to a standard scheme for classifying products in the HS.

Any of the aforementioned kinds of tariffs may be non-discriminatory” or “discriminatory.” A non-discriminatory rate indicates an importing country applies a stated tariff to all like products regardless of origin. An example is the MFN tariff rate is a non-discriminatory one, as all like products from WTO Members. Significantly, different countries – including WTO Members – may (and typically do) have different tariffs on a particular item. The rice tariff in Japan is notoriously high, whereas in other countries it is far lower. The point about “non-discrimination” is the importing country, *e.g.*, Japan, applies the same tariff to like-product rice from all other countries.

In contrast, a “discriminatory” tariff indicates the like product attracts a different tariff rate from an importing country, depending on the country of origin. For example, if Japan charges a 100% duty on Thai rice, but 25% on Indian rice, the tariff discriminates against Thai rice, and the overall scheme confers a margin of preference of 75% to Indian rice (the difference between 100% and 25%). Discriminatory tariffs are permissible, under certain circumstances, namely, the application of trade remedies (such as AD duties or CVDs, or safeguards), RTAs, preferential schemes (like the *GSP*), and the treatment of non-WTO Members.

III. Tariff Peaks, Escalation, and Inversion

As its rubric suggests, a tariff “peak” is a high tariff, namely, a tariff that is particularly high given the other tariffs, or average tariff, in the Schedule of Concessions of a particular country. No standard definition of a tariff “peak” exists. However, a commonly accepted benchmark is 15% for a developed country. Developing countries and LDCs tend to have considerably higher average tariffs than developed countries. For some poor countries, 15% would be a low or average rate. Hence, for such countries, demarcating a tariff peak requires a higher figure than 15%.

Tariff escalation and tariff inversion are phenomena occurring within the Schedule of Concessions of several countries. As the rubrics suggests, they are mirror images. With tariff escalation, the applicable duty rate on a product rises as processing of that product advances. The rates on the raw materials needed to make the product are zero or low. The rates on intermediate (*i.e.*, semi-finished) inputs are relatively higher than, or at least the

same as, duties on raw materials. The rate on the finished product is high. In Table 16-1, data collected by the WTO from the late 1990s illustrate tariff escalation. A number of product categories are affected by tariff escalation, including fruit, leather, rubber, tobacco, and wood. In such categories, the *ad valorem* duties rise directly with the stage of processing.

To give a specific example, suppose the EU provides duty-free treatment on cocoa from Ghana, a 10% duty on cocoa that is semi-processed by adding sugar, and a 15% duty on chocolate candies. Clearly, as the stage of processing advances, the tariff rises. The implications of this tariff escalation ought to be obvious. On the one hand, chocolate candy producers in some EU states benefit from zero- or low-duty rates on inputs, and from protection against imports of the finished like product. On the other hand, SSACs that would like to diversify away from dependence for export revenues on primary commodities like cocoa face stiffer tariffs on processed goods. In general, tariff escalation is adverse to efforts by developing countries and LDCs to industrialize.

Table 16-1
Tariff Escalation in Schedules of Developed Countries (Late 1990s)

<i>Type of Product And Average Tariff Rate Imposed by Developed Countries</i>	<i>All Manufactured Goods, Except for Petroleum</i>	<i>All Natural Resource- Based Goods, Except for Petroleum</i>
Raw Materials	0.8	2.0
Semi-manufactured items	2.8	2.0
Finished Goods	6.2	5.9

During the 1960s, scholars and advocates for poor countries, including Raúl Prebisch (1901-1986), called for PTAs with developed countries to rectify the tariff escalation problem. One result was creation of the *GSP*, which authorizes (but does not require) any country to provide duty-free, or low-duty, access to products, including manufactured items, from less developed countries. The *GSP* is plagued by a number of difficulties that limit its efficacy, and tariff escalation continues to be observed in some developed country Schedules.

Tariff inversion also is observed. Here, the tariff rate varies inversely, not directly, with the stage of processing. Higher tariffs protect against imports of raw materials and inputs, and lower tariffs are imposed on finished goods. Tariff inversion creates an artificial incentive for producers to source inputs domestically, rather than rely on imported raw materials and intermediate goods. It may be part of a strategy to diminish dependence on foreign sources, or more generally associated with import substitution.

Developing countries and LDCs, to the extent they rely on exports of primary commodities or semi-finished items, are affected adversely by tariff inversion in developed countries. Exports of the items in which they have a keen interest face stiff tariffs, thus making it difficult for them to generate large export revenues. In turn, their efforts at

industrialization, by leveraging off of their comparative advantage in primary products, are impeded. Presumably, they could use the revenues from primary commodity exports to invest in enterprises making finished products. Not surprisingly, therefore, scholars and advocates point to the untoward effects on poor countries of tariff inversion as well as tariff escalation.

IV. ERP

- **Effective Protection and ERP Formula**

Schedules of Tariff Concessions can be deceiving. The degree of protection afforded to a domestic industry, and the extra charge importers must pay, is not always apparent from looking at an *ad valorem* tariff rate in a Tariff Schedule. To get an accurate picture of the degree of protection, economists rely on the concept of “Effective Protection,” and its implementing formula for the “Effective Rate of Protection.”

The basic formula for the Effective Rate of Protection is as follows:

$$\begin{array}{l} \text{Effective} \\ \text{Rate of} \\ \text{Protection} \end{array} = \frac{(\text{Value Added of a Good at Tariff-distorted Price}) - (\text{Value Added of the Good at World Market Price})}{\text{Value Added of the Good at World Market Price}}$$

or, to simplify using arithmetic symbols,

$$\text{ERP} = \frac{V_{\text{ATP}} - V_{\text{AWP}}}{V_{\text{AWP}}}$$

The term “value added” is meant to connote the value of an article of merchandise as added at a particular stage in the production process. Generally, these stages are raw (unfinished), intermediate (semi-finished), or final (finished).

- **ERP Example**

Consider a simple example. Suppose Japan imports sugar from Brazil and milk from New Zealand to make rice pudding. Japanese rice pudding producers rely on domestically-grown rice for their product. They sell the rice pudding domestically, and export it overseas. Rice pudding is the final product, and milk and sugar are the imported inputs. Because Japan has an FTA with New Zealand, it imports milk duty free. However, it has no special trade arrangement with Brazil, so it imposes the MFN duty rate on Brazilian sugar. Suppose, further, that Japan also imports rice pudding from India, *i.e.*, Indian producers are major competitors producing a like product. The MFN tariff rate on rice pudding imports is 10%.

What protection is afforded to Japanese rice pudding producers? The natural inclination is “10%,” because that is the *prima facie* tariff Japan puts on imported rice pudding. This answer is not necessarily correct. Indeed, it is wrong. It understates the true

level of protection, if there is a tariff only on imported rice pudding, but not on any components, like sugar or milk. It also is wrong in another sense. It overstates the true level of protection, if there is a tariff on any imported component used by Japanese producers to make rice pudding. The correct answer depends on the *ad valorem* tariff on the imported like product, namely, Indian rice pudding, in relation to the *ad valorem* tariff on components, namely, sugar. Table 16-2 summarizes the answer.

This Table relies on a few additional assumptions. First, the price of one container of Japanese rice pudding is (expressed in Japanese *yen*, ¥) is ¥ 2,000. That also is the price of Indian rice pudding, sold in Japan, if Japan imposes no duty on this imported product. In brief, these figures are free-trade prices. Second, if Japan imposes no duty on sugar imports, then the cost of Brazilian sugar needed per container of Japanese rice pudding is ¥ 800. This figure is the free trade price of sugar. Clearly, using world market (*i.e.*, free trade) prices, 40% of the value added in the finished product comes from sugar (¥ 800 divided by ¥ 2,000), and the remaining 60% (¥ 1,200 divided by ¥ 2,000) from the addition of milk from New Zealand and further processing in Japan.

Third, to highlight the impact on prices of imposing a tariff on inputs (*e.g.*, sugar) into finished goods (*e.g.*, rice pudding) that are consumed domestically and exported, the Table lays out eight distinct policy alternatives for Japan:

- (1) *Free Trade:*
Japan imposes no tariff either on the finished product (the like product, i.e., imported rice pudding), or the input (imported sugar).
- (2) 10% Duty on Finished Good (the like product, *i.e.*, imported rice pudding) Only:
Japan imposes a tariff only on imports of rice pudding, the like product in competition with Japanese-made rice pudding.
- (3) 10% Duty on Finished Good (the like product, *i.e.*, imported rice pudding), and 25% Duty on Input (imported sugar).
- (4) 10% Duty on Finished Good, and 50% Duty on Input.
- (5) 10% Duty on Finished Good, and 75% Duty on Input.
- (6) 10% Duty on Finished Good, and 100% Duty on Input.
- (7) 10% Duty on Finished Good, and 150% Duty on Input.
- (8) 10% Duty on Finished Good, and 200% Duty on Input.

Clearly, the key difference in the scenarios, particularly the instances of 50% protection on the finished product, is the degree of protection on the input.

Table 16-2
Illustrating Effective Protection –
Japan, Finished Good (Rice Pudding), and Input (Sugar)

Policy Option	Price of Finished Good (Rice Pudding)	Cost of Imported Inputs (Sugar)	Value Added at Tariff-Distorted Prices by Japanese Producers of Rice Pudding, VA_{TP} (Difference between Price of Finished Good and Cost of Imported Inputs)	ERP (VA_{TP} minus VA_{WP} divided by VA_{WP})
Free Trade (i.e., World Market Prices)	¥ 2,000.	¥ 800.	¥ 1,200. This figure is VA_{WP} , not VA_{TP} , because in this Policy Option there is no tariff distortion.	None. There is no tariff protection on the finished good or input.
10% Duty on Finished Good (Rice Pudding)	¥ 2,200. Free trade price plus 10% tariff.	¥ 800. Zero% duty on sugar.	¥ 1,400. This figure is VA_{TP} , because of price distortion the tariff causes.	16.67%. The difference between ¥ 1,400 and ¥ 1,200, divided by ¥ 1,200.
10% Duty on Finished Good (Rice Pudding) 25% Duty on Input (Sugar)	¥ 2,200. Free trade price (¥ 2,000) plus 10% tariff.	¥ 1,000. Free trade price (¥ 800) plus 25% duty (¥ 200) on sugar.	¥ 1,200. This figure is VA_{TP} , because of price distortions the tariffs cause.	0%. The difference between ¥ 1,200 and ¥ 1,200, divided by ¥ 1,200.

Table 16-2 (continued)

10% Duty on Finished Good 50% Duty on Input	¥ 2,200. Free trade price (¥ 2,000) plus 10% tariff.	¥ 1,200. Free trade price (¥ 800) plus 50% duty (¥ 400) on sugar.	¥ 1,000. This figure is a VA_{TP} , because of the price distortions the tariffs cause.	-16.67%. The difference between ¥ 1,000 and ¥ 1,200, divided by ¥ 1,200.
10% Duty on Finished Good 75% Duty on Input	¥ 2,200. Free trade price (¥ 2,000) plus 10% tariff.	¥ 1,400. Free trade price (¥ 800) plus 75% duty (¥ 600) on sugar.	¥ 600. This figure is a VA_{TP} , because of the price distortions the tariffs cause.	-50%. The difference between ¥ 600 and ¥ 1,200, divided by ¥ 1,200.
10% Duty on Finished Good 100% Duty on Input	¥ 2,200. Free trade price (¥2,000) plus 10% tariff.	¥ 1,600. Free trade price (¥ 800) plus 100% duty (¥ 800) on sugar.	¥ 400. This figure is VA_{TP} , because of price distortions the tariffs cause.	-66.67%. The difference between ¥ 400 and ¥ 1,200, divided by ¥ 1,200.
10% Duty on Finished Good 150% Duty on Input	¥ 2,200. Free trade price (¥2,000) plus 10% tariff.	¥ 2,000. Free trade price (¥ 800) plus 150% duty (¥1,200) on sugar.	¥ 200. This figure is VA_{TP} , because of price distortions the tariffs cause.	-83.33%. The difference between ¥ 0 and ¥ 1,200, divided by ¥ 1,200.
10% Duty on Finished Good 200% Duty on Input	¥ 2,200. Free trade price (¥ 2,000) plus 10% tariff.	¥ 2,400. Free trade price (¥800) plus 200% duty (¥1,600) on sugar.	- ¥ 200. This figure is VA_{TP} , because of price distortions the tariffs cause.	-116.67%. The difference between - ¥ 200 and ¥ 1,200, divided by ¥ 1,200.

As the Table evinces, the higher the level of protection, in terms of the *ad valorem* rate, for inputs (e.g., sugar), the lower the ERP. That is, the ERP for a finished product varies inversely with the level of protection imposed on its inputs. True, the producer of the finished product – Japanese rice pudding makers – benefit from a 10% duty on the like product imported from other countries like India. But, that benefit is undermined by the higher price the Japanese rice pudding makers must pay for a key component – sugar from Brazil – because of the tariff. With no sugar tariff, the ERP is 16.67%. But, with a 200% sugar tariff, the ERP is negative 116.67%.

Clearly, the ERP for a finished product turns negative with tariff escalation. If a finished product uses one or more imported components intensively in production, and if

tariffs on these components are higher than the protection for the finished good, then ERP becomes negative. Put differently, the imported finished product (Indian rice pudding) becomes cheaper than the domestic competitor (Japanese rice pudding), because tariffs on the components used by domestic producers have driven up their costs of production to render them uncompetitive against the imports.

An important policy insight from this fact is a country must have a coordinated strategy toward its Tariff Schedule. On the one hand, positive ERPs are sensible if they are intended to encourage assembly and finishing operations within a country whose producers use global sourcing of the cheapest possible inputs. In turn, positive ERPs are consistent with an Export Orientation policy, *i.e.*, a policy of industrialization and economic growth stimulated in part, possibly large part, by exports. In the example, Japan's goal might be to develop an international comparative advantage in processed agricultural products like rice pudding. However, the end result can be dependence on foreign source inputs, like Brazilian sugar. The higher the ERP, the greater the risk of dependence on imported parts.

On the other hand, negative ERPs are sensible if they are intended as an incentive to rely on domestic, rather than foreign, inputs. For instance, Japan might intend the ERP for rice pudding producers to be negative, because it wants them to use domestically-produced sugar or sugar substitutes. Accordingly, negative ERPs are consistent with an Import Substitution policy, *i.e.*, a policy of industrialization and economic growth by government intervention to promote selected domestic industries and restrict imports. In other words, Japan may be trying to develop a local sugar or sugar substitute industry, encourage input sourcing from this industry, and divert it from Brazilian sugar plantations. Yet, if ERPs are "too" negative, then the local producers cannot compete with the foreign like product, and the aim of Import Substitution is defeated.

Chapter 17

ECONOMICS OF PROTECTION (CONTINUED): TARIFFS AND QUOTAS⁵⁷³

I. Classical and Neo-Classical Economic Tariff Analysis

● Ricardo and Comparative Advantage Again

In Chapter 7 of his 1817 classic, *The Principles of Political Economy and Taxation*, David Ricardo (1772-1823) explains why a country is better off with international trade than under its opposite, autarky. The country experiences net economic benefits from a unilateral (and, therefore, unconditional) reduction (indeed, elimination) of tariff barriers. The gist of Ricardo's argument is the country is able to specialize in production of a commodity in which it has a comparative cost advantage. He illustrates the argument with the England and Portugal, and commodities such as cotton and wine. Economists depict production specialization with a graph of a country's "Production Possibilities Frontier." This Frontier delineates the maximum amount the country can produce with its existing stock of factors of production (*i.e.*, labor, land, human capital, physical capital, and technology). By identifying the terms of trade for a country with a line that is drawn tangent to the frontier and reflects the world market prices of one commodity against another, economists identify the theoretical point of production specialization.

In turn, argued Ricardo, a country can trade its exportable production surplus for an imported commodity in which it does not enjoy a comparative cost advantage. The cross-border exchange allows consumers in the country to realize a higher level of consumption than they had before, when their country engaged in an autarky. In accordance with their preferences, which economists express on a graph with "societal indifference" curves, the consumers can have more of the goods that interest them. Put succinctly, Ricardo's Law of Comparative Advantage holds that trade liberalization allows for net social gains to a country that dismantles its tariff barriers because that country can specialize in the production of what it is best at, in terms of relative cost, and it can consume a larger quantity of commodities on better terms.

Ricardo's Law of Comparative Advantage remains a fundamental economic paradigm in which to argue for trade liberalization. Ricardo argued, using arithmetic examples, that this law held even if one country had an absolute advantage, *i.e.*, it could produce more of every product more cheaply than another country. Essentially, his reasoning was there always would be at least one commodity in which a country had a relatively larger comparative cost advantage, and that would be the product in which it

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Documents References:

- (1) *Havana Charter* Articles 1-10
- (2) GATT Preamble, Articles I-II, XI
- (3) *WTO Agreement* Preamble

should specialize. As for the other product, the prospective trading partner had the relative cost advantage in that, and should specialize in its production.

While this paradigm is dominant in the minds of many free trade advocates, the economic costs and benefits of a tariff, and tariff reduction, are not always spelled out with precision. It is worth doing so, because those benefits are the economic rationale for binding tariffs at lower levels under GATT Article II. What justifies multilateral tariff cuts is Ricardo's Law of Comparative Advantage, and more precisely, the economic analysis of a tariff.

II. Burmese Jade Hypothetical, Military Rule, and U.S. Sanctions

● Struggle for Democracy

To illustrate the economics of a tariff, consider the following not-so-hypothetical example. Burma (Myanmar), which is a founding contracting party to GATT, gained independence from Britain in 1948, having been subject to the Japanese occupation in the Second World War.⁵⁷⁴ In 1948, Burma was the wealthiest country in Southeast Asia. From 1948-1962, this ethnically diverse nation was a fledgling democracy. It had robust elections in 1960, with the political party, the Union Party, of U Nu (1907-1995) – the founding Prime Minister (from 1948-1956, and again from 1957-1958, and 1960-1962) – taking power after a split in his Party. However, in 1962, General Ne Win (1911-2002) took power in a *coup d'état*, and pursued autarkic trade policies between 1962-1988. The General, who had headed a caretaker government from 1958-60 amidst the fractures in U Nu's Party, espoused a "Burmese Way of Socialism," which would (*inter alia*) lead to greater self-reliance and inward orientation as distinct from export-oriented growth as advocated by the renowned Burmese economist Hla Mynt (1929-2017). (His "vent for surplus" theory is discussed in a separate Chapter.)

Politics became restrictive, too. General Ne Win set up a one-party system under his "Burma Socialist Program Party" (BSSP). In 1974, a new Constitution was agreed, whereby power was transferred from the military to a new "People's Assembly." But, the General, along with other military officers, stayed in power. He remained President until 1981, at which point San Yu (1918-1996) became the President. But he was never far from power, and the military remained the power behind the Presidency. In 1988, following the 8888 Uprising (named after the date they started, 8 August 1988) – mass anti-government protests, depicted in the movie, *Beyond Rangoon* (1995), in which the military killed thousands of pro-democracy protestors, including unarmed Buddhist monks – General Ne Win was deposed by a group of military officers. They named their ruling *junta* the "State Law and Order Restoration Commission" (SLORC), and in 1997 renamed it with the euphemisms "State Peace and Democracy Commission" or "State Peace and Development

⁵⁷⁴ For an excellent tabular synopsis of modern Burmese political upheaval, from which several points in the above discussion are drawn, see Dominic Faulder, *Myanmar's Iron-fisted Ruler Min Aung Hlaing Fights to Stay on his Throne*, NIKKEI ASIA, 1 February 2022, <https://asia.nikkei.com/Spotlight/The-Big-Story/Myanmar-s-iron-fisted-ruler-Min-Aung-Hlaing-fights-to-stay-on-his-throne>. [Hereinafter, *Myanmar's Iron-fisted Ruler*.]

Council” (SPDC). General Saw Maung headed SLORC, and General Than Shwe (1933-) replaced him in 1992.

Pro-democracy uprisings continued, of course, for instance, in 2007, amidst a deteriorating economy marked by (*inter alia*) increased fuel prices. They coalesced around the head of Burma’s National League for Democracy (NLD), Aung San Suu Kyi (1945-), who SLORC put under house arrest in 1989. Condemnations rang from the U.N., but with little effect on the ground in Burma. When, in 2010, the military *junta* held a general election to approve a new Constitution, the NLD boycotted – and the military’s party, the Union Solidarity and Development Party (USDP or USD Party), claimed an 80% win. Ms. Suu Kyi won the 1991 Nobel Peace Prize for her non-violent struggle for human rights and democracy, and supported an international boycott against the military *junta*. Several of these events are depicted in the movie *The Lady* (2012).

Yet, Ms. Suu Kyi received serious international criticism for inaction in the 2015-2018 Rohingya refugee crisis, and in November 2018 was stripped by Amnesty International of its top prize, the Ambassador of Conscience Award, which she had received in 2009 while under house arrest. The rulers sought greater trade and investment with the outside world. Many countries, including the U.S. and those of the EU – but not China – imposed trade, financial, and investment sanctions against the Burmese *junta* during the 1990s and early 2000s. The military annulled the NLD’s 1990 election victory, and again put Ms. Suu Kyi under house arrest. She spent 15 of the 21 years between 1989 and 2010 under house arrest, chronicled masterfully in the 2011 movie *The Lady*. Only in April 2012, in part due to the pressure of economic sanctions, did the Burmese government hold elections in which Aung San Suu Kyi and other opposition leaders participated. She herself won a seat for the constituency of Kawhmu in the *Pyithu Hluttaw*, the Lower House (or “House of Representatives,” which has 440 seats) of the bicameral “Assembly of the Union,” or Parliament. (The Upper House is the *Amyotha Hluttaw*, or “House of Nationalities,” has 224 seats) Yet, there were boycotts and allegations of fraud.

Thereafter, countries imposing sanctions suspended them. For example, the U.S. commenced sanctions in May 1997, under *Executive Order* 13047 issued by President Bill Clinton (1946-). Following an 11 July 2012 *Executive Order* by President Barack H. Obama (1961-), the U.S. eased sanctions. That *Order* provided a general license for American businesses to invest directly in Burma, and enter into dollar-denominated financial transactions, and relaxed the import ban existing under the *Burmese Freedom and Democracy Act of 2003* and *The Tom Lantos Block Burmese JADE (Junta’s Anti-Democratic Efforts) Act of 2008*. Yet, in June 2012 and repeatedly thereafter, Aung San Suu Kyi warned all foreign businesses not to rush into Burma seeking deals without regard to their consequences for the Burmese people.

A watershed occurred in November 2015 with the first openly-contested elections since 1990.⁵⁷⁵ The NLD won an absolute majority in both chambers of Parliament (well as

⁵⁷⁵ For an analysis of this watershed, see Nehginpao Kipgen, *Decoding Myanmar’s 2015 Election*, XLVII ASIAN AFFAIRS – JOURNAL OF THE ROYAL SOCIETY FOR ASIAN AFFAIRS number II, 215-233 (July 2016), <https://rsaa.org.uk/journal/> (offering the prescient conclusion: “Democratization theory says that

in the State and Regional *Hluttaws*, *i.e.*, Local Assemblies). To be sure, thanks to the military, the Constitution barred Ms. Suu Kyi from becoming President (on the ground her husband and children were foreign citizens). The military also reserved seats in Parliament for itself (*i.e.*, for the USDP), which were uncontested: 25% (56 seats) in the Upper House, and 25% (100 seats) in the Lower House. Nevertheless, the NLD won 86% of all contested seats in the Assembly (235 of the 330 contested seats in the House of Representatives and 135 of the 168 in the House of Nationalities), far above the 67% supermajority needed to select the President and Vice President. In March 2016, wearing the traditional Burmese head scarf, orange shirt, and sarong-like *longyi* (in contrast to the green-uniformed military uniforms), Mr. Htin Kyaw (1946-) took the oath as President of Burma's first civilian led government since the 1962 *coup d'état*.

President Obama followed up in September 2016 with a *Proclamation* restoring Burma's status as a BDC, and designating it as an LDC, for *GSP* treatment, and in October 2016 with an *Executive Order* terminating all sanctions.⁵⁷⁶ His *Order* explicitly linked trade benefits with democracy and human rights: "the situation that gave rise to the declaration of a national emergency [under the 1977 *IEEPA*] in *Executive Order* 13047 of May 20, 1997, with respect to the actions and policies of the Government of Burma, in particular a deepening pattern of severe repression by the State Law and Order Restoration Council, the then-governing regime in Burma, ... has been significantly altered by Burma's substantial advances to promote democracy, including historic elections in November 2015 that resulted in the former opposition party, the National League for Democracy, winning a majority of seats in the national parliament and the formation of a democratically elected, civilian-led government; the release of many political prisoners; and greater enjoyment of human rights and fundamental freedoms, including freedom of expression and freedom of association and peaceful assembly."

While in power, the military *junta* proposed to adopt trade liberalization policies, including the reduction or elimination of tariffs and NTBs on various categories of imported merchandise. One such NTB was an import ban on foreign-produced jade, which (by assumption) protected Burmese jade producers for years. However, the generals encountered stiff resistance from domestic jade producers. They lobbied the generals to impose a 25% *ad valorem* tariff rate to protect them from foreign competition once the

elections are necessary for democratization, but there are contending debates as to whether the holding of elections *per se* guarantees a successful democratic transition or entrenches authoritarianism. ... Whether the [2015] election can lead the country toward a more stable democracy depends on a number of factors. [For example,] [t]he military leaders – present and former generals – must be convinced that the peace process with ethnic armed groups is politically resolved and there is no more threat to the three core principles: non-disintegration of the union, non-disintegration of national solidarity, and perpetuation of national sovereignty.”).

⁵⁷⁶ See *Executive Order, Termination of Emergency with Respect to the Actions and Policies of the Government of Burma* (7 October 2016), www.treasury.gov/resource-center/sanctions/Programs/Documents/burma_eo_termination.pdf. The President also restored Burma's status as a BDC for purposes of *GSP* treatment. See *Presidential Proclamation to the Congress – Restoring Burma's Trade Benefits Under the Generalized System of Preferences (GSP)* (14 September 2016), <https://obamawhitehouse.archives.gov/the-press-office/2016/09/14/presidential-proclamation-congress-restoring-burmas-trade-benefits-under>.

junta eliminated the import ban. Burmese jade producers feared free trade because of competition from Chinese jade, hence Burmese producers opposed the move.

Burmese jade is arguably the best in the world, being of a uniquely high quality and pure color, and thus is not necessarily “like” Chinese jade. Still, Burmese producers worry about losing domestic market share, because of import competition from imports, the price of which will drop with free trade. Consider the economics of the trade liberalization policies championed by the military, but opposed by Ms. Suu Kyi.

- **February 2021 Military Coup and Biden Executive Order**

Also consider the aforementioned points in light of another watershed development in modern Burmese history. On 1 February 2021, the military seized power in a *coup d'état* following elections in which Ms. Suu Ky's NLD won 83% of the seats in the country's legislature (396 out of 476 seats) against the military's USD Party (33 seats).⁵⁷⁷ The army chief, General Min Aung Hlaing (1956-) led the *coup*. It was the third military takeover of a civilian government since Burma's 1948 independence. The General “appear[ed] to be following in the footsteps of military leaders who believe themselves to be reincarnations of ancient Burmese warrior kings.”⁵⁷⁸

The military alleged the election, in which 70% of eligible voters turned out despite the COVID-19 pandemic, was marred by fraud; Burma's Election Commission disagreed, finding no widespread fraud, and the *coup* signaled a return to 1962-2011, when the military ruled Burma.⁵⁷⁹ Indeed, the election had been only the second one under Burma's modern Constitution, which reserved 25% of the parliamentary seats for military appointees (and thus a veto on Constitutional reform), and the portfolios of the Ministries of Defense, Foreign Affairs, and Defense,⁵⁸⁰ and *coup* was the first one against a civilian

⁵⁷⁷ See *Myanmar Coup: Aung San Suu Kyi Detained as Military Seizes Control*, BBC NEWS, 1 February 2021, www.bbc.com/news/world-asia-55882489 [hereinafter, *Myanmar Coup: Aung San Suu Kyi Detained*]; *Anti-Coup Protests Ring Out in Myanmar's Main City*, REUTERS, 1 February 2021, www.reuters.com/article/us-myanmar-politics/coup-prompts-outcry-from-myanmar-as-biden-threatens-sanctions-idUSKBN2A139S [hereinafter, *Anti-Coup Protests*]; John Reed, *Myanmar Military Launches Coup Against Aung San Suu Kyi*, FINANCIAL TIMES, 31 January 2021, www.ft.com/content/1edff5ac-3528-4e51-8ef7-a07858b93442?shareType=nongift [hereinafter, *Myanmar Military Launches*]; Hannah Beech, *Myanmar's Leader, Daw Aung San Suu Kyi, Is Detained Amid Coup*, THE NEW YORK TIMES, 31 January 2021, www.nytimes.com/2021/01/31/world/asia/myanmar-coup-aung-san-suu-kyi.html?referringSource=articleShare [hereinafter, *Myanmar's Leader, Daw Aung*].

⁵⁷⁸ *Myanmar's Iron-fisted Ruler*.

⁵⁷⁹ See *Myanmar Coup: Aung San Suu Ky Detained*.

⁵⁸⁰ See *Myanmar Military Launches*.

government since 1962.⁵⁸¹ It also marked the second time since 1962 the military refused to recognize landslide election results in favor of the NLD: it did so in 1990.⁵⁸²

The *coup* attracted worldwide, condemnation – except from China.⁵⁸³ The Administration of President Joseph R. Biden (1942-, President, 2021-) threatened to

⁵⁸¹ See *Myanmar Coup: Aung San Suu Ky Detained*. By way of summary:

The military tried to justify the 1962 putsch as necessary to keep the Union of Burma, as the country was then known, unified in the face of ethnic insurgencies in the country's borderlands. Minority groups, which make up roughly one third of the country's population, suffered widespread persecution during military rule. Children were forced to become minesweepers, and women were subjected to gang rape.

But military-linked abuses were directed against the Bamar ethnic majority, too. Thousands were thrown into jail as political prisoners, and a fearsome military intelligence network convinced many that walls, whether cement or bamboo, had eyes and ears to spy on them.

After a massacre of pro-democracy protesters in 1988, elections were held two years later. The National League for Democracy won convincingly, but the results were ignored by the generals. A generation of politicians spent their prime in prison.

In 2015, the National League for Democracy again secured a landslide electoral victory. This time, the military honored the results.

Myanmar's Leader, Daw Aung.

⁵⁸² See *Anti-Coup Protests*. In effect, the military never gave up power. See *id.* (observing that “[f]ollowing mass protests led by Buddhist monks in 2007, the generals set a course for compromise, while never relinquishing ultimate control.”).

⁵⁸³ See *Myanmar Junta Blocks Facebook, Clamping Down on Opposition to Coup*, REUTERS, 3 February 2021, www.reuters.com/article/us-myanmar-politics/u-n-chief-vows-to-rally-global-pressure-to-make-sure-myanmar-coup-fails-idUSKBN2A338K; *Anti-Coup Protests*.

On Sino-Burmese relations, see, e.g., Toru Takahashi, *It's Complicated: Myanmar and China Have a Difficult Relationship*, NIKKEI ASIA, 13 February 2021, <https://asia.nikkei.com/Spotlight/Comment/It-s-complicated-Myanmar-and-China-have-a-difficult-relationship>. Mr. Takahashi astutely points out:

China's response to the *coup d'état* in Myanmar on Feb. 1 was quiet, merely describing the country as a 'friendly neighbor.' Perhaps it was difficult for Beijing to acknowledge the political drama in a country that shares a border of 2,160 km.

...

The relationship between Myanmar and China is not simple.

Myanmar gained its independence from Britain in 1948, and the Chinese Communist Party founded the People's Republic of China in 1949. The two states, born at nearly the same time, established diplomatic relations in 1950 and signed a border treaty in 1960. For China, which is still involved in a border dispute with India, Myanmar was the first country with which it amicably resolved a border dispute.

But the warm relations changed dramatically in the 1960s. In 1962, the army, led by Gen. Ne Win, overthrew the civilian government in a *coup*. Then the Cultural Revolution began in China in 1966, and the export of Communist revolution became a pillar of Beijing's foreign policy.

China provided funds and weapons to the Burma Communist Party, the largest anti-government armed group in Myanmar at the time, and relations between China and

Myanmar's military government deteriorated. In 1967, when a massive anti-Chinese riot broke out in Yangon, the two countries summoned each other's ambassadors.

Then things turned better. After the end of the Cultural Revolution in 1976, Deng Xiaoping visited Myanmar on his first foreign trip to restore relations by reducing support for the Burmese Communist Party.

In 1988, a pro-democracy protest broke out in Myanmar, and Aung San Suu Kyi, who had returned from the U.K. to take care of her sick mother, appeared on the political stage. When the Ne Win administration cracked down on the protests and thousands were killed, the army carried out an "internal *coup*" to overthrow the regime and continued military rule.

China was the first country in the world to approve Myanmar's military *junta*, but China itself also came under heavy criticism from the West for crushing the Tiananmen Square protests in 1989. For China, closer relations with Myanmar, which was in a similar position to its own, had strategic significance.

When the U.S. and Europe tightened economic sanctions on Myanmar after 1997, China, which had emerged as an economic power, supported Myanmar as a major investor and importer – the military *junta* survived the Western sanctions because of China.

However, in 2003, the *junta* drew up a road map and prepared for a democratic transition because it understood the danger of excessive dependence on China and the importance of improving relations with the West. The *junta* maneuvered to ease dependence on China.

In 2011, the administration of President Thein Sein suddenly announced a freeze on the construction of the Myitsone Dam, which was being built jointly with China on the upper reaches of the Irrawaddy River. The project had long been criticized for its impact on the environment, and Thein Sein explained that it was against the will of the people.

In 2014, a project to jointly build a railroad from China's Yunnan Province to Kyawpyu in western Myanmar was also canceled due to domestic opposition in Myanmar. Needless to say, China has expressed its displeasure at these measures by its neighbor.

It was instead the government led by Suu Kyi, which took office in 2016, that brought the two countries closer together. When Suu Kyi herself came under fire from foreign governments for her persecution of the Rohingya Muslim minority, she turned to China.

Suu Kyi agreed to develop the China-Myanmar Economic Corridor of the Belt and Road Initiative. In addition to the development of the port at Kyauphyu, three weeks before the political upheaval she signed a memorandum of understanding to conduct a renewed feasibility study of a railroad project that had been scrapped by the military government.

There is no doubt that the Myanmar military, having regained political power, is counting on China's support for the time being. However, it was the military that recognized the risk of depending too much on China in the first place.

The two words that make people uncomfortable in Myanmar are "army" and "China."

Id.

reimpose sanctions unless the *junta* turned power over to the properly elected officials. Ten days later, he did. President Biden issued *Executive Order* 14014 directing renewed sanctions:⁵⁸⁴ He found:

the situation in and in relation to Burma, and in particular the February 1, 2021, *coup*, in which the military overthrew the democratically elected civilian government of Burma and unjustly arrested and detained government leaders, politicians, human rights defenders, journalists, and religious leaders, thereby rejecting the will of the people of Burma as expressed in elections held in November 2020 and undermining the country's democratic transition and rule of law, constitutes an unusual and extraordinary threat to the national security and foreign policy of the United States.

Thus, Mr. Biden ordered:

Section 1.

⁵⁸⁴ See *Blocking Property With Respect to the Situation in Burma*, 86 Federal Register number 28, 9429-9432 (10 February 2021), www.govinfo.gov/content/pkg/FR-2021-02-12/pdf/2021-03139.pdf. In declaring an “unusual and extraordinary threat to the national security and foreign policy of the United States,” the President invoked the *IEEPA*, 50 U.S.C. §§ 1701 *et seq.* and *National Emergencies Act*, 50 U.S.C. §§ 1601 *et seq.* (discussed in a separate Chapter).

In a fascinating, skillful maneuver, the Federal Reserve Bank of New York slow-walked a request from the *junta* to withdraw \$1 billion from its account so as to give time for President Biden to issue his *Executive Order*, which thereby gave the New York Fed the legal authority to freeze the Burmese account:

Myanmar's military rulers attempted to move about \$1 billion held at the Federal Reserve Bank of New York days after seizing power on Feb. 1, prompting U.S. officials to put a freeze on the funds....

The transaction on Feb. 4 in the name of the Central Bank of Myanmar was first blocked by Fed safeguards. U.S. government officials then stalled on approving the transfer until an executive order issued by President Joe Biden gave them legal authority to block it indefinitely....

A spokesman for the New York Fed declined to comment on specific account holders. The U.S. Treasury Department also declined to comment.

The attempt came after Myanmar's military installed a new Central Bank Governor and detained reformist officials during the *coup*.

It marked an apparent effort by Myanmar's generals to limit exposure to international sanctions after they arrested elected officials, including *de facto* leader Aung San Suu Kyi....

Simon Lewis & Humeyra Pamuk, *Exclusive: U.S. Blocked Myanmar Junta Attempt To Empty \$1 Billion New York Fed* – Sources, REUTERS, 4 March 2021, www.reuters.com/article/us-myanmar-politics-usa-fed-exclusive/exclusive-u-s-blocked-myanmar-junta-attempt-to-empty-1-billion-new-york-fed-account-sources-idUSKCN2AW2MD. [Hereinafter, *Exclusive: U.S. Blocked.*]

- (a) All property and interests in property that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of any United States person of the following persons are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in: any foreign person determined by the Secretary of the Treasury, in consultation with the Secretary of State:
- (i) to operate in the defense sector of the Burmese economy or any other sector of the Burmese economy as may be determined by the Secretary of the Treasury, in consultation with the Secretary of State;
 - (ii) to be responsible for or complicit in, or to have directly or indirectly engaged or attempted to engage in, any of the following:
 - (A) actions or policies that undermine democratic processes or institutions in Burma;
 - (B) actions or policies that threaten the peace, security, or stability of Burma;
 - (C) actions or policies that prohibit, limit, or penalize the exercise of freedom of expression or assembly by people in Burma, or that limit access to print, online, or broadcast media in Burma; or
 - (D) the arbitrary detention or torture of any person in Burma or other serious human rights abuse in Burma;
 - (iii) to be or have been a leader or official of:
 - (A) the military or security forces of Burma, or any successor entity to any of the foregoing;
 - (B) the Government of Burma on or after February 2, 2021;
 - (C) an entity that has, or whose members have, engaged in any activity described in subsection (a)(ii) of this section relating to the leader's or official's tenure; or
 - (D) an entity whose property and interests in property are blocked pursuant to this order as a result of activities related to the leader's or official's tenure;
 - (iv) to be a political subdivision, agency, or instrumentality of the Government of Burma;
 - (v) to be a spouse or adult child of any person whose property and interests in property are blocked pursuant to this *Order*;
 - (vi) to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of any person whose property and interests in property are blocked pursuant to this order; or
 - (vii) to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, the military

- or security forces of Burma or any person whose property and interests in property are blocked pursuant to this *Order*.
- (b) The prohibitions in Subsection (a) of this Section apply except to the extent provided by statutes, or in regulations, orders, directives, or licenses that may be issued [by OFAC] pursuant to this *Order*, and notwithstanding any contract entered into or any license or permit granted before the date of this *Order*.

Section 2.

The prohibitions in Section 1 of this *Order* include:

- (a) the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any person whose property and interests in property are blocked pursuant to this order; and
- (b) the receipt of any contribution or provision of funds, goods, or services from any such person.

...

Section 6.

For the purposes of this *Order*:

- (a) the term “entity” means a partnership, association, trust, joint venture, corporation, group, subgroup, or other organization;
- (b) the term “Government of Burma” means the Government of Burma, any political subdivision, agency, or instrumentality thereof, including the Central Bank of Myanmar, and any person owned or controlled by, or acting for or on behalf of, the Government of Burma;
- (c) the term “noncitizen” means any person who is not a citizen or noncitizen national of the United States;
- (d) the term “person” means an individual or entity; and
- (e) the term “United States person” means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States.

Concomitantly, OFAC added 10 individuals – six military officials and four State Administration Council members, plus three entities – to its SDN List.⁵⁸⁵ The individuals directly organized or oversaw the *coup*, or took power under the guise of the SAC, after the *coup*, while the entities were owned or controlled by the Burmese military.⁵⁸⁶ Any

⁵⁸⁵ See U.S. Department of the Treasury, Office of Foreign Assets Control, *Issuance of Executive Order “Blocking Property With Respect To The Situation In Burma;” Burma-related Designations and Designations Updates*, 11 February 2021, <https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20210211>.

⁵⁸⁶ See Yuichi Nitta, Takashi Nakano & Takeru Goto, *Myanmar Military Companies Become Prime Target For U.S. Sanctions*, NIKKEI ASIA, 12 February 2021, <https://asia.nikkei.com/Spotlight/Myanmar-Coup/Myanmar-military-companies-become-prime-target-for-US-sanctions> (reporting: “Two such companies are Myanmar Economic Holdings, whose shareholders include current and former members of the military, and military-controlled Myanmar Economic Corp. Both conglomerates have interests across a broad range of industries, including agriculture, mining, real estate, gem extraction, banking and insurance,

ports, and telecommunications. Where the profits from these businesses go is unclear. But the U.N. Human Rights Council said in a 2019 report on the Rohingya crisis that revenue from these companies ‘provides financial support’ for ‘international human rights and humanitarian law violations’ by the military.”). [Hereinafter, *Myanmar Military Companies*.]

With continued protests against the *coup*, on 10 March, the President upped the pressure on the Burmese generals, imposing sanctions on two of the adult children of the Burmese military *coup* leader, General Min Aung Hlaing, and the six companies (which included construction, gyms, galleries, media, and restaurant businesses) they owned or controlled. See *Biden Sanctions Myanmar Coup Leader’s Children, Their Businesses*, BLOOMBERG, 10 March 2021, www.bloomberg.com/news/articles/2021-03-11/biden-sanctions-myanmar-coup-leader-s-children-their-businesses?sref=7sxw9Sxl (also noting the consequence of the sanctions, namely, American citizens were forbidden from doing business with the sanctioned persons and entities); Katrina Manson & John Reed, *U.S. Launches Additional Myanmar Sanctions as Protests Escalate*, FINANCIAL TIMES, 11 March 2021, www.ft.com/content/e8cddd3-d41a-42c6-b4cf-6ecbd1bfcc8f?shareType=nongift (also observing this round of measures “fell short of stronger measures sought by activists to deprive the *junta* of crucial revenues, including potential sanctions against Myanmar Oil and Gas Enterprise [MOGE], the state energy company,” and likewise did not entail “penalties against subsidiaries of Myanmar Economic Holdings Limited and Myanmar Economic Corporation, military-linked conglomerates, or the two umbrella entities themselves,” though MEHL and MEC were on the DOC’s blacklist.). On 22 March, the U.S. increased pressure further on the generals by expanding the list of sanctioned persons, and the EU also imposed sanctions of its own. See *EU and U.S. Sanctions Step Up Pressure on Myanmar Military Over Coup*, REUTERS, 22 March 2021, www.reuters.com/article/us-myanmar-politics/eu-and-u-s-sanctions-step-up-pressure-on-myanmar-military-over-coup-idUSKBN2BE074 (reporting: “The 11 individuals targeted [by the EU] included General Min Aung Hlaing, the Commander-in-Chief of the Myanmar military and head of the *junta* that has taken power. Washington had already sanctioned Min Aung Hlaing and the [new] measures ... expanded the list of targets.”) [Hereinafter, *EU and U.S. Sanctions Step Up*.]

The 22 March 2021 expansion was a quintessential illustration of targeted sanctions, in that OFAC knew precisely who to penalize by adding to the SDN list: two Burmese military leaders, and two Burmese military divisions, responsible for, or complicit in, violent repression of freedom of assembly and expression in connection with pro-democracy protests. The leaders were: (1) Than Hlaing, Chief of the Burma Police Force and Deputy Home Affairs Minister, and (2) Lieutenant General Aung Soe, a Burmese Bureau of Special Operations Commander. The divisions were the (1) 33rd Light Infantry Division of the Burmese Army and (2) 77th Light Infantry Division of the Burmese Army. Still another expansion came on 26 March, when the U.S. and U.K. The U.S. Department of the Treasury added MEC and MEHL to its blacklist, thus freezing any of their assets within America’s reach, and the U.K. imposed sanctions on MEHL. See Tim McDonald, *U.S. and U.K. Ratchet Up Sanctions on Myanmar’s Military*, BBC NEWS, 25 March 2021, www.bbc.com/news/business-56248559. This expansion was significant in that it involved the U.K., and targeted the two entities that “control significant portions of Myanmar’s economy, with interests across many of the country’s major industries.” *Id.* Additionally, the USTR suspended its platform government-to-government cooperation on commercial issues with Burma, namely, the 2013 *TIFA*. See Office of the United States Trade Representative, *USTR Suspends Trade Engagement with Burma following Military Coup and Violence against Civilians* (29 March 2021), <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/march/ustr-suspends-trade-engagement-burma-following-military-coup-and-violence-against-civilians>.

In May, the Biden Administration further tightened its sanctions. It took aim at the governing SAC, plus other officials, some of whom were from Myanmar’s private sector (that is, non- or ex-military officials, but who assisted the *junta*). The sanctions involved freezing assets subject to U.S. jurisdiction, and barring Americans from transacting with the targets. See Daphne Psaledakis & Simon Lewis, *U.S. Allies Coordinate New Sanctions On Myanmar Junta*, REUTERS, 17 May 2021, www.reuters.com/article/us-myanmar-politics-usa-sanctions/u-s-imposes-fresh-sanctions-on-myanmar-junta-targets-governing-body-idUSKCN2CY1JZ (reporting: “The U.S. sanctions list included four members of the SAC and nine other officials the [U.S.] Treasury said were key members of Myanmar’s military government, including the governor of the central bank and the chairman of the military-appointed electoral body, the Union Election Commission. The move appeared to be the first time Washington has targeted civilian officials who are working with the *junta*, although some of them are retired military officers.”).

assets within reach of U.S. authorities of these individuals and their families and entities were blocked (in effect, frozen).

However, neither President Biden's *Executive Order* nor the OFAC List were anywhere close to a comprehensive trade embargo of Burma, though under Section 1(b) of the *Order*, BIS tightened export controls, that is, it increased the difficulty to obtain a license to ship goods or services to Burma. In particular, OFAC targeted exports to the Burmese Ministries of Defense and Home Affairs, Armed Forces, and Security Services, saying that it would apply a presumption of denial for any license request to ship merchandise to these targets.⁵⁸⁷ BIS also added Burma to its list of countries (with China, Russia, and Venezuela) subject to the Military End User and End User Rule, and downgrading Burma's status among Country Groups from "B" to a lower one (*i.e.*, to a category, Group D:1, to which stricter restrictions apply, including drastic limits on the use of license exceptions).⁵⁸⁸ (The "MEU" Rule and Country Groupings are discussed in a separate Chapter.)

However "smart" the Biden Administration sanctions were, query the extent of their potential efficacy:

The two major conglomerates founded by the Defense Ministry, Myanmar Economic Holdings Public Company Ltd. (MEHL) and Myanmar Economic Corp. (MEC), have cemented the military's role at the center of the economy. They offer a wide variety of civil society's essential goods and services; they also employ thousands of civilian and military personnel, control industries including real estate, alcohol, tobacco, and natural resources, and pay dividends to hundreds of thousands of soldiers.

As a result, traditional measures of business success are sometimes irrelevant, and international sanctions designed to put pressure on the *junta* after the February *coup* are likely to have minimal effect....

K. Oahn Ha, Khine Lin Kyaw & Jin Wu, *Myanmar's Generals Run a Nearly Sanction-Proof Business Empire*, BLOOMBERG, 10 May 2021, www.bloomberg.com/graphics/2021-myanmar-military-business/?sref=7sxxw9Sxl. In other words, whether the sanctions could compel a change in the target's behavior was questionable. Of course (as discussed in a separate Chapter), utilitarian outcomes are not the only justification for sanctions: there also is the deontological rationale that the sanctioning country (here, the U.S.) finds transactions with the target (Burma) intrinsically morally unacceptable.

⁵⁸⁷ See U.S. Department of Commerce, Bureau of Industry and Security, *Burma: Implementation of Sanctions*, 6 Federal Register number 31, 10011 (18 February 2021), www.govinfo.gov/content/pkg/FR-2021-02-18/pdf/2021-03350.pdf (articulating a stricter licensing policy for Burma and the suspension of certain license exceptions in response to the military *coup*, including application of a presumption of denial license review standard for all items that are destined for Burma's Ministries of Defense or Home Affairs or for the Burmese military).

⁵⁸⁸ See U.S. Department of Commerce, Bureau of Industry and Security, *Burma: Implementation of Sanctions*, 86 Federal Register number 43, 13173-13178 (8 March 2021), www.govinfo.gov/content/pkg/FR-2021-03-08/pdf/2021-04745.pdf and *Addition of Entities to the Entity List*, 86 Federal Register number 43, 13179-13181 (8 March 2021), www.govinfo.gov/content/pkg/FR-2021-03-08/pdf/2021-04794.pdf?utm_campaign=subscription%20mailing%20list&utm_source=federalregister.gov&utm_medium=email (further strengthening U.S. sanctions against Burma by (1) adding persons to the Entity List, (2) announcing a more restrictive license review policy, (3) shifting Burma from Country Group B to Group D:1, (4) subjecting Burma to the MEU restrictions, and (5) moving Burma to Tier 3 for Computer End Users, and (6) placing additional limits on the use of license exceptions). (The Entity List is discussed in a separate Chapter.) See also U.S. Department of Commerce, Bureau of Industry and Security, Press Release, *Commerce Increases Restrictions on Burmese Military by Adding Four Entities to Entity List in Continued*

Rather, President Biden's *Order* imposed so-called "smart" sanctions that took aim at the Burmese military officials responsible for the *coup*, given the substantial role they play in Burma's economy.⁵⁸⁹ He opted not to reimpose the comprehensive embargo America had applied to Burma that his former boss, President Obama, repealed in 2016:

Following the full-on economic isolation strategy of the past would risk driving Myanmar closer to China, and there is concern about the effect such measures would have on the lives of the general public.

But sanctions limited to military-linked companies alone have less bite, making cooperation [by the U.S.] with partners such as Japan and European nations all the more important.⁵⁹⁰

Response to the Recent Military Coup (2 July 2021), www.commerce.gov/news/press-releases/2021/07/commerce-increases-restrictions-burmese-military-adding-four-entities (adding four more Burmese entities to the Entity List because of their relation to the Burmese military and its February 2021 coup, thus restricting the ability of these entities to access commodities, software, and technology subject to the EAR).

⁵⁸⁹ In *Executive Order* 13662, concerning Russia, President Obama started the strategy of designating a targeted individual or entity for its operation in a certain sector of the country at issue, such as defense, finance, minerals, oil, or shipping, and his successor continued this approach with respect to Venezuela. Typically, the sector is a critical one to the target country, in terms of earning export revenues and/or attracting investment. This strategy is useful for OFAC in persuading third countries not to deal with the targeted individual or entity, and thus isolate the sector and disrupt funding to the regime of that country.

⁵⁹⁰ *Myanmar Military Companies*. Avoidance of driving Burma closer to China was a key concern of the Biden Administration, particularly amidst the Sino-American Trade War (discussed in a separate Chapter), and in view of the reality that before the *coup*, Burma had distanced itself from China:

Data shows that under the Myanmar government led by State Counselor Aung San Suu Kyi, who was ousted on Feb. 1, economic ties with China weakened. As the Myanmar military *junta* tightens its grip on power, bilateral relations will be key for the military-led government's efforts to buttress the economy.

Under the government led by Suu Kyi's National League for Democracy, the economy expanded its ties with the West; as a result, outstanding debt with China decreased by 26%. Also, trade with Western countries increased and the trade deficit with China shrank.

If the U.S. and Europe impose sanctions, it will be a huge blow to the economy. The military *junta* could once again turn its attention to China, which is expanding its clout through the Belt and Road Initiative.

...

BRI-related funding for the 10 ASEAN countries since 2013 has amounted to \$304.1 billion, equivalent to half their annual fiscal spending.

Of them, Myanmar, Laos, and Cambodia are the three countries that rely heavily on China. Although the funding for Myanmar at \$21.7 billion is less than one-third the size for Indonesia, all three of the mainland Southeast Asian countries have accepted Chinese investment and loans that are 1.6 to 2 times larger than their annual fiscal expenditures.

China's heavy economic influence can be easily seen in Myanmar. In Yangon, where motorcycles are banned, buses are indispensable when citizens travel and most are made

Thus, under the *Order*, U.S. persons could continue to engage in import, export, and FDI transactions with Burma – though they had to know their Burmese counterparties to be sure they were not dealing with an OFAC-sanctioned person or entity.

in China. Although trade with Japan, the U.S., and Europe has been increasing, China is still the largest importer and exporter, accounting for over 30% of Myanmar's trade.

Myanmar, however, has a history of keeping itself at arm's length from China to avoid being swallowed up by its giant neighbor.

... Myanmar's outstanding debt to China was \$3.34 billion at the end of 2019, down 26% from the end of 2015, right before the NLD government came to power. This is in contrast to the 72% and 34% increases in neighboring Laos and Cambodia, respectively, over the same period. ...

If the country falls into default, there is a risk of falling into a debt trap in which it is forced to hand over critical infrastructure to Beijing. And Myanmar has been keenly aware of this.

One example of the change in policy is the revised plan to build a port in Kyaukpyu, overlooking the Indian Ocean. The port is connected to two 870-km pipelines carrying oil and natural gas to Yunnan Province. If large ships could enter the port, oil and gas from the Middle East and Africa could be transported to inland China without traveling through the Strait of Malacca, a geopolitical choke point.

The scale of this project was initially planned at \$7.2 billion but was slashed to \$1.3 billion when the basic agreement was reached in November 2018. The project's details were changed at Myanmar's request, and additional investment will be decided on once demand for the port is known.

But Myanmar's attempt to ease economic dependence on China has not been easy.

Moreover, the U.S. and Europe are considering sanctions against the military *junta* – high risks in the country will inevitably make foreign investment stall. ... Japan's Kirin Holdings announced it will terminate its two joint beer ventures in Myanmar.

If the *junta* is further isolated, one country that Naypyitaw is likely to approach is China – a country with historic ties as well as one that has been cautious toward sanctions.

Iori Kawate & Yuichi Nitta, *Myanmar's Debt to China Decreases 25% Under Ousted Suu Kyi*, NIKKEI ASIA, 7 February 2021, <https://asia.nikkei.com/Spotlight/Datawatch/Myanmar-s-debt-to-China-decreases-26-under-ousted-Suu-Kyi>. See also Khine Lin Kyaw & Philip Heijmans, *Myanmar's Army Chief Challenges Biden, Bets Big on China*, BLOOMBERG, 1 February 2021, www.bloomberg.com/news/articles/2021-02-01/myanmar-s-army-chief-challenges-biden-and-bets-big-on-china?sref=7sww9Sxl (observing: “[Burmese] Army Chief Min Aung Hlaing, ... already faces sanctions from the U.S. and U.K. due to a brutal crackdown against Rohingya Muslims that has led to accusations of genocide. Beijing, meanwhile, has shown him respect: In a meeting last month [January 2021] with the 64-year-old general, Chinese Foreign Minister Wang Yi called the two countries ‘brothers’ while praising the military’s ‘national revitalization.’ ... A key part of the U.S. strategy to counter China’s rise has been an effort to rally democracies in Asia to back a “free and open” region that contrasts with Beijing’s single-party rule. Yet democracy advocates in places like Malaysia and Thailand have lost ground without consequences under the presidency of Donald Trump, whose own bid to overturn the U.S. election results prompted [on 6 January 2021] a deadly mob to storm the Capitol.”). [Hereinafter, *Myanmar's Army Chief*.]

As America's sanctions evolved, the targets expanded to include the lucrative Burmese jade industry:

The U.S. Treasury Department has imposed sanctions on a Myanmar state-owned gems enterprise, in a bid to deprive the military government of funds.

The Treasury described Myanmar Gems Enterprise (MGE) as “a key economic resource” for the military regime.

Myanmar is the world's main source of jade and a major source of rubies, sapphires and other gems.

...

MGE oversees most jade and gemstone industries in Myanmar and is responsible for licensing and regulating the sector, collecting royalties and marketing jade and gemstones in Burma.

A 2019 U.N. Report on the economic interests of the Myanmar military said it was among a number of state-owned enterprises that “play a dominant role in Myanmar's economy, generating about half the government's revenue, spending half the government's budget and regulating much of the formal economy.”

The Report said MGE's leadership is mostly comprised of former military leaders.

A previous report from Global Witness put the estimated value of Myanmar's jade at \$31 bn ... in 2014, based on the officially recorded jade production figures of 16,684 tons.

The Extractive Industries Transparency Initiative's most recent statistics, from 2018, suggest that jade production has roughly doubled since then.⁵⁹¹

Yet, Ms. Suu Kyi had (at last in previous iterations of the decades-long struggle for authentic civilian rule) advocated for more restrictions, namely, no commercial dealings with the country as long as the bad guys, as it were, ran it. To mark the two-year anniversary of the military coup, in February 2023 the U.S. announced more restrictions, in collaboration with its allies, Australia and Canada. The targets were Myanmar's “Union Election Commission, mining enterprises, energy officials, current and former military officials,” and the Myanma Oil and Gas Enterprise (MOGE)” an SOE responsible for oil

⁵⁹¹ *Myanmar: U.S. Hits State-Owned Gem Company with Sanctions*, BBC News, 8 April 2021, www.bbc.com/news/business-56685106. The Global Witness Report is *Jade: Myanmar's Big State Secret* (23 October 2015), www.globalwitness.org/en/campaigns/oil-gas-and-mining/myanmarjade/.

and gas exploration, production, and distribution.⁵⁹² Burma's military generals were undeterred. In March 2023, they disbanded the NLD plus 39 other opposition parties.⁵⁹³

Ms. Suu Ky's pro-sanctions position is manifest via the Burmese Jade hypothetical: should America go further than the Biden *Executive Order*, and cut-off trade relations with Burma, in support of her and the NLD, or should the U.S. support trade liberalization as advocated by the military, restrict itself to targeted sanctions as per the *Order*, and thereby help the regime avoid the negative net welfare effects of protection for Burmese jade producers? Or, as Bloomberg succinctly put it: "Biden now faces a dilemma in crafting a response that will punish Myanmar's generals without hurting the wider population, which suffered under sanctions imposed in the 1990s before the country's shift toward democracy a decade ago."⁵⁹⁴

The *coup* was a disgraceful irony for Ms. Suu Kyi, who had essentially defended the military in its genocidal treatment of the Rohingya, including in a 2019 ICJ case,⁵⁹⁵ yet found herself again under house arrest, as she had been for almost 15 years across 1989-2010 – her jailers being the generals, who charged her with three criminal offenses, possessing illegal walkie-talkies (allegedly she lacked a license for them under the *Telecommunications Law*) and violating the Burma's *Natural Disaster Law*,⁵⁹⁶ plus publishing information that may cause "fear or alarm" (a British colonial-era law).⁵⁹⁷ Subsequently, they tacked on the accusation (without evidence) she illegally accepted \$600,000 and 11 kg of gold.⁵⁹⁸ She seemed destined for a lengthy imprisonment.⁵⁹⁹ In

⁵⁹² Daphne Psalidakis & Simon Lewis, *U.S., Allies Mark Anniversary of Myanmar Coup with Fresh Sanctions*, REUTERS, 31 January 2023, www.reuters.com/world/asia-pacific/us-canada-australia-impose-new-sanctions-myanmar-2023-01-31/.

⁵⁹³ See Sui-Lee Wee, *Junta Disbands Aung San Suu Kyi's Political Party in Myanmar*, THE NEW YORK TIMES, 28 March 2023, www.nytimes.com/2023/03/28/world/asia/myanmar-election.html?smid=nytcore-ios-share&referringSource=articleShare.

⁵⁹⁴ *Myanmar's Army Chief*.

⁵⁹⁵ See John Reed, *Myanmar Coup Blindsides the West*, FINANCIAL TIMES, 1 February 2021, www.ft.com/content/cee63a22-4796-48bb-bcc3-0e3c95114ee0?shareType=nongift. [Hereinafter, *Myanmar Coup Blindsides*.]

⁵⁹⁶ See *Myanmar Coup: Aung San Suu Kyi Faces New Charge Amid Protests*, BBC News, 16 February 2021, www.bbc.com/news/world-asia-56074429.

⁵⁹⁷ *Myanmar's Suu Kyi Appears in Court as Junta Blocks Comeback Path*, NIKKEI ASIA, 1 March 2021, <https://asia.nikkei.com/Spotlight/Myanmar-Coup/Myanmar-s-Suu-Kyi-appears-in-court-as-junta-blocks-comeback-path>. [Hereinafter, *Myanmar's Suu Kyi Appears*.]

⁵⁹⁸ See *Myanmar's Military Accuses Suu Kyi of Taking \$600,000 and Gold*, BBC NEWS, 11 March 2021, www.bbc.com/news/world-asia-56327764.

⁵⁹⁹ In December 2021:

Ousted Myanmar leader Aung San Suu Kyi ... [was] sentenced to four years in prison, the first in a series of verdicts that could jail her for life.

She was found guilty on charges of inciting dissent and breaking Covid rules under a natural disasters law.

Ms. Suu Kyi faces 11 charges in total, which have been widely condemned as unjust. She has denied all charges.

She has been in detention since a military *coup* in February which toppled her elected civilian government.

It is not clear when or if Ms. Suu Kyi will be placed in prison. She is being held at an undisclosed location.

...

The 76-year-old has been slapped with an array of charges, including several counts of corruption and violating the official secrets act.

In one case, Ms. Suu Kyi was convicted of violating Covid restrictions for campaigning during last year's election – she had waved to supporters while wearing a mask and face shield.

In the other she was found guilty of inciting unrest for a statement calling for public opposition to the *coup*, put out by her party after she had already been taken into custody.

Ms. Suu Kyi's lawyers, who had been the sole source of information on the legal proceedings, have also been served with gag orders forbidding them from releasing information.

...

A spokesman for the newly formed National Unity Government, a group made up of pro-democracy figures and opponents of the *coup*, had earlier ... [said] Ms. Suu Kyi was struggling.

"She is not O.K. ... military generals are preparing for 104 years of sentences for her in prison. They want her to die in prison," Dr. Sasa said.

The military had seized power alleging voter fraud in general elections held last year in which the NLD won by a landslide.

However, independent election observers have said the elections were largely free and fair.

The *coup* triggered widespread demonstrations and Myanmar's military has cracked down on pro-democracy protesters, activists and journalists.

Ms. Suu Kyi is one of more than 10,600 people to have been arrested by the *junta* since February, and at least 1,303 others killed in the demonstrations, according to the monitoring group Assistance Association for Political Prisoners.

Aung San Suu Kyi: Myanmar Court Sentences Ousted Leader to Four Years Jail, BBC NEWS, 6 December 2021, www.bbc.com/news/world-asia-59544484.

The four-year sentence was halved to two years, following a pardon, but Ms. Suu Kyi still faced a sentence of over a century. See *Myanmar Cuts Suu Kyi's Sentence to 2 Years from 4*, NIKKEI ASIA, 6 December 2021, <https://asia.nikkei.com/Spotlight/Myanmar-Crisis/Myanmar-cuts-Suu-Kyi-s-sentence-to-2-years-from-4> (reporting: "Top officials in military-ruled Myanmar said ... that the four-year prison sentence handed down to Aung San Suu Kyi that day will be halved to two years after a partial pardon by military leader Min Aung Hlaing. A Court had sentenced Suu Kyi to four years for incitement against the military and violating COVID-19 restrictions. She will remain under house arrest at a government facility in Naypyitaw, the country's capital, rather than jailed.... Suu Kyi, 76, was State Counselor before the military seized power in February. The verdict in the trial in Naypyitaw was the first one against the deposed leader as the military regime evidently aims to shut her out of politics. With other charges pending, including violating the *Official Secrets Act* and *Anti-Corruption Law*, Suu Kyi is facing 11 criminal cases, with maximum sentences totaling more than 100 years if sentenced consecutively. More charges are highly likely to be filed against Suu Kyi, according to the sources.").

Indeed, in January 2022, the specter of an extraordinarily lengthy prison term on flimsy charges remained:

A Court in military-ruled Myanmar ... sentenced ousted leader Aung San Suu Kyi to four years in jail on charges including possession of unlicensed walkie-talkies....

The latest sentencing in legal proceedings that rights groups have criticized as a farce and a “Courtroom circus” means she faces a six-year jail term after two convictions last month [December 2021].

She is on trial in nearly a dozen cases that carry combined maximum sentences of more than 100 years in prison. She denies all charges.

...

Suu Kyi was detained on the day of the Feb. 1 [2021] coup and days later, police said six illegally imported walkie-talkies were found during a search of her home.

International human rights groups, the Norwegian Nobel Committee and the United States assailed the news, with U.S. State Department spokesman Ned Price calling the convictions “an affront to justice and the rule of law” and demanding the release of Suu Kyi and other political detainees.

The Court handed her a two-year sentence for breaching an export-import law by possessing the handheld radios and one year for having a set of signal jammers. The two sentences will run concurrently....

She was also sentenced to two years on another charge of breaching a natural disaster management law related to coronavirus rules, the source said.

...

On Dec. 6, she received a four-year jail sentence for incitement and breaching coronavirus rules.

That sentence, which was later reduced to two years, was met by a chorus of international condemnation.

Myanmar’s Suu Kyi Faces Six Years in Jail After New Sentences – Source, REUTERS, 10 January 2022, www.reuters.com/world/asia-pacific/myanmar-court-sentences-ousted-leader-suu-kyi-over-walkie-talkies-source-2022-01-10/. See also *Aung San Suu Kyi: Ousted Myanmar Leader Jailed for Another Four Years*, BBC NEWS, 10 January 2022, www.bbc.com/news/world-asia-59933706 (reporting: “the charges in the latest case stem from when soldiers searched her house on the day of the coup by forces led by army chief General Min Aung Hlaing. The devices they say they discovered are presumed to have been used by her security guards, resulting in a conviction widely viewed as no more than a tactic to justify detaining her.”).

In April 2022, Ms. Suu Kyi was sentenced to another five years imprisonment on charges of corruption, which meant the 76-year-old faced almost two centuries in jail. See Frances Mao, *Aung San Suu Kyi: Myanmar Sentences Ex-leader to Jail for Corruption*, BBC NEWS, 27 April 2022, www.bbc.com/news/world-asia-61239881 (reporting: “a junta court found her guilty of taking a \$600,000 (£477,000) bribe in the form of cash and gold bars from the former head of Yangon, Myanmar’s largest city and region. She was sentenced to five years in jail. ... The latest conviction takes her total prison sentence to 11 years, as she was previously found guilty for other offenses. In December [2021], she was convicted of inciting dissent against the military and breaking public health Covid rules. In January she was also found guilty of having contraband walkie-talkie radios in her house and breaching more Covid rules. Ms Suu Kyi still faces 10 other corruption charges, each carrying a maximum penalty of 15 years, as well as charges on electoral fraud and violating the *Official Secrets Act*. ... If convicted on all her charges, she would face a total jail sentence of more than 190 years....”).

In August 2022, Ms. Suu Kyi was sentenced to another three years imprisonment, this time for election fraud. See Oliver Slow, *Myanmar: Aung San Suu Kyi Given Three More Years for “Election Fraud,”*

BBC NEWS, 2 September 2022, www.bbc.com/news/world-62763419 (reporting: “A military-run court in Myanmar has sentenced Aung San Suu Kyi to a further three years in prison on election fraud charges...Ms. Suu Kyi – the country’s former leader – has now been sentenced to 20 years in prison on 11 counts, with several charges remaining. She denies all of the accusations, and the trials have been condemned by rights groups as politically motivated. If convicted on all charges, she could face almost 200 years in prison. The new sentence included hard labor.... The 77-year-old Nobel laureate has spent most of her time in detention under house arrest in the capital Nay Pyi Taw. The public and media have had no access to the closed-door hearings and the military has prevented her lawyers from speaking to journalists. The court found her guilty of committing fraud in the November 2020 general election, which her party, the National League for Democracy (NLD), won overwhelmingly. The army launched a coup last year after alleging there had been massive voter fraud in the vote, but independent election observers said the poll was ‘representative of the will of the people.’ Civil rights and democracy groups have denounced the legal proceedings against Ms. Suu Kyi and others as a farce. The U.N. has said she is facing a ‘sham trial.’ Myanmar’s military regime says Ms Suu Kyi’s trials are part of the legal process. A spokesperson for Amnesty International ... [said military is using the legal system as ‘another convenient tool in its arsenal to smother dissent.’”). The following month, Ms. Suu Kyi was sentenced – following a closed-door trial by the junta’s court – to a further three years for breach (which she denied) of the *Official Secrets Act*. See Frances Mao, *Sean Turnell: Australian Adviser to Suu Kyi Gets Three Years Jail in Myanmar*, BBC NEWS, 29 September 2022, www.bbc.com/news/world-asia-63070543 (also reporting: “She has already been sentenced to more than two decades in prison on over a dozen counts brought by the military government – with several charges still remaining. If convicted on all charges, she could face almost 200 years in prison. ... It’s estimated more than 15,600 people – including lawmakers, activists, and journalists – have been arrested since the military seized power.”).

In October 2022, another three-year sentence was handed down, this one for (supposedly) accepting a bribe from a businessman. See *Myanmar Court Jails Suu Kyi for Three Years for Graft – Source*, REUTERS, 11 October 2022, www.reuters.com/world/asia-pacific/myanmar-court-sentences-suu-kyi-3-years-jail-graft-source-2022-10-12/.

In December 2022, the military *junta* tacked on an additional seven-year sentence, raising Ms. Suu Kyi’s overall jail time – to that point – to 33 years:

The country’s former democratically-elected leader has been under house arrest since a military ousted her government in a coup in February 2021.

Since then she’s faced 18 months of trials on 19 charges – which [human] rights groups say are a sham.

The U.N. Security Council called for her release ... [earlier in December 2022].

... [S] he was sentenced on the final five charges she faced. A court found her guilty of corruption because she had not followed regulations in renting a helicopter for a government minister.

She had already been convicted of 14 different crimes, including breaching Covid public safety rules, importing walkie-talkies and violating the *Official Secrets Act*.

Her trials this year have been set behind closed-doors where the public and media are barred access and her lawyers are also banned from speaking to journalists. She has denied all the charges against her.

Frances Mao, *Aung San Suu Kyi Jailed for a Further Seven Years*, BBC NEWS, 30 December 2022, www.bbc.com/news/world-asia-64123149.

In 2023, the junta seemed to change tack, at least slightly. The military pardoned the 78-year-old Ms. Suu Kyi in five of the 19 charges against her, cutting her jail sentence from 33 to 27 years, and moving her from a prison facility to house arrest. See Jonathan Head & Derek Cai, *Myanmar: Aung San Suu Kyi Jail Term Reduced After Some Pardons*, BBC NEWS, 1 August 2023, www.bbc.com/news/world-asia-66357403.

March 2022, the U.S. officially concluded that the Burmese military had committed crimes against humanity, specifically, genocide against the Rohingya.⁶⁰⁰

What was almost undeniably true was Ms. Suu Kyi had failed to entrench democracy in the country when she wielded power and thus had the chance:

In the years Myanmar was cowed by a military *junta*, people would tuck away secret photos of Daw Aung San Suu Kyi, talismans of the heroine of democracy who would save her country from a fearsome army even though she was under house arrest.

But after she and her party won historic elections in 2015 and again last year by a landslide – cementing her own popularity within Myanmar – Ms. Aung San Suu Kyi came to be viewed by the outside world as something altogether different: a fallen patron saint who had made a Faustian pact with the generals and no longer deserved her Nobel Peace Prize.

In the end, Ms. Aung San Suu Kyi, 75, could not protect her people, nor could she placate the generals. On Monday, the military, which had ruled the country for nearly five decades, seized power again in a *coup*, cutting short the governance of her National League for Democracy after just five years.

...

The disappearance of Ms. Aung San Suu Kyi, who represented two entirely different archetypes to two different audiences, domestic and foreign, proved her inability to do what so many expected: form a political equipoise with the military with whom she shared power.

By allowing negotiations with General Min Aung Hlaing to wither, Ms. Aung San Suu Kyi had lost the military's ear. And by defending the generals in their ethnic cleansing of Rohingya Muslims, she lost the trust of an international community that had championed her for decades.⁶⁰¹

Unsurprisingly, the military showed little inclination to back down, notwithstanding protests by millions across the country:

[M]ilitary Chief Min Aung Hlaing ... [said] the military would abide by the Constitution. ... [Subsequently,] it became clear what the military meant

⁶⁰⁰ Humeyra Pamuk & Simon Lewis, *Biden Administration Rules Myanmar Army Committed Genocide Against Rohingya*, REUTERS, 20 March 2022, www.reuters.com/world/asia-pacific/exclusive-biden-administration-rules-myanmar-army-committed-genocide-against-2022-03-20/ (also noting: "Since the Cold War, the State Department has formally used the term six times to describe massacres in Bosnia, Rwanda, Iraq and Darfur, the Islamic State's attacks on Yazidis and other minorities, and most recently last year, over China's treatment of Uyghurs and other Muslims. China denies the genocide claims.").

⁶⁰¹ Hannah Beach, *Democracy Hero? Military Foil? Myanmar's Leader Ends Up as Neither*, THE NEW YORK TIMES, 1 February 2021, www.nytimes.com/2021/02/01/world/asia/myanmar-coup-aung-san-suu-kyi.html?referringSource=articleShare.

by this. The *Tatmadaw* [*i.e.*, an omnipotent military] said that its order was in line with Article 417 of the Constitution, which allowed a state of emergency to be declared by the President for a year in circumstances that might “disintegrate the union or disintegrate national solidarity.”⁶⁰²

And, not surprisingly, the military cut off internet services, violently suppressed dissent (killing at least 54 persons by 4 March,⁶⁰³ with the toll rising to at least 250 by 22 March,⁶⁰⁴ over 400 as of Palm Sunday,⁶⁰⁵ over 600 the week after Easter,⁶⁰⁶ and over 700 by the 24 April ASEAN summit⁶⁰⁷), and threatened protestors with 20 years imprisonment.⁶⁰⁸ Amidst these developments, was Ms. Suu Kyi correct all along to urge a boycott of Burma?

- **Graphical and Tabular Explanation**

From an economic perspective, the argument of Burmese jade producers is narrow and self-interested. It neglects the net benefit to Burma that would result from dismantling the tariff. This result is evident from Graph 17-1, the key points of which Table 17-1 summarizes.⁶⁰⁹ To begin, a tariff is a tax on imports that, at given world prices, raises the internal (or domestic) price of imported merchandise. The amount of increase is in proportion to the rate at which the tariff is imposed. So, if Burma imposes a 25% tariff on imported jade, then a \$1,000 shipment of jade from China would cost, to Burmese consumers, \$1,250. Imposition of a tariff affects three distinct constituencies in an importing country – consumers, producers, and the government.

Domestic consumers suffer from a tariff. They must pay a higher price for imported merchandise. Domestic producers of a like, directly competitive, or substitutable produce (*i.e.*, of any good that may be consumed in lieu of the imported good) benefit from a tariff.

⁶⁰² See *Myanmar Coup Blindsides*.

⁶⁰³ See *Exclusive: U.S. Blocked; Myanmar’s Suu Kyi Appears*.

⁶⁰⁴ See *EU and U.S. Sanctions Step Up*.

⁶⁰⁵ See *Myanmar Coup: Generals Celebrated Amid Global Fury Over Massacre*, BBC NEWS, 29 March 2021, www.bbc.com/news/world-asia-56547381.

⁶⁰⁶ *Myanmar Junta Says Protests Are Dwindling As At Least 10 Reported Killed By Troops*, REUTERS, 9 April 2021, www.reuters.com/article/us-myanmar-politics/myanmar-junta-says-protests-are-dwindling-as-at-least-10-reported-killed-by-troops-idUSKBN2BW0ZC.

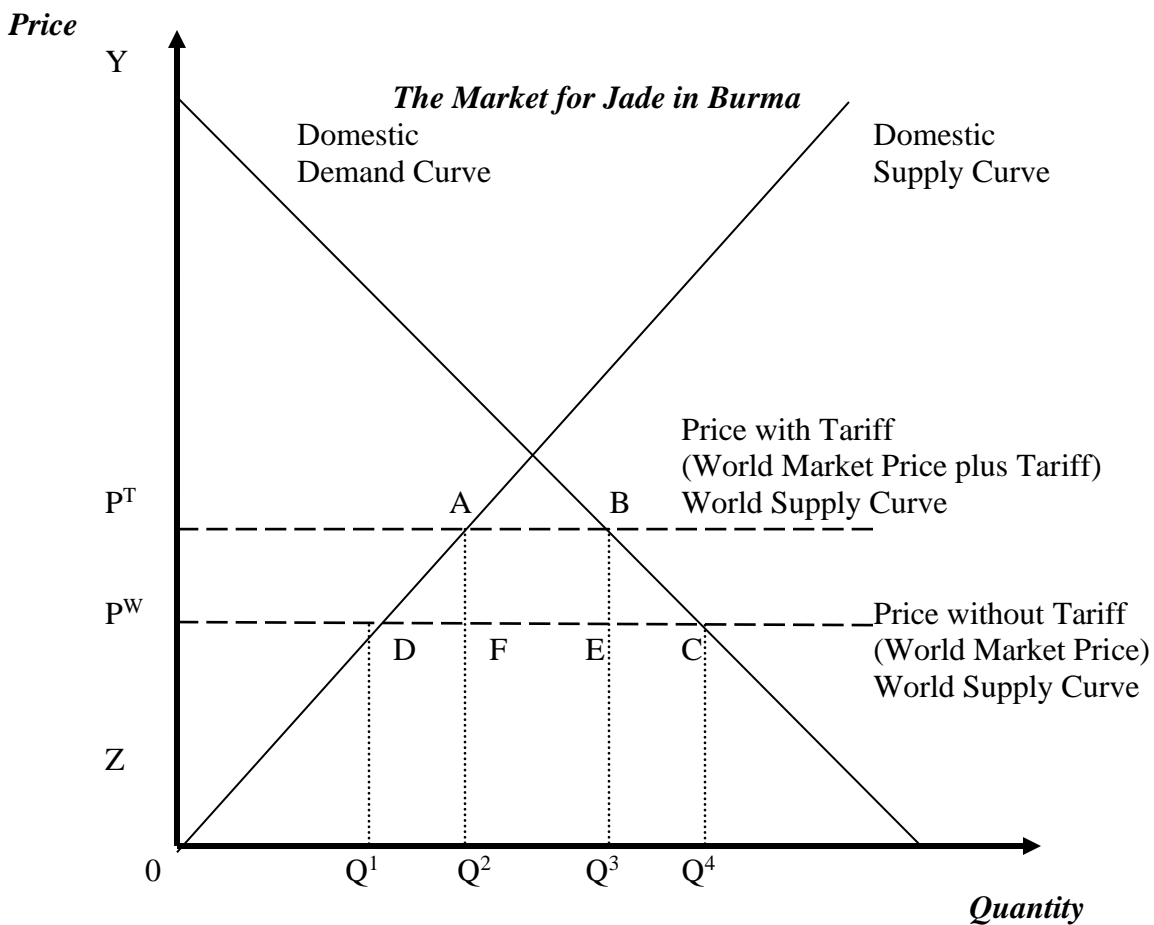
⁶⁰⁷ *Myanmar: Military Chief Urged to Stop Violence on First Foreign Trip*, BBC News, 25 April 2021, www.bbc.com/news/world-asia-56855166?piiano-modal (also reporting (per Jonathan Head): “ASEAN leaders have been widely criticized for inviting to their meeting the man responsible for overthrowing the elected government in Myanmar, and for unleashing savage violence on those opposed to his coup. They may now argue that it was worth it; that by attending, Min Aung Hlaing has accepted the meeting’s concluding statement calling for an end to the violence and the start of dialogue with an opposition movement that enjoys substantial popular support. The general was described by his Indonesian hosts only as the armed forces commander and not the head of a legitimate government. However, an appeal for the release of political prisoners was dropped from the final communique. ... ASEAN member states fear that unless this happens, they may have a civil war, or even a failed state, on their doorstep.”).

⁶⁰⁸ See generally *Myanmar Coup: MPs Urge UN to Investigate “Gross Human Rights Violations,”* BBC News, 12 February 2021, www.bbc.com/news/world-asia-56037305 (discussing the suppression by the military of protestors).

⁶⁰⁹ The intersection of domestic demand and supply curves represents equilibrium price and quantity conditions in Burma under autarky.

They receive a higher price for their output than would be the case if free trade were pursued. To be sure, the price of a domestic good – such as jade produced in Burma – need not rise, because obviously it is not subject to the tariff. However, domestic producers may respond to tariff protection by raising their prices to some degree to gain extra revenue. Presumably, domestic producers would not raise their prices to the same levels as imported merchandise (as they would lose the benefit of tariff protection). As for the government of the importing country, it gains from imposing a tariff insofar as it collects tariff revenues. This gain is particularly significant for poor countries that rely heavily on tariffs to fund government programs.

Graph 17-1
Neo-Classical Economic Analysis of Tariff



Indubitably, this group-by-group accounting is simplistic.

Why? It does not consider whether domestic producers, if they raise their prices, will behave in a far-sighted manner. Will they re-invest the added revenues to enhance their efficiency and prepare for international competition if, and when, protection is removed? As for the government, what will it do with the tariff revenue? Might it invest the funds in education and infrastructure projects that support economic growth, or will it

apply them to transfer payment obligations (*e.g.*, welfare) or use them to pay down official debt?

Table 17-1
Summary of Neo-Classical Economic Analysis of Tariff

<i>Constituency within Burma</i>	<i>Domestic Price before Tariff is Imposed (same as World Market Price)</i> <i>and</i> <i>Quantity of Imports without Tariff (domestic demand minus domestic supply)</i>	<i>Domestic Price after Tariff is Imposed (World Market Price plus Tariff)</i> <i>and</i> <i>Quantity of Imports with Tariff (domestic demand minus domestic supply)</i>	<i>Amount of Surplus or Revenue before Tariff is Imposed (area)</i>	<i>Amount of Consumer or Producer Surplus, or Government Revenue, after Tariff is Imposed (area)</i>
Consumers	P^W $Q^4 - Q^1$	P^T $Q^3 - Q^2$	YCP^W	YBP^T
Producers			ZDP^W	ZAP^T
Government			None	ABEF
Net Effects from Imposing Tariff				Consumers lose $BCP^W P^T$ surplus. Producers gain $ADP^W P^T$. Government gains ABEF tariff revenue. Burma loses BCE (consumption cost) plus AFD (production cost).

Put succinctly, the standard Neo-Classical economic analysis of a tariff is static. It does not measure the uses to which higher domestic producer revenues or government tariff revenues are put over time. The analysis also is insular. It leaves out the effect on exporters in a foreign country – like jade producers in China – of a tariff in one market. Similarly, it leaves out knock-on effects. Perhaps Chinese producers, dissuaded by the tariff from exporting large volumes to Burma, divert some of their trade to Thailand and Vietnam. The Burmese tariff has changed the pattern of Chinese jade exports, but the above analysis does not examine the effects of those exports on third countries.

Setting aside these shortcomings, the analysis does furnish useful insights. It highlights the source of loss to consumers, and of gains to producers and the government.

In turn, it provides a visual depiction of the net welfare cost of a tariff. These insights come from an appreciation of the demand and supply curves, and the price lines.

On any chart measuring price (on the vertical axis) and quantity (on the horizontal axis), the demand curve for any normal good slopes downward, *i.e.*, there is an inverse relationship between price paid and quantity demanded. Domestic consumers are willing and able to consume a larger quantity of the good as its price falls. Put simply, consumers buy more of a good if it is cheaper (assuming, of course, it is directly substitutable with other goods, which implies competition among goods is based on price, not on other criteria like quality or product differentiation).

Conversely, the supply curve slopes upward, *i.e.*, there is a direct relationship between price received and quantity supplied. Domestic producers are willing and able to increase output as the price they obtain for their work rises. The upward slope of this, or any, supply curve also reflects increasing costs of production – as output increase, production costs increase (though, with economies of scale, per unit long run average costs may decline). That is why producers require a higher price to coax out more production. The intersection between the domestic demand and supply curves represents a market equilibrium point. At this point, assuming autarkic conditions, producers meet consumptive demand in exchange for a particular price.

To continue the illustration, assume Burma's economy opens to international trade, and the world market price for the good in question – jade – is below the autarkic equilibrium. That price is depicted in the Graph as P^W , and no tariff is yet imposed. The horizontal line emanating from P^W is, in effect, the world supply of jade. It is made up of all jade production around the world – Chinese, Burmese, Thai, and so forth. The line is horizontal to reflect that Burmese consumers are “price takers” in the world market. This line presumes Burma is a small country player in the world jade market. Burmese consumers do not have sufficient market power, in the sense of being large buyers of jade relative to other countries, to influence the world market price. Rather, consumers in Burma must accept whatever price is set on the world market, which in turn depends on aggregate global production and consumption.

Burmese consumers would like to buy an amount of jade represented by Q^4 , which corresponds to point C on their demand curve. Burmese producers prefer to supply an amount of jade represented by Q^1 , which corresponds to point D on their supply curve. Foreign producers must supply the difference between these 2 quantities, which is Q^4 minus Q^1 , and which corresponds to the gap between points C and D. Thus, at the given world market price, P^W , Burma will import $Q^4 - Q^1$ jade from countries like China.

Many jade consumers in Burma are willing and able to pay a price higher than P^W for jade. They are represented on the demand curve as the portion from point X to point C. Theoretically, the demand curve consists of thousands, or millions, of individuals, and the willingness and ability of each one to pay a certain price in exchange for a specific quantity is reflected at a particular point on that curve. The demand curve aggregates all these individual scenarios. Every consumer on the demand curve above point C would be willing

and able to pay more than P^W to obtain a corresponding quantity of jade. With free trade, however, these consumers need not do so; rather, they need pay only P^W . In that sense, they get a “surplus” from trade, a benefit quantified by the difference between the higher value they could and would pay, and the amount, P^W , which they actually pay. This amount, for all consumers above point C, is “consumer surplus.” The Graph depicts it as the triangle whose points are YCP^W . This triangle reflects the price gap (between P^W and X) and the quantity demanded (between C and P^W).

It is possible to see this result by looking at areas underneath the demand curve. Burmese consumers spend CQ^4OP^W on jade, which consists of the quantity they purchase (Q^4) multiplied by the price at which they purchase the jade (P^W). Of this total expenditure, they spend DQ^1OP^W on jade manufactured in Burma, and CQ^4Q^1D on imported jade. That is because $Q^4 - Q^1$ jade is imported, and Q^1 jade is produced in Burma. However, Burmese consumers are willing and able to spend YCQ^4O on jade. That is, there are consumers willing to pay a price for jade higher than P^W , yet they do not have to. For these consumers, the area underneath the demand curve is surplus, once the actual amount they do pay (CQ^4OP^W) is subtracted.

A similar analysis exists for jade producers in Burma. Some of them are willing and able to produce a specified quantity of jade at a price below P^W . They are represented on the supply curve between the points Z and D. With free trade, these producers receive P^W , which exceeds the amount they actually could and would insist upon to produce. Accordingly, they obtain a benefit from trade, which is called “producer surplus.” It is depicted by the triangle whose points are ZDP^W . This triangle reflects the price gap (between P^W and Z) and the quantity supplied (between Z and D).

Another way to appreciate why the triangle ZCP^W represents producer surplus is to consider the meaning of the rectangle DQ^1OP^W . It represents total revenue earned by Burmese jade producers, consisting of the quantity of jade they sell (Q^1) multiplied by the price at which they sell the jade (P^W). From this rectangle, to calculate their profit, producers must subtract costs. The area underneath the supply curve, which is DQ^1OZ , represents those costs. Subtracting it from the total revenue rectangle leaves the surplus of ZDP^W , *i.e.*, the triangle above the supply curve.

Both consumer and producer surplus are an area on the Graph. Consumer surplus logically is the area below the demand curve to the prevailing price (implying a saving in expenditure between what consumers on the higher end of the demand curve are willing and able to pay and what they actually have to pay). Producer surplus logically is the area above the supply curve up to the prevailing price (implying a gain from selling output at a price above that at which they were willing and able to produce).

As for the third constituency, the government, its “benefit” takes the form of tariff revenue. The quantity of imports at the world market price, P^W , is the difference between domestic demand and supply, Q^4 minus Q^1 . However, with free trade, no tariff is imposed on these imports, hence tariff revenue is zero.

Continuing the hypothetical, suppose Burma's military *junta* gives into its domestic jade producers. There are a variety of reasons why it might do so. First, producers are a concentrated lobby. Benefits of protection are focused on them. Conversely, consumers are a diffuse lot. Benefits of free trade are spread among tens of thousands of individuals. They may not be organized into an effective political lobbying group. Thus, while a minority, the voice of the producers resonates loudly and clearly in the relevant government ministries. Indeed, that voice may promise political support for the ruling *junta*. That suggests a second reason for giving into the demand for tariff protection – cozy, if not corrupt, relationships.

On the Graph, imposition of a tariff is depicted by the horizontal line at the level P^T . This level is the world market price, P^W , plus the amount of the tariff (*e.g.*, 25% *ad valorem*). The result of the tariff is to increase the price of jade paid by Burmese consumers in proportion to the amount of the tariff. This increase is the difference between P^T and P^W . Stated differently, the world supply curve of jade (both Burmese and foreign) Burmese consumers face rises to the horizontal line emanating from P^T , and that level is the new price Burmese consumers must pay. It is worth highlighting that the world price remains at P^W . It is assumed Burma cannot change this price by imposing a tariff, because Burma is an insufficiently small player – consumer – in the world market to move world market prices. But, the domestic price Burmese consumers must pay rises to P^T . Therefore, the tariff creates a differential between world and domestic jade prices.

Because of the inverse relationship between price and quantity demanded, consumers of jade in Burma scale back their consumption from point C to point B, that is, from Q^4 to Q^3 . With the rise in price faced by domestic consumers from P^W to P^T , they cut consumption from point C, corresponding to quantity Q^4 , to point B, corresponding to quantity Q^3 . The effect on consumer welfare of this price rise obviously must be adverse, and it is. With free trade, Burmese consumers had spent CQ^4OP^W on jade. With the tariff, consumers spend BQ^3OP^T . The difference between these two areas is the rectangle BEP^WP^T , plus the small triangle BCE. They sum up to the total loss incurred by consumers because of the tariff, and each of these areas has significance.

The rectangle BEP^WP^T reflects additional funds consumers in Burma must pay for jade owing to the tariff. That is, this rectangle represents income redistribution from consumers to the other two constituencies in society. Of this rectangle, the area ADP^WP^T is an income transfer to producers in Burma, and the area $ABEF$ is an income transfer to the Burmese government. Domestic producers boost output in response to the tariff, from Q^1 to Q^2 , and (again, as explained below), the result is an inefficient allocation of productive resources into jade production, shown by the triangle AFD . The government collects tariff revenue in the amount of $ABEF$.

As for the triangle BCE, it reflects lost consumption opportunities. These losses are measured by the amount of the decrease in consumption multiplied by the value of jade in terms of the willingness and ability of each Burmese consumer to pay. Consumers would have paid a price for units between Q^4 and Q^3 reflected by their demand curve, specifically the portion of the curve between points C and B. Thus, the consumption cost of the tariff

is demarcated by the triangle BCE.⁶¹⁰ Because Burmese consumers no longer face the world market price P^W , they cannot buy $Q^4 - Q^3$ units of jade at that price. They must accept Q^3 units at the higher price P^T .

In brief, the total loss for consumers is the area BCP^{WP^T} . Of this area, BCE symbolizes a decrease in consumption. The remaining area, BEP^{WP^T} represents an income transfer, of which ABP^{WP^T} goes to producers, and ABEF goes to the government.

What about the implications of the tariff for jade producers in Burma? Imposition of the tariff affords them the opportunity to fetch a higher price for their output, which they are wont to do as far as possible without pricing their jade above imported jade. They may, then, raise their prices from P^W to P^T . Because of the direct relationship between price and quantity supplied, producers of jade in Burma eagerly shift factors resources into jade mining and boost output. They expand product from D to A on the supply curve, that is, from Q^1 to Q^2 . The gap between domestic demand and supply narrows from $Q^4 - Q^1$ to $Q^3 - Q^2$. Thus, imports fall to $Q^3 - Q^2$. Burmese jade producers fulfill a larger amount of domestic consumption than before, which is precisely the expected effect of the tariff.

Not surprisingly, as a result of increased output and per unit price, total revenue for Burmese jade producers jumps from DQ^1OP^W to AQ^2OP^T . Their cost of production rises from DQ^1OZ to AQ^2OZ . But, with the increase in total revenue, their surplus also rises from ZDP^W to AZP^T . The change in producer surplus is a gain of ADP^{WP^T} , the predictability of which helps explain why the Burmese jade industry support the tariff. In sum, the tariff encourages more production (indeed, as explained below, over-production) of the local import substitute, and conversely reduced consumption (indeed, under-consumption) of the imported item.

As intimated above, the Burmese government obtains revenue from the tariff in the amount of the tariff multiplied by the volume of imports. On the Graph, this amount is the rectangle ABEF, which is the tariff (P^T minus P^W) multiplied by import volume (Q^3 minus Q^2). Here, then, is one constituency that gains from the tariff.

Producers of jade in Burma also gain. For them, surplus expands from ZDP^W to ZAP^T . The difference is the shape ADP^{TP^W} . A larger number of domestic producers are willing and able to produce jade at the price P^T than were willing to do so at the price P^W ,

⁶¹⁰ Technically, it could be argued the proper measurement of the consumption cost is to consider the area BCE and the area CQ^4Q^3E . That argument would be based on the simple subtraction of areas, namely, the pre-tariff consumption expenditure of CQ^4OP^W minus the post-tariff consumption expenditure of BQ^3P^T . The difference is BEP^{WP^T} , which reflects the transfer of income from consumers to producers (ADP^{WP^T}) and to the government (ABEF), plus BCQ^4Q^3 . Following this argument, the triangle BCE and the rectangle CQ^4Q^3E together represent lost, or foregone, consumption opportunities from the tariff. However, a distinction could be made between the triangle BCE, which is opportunity cost, in a pure sense, and the rectangle CQ^4Q^3E , which represents money Burmese consumers no longer have to spend for Chinese jade. They were spending this money previously when they were importing $Q^4 - Q^1$ Chinese jade. Now, they import the difference $Q^3 - Q^2$, which is less, in volume terms. Hence, Burmese consumers are saving money. The money saved is a benefit to them, so the net loss to consumers from lost consumption is the triangle above the rectangle, namely, BCE.

simply because P^T exceeds P^W . The supply curve between the points D and A represents these producers. They enter the jade market because of the higher price caused by the tariff. The tariff creates an artificial incentive for some Burmese factors of production to re-deploy into the jade sector.

As before without the tariff, there is another method – using subtraction of graphic areas – to compute producer surplus. Consider the meaning of the rectangle AQ^2OP^T . It represents total revenue earned by Burmese jade producers, consisting of the quantity of jade they sell (Q^2) multiplied by the price at which they sell the jade (P^T). From this rectangle, to calculate their profit, producers must subtract costs. The area underneath the supply curve, AQ^2OZ , represents those costs. Subtracting it from the total revenue rectangle leaves the surplus of ZAP^T , *i.e.*, the triangle above the supply curve.

Clearly, domestic producers benefit from tariff protection in the amount of increased producer surplus, ADP^TP^W . That is not true for domestic consumers. Because they face a higher price, many of them scale back consumption. On the Graph, they are consumers lying on the demand curve between points C and B. Correspondingly, consumer surplus falls from YCP^W to $XBPT$. The difference is BCP^WP^T . The contrasting ramifications of the tariff have technical economic labels associated with them, namely, an “income distribution” (or “income transfer”) effect and a “resource allocation” effect.

That is, first, any tariff (be it on jade imports into Burma or petroleum imports into the U.S.) redistributes, or transfers, income away from consumers toward producers. Consumers give up some of their surplus, and they give it up to producers. On the Graph, of the loss in consumer surplus of BCP^WP^T , a portion, specifically, DAP^TP^W , is transferred to producers. Put bluntly, this portion is money out of the pockets of Burmese consumers and into the coffers of producers.

A second portion of lost consumer surplus of BCP^WP^T , namely $ABEF$, signifies a transfer from consumers to the government. To be sure, the government collects tariff revenue directly from importers, but consumers foot the bill in the form of the higher price, P^T . In brief, by increasing the domestic price of imports by comparison with their levels under free trade, a tariff causes income to be redistributed among groups within an economy, notably, from consumers to producers and the government.

As for the second ramification, resource allocation, any tariff causes domestic producers to make too high a level of the import substitute (*e.g.*, Burmese jade), and concomitantly forces domestic consumers to purchase too low a volume of imported merchandise (*e.g.*, Chinese jade). In other words, a tariff induces too much domestic output and too little domestic consumption of the import, with the result being an inefficient allocation of domestic factors of production dedicated to produce the import substitute. In sum, in the illustration of Burma, too much Burmese jade is produced in lieu of importing Chinese jade, and too little imported Chinese jade is consumed.

What does “too much” mean? With respect to domestic production, it means that given the world market price of Chinese jade undistorted by the Burmese tariff, it would

be cheaper for Burma to import Chinese jade than to produce more jade at home. With respect to domestic consumption, “too little” means that given the world market price of Chinese jade undistorted by the Burmese tariff, it would be socially optimal to consume more of the Chinese jade.

Significantly, the income and resource allocation effects are largely hidden from the eyes of the public in the importing country. For instance, when a consumer in Burma purchases jade jewelry, the jeweler provides the customer with a bill that does not include, as a separate itemized item, the tariff. Rather, the bill provides a sub-total, any applicable sales or other taxes or fees, and a total price. The amount of the income of the consumer being redistributed to jade producers in Burma, through the tariff, is not transparent to the consumer. Similarly, the change in domestic production patterns, specifically the reallocation of factors to the jade sector and away from other areas of the Burmese economy, is not readily apparent to the public. To the contrary, it is most evident to the laborers changing jobs from, say, mining sapphires to mining jade.

An obvious question is why the Burmese government eschews transparent redistribution of income in favor of domestic jade producers. The answer is equally obvious: that action would be too controversial politically. Direct income transfers are not only more transparent to the public, but also avoid imposing welfare costs on consumers (in the form of lost consumer surplus) because (unlike a tariff) it has no effect on domestic prices, and thus are favored by economists over trade protection.

Yet, a direct income transfer, in lieu of a tariff, must be funded in some way. That is, a tariff yields revenue to the government, whereas income redistribution is – from the perspective of a government – a subsidy that must be funded from some source. More ominously, the virtue of transparency can be, from the perspective of a government, a vice. The visibility of the income transfer may cause individuals and businesses in transferor sectors (*i.e.*, those economic agents from which money is being redistributed) to protest. The protests may be socially disruptive, and could destabilize the government. Why not, take the “quieter” road of a tariff? – or, so the thinking in official circles goes.

The income and resource allocation effects also relate to a second, and fundamental, question about any tariff, namely, what is its net effect? Invariably, the answer is that consumers lose surplus, which is offset by the gains to producers of surplus and to the government of revenue. However, the offset is partial, as there is a net loss to society represented by two triangles in a graphical analysis. In other words, in virtually all instances, the amount domestic consumers lose as a result of a tariff exceeds the sum of the gains to domestic producer and the government, hence the overall effect on the economy of the importing country is negative.

- **Synopsis**

From the Graph, two triangles, BCE and AFD, symbolize the net loss to Burma from the tariff. They are the “consumption cost” and “production cost,” respectively:

- (1) The triangle BCE is the consumption cost of the tariff and, therefore, the income transferred from domestic jade consumers to domestic jade producers. Specifically, the consumption cost arises from the fact the tariff leads to higher prices in the domestic economy (from P^W to P^T) and reduced consumption of the imported product (from the difference between Q^4 and Q^1 to the difference between Q^3 and Q^2). This artificial distortion sends a signal to consumers to scale back consumption from the optimal level. That level, at point C, is where the marginal social value of jade, measured by CQ^4 , equals its marginal social cost, also CQ^4 . The scale back in consumption is to a sub-optimal level, namely, point B. This point is sub-optimal. The marginal social value of jade, which BQ^3 measures and corresponds to the tariff-induced price, P^T , exceeds the marginal social value of the good, which is EQ^3 and corresponds to the undistorted world market price, P^T . Social welfare would rise if consumers could boost their consumption by the difference between Q^4 and Q^3 units, but they are unwilling and unable to do so, because of the tariff.

- (2) The triangle AFD is the production cost of the tariff and, therefore, the resources reallocated to domestic jade production. Specifically, the production cost arises from the fact the tariff leads to higher prices in the domestic economy (from P^W to P^T) and reduced imports (from the difference between Q^4 and Q^1 to the difference between Q^3 and Q^2). This artificial distortion sends a signal to factor resources, inducing labor, land, human capital, physical capital, and technology to shift to the protected sector (evidenced by the movement on the supply curve from D to A), and boost output of the import substitute (from Q^1 to Q^2).

To recap, jade producers gain $DAP^T P^W$ in surplus. The government gains $ABEF$ in tariff revenue. Consumers lose $BCP^W P^T$ in surplus. Their loss outweighs the gains. The net loss to Burmese society is a consumption cost of BCE plus a production cost of AFD .

A relevant follow-up question is how Neo-Classical economists are so sure the total loss to consumers (on the Graph, $BCP^W P^T$) must outweigh the total gain to producers (on the Graph, $ADP^W P^T$). The short answer is domestic consumption is greater under free trade than domestic production.

Yet, the calculation of overall economic welfare rests on key implicit assumptions. One such assumption is each constituency in a society is of equal value. That is, the interests of consumers, producers, and the government are given equal importance. If, to the contrary, the interest of any one or two of the groups is elevated over the remaining group or groups, then the net conclusion may change.

A second assumption is that but for the tariff, factor resources would remain in more productive endeavors than increasing output of the import substitute. For example, suppose Burmese resources used to expand jade production are drawn from rice paddies. To call this shift economically inefficient presumes the resources are better deployed in

paddy fields than jade mines. Perhaps the resources were underemployed, or even of zero marginal productivity (*i.e.*, labor surplus), in those fields. The judgment also presumes the resources would not be allocated to an activity even less efficient than mining.

Another way to characterize the argument about productive inefficiency is to consider the relationship between factor returns, especially wages to laborers, and productivity. Neo-Classical economic theory teaches that the level of wages per hour reflects the level of productivity, *i.e.*, workers are compensated commensurate with their output per hour. Free trade is a discipline on management and labor, because it compels them to keep wage claims in line with productivity growth. Consider the following modification of the hypothetical illustration involving Burma and the jade market.

Suppose productivity of Burmese jade miners increases by 10%, but their wages rise by 15%. The price of Burmese jade will rise. But, this price will not be justified by either an increase in the quantity or quality of Burmese jade. Consequently, Burmese jade will be less competitive, on the world market, in comparison with Chinese jade. What occurs to the link between wage claims and productivity when an industry, like Burmese jade, is granted protection through a tariff? The link is de-coupled, or broken. Wages can grow more rapidly than productivity, and profits can be abnormally high, because of the trade barrier to the substitute foreign good. So, imposing a tariff to help Burmese jade producers encourages higher costs and inefficiencies.

III. Optimum Tariff Argument

- **Price Taker Assumption**

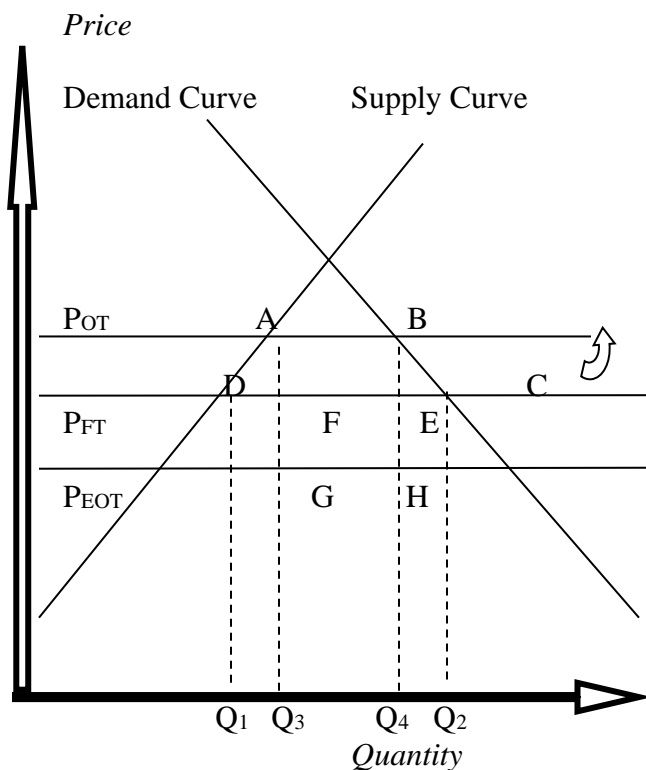
There is a third implicit assumption of Neo-Classical tariff analysis: the importing country is a price taker in world markets. Is that invariably true? The so-called “optimum tariff argument,” or “TOT argument,” suggests not, and indicates a country may benefit from imposing a tariff. That is, the standard Neo-Classical analysis of tariffs assumes an importing country contemplating imposition or retention of a tariff is an insufficiently important consumer in the world market for the product in question to affect the price of that product. In fact, that assumption may be untrue. Graph 17-2 illustrates the optimum tariff argument, and Table 17-2 summarizes the results from the Graph.

Interestingly, during the Sino-American Trade War (discussed in a separate Chapter) it was thought the optimum tariff argument might be relevant. America was such a large consumer of Chinese merchandise that the 10%-25% tariff the U.S. imposed on Chinese imports under Section 301 of the *Trade Act of 1974*, as amended, might lead to a fall in the price of those imports. On the one hand, American consumers would face a higher price for the imports, thanks to the tariff – corresponding to P_{OT} in Graph 17-2 below. On the other hand, Chinese producer-exporters would receive a lower price for their exports – corresponding to P_{EOT} in the Graph – as the world market price, P_{FT} , fell thanks to the decline in demand in their biggest market, America.

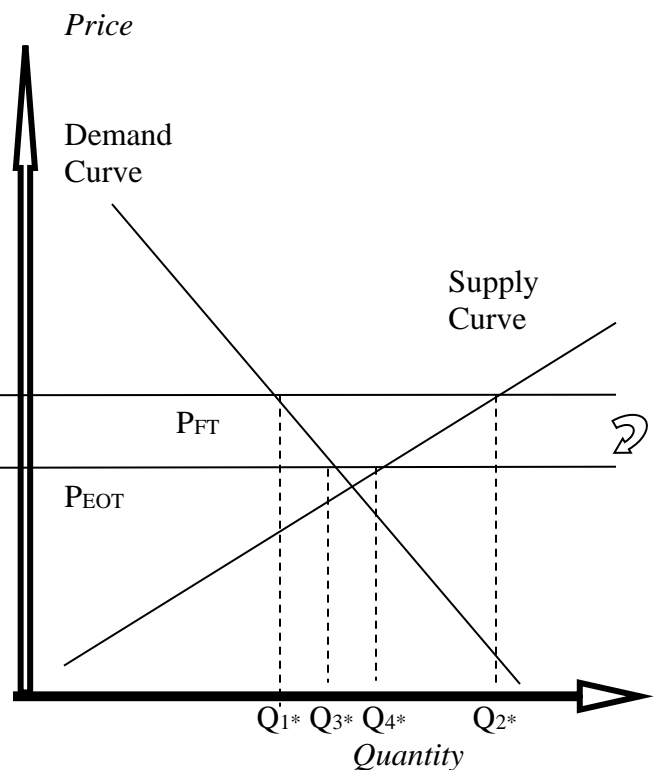
From the outset, it must be stressed the instances in which the optimum tariff argument holds are rare. They occur only when consumption of imports by a particular country accounts for a large share of aggregate world consumption. Consequently, a change in domestic consumption patterns can influence world market prices. That is, the market for the product in question is not a perfectly competitive one characterized by a large number of undifferentiated consumers, no one of which is powerful enough to influence prices. Rather, in that market, the country is a “price maker,” *i.e.*, the country is a large enough consumer to affect world market prices by curtailing its demand for imports through imposition of a tariff. The effect is a decrease in the world market price, and thus an improvement in the country’s TOT (*i.e.*, a lower price of imports in relation to the price of exports).

Graph 17-2
Optimum Tariff Argument

Market for Tea in England
Importing Country



Market for Tea in South Africa
(Exporting Country)



- **Intuition and Argument**

Professors Husted and Melvin explain the intuition behind the optimum tariff argument:

Suppose that the country that imposes a tariff is a large country in the sense that it is a significant importer (or exporter) of the product in question. In

that case, the imposition of a tariff could lead to a welfare improvement for the country, relative to free trade. In essence, because the country has market power, by imposing a tariff it is able to obtain the goods it continues to purchase at a lower world price. *By forcing down the world price, the tariff-imposing country, in effect, shifts some of the burden of the tariff onto the exporting country.*⁶¹¹

In other words, once an importing country imposes a tariff, the country consumes less of dutiable merchandise. The resulting diminution in demand is significant, as the country makes up a large percentage of world market demand. When its consumption of the merchandise falls, the world market feels the impact, namely, a lower world market price for the imported merchandise. The drop in the world market price adversely affects exporters of the product, thus shifting some of the burden of the tariff from consumers in the importing country (who, in the normal scenario, suffer from higher prices caused by the tariff) to exporters (who, in the optimal tariff scenario, suffer from lower prices for their product). The irony of this outcome is the tariff causes it.

The Graph of the optimal tariff argument consists of two panels, one for the importing country, on the left hand, and one for the exporting country, on the right hand. Assume the product in question is tea, the importing country is England, and the exporting country is South Africa. (Choosing Sri Lanka as the exporting country would be obvious, but it is the world's largest tea exporter, and that fact would complicate the example. England is a renowned tea importer, and in Colonial times set up tea plantations in Ceylon.) The left-hand panel of the Graph shows the market for English tea, combining both a demand and supply curve. The right-hand panel shows the South African tea market.

The Graph is similar, but not identical, to the Graph of a normal tariff scenario.⁶¹² In each country, the demand curve reflects willingness and ability of consumers to purchase alternative quantities of tea at a given array of prices. The supply curve shows willingness and ability of producers to offer alternative quantities of tea at an array of prices. The supply curve is an aggregate one, depicting both domestic tea production and imported tea. The critical point about the supply curve in the English market is it slopes upward because the price of tea to English consumers is not constant. England, by hypothesis, is a large country consumer of tea. So, the price of tea depends on the quantity of tea bought in England.

⁶¹¹ STEVEN HUSTED & MICHAEL MELVIN, INTERNATIONAL ECONOMICS 168-169 (4th ed., 1998). (Emphasis added.)

⁶¹² Imposition of an optimum tariff raises the domestic price in England from the free trade price P_{FT} to P_{OT} , but depresses the world market price. Hence, exporters get a price below the free trade price, namely, P_{EOT} .

Table 17-2
Summary of Key Points on Optimum Tariff

<i>Constituency in England (Importing Country) or South Africa (Exporting Country)</i>	<i>Domestic Price before Optimum Tariff is Imposed (same as Free Trade Price) and Quantity of Imports without Optimum Tariff (domestic demand minus domestic supply)</i>	<i>Domestic Price after Optimum Tariff is Imposed (Free Trade Price as affected by Tariff) and Quantity of Imports with Optimum Tariff (domestic demand minus domestic supply)</i>	<i>Change in Surplus as a Result of the Optimum Tariff (area)</i>
Consumers	P_{FT} $Q_2 - Q_1$	POT in England PE _{OT} in South Africa $Q_4 - Q_3$	Decrease of POTBCP _{FT}
Producers			Increase of POTADP _{FT}
Government			Tariff Revenue of ABHG
Net Effects of Optimum Tariff			Consumption cost of BCE. Production cost of AFD. Overall tariff revenue of ABHG. English consumers pay ABEF of tariff. South African exporters pay EFGH of tariff. England shifts some of the burden of tariff to South Africa.

With free trade (*i.e.*, no tariffs), the equilibrium price is P_{FT} . While this price would be the intersection of the English demand and supply curves if England were the only tea consumer in the world, it is not at that point because there are other countries importing tea.

Accordingly, P_{FT} lies at a level below the intersection of English demand and supply, and at that level England imports tea in the amount of the difference between Q_2 and Q_1 . This difference corresponds to the difference between Q_2^* and Q_1^* in the South African market. (The English import volume of $Q_2 - Q_1$, and the South African export volume of $Q_2^* - Q_1^*$, would be identical if England imported only from South Africa, which

may or may not be the case.) However, at P_{FT} , South Africa is a net exporter of tea, and the position of its supply and demand curves relative to those curves for England reflect this fact. The difference between Q_2 and Q_1 in the South African market is an exportable surplus, and South Africa exports this amount to England.

Suppose England imposes an optimal tariff on tea imports. It does so as a large country consumer of tea, *i.e.*, a price maker, not a price taker. (This fact is evidenced in part by the upward slope of the supply curve for tea England faces.) As a result of the optimal tariff, there is a rise in the domestic price of tea, from the initial free trade price of P_{FT} to P_{OT} . Clearly, consumption of tea in England falls from point C on the demand curve to point B. Correspondingly, tea production rises from point D to point A. As a result, imports decline from the difference between Q_2 and Q_1 to that between Q_4 and Q_3 .

In England, as a result of the optimal tariff, consumers experience a loss of their surplus. This loss is the area $P_{OT}ABCP_{FT}$. However, English tea producers garner an increase in their surplus in the amount of $P_{OT}ADP_{FT}$. The difference between these two areas on the Graph is the shape ABCD. The area BCE is the consumption cost of the tariff, and the area AFD is the production cost of the tariff. Accordingly, to this point, the graphical analysis is essentially the same as for the non-optimal tariff scenario.

At this point, the analysis changes. What price do South African tea exporters receive? The answer is not the same price paid by English consumers. If it were, then it would imply His Majesty's Government takes all the tariff revenue and hands it over to South African tea planters. The answer is also not the free trade price. If it were, then it would contradict the initial assumption England is a large-country consumer with influence on world market prices. By assumption, England's tariff pushes down the world market price. Thus, the price South African planters receive must be below P_{FT} – and it is, at the level P_{EOT} (standing for the exporters' price with the optimum tariff).

At the price P_{EOT} , England imports the difference between Q_4 and Q_3 . Thus, His Majesty's Government gains the area ABHG in tariff revenue. (That is a larger block of revenue than if the scenario is a non-optimum tariff.) Does this tariff revenue outweigh the consumption cost of the tariff (BCE) plus the production cost of the tariff (AFD)? From the Graph itself, the answer is indeterminate, *i.e.*, the net welfare effect on England of imposing the optimum tariff could be positive or negative. In practice, the answer depends on the relative sizes of the tariff revenue, on the one hand, and the consumption and production costs, on the other hand. In turn, those relative sizes depend on the slopes of the demand and supply curves and the size of the tariff imposed by England.

Two points are clear. First, South African exporters pay part of the optimum tariff revenues of ABHG. (Technically, as a legal matter, tea importers in England are liable, but economists presume importers pass on the tariff to their suppliers overseas, if the two entities are distinct). Specifically, South African exporters pay EFGH of the tariff. Why is this so? Before the tariff, they received a price of P_{FT} for their tea. With the tariff, the price drops to P_{EOT} . Accordingly, they bear the brunt of the decline from the free trade price to P_{EOT} . Similarly, but conversely, with free trade, English consumers paid P_{FT} , and with the

optimum tariff, they pay P_{OT} . Therefore, English consumers bear the brunt of the price rise, from P_{FT} to P_{OT} . In brief, the tea exporters suffer from the lower price for their product, and the tea drinkers suffer from the higher price for their purchases. The “bottom line” is England has sufficient market power to shift some of the burden of the optimum tariff to South African exporters.

The second point from the Graph goes to the concept of an optimal tariff. It is optimal not in the sense that it unequivocally raises net welfare in the importing country every time. Again, that result depends on demand and supply conditions, and the level at which the tariff is set. Rather, the tariff is “optimal” in comparison with the level of welfare under free trade conditions.

In England’s case, the Government’s goal is to set the tariff at a level that maximizes the difference between the tariff revenue it collects, $ABGH$, and the consumption and production costs of the tariff (BCE and AFG) respectively. The Government seeks to maximize the difference between the area $EFGH$ and the consumption and production costs. That is because $EFGH$ is tariff revenue the Government gains in the optimal tariff scenario that it does not get in the normal (non-optimal) scenario (because the free trade price is unaffected in that scenario).

The second point is the key insight from the argument, namely, that an importing country in the position of England in the example can set the tariff at a level that enhances that country’s net welfare relative to its net welfare with free trade. The effects of a drop in world market price counter-balance the usual adverse effects associated with a tariff (namely, a decline in consumer surplus that offsets gains in producer surplus and tariff revenue). The tariff is set to induce a drop in world market price that offsets the rise in price caused by the tariff.

For instance, normally, a 25% tariff would lead to a rise in the domestic price of up to 25%, but have no effect on the world market price. In the optimal tariff scenario, a 25% tariff causes a 25% drop in both domestic and world market prices (which are the same). In this example, the tariff has no effect on prices, and thus there is no change in either consumer or producer surplus.

- **Three Rebuttals**

There are three rebuttals to the optimum tariff argument. First, in the vast majority of markets, any one country is too small a consumer of a product to affect the world market price of that product. Few countries are large enough consumers of a good to affect its world market price.

Second, even in the rare instance of a price-making country, there is no assurance the government of that country has the technical capacity to set a tariff at an optimum level. To do so requires a large amount of data about domestic and world market demand and supply conditions, and prices. In the above example, it is possible a country sets the tariff at too high or too low a level.

Third, even assuming the price-making country “calculates it right,” there is the possibility of retaliation. The trading partners of that country may increase their own tariffs to protect their agricultural and industrial producers. The overall economic result, for the world, of increased protectionism would be negative. The “bottom line” is the optimum tariff argument is a weak one against multilateral tariff reductions under the auspices of GATT and the WTO.

IV. Neo-Classical Economic Quota Analysis

- **Limitless NTB Types**

There seems to be no limit to the types of NTBs governments can concoct to protect favored sectors. As MFN tariffs, particularly on industrial goods, declined in the post-Second World War era, NTBs proliferated. After all, once bound, other than raising an applied duty rate to the bound level, what protectionist devices are left to an importing country? The answer is an NTB, or a trade remedy. Developing countries and LDCs are both victims and perpetrators of NTBs. For example, SSACs impose more NTBs on trade with each other than on trade with third countries.⁶¹³ Their doing so has proved a major impediment to trade integration in that region. Their exports to developed countries can be impeded by NTBs masquerading as legitimate SPS or TBT measures.

- **Graphical Analysis**

QRs are a major category of NTBs. Among QRs, a major species is a quota. A quota constricts supply and raises the price of merchandise subject to the quota. So, consumer surplus declines, producer surplus rises, and quota rents are generated. The other two ramifications do not offset the decline in Consumer Surplus. Thus, a dead weight loss occurs, as conventional Neo-Classical analysis predicts.

Graph 17-3 depicts this analysis using the U.S. sugar market. (The analysis may be generalized to any market in any country.) Historically, imports into this market have been subject to quotas. As usual, the demand curve slopes downward, reflecting an inverse relationship between the price of merchandise, and the quantity of it, consumers are willing and able to buy. This curve shows demand for sugar by U.S. consumers. The supply curve slopes upward, intimating a direct relationship between the price of merchandise and its quantity producers willingly and ably make and sell. This curve represents sugar grown, processed, and refined in the U.S.

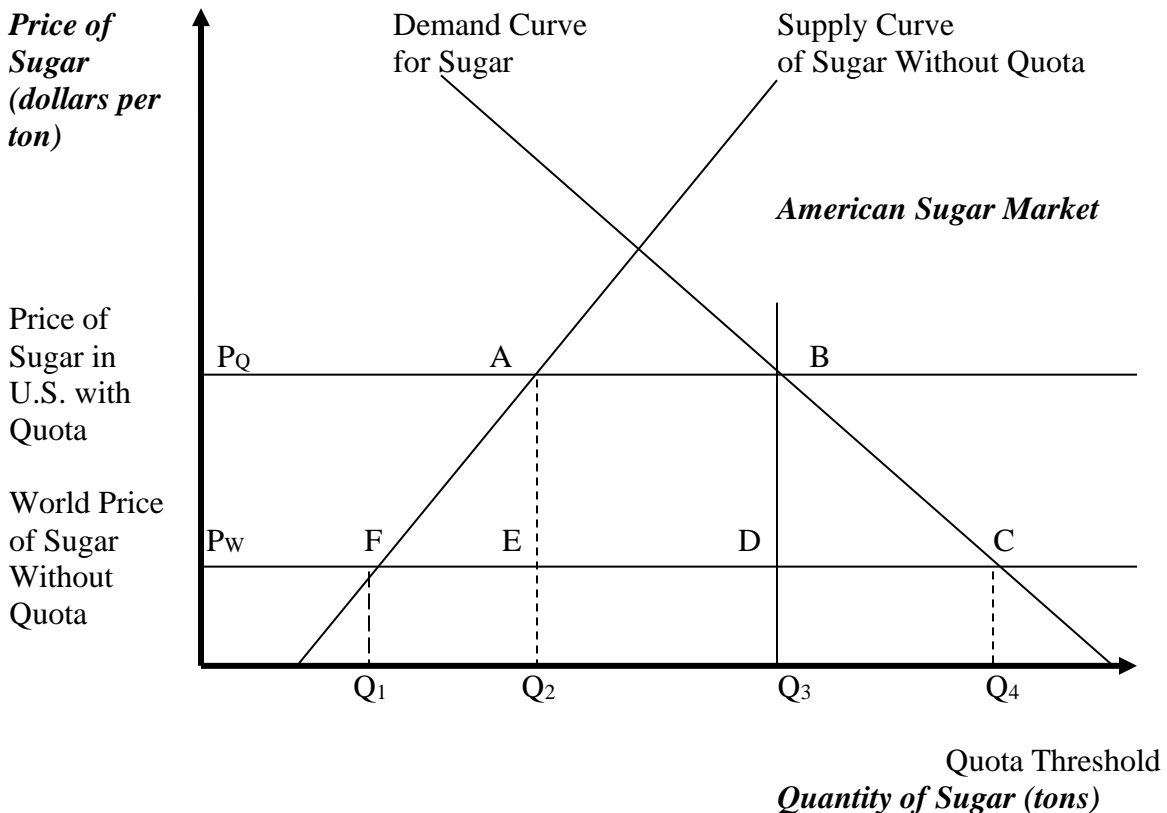
Consumer Surplus is the area underneath a demand curve, and above the market price of the good. The area is “surplus,” because consumers on the relevant portion of the demand curve are willing and able to spend a price for merchandise higher than the prevailing market price. As these particular consumers pay less for the good than they

⁶¹³ See “Lamy Underlines Need to Continue Building Trade Capacity of Developing Countries,” Speech of Pascal Lamy, WTO Director-General, to International Trade Centre (ITC) Joint Advisory Group, 21 May 2012, www.wto.org.

theoretically would be willing and able to, they reap a “surplus.” Producer Surplus is the area above a supply curve, and below the market price of merchandise. The area is “surplus” to producers, because businesses are willing and able to make and sell a good for a price lower than the prevailing market price. As these particular producers get a higher price for their output than they theoretically seek, they receive a “surplus.”

Assume the world market price of sugar without a quota is P_w . This price prevails in the U.S. market if no quota regime exists, *i.e.*, if there is free trade in sugar. At this price, the quantity Americans demand, Q_4 , exceeds the available supply from American producers, Q_1 . The gap, $Q_4 - Q_1$, must be made up by imports. In effect, the points C and F are the free trade equilibrium domestic supply and demand amounts, respectively.

Graph 17-3
Welfare Effects of Quota



Suppose American producers lobby successfully for protection from imports in the form of a quota. The effective supply curve changes from the upward sloping one to one that, at the quota threshold, becomes a vertical line. The hypothesized quota amount is Q_3 . No sugar may be lawfully imported in excess of Q_3 . With supply constricted at a quantity less than necessary to satisfy demand, the price of sugar rises from P_w to P_Q . At the new, higher price, some consumers find sugar too expensive, and demand falls from Q_4 to Q_3 . Therefore, the gap between demand and supply falls from $Q_4 - Q_1$ to $Q_3 - Q_2$. This gap is satisfied by imports, *i.e.*, $Q_3 - Q_2$ is imported. The price differential of $P_Q - P_w$ generates a profit per unit, or Quota Rent received by any entity possessing the right (*e.g.*, in the form of a license) to import and re-sell sugar. In effect, points B and A represent the new equilibrium domestic demand and supply, respectively, with the quota.

- **Three Ramifications**

The price increase from P_w to P_Q has three ramifications. First, Consumer Surplus declines by the area P_QBCP_w . With the higher price, P_Q , fewer consumers are willing and able to purchase sugar, *i.e.*, fewer consumers would buy sugar at a price higher than the prevailing price, P_w . That reduction entails lost Consumer Surplus. The decrease in Consumer Surplus is akin to the increase that occurs through tariff protection, where the tariff results in a price P_Q . The consumers that remain in the market do not have the option of turning to foreign suppliers beyond the quota threshold quantity Q_2 .

Second, Producer Surplus increases by the amount P_QAFP_w . Because American sugar producers receive a higher price for their output – P_Q instead of P_w – they gain. This gain takes the form of a jump in the number of producers willing and able to participate in the market at the prevailing price in comparison with the price indicated by their position on the supply curve. The increase in Producer Surplus is akin to the increase that occurs through tariff protection, where the tariff results in a price P_Q . In both instances, it is essentially higher profits obtained by domestic producers than received without protection. That is, Producer Surplus increases because of reduced competition from imports of a like product, which enables domestic producers to raise their prices without the risk of losing customers to foreign suppliers.

Third, a “Quota Rent” is generated. This “Rent” is a profit arising because a quota artificially raises the price of imported merchandise. The area ABDE represents this Rent. The area is the volume of sugar allowed into the U.S. under the quota, $Q_3 - Q_2$, multiplied by the price differential between the quota price, P_Q , and the world market price, P_w . The Quota Rent, or artificial gain, accrues to any entity holding the right to import sugar and sell the imported sugar. The right could be obtained by licensees, assuming the quota is effected through a licensing regime. If the U.S. government gives licenses to existing domestic sugar producers, then they get the Rent (*i.e.*, all of ABDE), and this Rent supplements their increased Producer Surplus. If the government gives the licenses to foreign firms exporting the merchandise, then those firms capture the Rent. The Rent takes the form of a gain from being able to sell sugar at a price artificially inflated by the quota.

The gain is at the direct expense of American consumers. It is a redistribution of income from consumers to the entities holding the quota right.

If an importing country government gives licenses in a quota to foreign exporters, and the government negotiates the import threshold with those exporters, then the regime is a VER (also called an OMA or VRA). The welfare analysis is the same as for a quota.

- **Contrast with Tariff and Quota Rents**

Had protection of the domestic sugar market taken the form of a tariff, and the tariff resulted in a price P_Q , then ABDE would have been tariff revenue accruing to the U.S. government. Not surprisingly, then, economists encourage the conversion of quotas into tariffs, *i.e.*, tariffication, and in some instances – such as Article 4:2 of the *WTO Agreement on Agriculture*, this conversion is mandatory.

To calculate the tariff equivalent of a quota, the difference between the price of merchandise subject to a quota and the world market price is divided by the world market price. That is:

$$\text{Tariff Equivalent of Quota} = \frac{(\text{Price of Merchandise Constrained by a Quota}) - (\text{World Market Price of the Merchandise})}{(\text{World Market Price of the Merchandise})} \times (100)$$

For example, if the per unit quota-constrained price is \$15, and the world market price \$10, then the Tariff Equivalent would be:

$$\frac{(15 - 10)}{(10)} \times (100) = 50\%$$

In brief, a “Tariff Equivalent” refers to the replacement of a quota with a tariff set at a rate that provides the same degree of restriction on imports as the quota.

It is incorrect to state categorically that “a tariff raises revenue for the importing government, while an import quota creates revenue for foreign producers,” and “[t]his excess profit is not collected by the importing country but accrues to the foreign producers of the product.”⁶¹⁴ In the hypothetical, there is one way the U.S. government (or any government in its position) could capture all or part of the Quota Rent. Rather than give away licenses to foreign sugar producers (or to governments, which then allocate them to private producers), the U.S. could auction licenses to import and re-sell sugar. With a competitive bidding process, the license price, multiplied by the number of licenses, may approximate the Quota Rent of ABDE. Yet, few developed WTO Members use competitive auction systems to allocate quota shares.

⁶¹⁴ MITSUO MATSUSHITA, THOMAS J. SCHOENBAUM & PETROS C. MAVROIDIS, *THE WORLD TRADE ORGANIZATION – LAW, PRACTICE, AND POLICY* 124 (2003).

One reason why an importing country government might not want the public to know the amount private individuals or businesses would be willing to pay for a license is if they did, then the cost to consumers of the quota regime (the decrease in Consumer Surplus) would be transparent. Another reason is the bureaucratic expenses associated with administering an auction system. Even if a government captures ABDE in Quota Rent, to compute its profit, it must subtract from this gross revenue its expenses in running the license regime. A third reason why a government may avoid a competitive auction system is its aim to keep any quota protection temporary. Should it capture a Quota Rent, then it may become dependent on that Rent to finance a special program, and interests in the program may vest.

There is another reason a government of an importing country is loathe to inform governments of exporting countries it is auctioning off licenses to import merchandise from them and capturing the Quota Rent. The exporting country governments might protest against rent-seeking behavior, and outright profiteering, to the detriment of their exporters (assuming the exporters would have received the licenses). Reasonably, GATT Article XIII calls for allocation of shares in a quota by agreement with principal supplying countries, or failing such a deal, by allotment based on trade shares in a recent representative period. Other means entail legal risks, as the EC found out in the 1997 *Bananas* case.

The size of the Quota Rent depends on where the quota threshold is set and the consequent price increase. This increase depends in part on relative elasticities of supply and demand. Professors Husted and Melvin report that in the mid-1980s, the U.S. could have obtained between \$3.7 and \$6.8 billion annually by auctioning licenses on quotas then in place on steel, and on T&A. In another illustration, Professors Dunn and Mutti explain:

If quota rights are allocated to importers, they receive the windfall profit. Suppose oil can be purchased on the world market at \$1.50 per barrel and shipped to the East Coast of the United States for \$0.75 per barrel for a total landed cost of \$2.25; at the same time a U.S. quota is being used to protect an internal price of approximately \$3.50. Those allowed to import oil into the United States receive a gift of \$1.25 per barrel. They land oil at a cost of \$2.25, and it is immediately worth \$3.50. This example is not accidental. It was the situation prevailing from the 1950s into the 1960s in the United States, and it produced enormous monopoly rents for the major oil companies that were allocated quota rights by Washington.

[A] key assumption of the oil example ... is that U.S. importers are able to buy foreign goods at a world price that does not rise as a result of U.S. actions. This outcome is particularly likely when there are many foreign producers who are not organized in any way to take advantage of the scarcity of the product in the U.S. market.⁶¹⁵

⁶¹⁵ ROBERT M. DUNN JR. & JOHN H. MUTTI, *INTERNATIONAL ECONOMICS* 130-131 (5th ed. 2000).

Likewise, Professors Husted and Melvin recall oil import quotas imposed by the U.S. in the 1960s, which were designed to increase the competitiveness of American oil fields.⁶¹⁶ The U.S. government gave American oil companies the quota, and set a low import threshold. As a result, companies were able to import oil from the Persian Gulf at \$1.85 per barrel, and sell it in the U.S. at a 67% mark-up, or \$3.10 per barrel. In 1966, the companies obtained \$620 million in Quota Rent (or \$2.6 billion in 1993 dollars).

- **Net Welfare Effect**

What is the net welfare effect of the quota? The triangles AEF and BDC are the answer. The first triangle, AEF, represents an inefficient allocation of factors of production in the American economy to sugar production. Under world market price conditions, less land, labor, physical capital, human capital, and technology would be dedicated to growing, refining, and processing sugar than is allocated under the quota regime. By constricting supply and raising price, the quota distorts the domestic market and creates an artificial incentive to over-produce sugar in the US. The over-production is ironic, because it still is not enough to satisfy domestic demand. The second triangle, BDC, represents lost consumption opportunities. A segment of American buyers cannot afford sugar, and are knocked out of the market by the quota.

Taken together, the two triangles, AEF plus BDC, are dead weight loss from the quota. This loss is the net effect of the quota: the decline in Consumer Surplus, plus the increase in Producer Surplus and Quota Rents. The dead weight loss is akin to the net affect of protection via a tariff, where the tariff results in price P_Q . Professors Krugman and Obstfeld, citing early 1990s data on the U.S. sugar import quota regime, observe:

The sugar quota illustrates in an extreme way the tendency of protection to provide benefits to a small group of producers, each of whom receives a large benefit, at the expense of a large number of consumers, each of whom bears only a small cost. ... [T]he yearly consumer loss amounts to only about \$6 *per capita*, or perhaps \$25 for a typical family. Not surprisingly, the average American voter is unaware that the sugar quota exists, and so there is little effective opposition.

From the point of view of the sugar producers, however, the quota is a life-or-death issue. The U.S. sugar industry employs only about 12,000 workers, so the producer gains from the quota represent an implicit subsidy of about \$90,000 per employee. It should be no surprise that sugar producers are very effectively mobilized in defense of their protection.

Opponents of protection often try to frame their criticism not in terms of consumer and producer surplus, but in terms of the cost to consumers of every job “saved” by an import restriction. Economists who have studied the sugar industry believe that even with free trade, most of

⁶¹⁶ See STEVEN HUSTED & MICHAEL MELVIN, INTERNATIONAL ECONOMICS 168-169 (4th ed.1998). (Emphasis added.)

the U.S. industry would survive; only 2,000 or 3,000 workers would be displaced. Thus, the consumer cost per job saved is more than \$500,000.⁶¹⁷

However, an important caveat must be issued.

This net welfare analysis implicitly assumes equal weighting of consumer, producer, and government interests. Depending on the country, market, and cultural, social, and political circumstances, the interest of one sector may be exalted. Consider the sugar market in a small Latin American country. Many poor families depend on sugar plantations for livelihood. Immediate, uncompensated removal of quota protection could doom them economically, leaving them with a devil's choice as to whether to rely on illicit activities for meager income, education, and health care.

⁶¹⁷ PAUL R. KRUGMAN & MAURICE OBSTFELD, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 202-203 (4th ed. 1997).

Part Five

HISTORICAL FOUNDATIONS

Chapter 18

AMERICAN TRADE HISTORY⁶¹⁸

I. Pre-Revolutionary Colonial Status⁶¹⁹

Trade in Colonial America was developed, and controlled, by Great Britain through the leading economic theory of the age: Mercantilism. The first English settlers arrived in Jamestown in 1607, and thereafter the 13 Crown Colonies developed. Mercantilism was the international trade policy prevailing at the time in the British Empire, as it was throughout the vast majority of Western Europe. So, government control of foreign trade was of paramount importance for national security and prosperity in England.⁶²⁰ The overarching economic goal of mercantilism was to run a trade surplus, which meant the generating a large surplus of exports over imports.⁶²¹ That way, Great Britain could accumulate gold and other precious metals (as payment for its exports), and invest them in its military, agricultural, and industrial sectors.

Pursuing the same Mercantilist goal, other powerful Europe countries in the 16th through 18th centuries sought to build a network of overseas colonies – in Africa, Asia, and Latin America. These networks supported their domestic markets, and by extension, their treasuries: Mother countries ensured their colonies exported commodities and natural resources that industries in the Mother countries used as inputs into finished products. They exported those products back to the Colonies, resulting in a dependence of the Colonies on the Mother countries both for (1) market access for raw materials like cotton and sugar, and (2) imports of high value-added merchandise.

While the network of colonies supported the home merchants in London, the British government also needed to ensure the developing colonial trade in America did not compete with, or drive out, British merchants. Would-be American entrepreneurs were a threat to the British economic establishment. The Colonies in America were captive markets for British industry, bound to the British Empire, and so it should remain. The Empire viewed trade from the American Colonies as a means to enrich the Mother country, with little regard, if any, for the prosperity and welfare of the colonies themselves. To protect its domestic market and increase its international political and military power, the British government partnered with domestic merchants in London and excluded other Empires and merchants based in its own Colonies. The American Colonies could not trade with any other British colonies, or with other Empires (such as the French and Spanish)

⁶¹⁸ Documents References:

- (1) *Havana Charter Preamble*
- (2) *GATT Preamble*
- (3) *WTO Agreement Preamble*

⁶¹⁹ This discussion draws on PETER ANDREAS, *SMUGGLER NATION* Part I (2013). [Hereinafter, ANDREAS.]

⁶²⁰ See Laura LaHaye, *Mercantilism*, in *THE CONCISE ENCYCLOPEDIA OF ECONOMICS* (Library of Economics and Liberty, 2008), www.econlib.org/library/Enc/Mercantilism.html. [Hereinafter, LaHaye.]

⁶²¹ See LaHaye.

and their Colonies – at least not without a special dispensation from London.

In no document is the fact the Crown controlled trade from the 13 Colonies better evidenced than the 1776 *Declaration of Independence*. Among the list of grievances listed by Thomas Jefferson (1743-1826) was that King George of England was “cutting off our Trade with all parts of the world: ... imposing Taxes on us without our Consent.” Using trade barriers, regulations, and domestic subsidies, the British Empire strictly, and successfully, controlled American Colonial trade for the sole benefit of London merchants and the English nation-state. These regulations, namely the *Acts of Navigation and Trade*, permitted the colonies to produce only raw materials and to trade only among each other and England.⁶²²

As a natural consequence of strict British imperialistic trade controls, many American Colonial merchants turned to smuggling. A diverse array of opportunities and incentives for illicit trade throughout the American Colonies abounded.⁶²³ For example, Northern Colonies such as Massachusetts used an array of smuggling techniques and trade routes, because their manufactured products held little value for English consumers, so they needed to reach markets outside Great Britain. Southern Colonies such as Georgia, in contrast, required fewer illicit trade schemes, because their raw products (*e.g.*, cotton and tobacco) received much more favorable treatment in the British Empire.⁶²⁴

Succinctly put, Northern manufacturers posed a competitive threat to British manufacturing titans, whereas Southern plantation owners did not, and indeed provided necessary inputs to British industry. Treated thusly, Northerners needed to smuggle their goods out of the Colonies if they were to sell them overseas; Southerners did not. To be sure, the Southern Colonies still concocted and benefitted from illicit trade schemes. But, those schemes took the form of evading customs duties (*i.e.*, not paying British tariffs), rather than clandestine shipments to other markets.

II. American Revolution, Boston Tea Party, and Independence⁶²⁵

● Origins of Smuggling in American Colonies

For decades, British Imperial authorities largely ignored the rampant illicit trade happening in the American Colonies. One consequence of this lax legal enforcement was the Colonies grew and developed into relative prosperity. In the late 17th and first half of the 18th century, Britain was more concerned with excluding other European Empires from America than discouraging illicit trade. Britain needed Colonial loyalty to reinforce her focus on the geopolitical struggles from the European continent to Africa, Asia, and Latin America. As far as possible, rather than stir up trouble in America, Britain sought to ensure production and consumption in its home market continued uninterrupted. The authorities

⁶²² This discussion draws on WILLIAM NESTER, *THE GREAT FRONTIER WAR: BRITAIN, FRANCE, AND THE IMPERIAL STRUGGLE FOR NORTH AMERICA, 1607-1755* (2000).

⁶²³ ANDREAS, 14.

⁶²⁴ ANDREAS, 15.

⁶²⁵ This discussion draws on ANDREAS, PART I.

understood the pragmatic benefits of goods smuggled from America to Britain: increased consumption opportunities at lower prices. If the authorities could profit from smuggling (e.g., via accepting bribes from the smugglers) – and they did – then so much the better. In brief, an age of tolerance spanning roughly 80 years from the 1690s and early 1700s transpired.

Not until later in the 1700s did the British enforce strictly trade regulations and impose rigorously revenue collection from duties on merchandise in the Colonies. Over time, the British stopped turning a blind eye and began cracking down on smuggling throughout the Colonies. Colonists defended American freedom, and the Founding Fathers protested unfair taxation, leading to the American Revolution. Yet, it is critical to appreciate how much Colonial outrage at the British government was directed at customs officers and their enforcement of trade laws.

Those British Imperial actions curtailed, and threatened to eliminate entirely, illicit trade in the American Colonies. Legal and illegal trade had created a consumer society in the Colonies, and the enforcement of existing trade laws by British customs agents disrupted the lifestyle to which the Colonists had grown accustomed. To say America was founded on smuggling would be too strong, but to deny its importance in the motivations for the Revolution would dishonour.

Ideas circulating in the Age of Enlightenment (roughly 1650 through 1800), combined with strict enforcement of trade laws and discrimination against American Colonial merchants by British customs agents, were the powder keg of revolution. With the removal of the French military threat from the American Colonies at the conclusion of the French and Indian War (1754-1763, also called the Seven Years' War), the British Monarchy and Parliament turned its focus directly to the Colonies, and began enforcing tough measures, some of which had been in existence. In effect, the British no longer were distracted by the French in the American colonies.

- **1765 *Stamp Act* and Cost of 1754-1763 French and Indian War**

Among the most notorious such legislation was the 1765 *Stamp Act*. It consisted of a series of direct taxes specifically targeted at the American Colonies. Britain believed the Colonies should contribute more to maintain their status as Colonies in the Empire. One motivation was the defense Britain provided the Colonists against the French in the French and Indian War: that defense cost money, so the Colonists, as beneficiaries, should help cover it.

- **American Colonial Tea Market Before 1773 *Tea Act* and Incentive for Smuggling**

Strict enforcement of trade regulations and imposition of new trade laws on the Colonies infuriated colonists, especially those in New England. New Englanders were sensitive to the regulations due to their dependency on British markets. Regulations passed by the British Parliament in the late 18th century, specifically the *Stamp Act* and 1773 *Tea Act*

Act (the latter being part of the *Townshend Revenue Acts*), led to the 1773 political protest known as the “Boston Tea Party.” British law included since roughly 1720 a trade restriction requiring Colonists to import tea only and directly from Britain.

Prior to the *Tea Act*, taxes imposed in Britain on tea had driven up tea prices in Britain. That tea was imported into Britain by the British East India Company, which procured the tea from many sources in and around the British Empire, such as India. Obviously, tea is not grown in America, so Colonists were dependent on imported tea, just like Britishers living in England. The Company held a virtual monopoly, thanks to an Act of Parliament in 1698, on all tea trade throughout the British Empire. But, with the high taxes imposed on tea in Britain, tea prices rose there, and also in the American Colonies – because tea in those Colonies came through Britain. Again, the American Colonies were forbidden from importing tea directly from India or other sources.

With the higher tea prices in Britain, the English stopped buying “legal” tea from the East India Company. British tea merchants started smuggling tea into England from the Netherlands – the Dutch government had no tax on tea, and the Dutch East India Company obtained tea in and around Dutch Colonies. Similarly, American tea merchants ceased buying the high-tax legal tea through Britain, and started smuggling tea from the Dutch. Simply put, British taxes on tea created an incentive for tea smuggling in both the home and Colonial markets. The smugglers into the American market were none other than New England merchants, whose customer base enjoyed finer, luxury merchandise.

From the perspective of the British East India Company holding the monopoly on legal tea, it continued to import tea, but it could not sell it in Britain, or onward to the American Colonies. Its warehouses piled up with tea: neither British nor American clientele wanted the high-taxed tea, when they could get cheaper, smuggled tea from the Dutch. So, the Company petitioned Parliament, complaining of its surfeit of tea and enormous losses it suffered due to taxes in Britain. The petition paid off with two Parliamentary enactments, both of which were to the direct benefit of Britain’s flagship multinational Crown corporation – the Company.

- **1767 *Indemnity Act* and 1773 *Tea Act***

First, via the 1767 *Indemnity Act*, Britain reduced its taxes on tea consumed in Britain. Under that *Act*, Britain also agreed to refund 25% of the duties the East India Company had to pay on tea it exported from Britain to the Colonies. The British government understood that this refund would cost its Treasury, so in 1773 it passed the *Tea Act*. The *Tea Act* established new taxes on tea imposed directly on British Colonies in North America on tea consumed there. In effect, while the *Indemnity Act* gave British tea drinkers tax relief, the *Tea Act* shifted taxes to American Colonial consumers.

Additionally, the *Tea Act* worked in tandem with the *Indemnity Act* to wipe out smuggling from the Dutch. The *Indemnity Act* granted the British East India Company a 25% duty refund on tea exports to the American Colonies. The *Tea Act* extended the benefits to the Company.

First, the *Tea Act* empowered the Company to ship tea directly to the Colonies, without routing it through Britain. Until this *Act*, the Company could not ship tea directly from its point of production, say in India, to the American Colonies. It had to route the tea through Britain. But, with the *Tea Act*, the Company was permitted to export tea to the American Colonies directly, eliminating the need for traditional middlemen who bought tea at wholesale auctions in London, and then exported it at a huge mark-up price to the Colonies. Second, all of the Company's tea exports were free of export duties, whether the shipments were direct from a source like India, or out of its warehouses in Britain.

These Parliamentary measures helped the British East India Company lower the price of legal tea, narrowing or eliminating the differential that had favored smuggled tea. The Company appointed Colonial merchants to receive the tea on consignment. The consignees then sold tea for a commission. The end result was the Company undercut the price of tea smuggled by the American Colonists from the Dutch into the Colonies. Legal tea was cheaper than illegal tea for the first time in the history of the American Colonies.

- **Taxation Without Representation and 1773 Boston Tea Party**

The Boston Tea Party was in direct defiance of strict enforcement of laws not previously enforced, the *Stamp Act*, and a protest against the effects on the American Colonial tea market of the *Indemnity and Tea Acts*. American Colonists gathered in Boston to protest the British Parliament taxation of the Colonies without any elected representation from the Colonists in Parliament. Parliament held the interests of the Colonists second to those of the Empire, and maintained the Colonies were “virtually” represented. In November 1773, American Colonists, dressed as Native American Mohawk warriors, boarded British ships in Boston Harbor that were loaded with over 300 chests of tea from the East India Company. The Americans dumped all of the tea into the water in a dramatic and daring act that came to be known as the Boston Tea Party.

- **1774 Intolerable Acts**

In response, Parliament passed the 1774 *Intolerable Acts* to reassert control over the American Colonies and demonstrate its superiority as supreme governing authority. These *Acts* were punitive, stripping Massachusetts of its self-governing power. Given ideas of individualism, rationalism, and political freedom circulating in the Age of Enlightenment, many Colonists saw these *Acts* as violations of their natural legal rights and, therefore, as threats to the liberties of all Colonial America, not solely Massachusetts. The hopes of Parliament to squash the rebels and enemies of the Empire backfired drastically. The *Acts* helped unite the diverse Colonies to form the First Continental Congress in Philadelphia in 1774.

- **From Trade War to Open War:
First and Second Continental Congress and 1776 Declaration of Independence**

The First Continental Congress had immediate effects on Colonial trade. Although it lacked true authority in the eyes of Britain, it successfully organized a boycott by all 13 Colonies against the purchase of British goods. In response, the British sent soldiers to Massachusetts, closed the local government, and imposed direct rule by military. As a consequence, the Colonies organized their militias and met the British army at Lexington and Concord on 19 April 1775, the beginning of the American Revolution. With the “shot heard around the world,” a trade war became an open war.

Following a year of fighting the British military and the formation of the Second Continental Congress in Philadelphia, the Colonial delegations unanimously approved the *Declaration of Independence* on 4 July 1776. The *Declaration* marked the formation of a new sovereign nation, completely independent of the British Empire, which called itself the United States of America.

III. Smuggler Nation?⁶²⁶

The U.S. has deep roots in smuggling trade, albeit ones that typically do not receive prominent attention in orthodox textbooks. From molasses used for making rum in the Colonies to the current scourge of narcotics, smuggling has played a major role in the history of American trade. Indeed, from an historical perspective, there is a viable argument – one that runs counter to the narrative about the lofty ideals underlying the American Revolution – that the origins of the American Republic lay in smuggling.

In the early Colonial years, merchants were actively engaged in smuggling large volumes of merchandise. The British Empire was preoccupied with land wars and political instability on the European continent and, therefore, largely ignored the vibrant illegal trade American Colonists did with third countries. Had Britain not eliminated other European powers from America, and then turned its focus to tightening its control over the Colonial trade, the Colonists might never have revolted against the Crown. Americans had grown accustomed to smuggling, which facilitated their nascent consumer society and lifestyle characterized by certain luxuries, such as illegal tea imported from the Dutch. Smugglers could import these items more cheaply than legal tea from Britain via the East India Company.

- **From Tea Smuggling to Demands for Free Trade**

Yet, as Britain clamped down on smuggling by enforcing existing trade laws, many luxuries disappeared. No longer could Colonial merchants induce a British customs agent to turn a blind eye to smuggled tea by giving the agent “a cut.” In the 1750s and 1760s, the agent demanded the smuggler-merchants import tea lawfully, under license, from the East India Company. The Colonists directed their outrage at their neighboring customs agents, most of whom the Crown appointed from among American settlers.

⁶²⁶ This discussion draws on Peter Andreas, *Smuggler Nation* pts I-II (New York, New York: Oxford University Press, 2013); Alfred E. Eckes, Jr. *Opening America’s Market: U.S. Foreign Trade Policy Since 1776* (Chapel Hill, North Carolina: University of North Carolina Press, 1995).

The passage of the 1765 *Stamp Act* (imposing a direct tax on Colonial Americans, and mandating printed materials in Colonial America be on stamped paper made in London) and 1773 *Tea Act* (granting the East India Company an import-export monopoly over tea) imperiled a freedom Colonists thought was guaranteed to them as British subjects, a freedom they enjoyed for decades: to evade taxes through smuggling. The *Tea Act*, like other restrictive trade regulations, threatened to drive smugglers out of business. It even threatened legal importers of tea with financial ruin if they were not selected as consignees. The East India Company was responsible for that selection, which it exercised with a view to undercutting prices of the smugglers' Dutch tea. That is, the *Act* made legal tea imported from Britain through the East India Company cheaper than illegal tea from the Dutch for the first time in American history. Thus provoked, tea smugglers, plus other Colonial merchants, staged the 1773 Boston Tea Party.

Exacerbating the dispute was British government use of “writs of assistance,” which essentially served as unrestricted search warrants. First introduced in 1760, these writs enabled customs agents to conduct increasingly aggressive inspections of the operations of American merchants, and to seize illicit goods. Many Colonists initially viewed these expanded powers as violations of their rights as British subjects, and later regarded them as a violation of their rights under Natural Law. The writ system also was susceptible to abuse. Operating with minimal oversight and little accountability, customs officials manipulated writs for personal gain. After all, they were appointed by London and worked in Boston, communications (much less inspections) were slow, and the temptation to resell seized smuggled goods for high profits was enticing.

In sum, enthusiasm of the Crown to enforce trade laws politicized Colonial smuggling and transformed it into a patriotic cause. Cracking down on trading violations was about economic interests, but it became something bigger. Fighting anti-smuggling enforcement came to symbolize defiance of an overbearing imperial authority, a *cause célèbre* of freedom. Free trade became a central rallying cry for the Colonists-turned-rebels around which their economic self-interest and political philosophy converged.

Moreover, smuggling became important to the success of the Revolutionary campaign. Smugglers put their knowledge of clandestine trade networks and operations in service of the newly formed Continental Congress and Army. They created what was a global supply chain for General Washington and his army throughout the Revolutionary War. Precisely the amount of smuggled goods that came into the Colonies before Independence is unknown, because few true records were ever kept, for obvious reasons. What is known is that on the eve of the 1775 Battles of Lexington and Concord, none of the 13 Colonies had powder mills; the rebels had to smuggle in gunpowder from the West Indies, which they did in exchange for fish, flour, indigo, and tobacco. Cut off from trade with England, the Americans obtained what they needed to fight the British from smuggled merchandise, and eventually manufactured their own ordinance.

- **Triangle Trade**

There was a second, more infamous, dimension to illegal trade in the Colonial Era and Revolutionary Period: “Triangle Trade” of rum, slaves, and molasses. Diagram 18-1 depicts this Trade. As early as the 16th century, the first leg of this Triangle was from a European port, such as England, to Africa, bringing textiles, manufactured goods, and rum to Africa. Then, the European ships would carry slaves to the Americas. Slaves – who were brought to the American Colonies in (if not before) 1619, though “captive Africans likely ... [were] present in the Americas in the 1400s and as early as 1526 in the region that would become the United States”⁶²⁷ – would work on plantations harvesting sugar cane, creating molasses and shipping it up to the New England Colonies. There, the Colonists would use the molasses in distilleries to make rum and ship the rum back to the European powers.

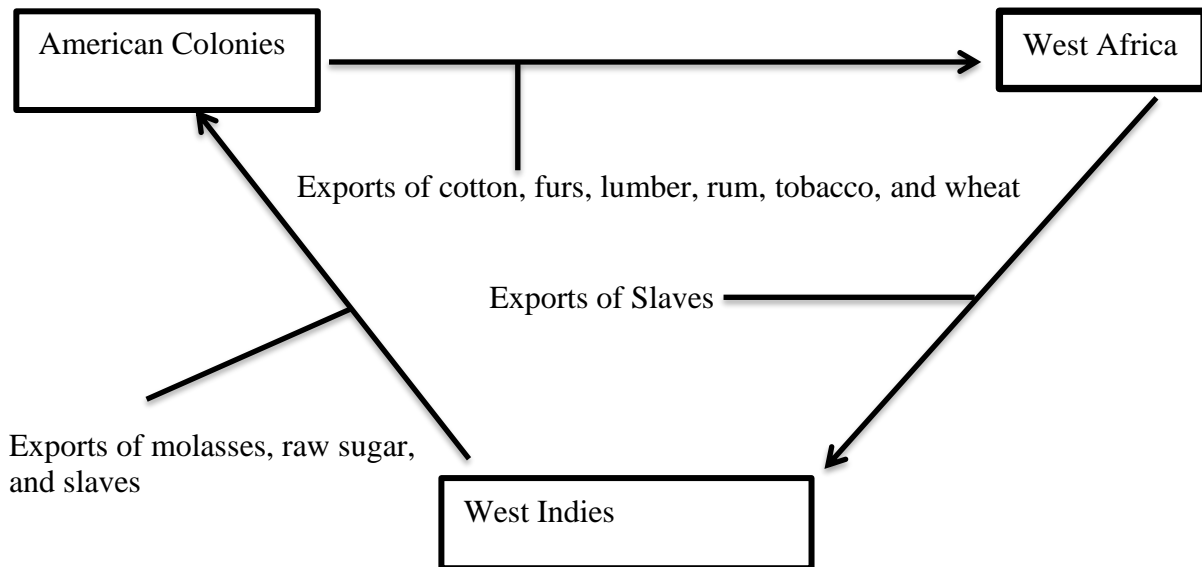
While immoral, the Triangle Trade was not illegal, and it evolved through the 16th, 17th, and 18th centuries. (Notably, the Dutch government – but not (as of May 2023) the U.S. or U.K. governments – apologized for its role in the slave trade,⁶²⁸ and recognized that trade as a crime against humanity.⁶²⁹) As the New England Colonies, especially Massachusetts and Rhode Island, became mass producers of rum, they began replacing Europe in the first leg of the Triangle. Rum production required smuggling on a large scale. Molasses is a key ingredient in rum, and labor is needed on sugar cane fields to turn sugar into its cooked liquid form for shipment to New England, *i.e.*, molasses. As ever-larger numbers of early Americans became landowners relatively quickly, the need for cheap labor increased. With increases in the demand for labor, the slave trade became an ingrained part of American society and would remain that way for almost 100 years after the Revolutionary War.

⁶²⁷ Crystal Ponti, *History Stories: America’s History of Slavery Began Long Before Jamestown*, HISTORY.COM, 14 August 2019, www.history.com/news/american-slavery-before-jamestown-1619.

⁶²⁸ Celestina Olulode, *St Kitts and Nevis Is Not Totally Free Under King Charles III, Says PM*, BBC NEWS, 8 May 2023, www.bbc.com/news/world-latin-america-65425416. Newly coronated King Charles III said he needed time “to deepen his understanding of the impact of slavery.” *Quoted in id* (adding: “That learning process has continued with vigor and determination since His Majesty’s Accession”....). Really?

⁶²⁹ Anna Holligan, *Netherlands Slavery: Saying Sorry Leaves Dutch Divided*, BBC NEWS, 19 December 2023, www.bbc.com/news/world-europe-63993283 (reporting: “The Netherlands has apologized for its colonial past and the enslavement and exploration mandated by the Dutch state during the 17th-19th centuries. Dutch Prime Minister Mark Rutte said that slavery must be recognized in ‘the clearest terms’ as ‘a crime against humanity.’”). *See also* Matt Murphy, *Dutch King Willem-Alexander Apologizes for Country’s Role in Slavery*, BBC NEWS, 2 July 2023, www.bbc.com/news/world-europe-66076562 (reporting: “The King of the Netherlands has formally apologized for his country’s role in the slave trade, saying he felt ‘personally and intensely’ affected. The country became a major colonial power after the 17th Century, holding territories across the globe, and Dutch slave traders trafficked more than 600,000 people. King Willem-Alexander ... called the practice a ‘horror.’ The royal family did nothing to stop it, he said. ... In June [2023], a new study revealed that Dutch rulers received the equivalent of € 545m (\$ 595m) in today’s money between 1675 and 1770 from colonies where slavery was enforced. ... King Willem-Alexander conceded that the ‘monarchs and rulers of the House of Orange took no steps against [slavery].’ ‘Today I’m standing here in front of you as your King and as part of the government. Today I am apologizing myself,’ he said. ‘Today, I am asking for forgiveness for the crystal-clear lack of action.’”).

**Diagram 18-1
Triangle Trade**



IV. Constitutional Compromise on Slavery⁶³⁰

- **No Bar on Domestic Transactions**

Following the victory of the Americans at the 1781 Battle of Yorktown (Virginia) – a victory made possible with French military intervention on the side of the Americans – the new nation needed a constitution. Following the 1781 *Articles of Confederation*, from 25 May to 17 September 1787, 55 delegates gathered at Philadelphia to draft a new Constitution. Nine of the 13 original Colonies, now States, or two-thirds, were needed for ratification; when 11 did so, the Constitution entered into force on 4 March 1789. (With North Carolina Rhode Island signing in 1790, waiting for the *Bill of Rights* from the new Congress, all 13 ratified.)

Slavery was among the most controversial issues the delegates debated at the Constitutional Convention. Many of the delegates personally owned slaves, especially those from Virginia and South Carolina. By the time of the summer 1787 Convention, slavery had been largely eliminated from New England. But, the entire Southern agrarian economy was built by and dependent on slave labor. Southern delegates were unwilling to accept any Constitutional regulation that might threaten the institution of slavery.

Slavery opponents eventually were defeated. They had no choice but to concede slavery would be allowed to continue in the newly formed U.S., unregulated by the Constitution. The Constitution did not bar the purchase or sale of slaves domestically.

⁶³⁰ This discussion draws on RICHARD BEEMAN, *PLAIN HONEST MEN: THE MAKING OF THE AMERICAN CONSTITUTION* (2009); Paul Finkelman, *How The Proslavery Constitution Led To The Civil War*, 43 *RUTGERS LAW JOURNAL* number 3 (Fall/Winter 2013).

- **Reciprocal Concessions on International Trade**

Perhaps even more contested was the issue of international trade in slaves. Delegates opposed to slavery argued the Constitution should prohibit the States from participating in international slave trade, specifically the importation of new slaves from Africa and the export of slaves to any other country. At one point, delegates in favor of slavery inserted language into the draft of the Constitution that would have prevented the Federal government from attempting to ban international slave trading, and from imposing taxes on the purchase or sale of slaves.

By late August 1787, nearing the end of the Convention, the delegates failed to reach a consensus on the language drafted by pro-slavery delegates. To resolve the issue, it was referred to an 11-member committee, which struck a compromise. Congress would have the power to ban the international slave trade, but not until 1808. (Shamefully, with domestic slave market prices rising after 1808, Southern planters continued to smuggled slaves into the U.S. until the last vessel, *Clotilda*, imported 109 African captives from Ouidah, in present-day Benin, to Alabama, arriving near Mobile after a horrific six-week voyage on 9 July 1860.⁶³¹) In exchange for this concession to pro-slavery delegates, two reciprocal concessions were made.

First, the power of the Federal government to regulate foreign commerce would be strengthened by provisions that allowed for taxation of slave trades in the international market. That is, during the 20-year period in which slave trading remained Constitutional, the Federal government held the power to tax that trade. Concomitantly, to impose such taxes, it was agreed that the requirement for passage of navigation acts would be lowered from two-thirds majorities of both Houses of Congress to simple majorities.

So, the relevant Constitutional language agreed upon was inserted into Article I, Section 9:

The Migration or Importation of such Persons as any of the States now existing shall think proper to admit, *shall not be prohibited by the Congress prior to the Year one thousand eight hundred and eight* [1808], but a Tax or duty may be imposed on such Importation, *not exceeding ten dollars* [U.S. \$10.00] for each Person.⁶³²

This first concession, then, was clearly a commercial one. In modern parlance, it was a transition rule: free trade with a permissible specific duty for two decades, after which an import ban would be imposed. What is chilling is the application of these terms to people.

The second concession agreed by the pro-slavery delegates in return for the 20-year right to continue the slave trade is the more famous one, and mixed politics with taxation.

⁶³¹ See Joel K. Bourne, Jr., *Last American Slave Ship, is Discovered in Alabama*, NATIONAL GEOGRAPHIC, 22 May 2019, www.nationalgeographic.com/culture/2019/05/clotilda-the-last-american-slave-ship-found-in-alabama/.

⁶³² Emphasis added.

It is called the “Three Fifths Compromise.” It has no direct international trade implication, but was part of the overall Convention bargain on slavery, and is of historical interest in its own right. This Compromise resulted from the debate on whether slaves would be counted among the population of a State to determine representation in Congress. Delegates from States with a large population of slaves argued that slaves should be counted among the population in determining representation, but should not be counted if the new federal government were to levy taxes on the basis of population. Delegates from States where slavery had become rare argued the exact opposite: slaves should be included in the population for purposes of taxes, but should not be counted for purposes of representation.

The “Three Fifths Compromise,” found in Article I, Section 2, Paragraph 3 of the Constitution, was the result:

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, *three fifths of all other Persons*.⁶³³

Regrettably, indeed, tragically, it would take a bloody Civil War (1861-1865), several Supreme Court decisions across many decades, and a Civil Rights movement (in the 1950s and 1960s), to begin reversing the legacy of slavery.

- **Four Lessons**

From the perspective of International Trade Law, four lessons may be drawn from the Constitutional debate about slavery. First, the most immoral of institutions – slavery – was endemic in the life of the American Colonies and early Republic. Agriculture was a sensitive American sector, and slavery was essential to production in that sector. Slavery illustrated that International Trade Law ineluctably involves moral choices, and picking among options often is swayed, if not adulterated, by economic interests.

Second, note the technique used by the delegates here: they are now standard in the negotiating kit of international trade lawyers. The delegates could not agree on an import ban, because of different moral and economic perspectives. After all, 25 of the 55 delegates owned slaves. (Thomas Jefferson, a slave owner, was Ambassador to France at the time of the Convention.)

Rather than abandon their Constitutional project, they deferred the issue. In a vast array of modern multilateral trade accords, and FTAs, this technique is used. For example, to protect sensitive goods or services sectors, importing countries do not want to grant tariff concessions, much less duty-free treatment, immediately upon the entry into force of the deal. Exporting countries demand such market access. The compromise is to put the sensitive merchandise or service sectors into a staging category. Trade is liberalized for all such items in that category, but only over an agreed upon period, such as five or 10 years.

⁶³³ Emphasis added.

The Constitutional delegates used the same technique, but the context was not phasing in free trade, but rather phasing out free trade, in slaves, *i.e.*, phasing in a permanent embargo.

Third, the delegates resorted to a specific duty, and bound it. Congress could tax international trade in slaves touching American shores up to, but not in excess of, \$10.00 per slave. That levy, based on import volume, is what today is known as a “specific duty,” and the fact it is a ceiling rate is called a “binding.” The specific duty of \$10.00 was significant in 1789. In 2013 purchasing power terms, the equivalent of a \$10.00 commodity would be \$269.00, and the labor value of that commodity would be \$4,240.⁶³⁴

The fourth lesson is perhaps the most uncomfortable one, particularly for Americans. Not infrequently, American trade negotiators and the commercial interests that back them criticize foreign countries for their trade measures. Sometimes that criticism takes on a moral tone, with the American side effectively contending the act, policy, or practice of a foreign government not only interferes with American market access, but also is offensive. Sometimes that criticism, including its moral tone, is correct. But, America did not always don the “white hat” in International Trade Law. Other than the Foreign Commerce Clause (Article I, Section 8, Clause 3), the only provision in the Constitution on international trade is one that permitted slavery for 20 years. The lesson, then, is humility that comes with historical knowledge.

V. Early American Trade Laws⁶³⁵

- **Continental Congress Goals of Reciprocal National and Unconditional MFN Treatment**

The Founding Fathers and other early Americans ardently supported free trade. The timely publication of Adam Smith’s *Wealth of Nations* in 1776 gave them plenty of intellectual ammunition to oppose the mercantilism of the Colonial era.

After declaring independence from Great Britain in 1776, the newly formed United States of America, under the direction of the Continental Congress, launched its first trade initiative. The Americans wanted foreign recognition as a formal nation-state. They bargained with their only available resource: access to the American market. John Adams (1735-1826), with input from Benjamin Franklin (1706-1790), drafted a model plan for commercial treaties to guide American negotiators. The Continental Congress approved it with only minor changes. The treaty plan proposed two options: reciprocal national treatment in commercial matters, or an unconditional MFN policy.

The first option called for equality of treatment with foreign nation-states. It was not a bilateral FTA in the modern sense. The vast majority of 18th century governments depended on tariffs as a principal source of revenue, and the young Continental Congress was no different. As drafted, the implementation of this option would have opened

⁶³⁴ See *Measuring Worth*, www.measuringworth.com.

⁶³⁵ This discussion draws on Alfred E. Eckes, Jr. *Opening America’s Market: U.S. Foreign Trade Policy Since 1776*, UNIVERSITY OF NORTH CAROLINA PRESS (1995).

European colonies to American merchants and trade, a result the early Americans desperately wanted.

The second option sought nondiscriminatory trade preferences equal to those given to most favored third parties. That was a courtesy the major European powers bestowed on each other. The young U.S. sought the same treatment for its goods in European ports of entry. With little to bargain, the Americans called for unconditional MFN treatment, whereas the Europeans tended to offer it amongst themselves on a conditional basis.

- **1778 *Franco-American Treaty***

The first trade treaty actually negotiated was the *Franco-American Treaty of Amity and Commerce of 1778*, agreed amidst the Revolutionary War. Unfortunately, it failed to obtain either equality under the reciprocal national treatment objective or unconditional MFN treatment. As for MFN treatment, Articles 2-4 of the *Treaty* stated.⁶³⁶

Article 2.nd

The most Christian King [*i.e.*, France], and the United States engage mutually not to grant any particular Favor to other Nations in respect of Commerce and Navigation, which shall not immediately become common to the other Party, who shall enjoy the same Favor freely, *if the Concession was freer made, or on allowing the same Compensation, if the Concession was Conditional.*

Article 3.d

The Subjects of the most Christian King shall pay in the Port Havens, Roads, Countries I[n] lands, Cities or Towns, of the United States or any of them, no other or greater Duties or Imposts of what Nature soever they may be, or by what Name soever called, than those which the Nations most favored are or shall be obliged to pay; and they shall enjoy all the Rights, Liberties, Privileges, Immunities and Exemptions in Trade, Navigation and Commerce, whether in passing from one Port in the said States to another, or in going to and from the same, from and to any Part of the World, which the said Nations do or shall enjoy.

Article 4

The Subjects, People and Inhabitants of the said United States, and each of them, shall not pay in the Ports, Havens Roads Isles, Cities & Places under the Domination of his most Christian Majesty in Europe, any other or greater Duties or Imposts, of what Nature soever, they may be, or by what Name soever called, that those which the most favored Nations are or shall be obliged to pay; & they shall enjoy all the Rights, Liberties, Privileges,

⁶³⁶ See www.avalon.law.yale.edu. (Emphasis added.)

Immunities & Exemptions, in Trade Navigation and Commerce whether in passing from one Port in the said Dominions in Europe to another, or in going to and from the same, from and to any Part of the World, which the said Nation do or shall enjoy.

In reality, Article 2 sets up a bifurcated MFN rule: if one party (*e.g.*, France) granted unconditional MFN treatment on a particular category of merchandise to a third party (*e.g.*, Spain), then it had to grant unconditional MFN treatment to the other party (*e.g.*, U.S.). But, if the grant to the third party was conditional, then what was owed to the party was conditional MFN treatment. Historians suggest that perhaps one rationale for this partial conditionality was neither the U.S. nor France wished to grant benefits to a mutual enemy, Britain. Moreover, as the *Treaty* was agreed during the Revolutionary War, what if America lost? France did not want MFN treatment to extend unconditionally to Britain.

Despite the *Treaty*, American merchandise still did not enjoy preferences in French-controlled areas. Article 3 obligated the U.S. to give France MFN treatment to France in all of its ports: American ports were open to French commerce. But, France gave that commitment only for French ports, not ports in all French Colonies, such as those in the Caribbean. France gave fuller MFN treatment to other European nations, but not Revolutionary America, meaning it regulated the access of American merchants to French colonies, sometimes discriminated against American ships. Put simply, France did not rid itself of mercantilism via the *Treaty*.

American delegations to other European countries were met with even less success than obtained with France. Overall, then, the trade initiative of the Continental Congress failed to remove mercantile restrictions from European markets.

- **Centralized Customs**

Another early American trade issue was institutional, namely, the weakness of the central government under the *Articles of Confederation*. The central government could not protect national commercial interests or use trade to influence the European balance of power, which had drastically shifted toward Great Britain and away from the Old World powers of France and Spain. Trade problems among the diverse states and with Europe nearly ruined the young, feeble government.

Consequently, early Americans began to see the benefits of having international trade regulated by a stronger national government. In 1789 the U.S. Constitution was ratified, with a new division of power: Congress would regulate foreign commerce and authorize customs duties. The executive branch retained the authority to make treaties. This division, whereby Congress regulates trade and the President negotiates trade agreements under authority Congress delegates, solved two problems: power over commerce was centralized at the federal level, but split among two branches that could check and balance each other against the evil of corruption.

- **1789 - First American Tariff**

The first tariff was implemented by the first Congress and signed by President Washington on 4 July 1789. By contemporary standard, this tariff hardly can be dubbed protectionist. The tariff was a single schedule of relatively low specific duties, and *ad valorem* duties that ranged from 5% to 15% that applied to all imports from all countries. This first tariff legislation served two three purposes.

First, tariffs were vital to raise government revenue. Indeed, between 1790 and 1860, tariffs accounted for 90% of federal tax revenue.⁶³⁷ They were imposed on goods as diverse as molasses, nails, and salt.

Second, the first tariff authorized drawback, or remittance of duties paid on goods that were imported and then subsequently exported elsewhere. Drawback is a feature of U.S. Customs Law to the present day. The Founders understood that drawback would encourage economic activity in America, and exports from America.

Third, creating a single schedule was consistent with the early American government's desire for equal treatment. Indeed, this schedule treated old enemy England exactly as ally France. With its anti-British stance and legacy of mercantilism, France responded predictably: it protested the American policy of outward equal treatment to commercial allies and non-treaty powers. Yet, just 10 days after the first American tariff legislation, France experienced regime change: the French Revolution.

VI. Pre-Civil War Battles Over Tariff Policy between North and South, and *Tariff of Abominations*⁶³⁸

● Conflicting Regional Trade Interests and Economic Nationalism

As far back as the Administration of President George Washington (1732-1799, President 1789-1797), States argued about the extent to which the Federal government ought to protect domestic manufacturers. Three regions were aligned on two sides of the issue: agrarian interests in the South against commercial industrialized New England and emerging industries in the Middle Atlantic.

President Washington believed the new country needed a manufacturing base. That was because of his experiences as Commander in Chief of the Continental Army in the Revolution, when young America lacked the capability to supply her Army with basic necessities to sustain a military campaign. Valley Forge was a case in point: in the winter of 1777-1778, the Army lost 2,500 soldiers to exposure and starvation for want of supplies.

⁶³⁷ *Sticking Up for a Scapegoat – A Historian on the Myths of American Trade*, THE ECONOMIST, 23 November 2017 (reviewing Douglas A. Irwin, *Clashing Over Commerce: A History of U.S. Trade Policy* (2017)), www.economist.com/news/books-and-arts/21731616-douglas-irwin-agrees-trade-policy-important-all-manner-powers-are-wrongly. [Hereinafter, *Sticking Up*.]

⁶³⁸ This discussion draws on Alfred E. Eckes, Jr. *Opening America's Market: U.S. Foreign Trade Policy Since 1776*, UNIVERSITY OF NORTH CAROLINA PRESS (1995).

President Washington promoted domestic manufactures, making an effort to buy American-made products at every opportunity.

This policy – American economic nationalism – was championed by the first Secretary of the Treasury, Alexander Hamilton (1755/1757-1804) in his famous December 1791 *Report on Manufactures*. Mercantilist in its leanings, the *Report* called for protecting infant industries via high tariffs so as to build a national industrial base. This policy has endured, with manifestations like 1933 *Buy American Act* preferences.

- **War of 1812 and *Tariff Act of 1816***

After the War of 1812 between Britain and the U.S., Americans were even more sympathetic to protection for domestic industries. That War produced a major ideological shift away from the policy of the earlier administrations of Presidents Washington, John Adams (1735-1826, President 1797-1801) and Thomas Jefferson (1743-1826, President 1801-1809). In this first phase of U.S. trade policy, the earlier Presidents had been idealistic in seeking perfect equality and reciprocal access for American exports to Europe. They never achieved free trade among the old powers of Europe and new U.S.

So, American leaders, beginning with President James Madison (1751-1836, President 1809-1817), turned to developing a strong, diversified manufacturing base at home to assure independence from foreign conflicts. Up to the Madison Administration, the Presidents saw tariffs primarily as a revenue-generating device for the government. With President Madison, tariffs became an instrument not only of revenue, but also of protection to serve an inward-looking policy of economic nationalism, or what in modern parlance might be dubbed national security.

Indeed, the *Tariff of 1816* was passed with the explicit goal of protecting American manufacturers from foreign competition. This *Tariff* was the first, and last, tariff legislation that received significant support from the Southern delegates. Senator Henry Clay (1777-1852) of Kentucky helped pass the *Tariff* legislation as part of his “American System” program, which entailed a balance among farming, industry, and commerce behind protective tariffs. But, as early as 1820, support from Southern delegates dried up, when the motivations of patriotism, prosperity, and avoiding a deficit were no longer compelling for them. They viewed the tariffs as purely protecting Northern industrial interests, to the disadvantage of their Southern agrarian economy. From 1820 onward, Southern states would consistently and systemically oppose all protective tariffs.

- **1828 *Tariff of Abominations***

Implementation of protective tariffs began what was the second distinct phase in American trade policy. It lasted 120 years, up to the Great Depression and New Deal legislation of President Franklin D. Roosevelt (1882-1945, President 1933-1945). During this reign of protectionism, high-tariff policy encouraged domestic manufacturing and fueled America’s industrial revolution. Contrary to the claims of opponents of protectionism, the policy did not impede national economic growth. In 1828, Congress

enacted the *Tariff of Abominations*, which put in place the highest tariff rates in all of American history. The *Tariff*, anathema to free traders and bitterly opposed by South Carolina politician John C. Calhoun (1782-1850, Vice President, 1825-1832, to Presidents John Quincy Adams and Andrew Jackson, Senator, 1832-1843 and 1846-1850), was a hallmark of this second phase.

Under it, the average rate of dutiable goods rose to a staggering 61.7% *ad valorem*. Such high rates led to the infamous Nullification Crisis in South Carolina, which started in 1832. Throughout the 1820s, America suffered economic decline. By the 1830s, South Carolina leaders blamed their State's woes on the *Tariff of Abominations*. South Carolina declared the *Tariff* unconstitutional and unenforceable within the State's boundaries. State authorities refused to collect revenues on dutiable items owed under the *Tariff*, dubbing it null and void within South Carolina.⁶³⁹ That is, citing States rights, those authorities prevented Federal officials from enforcing the *Tariff* at port facilities in South Carolina, and prepared militarily to combat Federal moves against them.

America almost descended into Civil War in the 1830s over trade policy. Tariffs affected livelihoods and evoked the most passionate of emotions. Threatening the use of force against the State, President Andrew Jackson (1767-1845, President 1829-1837) called South Carolina's actions "rebellious treason."⁶⁴⁰ Congressional delegates from South Carolina maintained that any attempt by the Federal government to use force to collect the tariffs owed would result in the secession of South Carolina from the Union. Fortunately, in 1832 Senator Clay engineered the *Compromise Tariff* in 1833 that allowed a gradual decline in tariff rates over the next 10 years to 20% by 1843. That Compromise staved off secession by South Carolina, though it came in 1861.

The year 1860 brought to the White House Abraham Lincoln (1809-1865, President 1861-1865), but before his inauguration in March of 1861, seven pro-slavery states (South Carolina, Mississippi, Florida, Alabama, Georgia, Louisiana, and Texas) seceded from the Union and formed the Confederate States of America, known as the Confederacy. This action plunged America into its most gruesome and debilitating military conflict: the 1861-1865 Civil War. In the decades leading up to the Civil War, States' rights and tariff issues became entangled with, and exacerbated by, the issue of slavery. The U.S. was two distinct regions: the Northern and Midwestern States, with their huge growth in industrial manufacturing, mining, and family farms, and the Southern States with its plantation economy, almost entirely based on slavery. Fueling industrial growth and urbanization in the North and Midwest were European (especially Irish and German) immigrants, and high birth rates. The South had fewer cities and less immigration, and while known for plantations, the bulk of its population was in subsistence agriculture.

The protectionist trade policies touted by politicians in the newly formed Republican Party conflicted with the free trade orientation of Southern-based Democrats.

⁶³⁹ They also declared unconstitutional compromise tariff legislation in 1832, saying it did not reduce tariffs to a sufficient extent.

⁶⁴⁰ JOHN S. BOWMAN, ED. *THE CIVIL WAR ALMANAC Chronology: The Approach to War at 12-50* (New York: Facts on File, Bison Book Corp., 1982).

High tariffs would raise the prices of manufactured items consumers purchased from foreign countries, and the South feared retaliatory action from Britain on cotton. To assure reciprocal open markets for its prize commodity, cotton, the South wanted to keep American industrial markets open. But, with infant industries to protect amidst the American industrial revolution (roughly 1843-1900), the North sought tariff barriers against more competitive British goods. (Britain experienced its industrial revolution, about a century earlier, *circa* 1783-1850.⁶⁴¹) This economic schism was a political one, too: Southern plantation owners feared an incapacitating loss of power and domination by the interests of Northern industrialists. Slavery was more than a moral wrong dividing the regions; it was integrally linked to the economic and political survival of one region, and orthogonal to the political economy of the other.

Leading up to the violence at Fort Sumter in 1861 between federal troops and South Carolina militia, the Republican Party openly urged Northern manufacturers and Midwestern farmers to blame a recession in 1857 on the low-tariff economic policies promulgated by the Southern-controlled Congress. As renowned historian Richard Hofstadter (1916-1970) points out, “[t]he Tariff of 1857 was the lowest tariff enacted by Congress since 1816.”⁶⁴² He also explains that in the years immediately preceding the Civil War, the attitude of Northern manufacturers to tariffs was volatile. Low tariffs were welcome in that they made prices for imported raw materials and inputs cheaper, but protection for finished goods also was welcome.

Hofstadter explains that the real schism over the Tariff of 1857 was not between Northern and Southern interests, but rather:

between the woolen manufacturers and the wool growers, both of whom had been in bad straits since the Tariff of 1846. During the decade following 1850 the domestic wool producer had steadily lost ground in the face of foreign competition; by 1860 two thirds of all the wool consumed in the country were foreign. The House Ways and Means Committee in 1856 had ascribed the depression in wool growing and woolen manufactures to the Tariff of 1846, which had raised the duties on raw wools to thirty per cent *ad valorem* and reduced that on flannels and blankets to twenty per cent. Previously all wool priced at seven cents a pound or under had been taxed five per cent, and wools over seven cents had been taxed three cents a pound and thirty per cent. This increase in the cost of his raw material, as well as other factors unrelated to the tariff, had so handicapped the manufacturer that his extensive business in blankets and broadcloth had been destroyed. . . . “The home market was destroyed for the farmer; in the foreign he could not compete, and the flocks were sent to the slaughter because the woolen

⁶⁴¹ While economic historians do not all agree on exact dates for industrial revolutions in different countries, W.W. Rostow, in his *The Stages of Economic Growth: A Non-Communist Manifesto* (3rd ed. 1990), bases his “Take Off” and “Drive to Maturity” Stages on the above dates. (Rostow’s growth model is discussed in a separate Chapter.)

⁶⁴² Richard Hofstadter, *The Tariff Issue on the Eve of the Civil War*, 44 THE AMERICAN HISTORICAL REVIEW number 1, 50-55, at 50 (October 1938). [Hereinafter, *The Tariff Issue*.]

factories had been sold at auction or converted to other services [the Committee Report, House Report Number 342, 34 Cong., 1st Session, declared].” The wool growers would be crushed if raw wools were admitted free of duty, it was held, and seriously harmed as consumers if manufacturers were protected and increased their prices. On the other hand, if woolen goods were not protected, domestic manufactures would be ruined and the growers deprived of their only market. To meet this dilemma the Committee advocated the exemption of all foreign wools costing less than fifteen and more than fifty cents a pound, the retention of duties on intermediate grades such as were produced at home, and the raising of duties on manufactures to adequate protection. The effect of this would be to lower the manufacturers’ costs in those wools which did not compete with domestic production, protect their finished product from foreign competition, and compensate the wool growers by retaining the existing thirty per cent duties on competing foreign wools.

...

It is obvious why the [wool] manufacturers urged a general reduction [in tariffs]. It was impossible to get direct protection because of the hostility of the South and the indifference of many interests in the North. They chose, therefore, to obtain a reduction in costs as a substitute for protection by scaling down the duties on their raw materials. This policy applied not only to wools but also to Manila hemp, flax, raw silk, lead, tin, brass, hides, linseed, and other articles. So eager were the woolen manufacturers to get the reductions that one concern in Lowell, Massachusetts, spent \$87,000 in promoting the passage of the [1857 House revenue] bill.

This explains the fact that manufacturers were not deeply averse to the raising of schedules after the South seceded. What is most significant with respect to the causation of the Civil War is the fact that there was no open hostility on this issue at the time between these manufacturers and the South that might have been exploited for a partisan purpose. Whatever latent hostility may have existed was kept from active expression by the admission of cheap raw wool free of duty. Unsatisfactory as this was to the wool growers, it had the desired effect upon manufacturers.⁶⁴³ ...

In brief, divisions over tariff policy in the late *antebellum* period were nuanced.

However, as Northern demand for Midwestern farm products grew, interests of the infant industries and family farmer aligned with the protectionist ideology of Republicans. Slavery was the hotly debated issue, but arguments for and against it were entangled with competing views of international trade policy. And, as the Civil War raged, the tariff policy divisions were more clearly regional.

⁶⁴³ *The Tariff Issue*, 51-54.

VII. Trade Policy from 1870s to 1930 *Smoot-Hawley Tariff Act*⁶⁴⁴

- **Post Civil War Golden Age of American Protectionism**

American trade policy between the Civil War and Great Depression (1929-1945) is heralded as the Golden Age of American Protectionism. Between 1871 and 1913 the average American tariff on dutiable imports never fell below 38%.⁶⁴⁵ This era is marked by partisan battles in Congress and the White House over trade issues that raged with fanatical zeal. In them, Republican, from President Lincoln to President Theodore Roosevelt (1858-1919, President 1901-1909) who proudly declared themselves protectionists, squared off against Democratic “free traders,” and their muckraking allies in the press.

Today, few economists or politicians openly embrace the “protectionist” label. In late 19th century America, it did not have such a pejorative connotation, and Republican political leaders – including President Lincoln – vigorously advocated for high protective tariffs. Not until the late 20th century did Republicans accept free trade theory with enthusiasm, though some in the early 21st century seem to be going full circle.

In 1885, during a Presidential campaign, William McKinley (1843-1901, President 1897-1901) and Theodore Roosevelt (1858-1919, Vice President March 1901-September 1901), asserted free trade would lead to useless labor (*i.e.*, unemployment) and disintegrate American values (by eroding family farms and industrial communities), but high tariffs would perpetuate American achievements and way of life. Their pronouncements are redolent of the ancient debate between the views of the Greek philosopher Plutarch (*circa* 46-119 A.D.) and Roman lyric poet Horace (*circa* 65-8 B.C.) (discussed in a separate Chapter).

So, from 1860 to 1932, Republicans practiced and preached a nationalistic trade policy with the intent to develop the American market and advance the commercial interests of domestic producers and workers.⁶⁴⁶ They argued high tariffs were essential to protecting American workers and their culture against cheap-labor imports. To sway the public, they measured the success of protectionism in terms of employment gains, and deemphasized the Neo-Classical economic measure of the successes of free trade, such as short-term gains for consumers and expanded production.

The Democratic Party espoused the exact opposite view. Free trade Democrats continually advocated for low tariffs. They repeatedly used the press to expose the corrupt relationship that protectionism perpetuated between Republican politicians and infant industries. Their argument, while not expressly Communist, was redolent of the Marxist-

⁶⁴⁴ This discussion draws on Alfred E. Eckes, Jr. *Opening America's Market: U.S. Foreign Trade Policy Since 1776*, UNIVERSITY OF NORTH CAROLINA PRESS 59-139 (1995).

⁶⁴⁵ See Alfred E. Eckes, Jr. *Opening America's Market: U.S. Foreign Trade Policy Since 1776*, UNIVERSITY OF NORTH CAROLINA PRESS 28 (1995).

⁶⁴⁶ See Alfred E. Eckes, Jr. *Opening America's Market: U.S. Foreign Trade Policy Since 1776*, University of North Carolina Press 31 (1995).

Leninist critique of unholy alliances in a Capitalist free trading system (discussed in a separate Chapter). Republicans needed campaign contributions to sustain their offices, while import-sensitive industries required protection to thrive, even survive. In this age before the *Sherman Act* and other antitrust laws, Democratic politicians argued against monopolies mollicoddled by protectionism, and saw lower tariffs as a trust-busting policy to spur competition. The fact Southern States had been the historical stronghold of Democrats partly explains the free trade orientation of their Party, as protectionism in the *antebellum* era had been an adversary of the agrarian-focused Southern economy.

Attacking Republican-supported monopolies gained Democrats support in the decades after the Civil War, but supporters questioned a *laissez faire* free trade regime. Did Democratic politicians have the conviction to collect taxes and govern the country responsibly if they implemented such a regime? Such doubts caused many Democrats to moderate their position, and advocate for a revenue-generating tariff. Appropriate levels of duty would maximize revenue to support the government and thereby allow for good governance, while incidentally protecting domestic manufacturers.

- **1890 McKinley Tariff**

During the post-*bellum*, pre-*Smoot-Hawley* period, Presidential election campaigns were marked by fierce, partisan debates over trade law and policy. Following the Civil War, up to the election of Democrat Franklin Delano Roosevelt in 1932 (1882-1945, President, 1932-1945), Republicans advocating protectionism won 14 out of 18 Presidential elections. Democrats still were stung by failed secession and Civil War. During the term of President Benjamin Harrison (1833-1901, President, 1889-1893), a Republican, the infamous *McKinley Tariff*, named for then House Means and Ways Committee Chairman William McKinley, was enacted.

This *Tariff*, effective 1 October 1890, extended the scope and increased the level of protectionism. In retrospect, available historical data indicate the *McKinley Tariff* actually may have reduced average rates.⁶⁴⁷ But, at the time, the continued battle over the *Tariff* resolved none of the partisan issues on trade.

When the White House changed hands in 1892 with the election of Democrat Grover Cleveland (1837-1908, President 1893-1897) for a second term, the partisan trade battle continued. In 1894, the *McKinley Tariff* was replaced by the *Wilson-Gorman Tariff*, which stayed in force until the 1897 *Dingley Tariff*, which in turn continued until the 1909 *Payne-Aldrich Tariff Act*. The *Wilson-Gorman Tariff* only slightly reduced tariff rates, much to the dissatisfaction of President Cleveland, who had campaigned on lowering tariff rates. The two successor tariff laws essentially were compromise bills that did little to reduce overall duty rates, though after the *Revenue Act of 1913*, which reinstated a federal income tax after passage of the 16th Amendment to the Constitution, those rates dropped

⁶⁴⁷ See Alfred E. Eckes, Jr. *Opening America's Market: U.S. Foreign Trade Policy Since 1776*, University of North Carolina Press 40 (1995).

significantly.⁶⁴⁸ The *1913 Act* combined both revenue topics: raising income taxes, but cutting tariffs.

Throughout this period, Republicans never swayed from their advocacy of protectionism. The Presidential campaign of 1912 brought another momentous tariff battle. Seeking to replicate the success in free trade advocacy of President Cleveland, the Democrats nominated Woodrow Wilson (1856-1924, President 1913-1921). In keeping with the tradition of his Party, Wilson called for tariff reduction and free trade, and won the election. His Presidency encompassed the First World War (1914-1918, which America entered in 1917), and his trade policy was marked by sanctions legislation, namely, the landmark *Trading with the Enemy Act of 1917*. The Republicans would not retake the White House until 1920, under President Warren G. Harding (1865-1923, President 1921-1923).

- **1930 Smoot-Hawley Tariff**

Under President Herbert Hoover (1874-1964, President 1929-1933), the notorious *Smoot-Hawley Tariff Act* became law as part of the *Tariff Act of 1930*. As a candidate, Hoover promised weary Midwestern farmers to increase tariffs on agricultural products. The final tariff Congress enacted raised duties by an average of 20% on about 22,000 imported farm and industrial products.⁶⁴⁹ Its enactment was one of the epic trade battles in U.S. trade history. The *Act* raised duties to the highest in over 100 years. Economic historians do not say this legislation caused the Great Depression, which the October 1929 stock market crash triggered, and which was underway before the *Smoot-Hawley Tariff* entered into force. Much of the blame lies with contractionary monetary policy by the Federal Reserve and other central banks. But, they agree the *Tariff* worsened its length and depth. The only duties in American history to exceed the *Smoot-Hawley* levels were those of the 1828 *Tariff of Abominations*.

Reciprocal retaliation ensued immediately, and a trade war – in the lexicographic sense of the term, “an economic conflict in which countries impose import restrictions on each other in order to harm each other’s trade”⁶⁵⁰ – was on. Foreign governments pushed up their trade barriers, thereby exposing the vulnerability of the U.S. and all other countries to protectionism. American exports fell dramatically, exceeded only by the decrease in imports. With increased tariffs and NTBs, plus competitive FX devaluations (as each country to maintain their gold reserves, discourage imports and boost exports by cheapening the value of its currency relative to other currencies), world trade contracted

⁶⁴⁸ In *Pollock v. Farmers’ Loan and Trust Co.*, 157 U.S. 428 (1895), the Supreme Court declared the income tax provision of the *Wilson-Gorman Tariff Act* unconstitutional, because it was a direct tax that was not apportioned by population in Article I, Section 2, Clause 3.

⁶⁴⁹ See Andrew Mayeda & Bryce Baschuk, *Trump Wanted A Trade War. Here’s What One Looks Like*, BLOOMBERG, 23 March 2018, www.bloomberg.com/politics/articles/2018-03-23/trump-wanted-a-trade-war-here-s-what-one-looks-like-quicktake; Andrew Polk, *Any Trade War is Going to Be Tactical*, BLOOMBERG, 7 March 2018, www.bloomberg.com/view/articles/2018-03-08/a-u-s-china-trade-war-will-be-very-tactical-at-least-for-now.

⁶⁵⁰ COLLINS ENGLISH DICTIONARY, www.collinsdictionary.com/us/dictionary/english/trade-war (entry for “trade war”).

sharply, thus exacerbating the Great Depression. In the 1932 Presidential campaign, Franklin Roosevelt vowed to lower tariffs. He won, and the Democratic Party retained control of Congress. President Roosevelt made good on his promise to lower tariffs with the *Reciprocal Trade Agreements Act of 1934* (19 U.S.C. §1351).

The *1934 Act* changed the face of tariff negotiations and the politics of domestic legislation implementing their results. It allowed the President to seek duty reductions on a bilateral basis, which President Roosevelt and his Secretary of State, Cordell Hull (1871-1955) did immediately and successfully. Further, the *Act* treated an agreed reduction in tariffs as legislation, requiring only majority approval of both houses of Congress, rather than as a treaty requiring a two-thirds advice-and-consent vote in the Senate, as traditionally occurred.⁶⁵¹ Thus, this *Act* was a forerunner to modern “fast track” legislation. (The *Smoot-Hawley* and *1934 Acts*, and their relationship to GATT, are discussed further in a separate Chapter.)

VIII. Three Patterns

Looking back across the broad sweep of the history of American trade law and policy up to the era of the Great Depression and Second World War, three patterns are noteworthy. First, International Trade Law has had profound effects in shaping American history. Smuggling by Colonial Era merchants and control of American trade were key issues in the Revolution. Trade with foreign nations and the slave trade were contested issues in Philadelphia during the writing of the Constitution. Regional disputes over protectionist versus free trade policies were a critical factor leading to the Civil War.

The protectionist-free trade schism was at the heart of most Post-Civil War Presidential campaigns. The 1890 *McKinley Tariff* was hotly contested, and the 1930 *Smoot-Hawley Tariff* and its attendant beggar-thy-neighbor policies exacerbated the length and severity of the Great Depression. Thereafter, trade debates continued, with the failed *Havana Charter*, American participation in GATT, and entry into the WTO and FTAs. In brief, the rules America should have on foreign commerce have marked critical turning points in American political life.

Second, America hardly has a consistent free trade history. Quite the contrary, while the Founding Fathers opposed mercantilism, various trade bills in American history have been notoriously protectionist. The policy behind those bills includes the argument of protecting infant industries, coupled with outright political power battles between different regional and sectoral interests in America. Professor Douglas Irwin reviews that history in his masterful, sweeping narrative, *Clashing Over Commerce: A History of U.S. Trade*

⁶⁵¹ For a discussion of the distinctions among a (1) “treaty” (which requires Senate advice and consent for ratification by a two-thirds majority), (2) “congressional-executive agreement” (which requires approval by a majority in both houses of Congress, and (3) sole executive agreement (which lacks both Senate ratification and Congressional authorization, but is based on inherent Presidential powers in foreign relations and national security, and the binding nature of which on the U.S. is debated), see Eugene Kontorovich, *Exiting Paris: What the Climate Accord Teaches About the Features of Treaties and Executive Agreements*, 51 CASE WESTERN RESERVE JOURNAL OF INTERNATIONAL LAW issues 1 & 2, 103-118 (Spring 2019).

Policy (2018).⁶⁵² He sees three successive phases in American trade history: revenue; restriction; and reciprocity.

In the first phase, from Colonial times through the Civil War, America relied on tariffs to raise revenue. Between 1790 and 1860, 90% of federal tax revenues came from tariffs.⁶⁵³ During the second phase, from the end of the Civil War (1865) to the birth of GATT (1947), restrictive tariffs were used to protect American industry and the industrialization process. The defeat of the Confederacy spelled the loss of political power in Congress to push through the Southern free trade agenda. Northern interests agreed with James Swank, founder of the American Iron and Steel Association: “protection in this country is only another name for Patriotism.”⁶⁵⁴ The GATT and multilateralism, motivated by the disastrous experience of the Great Depression and *Smoot-Hawley* tariffs, ushered in the third phase, in which reciprocal trade liberalization characterized American policy.⁶⁵⁵ To be sure, revenue, restriction, and reciprocity always had their political champions in Congress, backed by sectional interests, throughout all three phases, *i.e.*, American trade policy never has been dominated entirely by one approach. Rather, one tendency predominated over another depending its political economy. That remains so.

Third, despite America’s rich experience in international trade, there are many compelling issues that remain legally uncertain. For instance, what power does a President have to withdraw the United States from a trade agreement? Does the President have the unilateral authority under the Constitution to terminate a Congressional-Executive agreement (*i.e.*, a foreign trade deal that was approved by the House of Representatives and Senate by a majority vote, as the *WTO Agreement* and all FTAs were)?

President Donald J. Trump (1946-, President, 2017-) said he would do just that, with respect to *NAFTA* 1.0, after signing on 30 December the *USMCA*. He thereby pressured Congress to approve the new deal (*NAFTA* 2.0), because if it did not do so, then America would be left with no deal. Trade relations (with Mexico, at least) would revert to MFN tariff levels (though with Canada the 1989 *CUSFTA*, which *NAFTA* 1.0 superseded,

⁶⁵² For the classic early account of American tariff history, see Frank. W. Taussig, *The Tariff History of the United States* (5th ed., 1910, 2010 reprint). Taussig (1859-1940), a Harvard Professor of Economics, headed the Tariff Commission, the predecessor of the ITC.

⁶⁵³ Hereinafter, *Sticking Up*.

⁶⁵⁴ Quoted in *Sticking Up*.

⁶⁵⁵ For a study “on the nature of the interactional changes that occur between a hegemonic state,” the U.S., “and its systemic regime,” GATT, “as they both evolve and change in reaction of the nature of that relationship,” see Donald G. Beane, *The United States and GATT – A Relational Study* (Oxford, England: Pergamon / Elsevier Science Ltd., 2000). *Id.*, 1. Dr. Beane defines a “hegemon” “as a state that controls the security, credit, knowledge, and productive resources among a grouping of states,” and is both able (in terms of power) and willing to maintain the essential rules that govern international relations. *Id.*, 1. Interestingly, “[i]n contrast to the central ideas of hegemonic stability theory,” Dr. Beane starts “from the primary proposition that there is a two-way relationship between a hegemon and its reciprocal regime.” *Id.* Hence, his focus is “to identify and analyze the ways in which a regime and its hegemon acted as constraints on each other’s mode of operation and evolution,” that is, “the relationship between the GATT, as an increasingly stronger and independent organization (from the influence of the United States) and the United States, as, initially the primary post-World War II world-dominating economic power and subsequently, as one of the major interstate economic powers.” *Id.*

might re-apply); in other words, North American-wide DFQF treatment would be jeopardized.

Consider the conclusion of a September 2016 Congressional Research Service analysis:

U.S. FTAs have historically been approved as Congressional-Executive agreements by a majority vote of each house of Congress rather than as treaties ratified by the President after Senate approval by a two-thirds majority vote. FTAs are not self-executing agreements. Thus, legislation is required to provide U.S. bodies with domestic legal authority necessary to enforce and comply with the agreements' provisions. FTAs are legally binding agreements under international law.

All U.S. FTAs that have entered into force ... contain provisions allowing for a Party's withdrawal from, or termination of, the FTA upon advance notice to the other Parties. Questions have arisen regarding whether the President can unilaterally withdraw the United States from such agreements without the consent of Congress. The Constitution does not specifically address withdrawal from treaties or Congressional-Executive agreements. In some cases, the United States has withdrawn from international legal agreements pursuant to the joint action of the political branches. However, the weight of judicial and scholarly opinion suggests that the President possesses the exclusive constitutional authority to communicate with foreign powers, and such authority might provide the President with a constitutional basis for withdrawing from at least some types of international agreements. The agreement's subject matter, however, might be relevant to a legal analysis. As a practical matter, the President's communication of a notice of withdrawal from an FTA to trade partners in accordance with the FTA's terms would likely release the United States from its international obligations from the effective date of withdrawal onward as provided in the [1969] *Vienna Convention on the Law of Treaties*, which the United States has not ratified but considers to reflect, in many aspects, customary international law. Congress may thus find it difficult to prevent the President from terminating or withdrawing from an FTA. On the other hand, if Congress wanted to pressure the President to withdraw, it could enact a statute (over any presidential veto) that would repeal its approval and implementation in domestic law of an FTA.

Even in the event that the President could properly withdraw from an FTA unilaterally, the President cannot make laws, and thus repeal of Federal statutory provisions implementing U.S. FTA obligations requires congressional action. Congress has enacted provisions that appear to delegate to the President authority to repeal some provisions of Federal statutory law implementing FTA obligations upon termination of, or U.S. withdrawal from, the agreement. However, the President might not be able

to exercise this authority if a court struck down such provisions as unconstitutional or Congress amended or repealed them. Although the President cannot repeal other statutory provisions implementing FTA obligations without further congressional action, if the President identified a Federal regulation, order, or practice that implemented FTA obligations, the President may be able to rely on constitutional or statutory authority to repeal or limit the effect of the measure. Such actions by the President may be subject to judicial review.⁶⁵⁶

Embedded in these issues are several others. First, who has standing to challenge a Presidential withdrawal? Second, should a Court decline to hear the challenge under the “Political Question” doctrine?

The topic of unilateral American withdrawal from a trade agreement (as distinct from a security treaty), solely by Presidential action, is unusual. In 1866, President Andrew Johnson (1808-1875, President, 1865-1869) withdrew the U.S. from the *Canadian-American Reciprocity Treaty*.⁶⁵⁷ That *Treaty*, dating from 1858, liberalized trade between American and the then-British colonies in what later became Canada. However, Congress supported President Johnson’s decision, and raised no substantive or procedural Constitutional question. President Franklin Roosevelt pulled America out of three trade deals, all on the basis they were no longer in the national interest: in 1933, the 1927 *Convention for the Abolition of Import and Export Prohibitions and Restrictions*; in 1936, a bilateral trade deal with Italy dating from 1871; and, in 1944, the 1929 *Inter American Convention for Trademark and Commercial Protection*. FDR’s Secretary of State, Cordell Hull, agreed, and Congress stayed quiet. In January 2017, President Donald J. Trump withdrew America’s signature from *TPP* on similar grounds – that *TPP* was a bad deal for the country. But, Congress never had approved *TPP*, so it had never entered into force.

Throughout his 2015-2016 campaign for the Presidency, and the 2017-2018 *NAFTA* renegotiations, which he triggered, Mr. Trump threatened to withdraw from that

⁶⁵⁶ See Brandon J. Murrill, Congressional Research Service, *U.S. Withdrawal from Free Trade Agreements: Frequently Asked Legal Questions*, CRS Report 7-5700, R44630, Summary Page (7 September 2016), <https://fas.org/sgp/crs/misc/R44630.pdf>.

On the topic of Presidential *vis-à-vis* Congressional power in trade, see, e.g., Timothy Meyer & Ganesh Sitaraman, *Trade and the Separation of Powers*, 107 CALIFORNIA LAW REVIEW 583-672(2019) (arguing “the current discontent over trade is not just a matter of the distribution of economic gains and losses but a matter of the distribution of constitutional powers,” “trade has migrated from a domestic to a foreign affairs matter – and ultimately that it has becoming unhooked even from specific foreign affairs objectives,” and “[a]s trade drifted further away from the balance struck by our separation of powers and became increasingly rooted in the Presidency, agreements liberalizing trade rules became more viable – but at the cost of the political sustainability that comes with greater congressional involvement,” and “mak[ing] a normative case for rebalancing trade within the constitutional structure,” namely, “that trade shares few similarities with other foreign affairs and national security areas in which the President is seen to have a functional advantage, and perhaps surprisingly given the conventional wisdom, that the parochial interests of Congress present strong benefits to trade policymaking that are widely undervalued”).

⁶⁵⁷ See Dr. Todd Tucker, Roosevelt Institute, Washington, D.C., *Letter – U.S. Withdrawal From Free Trade Agreements Has Precedents*, FINANCIAL TIMES, 24 October 2017, www.ft.com/content/8b61c8ee-b5bc-11e7-a398-73d59db9e399; Shawn Donnan, *Republicans Gear Up to Fight Trump Over NAFTA*, FINANCIAL TIMES, 18 October 2017, www.ft.com/content/24b802fa-b451-11e7-a398-73d59db9e399.

deal if Canada and Mexico did not agree to his demands. *NAFTA* Article 2205 allows a Party to give notice to the other Parties that it might withdraw from the deal, and after six months that Party may withdraw if it chooses to do so. (The FTA remains in force between the remaining two Parties, Canada and Mexico, and *CUSFTA*, the operation of which *NAFTA* suspended, would enter back into force between the U.S. and Mexico, hence the real economic effect of an American withdrawal from *NAFTA* would be with respect to Mexico, where tariffs on both sides would snap back to their WTO MFN levels.) Yet, in passing the implementing legislation for *NAFTA*, the 1993 *NAFTA Implementation Act*, Congress needed to amend roughly 40 different provisions in the United States Code (for example, in Chapter 28, to account for *NAFTA* Chapter 19 AD-CVD panel system in relation to U.S. courts). Some of those provisions entailed funding. So, even if the President gave notice of withdrawal to Canada and Mexico, and after six months declared a pull out, Congress would need to agree, because it would have to make many surgical statutory changes.

Appreciating patterns in American trade history helps point up inconsistencies, if not hypocrisies, in American trade policy. Consider that duty rates under the *Tariff of Abominations* are on par with levels today in some developing and least developed countries. The USTR lambasts such countries for such protectionism. But, those countries, or at least some regions or sectors in them, are today in an industrial developmental stage comparable to America in the mid-1800s. They defend their tariff policy, as did America, with arguments such as the need for infant industry protection.

Moreover, knowing American history is useful in separating truth from fiction. For example, in October 2013, Ambassador Michael Froman (1962-), the USTR for President Barack H. Obama (1961-, President, 2009-2017), declared “President Obama is pursuing what is perhaps the most ambitious trade agenda in American history....”⁶⁵⁸ That statement was dubious.⁶⁵⁹

After all, at stake in the trade debates of the 1800s was the survival of America as a nation. In contrast, the Obama Administration negotiated no new FTAs, and neither launched nor concluded the Doha Round. It did not even obtain from Congress fast track trade negotiating authority. In terms of sheer ambition to expand market access opportunities for American exports, the Uruguay Round agenda pursued by Presidents George H.W. Bush (1924-, President, 1989-1993) and Bill Clinton (1946-, President 1993-2000) are unequalled. Similarly, America entered into several FTAs during the Presidency of President George W. Bush (1946-, President 2001-2009). The point is not about

⁶⁵⁸ Len Bracken, *USTR Froman Touts Trade Agenda As Response to Slowing Global Trade*, 30 International Trade Reporter (BNA) 1712 (7 November 2013) (quoting the address of the USTR to Buttonwood Gathering, sponsored by *The Economist*, in New York on 30 October 2013).

⁶⁵⁹ For a critique of the anti-free trade sentiment that has gripped much inside-the-Washington, D.C. beltway thinking during and after the Trump Administration, and a defense of liberal trade policies, see Alan Wm. Wolff, Robert Z. Lawrence & Gary Clyde Hufbauer, *Have Trade Agreements Been Bad for America?*, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS (PIIE) POLICY BRIEF 22-17, 10 (December 2022), www.piie.com/sites/default/files/2022-12/pb22-17.pdf.

partisanship. Rather, it is that what happened in the past helps gauge present realities and future prospects.

In sum, it is both gratifying and humbling to know one's field of endeavor, International Trade Law, is of central importance in American history. That knowledge can be put to good use around the globe. Looking to the future of American trade law and policy, the changing demographics of American society may be relevant. For example, consider the September 2022 observations of Ambassador Glen S. Fukushima, former Deputy Assistant USTR for Japan and China, and former President of the American Chamber of Commerce in Japan. When asked whether America would re-enter trade agreements, given its January 2017 withdrawal from *TPP*, he replied:

I believe that the United States will, in the future, enter into trade agreements. At present, there is a strong, inward-looking “America First” mentality advocated by former President Trump.

I don't believe this will last forever. By around 2045, the United States is projected to become a minority-majority nation [the nonwhite population will outnumber the white population].

When we look at opinion polls, it's clear that the non-white population as well as younger Americans are more likely to support trade, immigration, gun control, abortion rights, measures to combat climate change – policies that will move the United States in a more open, tolerant, and global direction.

...

Japan needs to appreciate more the strategic importance of engaging with American society. Even if tensions rise between the U.S. government and the Chinese Communist Party, if strong personal bonds between Chinese and American youth and intellectuals develop and strengthen over time, China's influence in the United States will deepen.

Asian Americans are the fastest-growing ethnic group in the United States, and Pew Research Center projects that by the 2060s will outnumber African Americans. The Asian American influence on U.S. Asia policy is likely to grow, and Chinese Americans – many of whom would like to strengthen ties between the United States and China – are by far the largest group among Asian Americans. Japan needs to continue efforts to enhance American interest in and understanding of Japan.⁶⁶⁰

Simply put, as in so many dimensions of a nation's history, in its foreign economic policies, demography is – at least to some degree – destiny.

⁶⁶⁰ Quoted in Yukihiro Sakaguchi, *U.S. Will Need More Time for Trade Liberalization: Former USTR Official*, NIKKEI ASIA, 27 September 2022, <https://asia.nikkei.com/Economy/Trade/U.S.-will-need-more-time-for-trade-liberalization-former-USTR-official>.

Chapter 19

PRESIDENTIAL TRADE POWERS⁶⁶¹

I. Foreign Commerce Clause (Article I, Section VIII, Clause 3)

Foreigners and Americans alike do well to remember that American trade policy is not made by the President alone, nor forged exclusively inside the Beltway around Washington, D.C. It is the product of 435 Members of the House of Representatives, and 100 Senators. In other words, American trade policy genuinely is made in America. That is because of Article I, Section VIII, Clause 3 of the U.S. Constitution. This provision, known as the Foreign Commerce Clause, grants Congress – not the President – the power to regulate international trade.

The Congress shall have the Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States [Clause 1];

To borrow Money on the credit of the United States [Clause 2];

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes [Clause 3];⁶⁶²

Note that this power extends to what International Trade Lawyers know as Customs Law, thanks to Clause 1. That means only Congress can alter America’s tariff rates.

Thus, to ask “what does the President think about trade?” is important, but not the key question. The underlying inquiry is “what does Congress think about trade?” To this question, there is never a single answer. Representatives and Senators come from every state in the Union, each with her own views on what is the best trade policy. Many come from industrial states, where their constituents advocate for protection, much the way Northern states have throughout history. Still others come from agricultural or service-sector oriented states, where their constituents seek greater access to foreign markets for their products through low tariffs. Large, diversified states, such as California and Texas, embody a hybrid of these views, and the policy persuasion from them typically depends on which constituents can muster up support for a winning candidate.

Overall, the historical post-Second World War (1939-1945) bipartisan consensus in favor of trade liberalization broke down by the 1990s, and politicians inclined to free

⁶⁶¹ Documents References:
 (1) *Havana Charter Preamble*
 (2) *GATT Preamble*
 (3) *WTO Agreement Preamble*

⁶⁶² Emphasis added.

trader or protectionist ideology flourish in both the Democrat and Republican parties. Sometimes the easiest, but not necessarily failsafe, way to predict the stance of an individual politician is to apply the Stolper-Samuelson Theorem (discussed in a separate Chapter) to the constituencies she represents.

The result of the Foreign Commerce Clause and Capitol Hill politics is that Congress periodically delegates trade negotiating authority to the President. It would be impracticable for America to be represented by 535 Representatives and Senators at the bargaining table, or even a subset thereof. Far better to have the Executive Branch handle trade negotiations with foreign governments, subject to strictures Congress puts down through “fast track” (also called “trade promotion”) legislation. Such grants of authority are subject to the Delegation Doctrine.

II. Trade-Related Delegation Doctrine Cases

- **1974 *Consumers Union v. Kissinger***⁶⁶³

Facts:

In the decade from 1958 to 1968, steel imports increased tenfold, coming primarily from Japan and a few European countries. The consequences for the U.S. steel industry were drastic. A strong domestic steel industry is important for national security, as well as overall domestic economic health. The increased imports threatened both.

In 1968, the Legislative and Executive branches offered a few solutions. Bills with substantial backing and popularity were introduced in Congress to impose mandatory import quotas on steel.⁶⁶⁴ The Executive branch disagreed with mandatory import quotas for three reasons: (1) it saw the problem as a temporary one, needing only a temporary solution, (2) it feared imposing a mandatory quota because of the possibility of retaliation by steel-exporting countries that were GATT contracting parties, and (3) mandatory import quotas could cause serious damage to American foreign relations.

To avoid these problems, the Executive branch opted for VERs (also called “VRAs” or “OMOs”) by foreign producers. In the case, the term “voluntary import restraints” was used, but they were the same as a VER – a statement of intent by foreign producers that were unenforceable under foreign or U.S. law. The tolerable levels of steel import were set by American officials.

The State Department entered into discussions with the foreign steel manufacturers and received letters from Japanese and European producers stating their intent to limit their steel exports to the U.S. to a specified maximum for each of the years 1969, 1970, and 1971.⁶⁶⁵ After this time period, domestic industry and union representatives, as well as the

⁶⁶³ *Consumers Union of U.S., Inc. v. Kissinger*, 506 F.2d 136 (D.C. Cir. 1974). [Hereinafter, *Consumers Union*.]

⁶⁶⁴ *Consumers Union*, 138.

⁶⁶⁵ *Consumers Union*, 138.

House Ways and Means Committee, sought extensions. Extensions on the specified maximum steel imports were agreed to for the years 1972, 1973 and 1974. Consumers Union, the plaintiffs in the case consisted of users of steel, as it sought open importation – and, therefore, lower prices – of the product.

Issues:

The first issue raised by Consumers Union was an antitrust allegation against the Secretary of State, Henry Kissinger, and various foreign steel producers. However, “for all practical purposes, [it] disappeared from this case when the plaintiff, for reasons best known to itself, stipulated its dismissal with prejudice.”⁶⁶⁶

The second issue, reached on appeal, was whether the President’s actions fell under the control and requirements of *Trade Expansion Act of 1962 (TEA)*. The express purpose of the *TEA* was to stimulate economic growth for domestically produced goods in foreign markets. The *Act* gave the President the authority to enter into trade agreements with foreign governments.

Note the *TEA* created the “Special Trade Representative,” or “STR,” later renamed the USTR, as an entity within the Executive Office of the President. Placing the USTR within the White House means it cannot be relocated into the DOC without Congressional authorization. From time to time, as in the first two months of the Trump Administration, President Kennedy’s logic in favor of a specially-designated body to represent America as the lead trade negotiator has been questioned with proposals – none successful – to merge the USTR with the DOC.

Holdings and Rationale:

According to the Court of Appeals, the *Act* is a clear delegation of legislative authority to the President from Congress for a specified purpose for use in certain circumstances. It allows the President to enter into binding, enforceable agreements with foreign nations so as to restrict or boost trade. If the President uses his authority under the *Act*, then he must follow its strict requirements. The plaintiffs alleged the President had invoked trade authority properly, but failed to follow the requirements of the *Act*.

The Court found the President actually was not invoking trade authority delegated to him under the *1962 TEA* and, therefore, was not required to follow its strict rules about entering into trade agreements. The Court reasoned that because these were nonbinding, unenforceable statements of intentions from foreign manufacturers, the President had not used his *TEA* statutory authority. He simply was asking foreign trading partners for voluntary restraints on their part, and his requests had not inhibited Congress from legislating on the importation of steel. The Court also reasoned there was no question of Congressional preemption on the issue of trade regulation, nor any conflict between “exclusive congressional regulation of foreign commerce – regulation enforced ultimately

⁶⁶⁶ *Consumers Union*, 141.

by halting violative importations at the border – and assurances of voluntary restraint given to the Executive.”⁶⁶⁷

Because foreign manufacturers voluntarily gave their assent to the President, there was no violation of, or even question arising under, Presidential trade authority delegated by Congress. The President was free to negotiate with foreign market participants. If they voluntarily agree to his request, then the President had not used trade authority. If the President has not used his trade authority, then its requirements are irrelevant.

Comments:

Under Article 11:1 of the Uruguay Round *Agreement on Safeguards*, VERs are illegal. Consider why. Does the answer lie in their proliferation, non-transparency, and detrimental effects on world trade that occurred in the 1970s and 1980s?

- **1975 *United States v. Yoshida***⁶⁶⁸

Facts and Overview:

Importers of zippers from Japan brought an action challenging the validity of a 1971 Presidential *Proclamation* imposing an import duty surcharge of 10% on all dutiable items.⁶⁶⁹ The Customs Court (renamed the CIT under the *Customs Court Act of 1980*) granted the importers’ motion for summary judgment. The Court of Customs and Patents Appeals (now Court of Appeals for the Federal Circuit) agreed neither the *Tariff Act of 1930* nor the *1962 TEA* authorized the Presidential Proclamation.

However, the Appeals Court reversed, saying adoption of the *Proclamation* fell within powers granted the President under the 1917 *Trading with the Enemy Act (TWEA)* to regulate or prohibit importation of goods during period of war or national emergency. The Court also found the *Proclamation* was properly related to the powers delegated and the emergency declared, *i.e.*, a serious BOP deficit was sufficient to invoke the Presidential powers under the *TWEA*:

Yoshida’s merchandise (zippers) was imported from Japan and entered the port of New York on August 17, 25, and 26, 1971. The government levied, in addition to the standard duty under [Tariff Schedule of the United States] TSUS item 745.72, an import duty surcharge of 10% in accordance with item 948.00, which was added to the TSUS by Presidential Proclamation 4074. Yoshida challenges only the validity of Proclamation 4074.⁶⁷⁰

...

⁶⁶⁷ *Consumers Union*, 143.

⁶⁶⁸ This discussion draws on the opinion written by Chief Judge Markey in *United States v. Yoshida Int’l, Inc.*, 526 F.2d 560 (C.C.P.A. 1975). [Hereinafter, *Yoshida*.]

⁶⁶⁹ *See Imposition of Supplemental Duty for Balance of Payments Purpose*, 15 August 1971.

⁶⁷⁰ *Yoshida*, 566.

During the summer of 1971, the United States was faced with an economic crisis. The nation suffered under an exceptionally severe and worsening balance of payments deficit. The gold reserve backing of the U.S. dollar had dropped from \$17.8 billion in 1960 to less than \$10.4 billion in June of 1971, reflecting a growing lack of confidence in the U.S. dollar abroad. Foreign exchange rates were being controlled by some of our major trading partners in such a way as to overvalue the U.S. dollar. That action, by stimulating U.S. imports and restraining U.S. exports, contributed substantially to the balance of payments deficit.⁶⁷¹

To address the sizeable deficit, President Richard M. Nixon (1913-1994, President, 1969-1974) issued a *Proclamation* that (*inter alia*) added a 10% surcharge on TSUS Item 948.00.

The timing of the *Proclamation* was crucial: 15 August 1971 was the date America closed the “gold window.” America had been under threat from British and French leaders, among others, to accept their holdings of U.S. dollars for gold at the official rate of one ounce of gold equaling \$35.00. Because the dollar was the reserve currency, and because the was importing an array of merchandise in part to fuel its Wars in Vietnam and on Poverty, foreign governments had accepted the dollar as a means of payment for goods they exported to America.

But, British Prime Minister Edward Heath (1916-2005, PM, 1970-1974) and French President Georges Pompidou (1911-1974, President, 1969-1974) had enough of dollars, and were concerned about dollar-driven inflation. Why not convert those dollars into gold, as the U.S. was legally obligated to do under the then-existing fixed exchange rate system and gold standard? Had they done so, America’s monetized gold reserves would have diminished – hence, President Nixon closed the window, and issued the *Proclamation* to reverse the BOP deficit.

Issue:

The sole issue before the Court of Customs and Patent Appeals was whether the Customs Court erred, as a matter of law, in holding that the Presidential *Proclamation* was outside the authority of the President. To resolve that issue, the Appeals Court examined whether the *Proclamation* was within the scope of the President’s authority under the Delegation Doctrine. The Court said authority delegated to the President to impose a 10% surcharge must be found in either:

- (1) the termination provisions of Section 350(a)(6) of the *Tariff Act of 1930*, as amended (*Tariff Act*),⁶⁷² and Section 255(b) of the *1962 TEA*, or
- (2) the emergency powers granted by Section 5(b) of the *TWEA*, as amended.

⁶⁷¹ *Yoshida*, 567.

⁶⁷² See 19 U.S.C. § 1351(a)(6).

If the Court found that authority was delegated to the President to impose this *Proclamation* under either possibility, then the Court had to decide whether that delegation of authority was constitutional.

Holding and Rationale:

The Appeals Court agreed with the Customs Court in finding there was no authority delegated to the President to impose a 10% surcharge in the termination powers of the *Tariff Act* and *TEA*. Under the second possible source of delegated authority, the *TWEA*, the Appeals Court found the express delegation of authority to be expansive. So expansive, in fact, that Chief Judge Markey remarks in the opinion:

it appears incontestable that s[ection] 5(b) does in fact delegate to the President, for use during war or during national emergency only, the power to “regulate importation.” The plain and unambiguous wording of the statute permits no other interpretation.⁶⁷³

That was true even though the “war” President Nixon cited in 1971 was the 1950-1953 Korean War. The remaining question for the Court was how, exactly, the President may regulate importation during a national emergency.

It would be unconstitutional for Congress to delegate the full measure of its authority to regulate commerce under the Constitution, as that would be not a delegation of responsibility, but rather an abdication thereof. Accordingly, there must be limits on how the President may execute his delegated authority to remain within the confines of the Constitution.

In drafting Section 5(b) of the *TWEA*, Congress included the phrase “by means of instructions, license, or otherwise” in regards to the authority it delegated to the President. The Appeals Court read this phrase to be expansive, given Congressional intent to allow the President to make executive decisions in times of national emergency. So, the Court ruled Congress, by enacting Section 5(b), properly authorized the President during a national emergency to regulate importation by imposing an import duty surcharge or by other means reasonably related to the particular emergency declared.

The Court said Section 5(b) allowed President Nixon to impose a specific surcharge as a reasonable response to the particular national emergency he declared. The President defined the BOP deficit to be an emergency, because of its detrimental and far-reaching implications: (1) a prolonged decline in America’s FX reserves, (2) serious threat to America’s trade position, and (3) an unfavorable balance of trade. The 10% surcharge on all dutiable items was an eminently reasonable measure in light of the emergency confronted, as it had a direct effect on all 3 problems. Hence, the invocation of the delegation of authority was Constitutional.

Comment:

⁶⁷³ *Yoshida*, 573.

The surcharge proved so successful in reversing payment outflows that it was revoked within months. And, no GATT Panel case ever was lodged against the U.S., despite the probability that the 10% surcharge breached GATT Article II:1(b) tariff bindings on at least some items.

III. Presidential Trade Negotiating Authority under Fast Track (TPA)

With their many, deep schisms, WTO Members were deadlocked as they approached the 6th Ministerial Conference in Hong Kong in December 2005. They downplayed expectations about results they could achieve, urging a basic agreement on modalities would be a success. Perhaps substantive results would be had in 2006. After all, trade talks often go “down to the wire,” and the deadline was 30 June 2007, when the authority of the American President to negotiate trade agreements, under the *Trade Promotion Authority (TPA)* legislation of 2002,⁶⁷⁴ would expire.

Every minute counted. To make matters more difficult, technically, the real deadline was midnight Eastern Standard Time (EST) on 31 March 2007. That was because of a *TPA* requirement the President notify Congress 90 days before expiry of negotiating authority he will submit to it a deal under *TPA* procedures. Negotiators for *KORUS* beat this deadline by 25 minutes, with Korean and American officials signing an accord just before noon on 1 April 2007 in Seoul. The 30th of March fell on a Friday, and negotiators worked the weekend, essentially getting the benefit of an extra 24 hours – Saturday, the 31st, plus the time zone difference between Washington, D.C., and Seoul. Doha Round negotiators were not so lucky. They failed to show notable progress to meet the 90-day notice rule.

The Foreign Commerce Clause (Article I, Section 8, Clause 3) of the Constitution gives Congress the power to regulate foreign trade. It delegates this authority, subject to the delegation doctrine, to the President. The authority is bounded by a time limit, and by negotiating objectives. Typically, multilateral trade rounds last at least as long as this time limit. In exchange for accepting the boundaries and objectives Congress sets, the President receives a commitment – manifest in the legislation delegating authority, such as *TPA* – that Congress will consider any negotiating outcome under special procedural rules.

The key such rule is an “up-or-down vote” on a proposed trade deal, without any amendment to or filibuster against that agreement. The prospect of Congress amending a carefully-crafted, delicately balanced multilateral trade deal would undermine the President’s negotiating credibility with other WTO Members, hence the bargain with Congress in *TPA*-type legislation. Moreover, if foreign trade negotiators anticipate the possibility Congress will pick apart a deal they negotiate with their American counterparts, then they may be reluctant to show their “final hand” during the negotiations. Without *TPA*, Congress looms as an active player – and the one with final say on the American side – in trade talks. Why not, then, wait until Congress has examined the terms of the deal, and then get to the bottom-line positions?

⁶⁷⁴ See 19 U.S.C. §§ 3801-3813.

This question hampers progress not only on multilateral trade deals, but on regional and bilateral ones, too. For example, by the 15th round of negotiations on a proposed *TPP* in December 2012, it was clear several countries were holding back on their best concessions. They knew the Administration of President Barack H. Obama (1961-, President, 2009-2017) lacked Congressionally delegated negotiating authority to make deals on key issues that mattered to them, such as in the dairy, sugar, and T&A sectors, and on government procurement of services.

During the Uruguay Round, Congress extended the authority – originally granted in 1988, and lapsing in 1991 – for 2 years, until 15 December 1993. On that date, negotiations actually finished. Yet, the bipartisan consensus in favor of multilateral trade negotiations, which existed for most of the post-Second World War era, degenerated during and after the Uruguay Round. A Democratic Congress approved implementing legislation for this Round, the 1994 *Uruguay Round Agreements Act*, but only in a lame duck session during the Presidency of Democrat Bill Clinton, after the November 1994 elections in which Republicans retook control of both Houses.

Democrat Franklin Delano Roosevelt (FDR, 1882-1945, President, 1932-1945) was the first American President to seek trade negotiating authority, which he did before that War. He got it in the form of the *1934 Act*, the antecedent of modern-day fast track legislation. The *1934 Act* covered just tariffs. Once FDR negotiated them bilaterally with a foreign country, he did not need further Congressional approval. The deal was done. Contemporary authority is different, in that it covers many topics beyond tariffs, and mandates an up-or-down vote by Congress.

Republicans Ronald Reagan (1911-2004, President, 1981-1989) and George H.W. Bush (1924-2018, President, 1989-2001) won that authority. But, by the late 1990s, President Bill Clinton (1946-, President, 1993-2001) twice failed to win renewal of trade negotiating authority. (In 1997, the attempts were Senate Bill 1269 and House Resolution 2621. In 1998, the attempt was Senate bill 2400.) Technically, he was not the first post-War President to lack this authority: Richard M. Nixon resigned the Presidency in August 1974, before Congress renewed it, to the benefit of Gerald R. Ford (1913-2006, President, 1974-1977). After the lapse in the Clinton years, in 2002, President George W. Bush (1946-President, 2001-2009) secured *TPA*, but by only one vote. No longer can an American President, and by extension a trading partner of America, rest assured Congress will grant negotiating authority.

Thus, without a Doha Round deal by the *TPA* expiry date, the President would have to persuade Congress to extend *TPA*. That could prove difficult, if the vote on the *CAFTA* was prologue. This deal passed on 30 June 2005 in the Senate by a 54-45 vote, but cleared the House of Representatives on 28 July 2005 by a 217-215 vote. The *CAFTA* battle left many House Democrats embittered. They perceived President George W. Bush failed to consult with them on *CAFTA* terms. For them, the protection of worker rights was a key term. They believed the President surrendered strong worker rights provisions (meeting the standards of the ILO), to which Central American countries were willing to adhere, in

exchange for a “stand still” commitment to enforce effectively their existing labor laws. And, in November 2006, the Democrats took control of both chambers of Congress.

Pro-labor advocates argued (*inter alia*) *TPA* renewal should be granted only if the core text of an FTA contain an obligation to adopt and enforce ILO standards. The Bush Administration, and many Republican legislators, worried that kind of obligation could be used to challenge U.S. labor laws. They called for a safe harbor exemption. Of course, as the AFL-CIO rightly intoned, a meaningful duty with a large exemption for America would be hypocritical. By April 2007, opposition to *TPA* renewal had significant momentum. A coalition of 713 environmental, farm, and labor groups – 102 of them national organizations, and 611 from states and localities – signed a letter to leaders in the Senate and House of Representatives. The letter said even if Democratic Party proposals for enhanced environmental and labor rights, and investor protections, were incorporated into a new *TPA* bill, the fast-track procedure was too broken to be fixed. The legislature of the State of Maine reinforced the message, unanimously adopting (in April 2007) a resolution (SP 649), spearheaded by the Maine Fair Trade Campaign, opposing *TPA* as an undemocratic, exclusive, inside-the-Beltway device yielding bad trade bargains.

This momentum produced a change in presumption. American and foreign trade negotiators had assumed they must finish a deal before *TPA* expired, and notify Congress of one by 31 March 2007. Now, it seemed *TPA* would not be renewed unless they first reached a deal, or clear draft accord, which Congress could accept. That is, the mentality changed from “we need to beat the deadline” to “we need to prove why our negotiating mandate should be renewed.” In accord with this shift, in April 2007, at a New Delhi, India meeting of the Group of Four (*i.e.*, WTO G-4 in the WTO, Brazil, India, EU, and U.S.), negotiators agreed to try to show results in the Doha Round by year-end 2007.

IV. May 2007 Bipartisan Trade Deal between Congress and President

- **Key Terms**

In May 2007, after much rhetorical bluster and hard negotiations, an agreement was struck, not on *TPA*, but a possible precursor to its renewal.⁶⁷⁵ Under the Bipartisan Trade Deal (BTD) Democrats, in control of Congress following the November 2006 elections, agreed to consider passage of bilateral FTAs negotiated with Panama and Peru, but not necessarily Colombia or Korea. (Ultimately, Congress passed all four deals, which arguably incorporated the key elements of the BTD.) Republicans agreed that henceforth, all trade agreements must include in their core text the following terms:

- (1) A commitment by each FTA party to “adopt, maintain, and enforce” in its

⁶⁷⁵ See Amy Tsui, Labor, *Administration in Intense Engagement on TPP, but AFL-CIO Concerned About Talks*, 29 International Trade Reporter (BNA) 181 (2 February 2012); Rossella Brevetti, *Democratic, GOP Law makers Reach Agreement with Administration on FTAs*, 24 International Trade Reporter (BNA) 674-75 (17 May 2007); Rossella Brevetti, *Administration Drafting Legal Text for Labor/Environment Deal with Congress*, 24 International Trade Reporter (BNA) 675-676 (17 May 2007); Rossella Brevetti, *AFL-CIO, USW Give Cool Response to Labor Deal on FTAs; Teamsters Opposed*, 24 International Trade Reporter (BNA) 676-677 (17 May 2007).

domestic law the five ILO core labor standards set out in the 1998 ILO *Declaration on Fundamental Principles and Rights at Work*, namely, the (1) freedom of association (including the right to organize), (2) right to bargain collectively, (3) elimination of all forms of compulsory (*i.e.*, forced) labor, (4) effective abolition of child labor, and (5) elimination of employment and occupational discrimination.

- (2) Authorization for an FTA party to condition central or sub-central government procurement contracts on adherence to the ILO *Declaration*.
- (3) A commitment by each FTA party to “adopt, implement, and enforce” in its domestic laws the obligations contained in seven major multilateral environmental agreements (MEAs), including the *Convention on International Trade in Endangered Species (CITES)* and *International Whaling Convention (IWC)*.
- (4) Enforcement of labor and environmental obligations through government (but not private party) action under FTA dispute settlement provisions, with the burden of proof on the complaining government to show the respondent has engaged in a “sustained or recurring course of action or inaction” (*i.e.*, a persistent pattern of violation) in respect of a labor or environmental obligation, which has an impact on trade or investment.
- (5) A prohibition against an FTA party using inadequate resources, or alternative priorities, as a defense in a case in which it is accused of failing to enforce labor laws relating to the ILO *Declaration*.
- (6) A conflict of laws provision that bars an FTA party from using as a defense an FTA provision to undermine MEA obligations, in a case in which an MEA affects performance of an FTA obligation.
- (7) A prohibition against any FTA party lowering labor or environmental laws.
- (8) Use of penalties for violations of labor or environmental obligations that are the same as for breaches of other FTA duties.
- (9) Allowance for faster access to generic medicines, especially for poor countries that are parties to an FTA, essentially by (1) modifying data exclusivity period (*i.e.*, the period during which the manufacturer of a generic drug is barred from using clinical test data from the innovating company) to 5 years in most cases (with expiration of the period in an FTA party at the same time as in the U.S., if the period already commenced), (2) ensuring data exclusivity rules do not prevent a party from taking a measure to protect public health, or invoke WTO authorizations, (3) eliminating any requirement that a drug regulatory agency withhold approval of a generic until it certifies marketing of the generic would not violate any existing

patent, and (4) removing any rules that obligate an FTA party to extend the term of a patent on a pharmaceutical product to account for delays in the process of approving the patent.

- (10) Clarification the U.S. has full authority to bar a foreign company from operating an American port, based on national security concerns, and exercise of this authority may not be challenged under the FTA.

Indubitably, the BTD among Democratic and Republican legislators, and the White House, evinced the declining authority of the President in setting the trade policy agenda, and concomitant reassertion by Congress of its Constitutional duty under the Commerce Clause (Article I, Section 8, Clause 3 of the Constitution) to regulate foreign trade. Indubitably, too, the May 2007 accord heralded a critical shift from the approach to labor and environmental issues taken in the 1990s and at the turn of the Millennium, as manifest in the *NAFTA* 1.0 and other FTAs to which the U.S. was a Party. Express invocation of the *ILO Declaration* and MEAs, and preclusion of certain defenses, are substantive differences – at least on paper.

The May 2007 agreement included a Strategic Worker Assistance and Training (SWAT) Initiative. SWAT extends beyond TAA, to encourage education, training, and portability of health and pension benefits for entire communities injured by the effects not only of trade liberalization, but also technology. This encouragement was not enough to bring major American labor unions to support either FTAs or Doha Round talks. The AFL-CIO, United Steel Workers of America (USW), and Teamsters expressed alarm at job outsourcing associated with trade liberalization, and skepticism about the extent to which enhanced labor provisions would improve meaningfully the lives of workers abroad.

Not surprisingly, the above-listed points in the May 2007 BTD reflect the positions of powerful lobbying groups, such as Americans for Democratic Action, Friends of the Earth, TransAfrica Forum, labor unions, and the Coalition of Service Industries (CSI). Query, whether this deal could be a “Trojan Horse”? Might international labor or environmental rules, beyond obligations specifically mentioned, creep into FTAs? Apparently eager to avoid incremental importation of other rules, the U.S. urged the only obligation concerned the *ILO Declaration* (and, presumably, the referenced MEAs), and that it was in full compliance.

But, in September 2009, the lobbying groups argued to the Administration of President Barack H. Obama the BTD did not go far enough. They called for a new approach to trade, which – in addition to the above points – would:

- (1) Eliminate trade promotion authority and expand Congressional oversight on trade issues.
- (2) Review all existing FTAs to address labor and environmental concerns, and assist constituencies that have not benefited from those deals.

- (3) Ensure any new FTA –
- (a) Addresses the worst forms of abusive child labor, as set out in ILO Convention 182, which 171 countries ratified in 1999 to deal with the reality that millions of children work in drug trafficking, pornography, prostitution, as slaves, and in other degrading or illicit activities.
 - (b) Prohibits trade in illegally harvested resources.
 - (c) Eliminates extraordinary foreign investor privileges, to ensure parity of treatment so that multinational enterprises are not given greater rights than domestic firms.
 - (d) Permits the U.S. to maintain “Buy American” clauses in its government procurement rules, insists on reciprocal access to government procurement markets, and requires such procurement not undermine environmental, labor, or human rights.
 - (e) Allows the U.S. to ban importation of food that fails to meet or exceed safety standards of the FDA.
 - (f) Authorizes the U.S. to ban importation of non-food merchandise that fails to meet or exceed safety standards of the Consumer Product Safety Commission (CPSC).
 - (g) Expands market access opportunities for American service providers, as 95% of services consumers live outside the U.S., and nearly 80% of American output and jobs is in the services sector.

The proposed 2009 *Trade Reform, Accountability, Development, and Employment (TRADE) Act* (H.R. 3012, S. 2821) manifested this call. Moreover, frustrated by the large number of labor rights cases stymied by murky loopholes and weak enforcement provisions, the AFL-CIO sought greater transparency, and stronger dispute settlement mechanisms, in any new FTA.

- **Fast Track Renewal, Finally?**

Throughout the first term of his Presidency, Barack H. Obama never sought *TPA* renewal. Shortly after re-election, in March 2013 when the USTR issued its annual *Trade Policy Agenda and Annual Report*, the Administration pledged to work with Congress on a *TPA* bill. But, it did not specify a date for submitting legislation.

Early in his second term, the AFL-CIO adopted at its 2013 quadrennial convention a resolution calling for abolition of fast track. It came to the conclusion that fast track had been abused by corporate interests, at the expense of working people – the 1%, to the detriment of the 99%. What was needed, said the AFL-CIO, was a new approach to trade that enforced American trade remedy rules, dealt with currency manipulation by other countries (to subsidize their exports), repaired and upgraded America’s port infrastructure, and – most importantly prioritized incomes of families on Main Street over bonuses on Wall Street.

Finally, in January 2014, Congress considered a *TPA* bill – the *Bipartisan Congressional Trade Priorities Act of 2014 (BCTPA)*, a proposed 4-year extension of Presidential trade negotiating authority introduced simultaneously in the Senate and House.⁶⁷⁶ This bill included not only the elements from the May 2007 *BTD*, such as a requirement for stronger labor and environmental provisions that were updated to reflect America’s newest FTAs, but also issues that since then had gained in prominence. Most notably among them were electronic commerce (both facilitating it while protecting cross-border data flows), SOEs (subjecting them to commercial disciplines), and currency manipulation (prohibiting it). Congress also required the USTR to consult and report with it, with provisions mandating every Senator and Congressman have access to negotiating texts, and accrediting any and all of them as negotiators (as opposed to a cap of 5 from each Committee of pertinent jurisdiction). The *BCTPA* also forbade any changes to U.S. law without express Congressional action, meaning no FTA rules could be self-executing. And, the bill allowed for Congress to pass a disapproval resolution retroactively, whereby fast-track procedures would not apply.

However, an argument against the bill was it was outdated. No longer were trade negotiations focused mainly on conventional tariffs or NTBs like QRs for which customs authorities were responsible. Rather, they were about post-border regulatory barriers to market access, how legislatures and supervisory agencies handle issues such as banking safety and soundness, food safety, digital trade, and data privacy, whether border protection is adequate, upgrading labor and environmental rules, and fighting currency manipulation. All such matters had to be treated with a view to helping the middle class advance in socioeconomic status. So, the idea of a single, up-or-down no amendment vote on an FTA in Congress following negotiations conducted nearly in their entirety by the Executive Branch was outmoded.

What is needed, said Senate Finance Committee Chairman Ron Wyden (Democrat-Oregon) in April 2014 to the American Apparel & Footwear Association, was to break through the dialectic of “fast track” and “no track,” and move to “smart track.” A smart track would give Congress greater say in selecting FTA partners, enhance transparency of trade negotiations, emphasize 21st century issues, require Congressional certification that negotiating objectives it sets are met before an FTA is concluded, and thus lead to greater public accountability of the USTR than orthodox delegation of trade negotiating authority.

- **Gridlock until October 2011 over FTAs, TAA, and GSP**

Whatever the track, many politicians, and the lobbying groups to which they responded, had *sui generis* demands to be met before they would endorse certain FTAs. Colombia needed to improve its labor and human rights record. Korea needed to grant more favorable treatment to American automobiles, and deregulate further its financial sector. Panama needed to cease holding itself out as an international tax haven. Absent these changes, the groups vowed to fight not only these FTAs, but also any trade agreement – including a Doha Round accord.

⁶⁷⁶ See House Resolution 3830 and Senate Bill 1900.

And so, they did. They blocked trade legislation right through until October 2011, when President Barack H. Obama finally submitted the Colombia, Korea, and Panama FTAs to Congress. As the Administration of President George W. Bush had negotiated these FTAs under *TPA* procedures, each was entitled to, and did, receive an up-or-down, no-amendment vote within 90 days of its submission to Congress.

Legislative action on the FTAs was itself a saga involving months of negotiations between the White House and Capitol Hill. On one side, the President wanted renewal of TAA. TAA reforms enacted in 2009 had expired in February 2011, so benefits to dislocated workers were cut to 2002 funding levels (commensurate with the previous major TAA bill). He also sought *GSP* renewal, which had expired in December 2010.

On the other side, many in Congress either did not want renewal of the TAA or *GSP* schemes, or sought to scale back the generosity of their benefits by cutting funding to TAA and limiting the scope of beneficiary countries and eligible products entitled to participate in the *GSP*. For them, FTA passage was a pre-condition to TAA or *GSP* renewal, because expanded market access in Colombia, Korea, and Panama would help boost American output, employment, and incomes. Buttressing this argument were the facts that (1) on 1 July 2011, the EU FTA with Korea took effect, (2) on 15 August 2011, Canada implemented an FTA with Colombia, and (3) by fall 2011, Australia and Canada were in advanced stages of inking an FTA with Korea. So, exports like Kansas wheat were at a competitive disadvantage in certain foreign markets (*e.g.*, Colombia), to which third-country competitors (*e.g.*, Canada) had duty-free, quota-free access by virtue of their FTAs.

In October 2011, the Executive and Legislative branches agreed on a compromise procedure: the President would submit, and Congress would consider, the FTAs, and renewal of TAA and *GSP*, in tandem. These branches agreed on the phrase “tandem passage,” which was intentionally ambiguous to elide over procedural issues such as allocation of time for debate on the various bills, and consideration of the FTAs, but not the TAA and *GSP*, under *TPA* procedures. That month, with Congressional passage and Presidential signature of all the legislation, America finally added 3 new FTA partners, and restored retroactively TAA and *GSP* benefits. Also included in the *Colombia FTA* implementing legislation was *ATPA* renewal.

The compromise still did not give the President fast track negotiating authority, which indubitably hurt the U.S. in *TPP* and *T-TIP* negotiations. The countries with which the U.S. negotiated could not be certain any concessions they obtained would not be undone by Congressional amendments once the House and Senate looked at the supposedly final trade agreement. Congress (in particular, the Senate Finance Committee), however, replied to a July 2013 request from President Obama for renewal of *TPA* by linking it to TAA reform.

The October 2011 compromise did not carry through to the 2014 *BCTPA* legislation. As soon as it was introduced, Republicans vowed to reject it if it was linked to an extension of TAA, whereas Democrats demanded linkage in return for their support. Indeed, the day after the *BCTPA* was tabled, Democrats introduced an alternative *TPA* bill

they said better addressed the trade concerns of the American middle class.

V. 2015 TPEA Fast Track Renewal at Last, but with Unbundling

In April-May 2015, Congress tried again, with *The Bipartisan Congressional Trade Priorities and Accountability Act of 2015* (Senate Bill 995, House Resolution 1890).⁶⁷⁷ The *Act* was a bipartisan effort, in that its sponsors were Republican Senator Orrin Hatch (Utah), Chairman of the Senate Finance Committee, Ranking Finance Committee Democrat Senator Ron Wyden (Oregon), and Republican Representative Paul Ryan (Wisconsin), Chairman of the House Ways and Means Committee. But, their co-sponsorship did not mean the *Act* enjoyed broad support across party lines. Many free-trade oriented Republicans supported the *Act*, and *TPP* and *T-TIP*, while most Democrats opposed these proposals, thus opposing a President from their party (Barack H. Obama).

In this *Act*, Congress gave a 6-year life to “fast track,” but set specific objectives for trade negotiations on *TPP* and *T-TIP*, and mandated transparency enhancements:

- (1) Objectives:
Among the 150 listed negotiating priorities, new trade pacts would have to contain provisions protecting labor, environmental, and human rights, fight currency manipulation, put disciplines on SOEs, limit the use of localization requirements, and eliminate barriers to digital trade in goods and services to ensure information could flow freely across the Internet.
- (2) Transparency:
The USTR would have to consult with Congress on trade negotiations, publish regular summaries of proposed trade agreement texts, and allow Senators and Congresspersons direct access to the talks. As with previous fast track legislation, the President would have to notify Congress that any new agreement is complete at least 90 days before he intends to sign it. But, unlike previous TPA rules, any new trade pact would have to be released publicly at least 60 days before the President signed the pact and sent it to Congress.⁶⁷⁸ That would ensure Congress had full access to the text of the accord. Thereafter, Congress could not begin considering the deal, or vote

⁶⁷⁷ As per the discussion below, the *Act* was passed and became Public Law 114-026, 129 Stat. 319 (29 June 2015), Title I.

⁶⁷⁸ It is erroneous to think the final, agreed upon text of a trade deal is set the moment negotiations are concluded. Typically, the language that is the basis for finishing negotiations needs changes, to clarify ambiguities, amplify certain matters, and remove stray points. Thus, after talks wrap up, “ironing out” language occurs over several days, or weeks, during which some give-and-take on substantive matters may happen. The exact number of days between (1) completion of negotiations and (2) publication of a final text varies according to factors such as the state of the text when talks finished, the complexity of the provisions, the number of parties. In the U.S. experience, texts were published in as quickly as 12 days (the *Oman FTA*) and as long as 113 days (the *Chile FTA*). Before *TPP*, the average was 43 days. See Krista Hughes, *Pacific Trade Pact Details Could be Released this Week: Source*, REUTERS, 4 November 2015, www.reuters.com/article/2015/11/04/us-trade-tpp-idUSKCN0ST28W20151104. The *TPP* text was published on 5 November 2015, exactly 30 days after the negotiations finished (5 October 2015), thus lowering the average.

on it, for at least 30 days. These periods summed to a 180-waiting period, or 6 months – which, in effect, pushed *TPP* and *T-TIP* into the 2016 Presidential election cycle.

In respect of human rights, the Senate Finance (but not the House Ways and Means) Committee voted an amendment to the bill stripping fast track authority for trade deals with a country the State Department classified as a “Tier 3” offender of standards against human trafficking under the *Trafficking Victims Protection Act (TVPA)* of 2000. That affected one *TPP* participant, Malaysia.

Congress also warned in the *Act* it could revoke “fast track” consideration of any trade pact, if a requisite number of legislators felt the President had neglected the negotiating objectives or failed to consult with it.

Contemporaneously, Congress considered separate bills to extend TAA (including an IRC amendment to extend and modify the health insurance tax credit in TAA), renew the *GSP* and *AGOA* programs, and renew a special preferential duty program for Haiti. Agreement to consider TAA extension along with Presidential trade negotiating authority – though not in the same bill, in contrast to the Kennedy-era 1962 *TEA* and Nixon-era 1974 *Trade Act* – was crucial in breaking a deadlock among the co-sponsors and their parties.

In May 2015, after bitter procedural maneuvering, the Senate passed the *Act* and TAA extension on a 62-37 vote. An effort by Senator Jeff Flake (Republican-Arizona) and like-minded Republicans to deny TAA extension failed on a 63-35 vote, as Democrats insisted they would not support TPA without TAA in tandem.

The *Act* garnered immediate opposition. For example, ISDS procedures in *TPP* triggered provoked controversy. Senators Elizabeth Warren (Democrat-Massachusetts), Heidi Heitkamp (Democrat-North Dakota) tried via an amendment to the *Act* to bar use of fast track approval for any FTA, including *TPP*, which contained an ISDS mechanism. The Senate defeated this effort.

Even more heatedly, critics charged the provision in the *Act* on currency manipulation contained only an exhortation not to engage in such behavior, but did not compel FTA Parties to follow IMF currency rules, and lacked a reliable enforcement mechanism. They were correct. The Senate expressly rejected by a 51-48 vote a currency manipulation amendment proposed by former USTR Senator Rob Portman (Republican-Ohio) and Senator Debbie Stabenow (Democrat-Michigan) that had an enforcement mechanism. Under that state-to-state mechanism, the U.S. could sue an FTA party for manipulating its currency to increase its exports. The Portman-Stabenow proposal defined “currency manipulation” according to IMF standards, as its sponsors pointed out all *TPP* negotiating countries were IMF members. Yet, the Senate rejection came amidst President Obama’s threat to veto the *Act* if it had an enforcement mechanism, which it claimed (rather vaguely) would be illegal under International Law.

In lieu of this proposal to prevent “currency wars,” the Senate approved by 70-29

an amendment offered by Senators Orrin Hatch (Republican-Utah) and Ron Wyden (Democrat-Oregon). The *Hatch-Wyden Amendment* had no enforcement mechanism against currency manipulation. It merely directed American trade negotiators to use tools they believed were most effective to deal with unfair currency practices. Its sponsors said the Amendment preserved the autonomy of the Federal Reserve and Department of Treasury with respect to monetary and FX policy, respectively, *i.e.*, avoiding foreign countries branding the U.S. as a currency manipulator.

The destiny of the TPA legislation, and TAA renewal packaged with it, in the House was uncertain. The House considered the package in June 2015, but unbundled it into three bills. The House (1) rejected the TAA bill (302-126), but passed the (2) TPA and (3) trade enforcement and customs bills (219-211, and 240-190, respectively). The House allowed for reconsideration, but its TAA rejection put TPA in doubt, and itself was unprecedented. For the first time since the Kennedy Administration, labor groups intentionally opposed TAA to defeat fast track. They argued it was better to save a job by rejecting TPA (and, by extension, *TPP*), than to lose a job to another post-*NAFTA* FTA and beg for TAA (which was underfunded anyway).

The following week, TPA proponents in the House countered with a vote on TPA alone, which they narrowly won (218-208). That bill (House Resolution 2146) covered not only *TPP*, but also *T-TIP* and the plurilateral *TISA*, as it granted fast track negotiating authority for 6 years, and essentially applied retroactively to these accords, which the Obama Administration was negotiating.⁶⁷⁹ The House action sent the TPA bill, without TAA, to the Senate for approval (which was required because the Senate had passed the TPA-TAA package). The Senate voted by the slimmest required margin to invoke cloture (60-37), meaning to end debate on TPA and thus prevent an expected filibuster against it, and passed the stand-alone measure narrowly. The President had promised to sign TPA only if it was accompanied by TAA, so with both chambers passing TPA alone, he needed both of them to pass a stand-alone TAA measure.

The process of unbundling TPA, TAA, and trade enforcement and customs, and renewing *AGOA*, disgusted even some legislators. Texas Senator and 2016 Republican Presidential Candidate Ted Cruz, who supported free trade, switched his vote on the cloture motion (*i.e.*, to allow a filibuster), and voted against TPA, writing:

As a general matter, I agree (as did Ronald Reagan) that free trade is good for America; when we open up foreign markets, it helps American farmers, ranchers, and manufacturers.

But TPA in this Congress has become enmeshed in corrupt Washington backroom deal-making, along with serious concerns that it would open up the potential for sweeping changes in our laws that trade agreements typically do not include.

⁶⁷⁹ Complicating matters further, but evincing the lengths to which proponents had to go to get TPA passed, the bill was attached to legislation about pensions for public sector employees, hence the overall name of H.R. 2146 was “Defending Public Safety Employees’ Retirement Act.”

...

First, WikiLeaks subsequently revealed new troubling information regarding the *Trade in Services Agreement*, or *TiSA*, one of the trade deals being negotiated by Obama.

Despite the administration's public assurances that it was not negotiating on immigration, several chapters of the *TiSA* draft posted online explicitly contained potential changes in federal immigration law. TPA would cover *TiSA*, and therefore these changes would presumably be subject to fast-track.

...

Second, TPA's progress through the House and Senate appears to have been made possible by secret deals between Republican Leadership and the Democrats.

...

There's too much corporate welfare, too much cronyism and corrupt deal making, by the Washington cartel. For too long, career politicians in both parties have supported government of the lobbyist, by the lobbyist, and for the lobbyist – at the expense of the taxpayers.⁶⁸⁰

Nevertheless, the Senate passed the House's stand-alone version of TPA (60-38).

In the final legislation – *i.e.*, the *Act* – Congress mandated a 90-day notice period before which the President could sign a new trade deal. That is, the President could not actually sign a deal until 90 days after notifying Congress of his intent to sign that deal. Thereafter (*i.e.*, following the signing date), the President had to wait 30 days before he could submit implementing legislation that contained any and all changes to domestic statutes necessary because of obligations under the new FTA. Once the President submitted implementing legislation, Congress had 90 days (specifically, legislative days) to vote. Congress also required the President submit a *Statement of Administrative Action* with legislation to implement a deal, and provide economic studies (undertaken by the ITC) of the effects of any deal on specific industry sectors and consumers, plus assessments about environmental and employment consequences of a deal.⁶⁸¹

The Senate and House then followed up by passing TAA – via the *Trade Preferences Extension Act of 2015*, or *2015 TPEA*, House Resolution 1295. They did so by a voice vote in the Senate, and 286-138 in the House. TAA was divorced from TPA, but incorporated *GSP* and *AGOA* renewal – a deliberate if cynical linkage to win Congressional Black Caucus support. Having sided with pro-free trade Republicans and business interests, and out-manuevered members of his own party who, after 20 years of experience with

⁶⁸⁰ Exclusive – Ted Cruz: *Obamatrade Enmeshed in Corrupt, Backroom Dealings*, BREITBART, 23 June 2015, posted at www.breitbart.com/big-government/2015/06/23/exclusive-ted-cruz-obamatrade-enmeshed-in-corrupt-backroom-dealings/.

⁶⁸¹ So, for example, with *TPP*, negotiations finished on 5 October 2015. The text was finalized and published on 5 November 2015, on which date the President notified Congress of his intent to sign the deal. The formal signing thus could not occur for 90 days after 5 November 2015, *i.e.*, until after 3 February 2016. It took place in Auckland, New Zealand, the official depository of the *TPP* text, on 4 February 2016.

NAFTA, were bitter about the effects of trade liberalization on the middle class and manufacturing sector workers, President Obama signed all the bills on 29 June 2015.

Thus ended a fast track negotiating authority drought of five years. Thus also was renewed aid for dislocated workers that otherwise would have expired in September. The bill President Obama signed applied TPA to any trade agreement completed before 1 July 2018. It also included a built-in extension period, namely, the President need only request Congress extend fast track authority, and unless Congress rejects the request, the authority lasted until 1 July 2021. President Donald J. Trump (1946-, President, 2017-2021) made such a request, and Congress did not disapprove it. President Joseph R. Biden (1942-, President, 2021-) did not try to renew this authority.

- **2015 *ENFORCE Act***

Unbundling did not end the disputes over (1) currency manipulation, (2) climate change, or (3) immigration, and a new controversy, human trafficking, emerged. Through the fall 2015, the chambers struggled to agree on a trade enforcement and customs bill, formally entitled the *Trade Facilitation and Trade Enforcement Act of 2015*, or 2015 *TFTEA* (House Resolution 644), sometimes called the “2015 *TEA*,” or “2015 *ENFORCE Act*.” The Senate and House versions of the customs bills differed on each point.

On the first topic, only the Senate version mandated DOC to investigate currency manipulation as a countervailable subsidy. The House version obliged the President to implement specific sanctions against any country that failed to correct its undervalued currency, such as barring that country from OPIC financing or government procurement. The House version did not incorporate the ideas of a long-standing, prominent voice on trade, Representative Sander Levin (Democrat-Michigan), namely, to build on the Senate bill by adding the IMF definition of “currency manipulation,” creating an independent panel to determine if a foreign country engages in such manipulation, and if so, whether that manipulation nullifies or impairs benefits to the U.S. under a trade agreement. On the second, third, and fourth topics, only the House version had provisions.

Via joint conference committee, compromise was reached in late 2015. In December 2015, the House passed the 2015 *ENFORCE Act* with a vote of 256-158. This major legislation modernizes CBP procedures, promotes trade facilitation, and most importantly both prioritizes trade remedy enforcement. Among its key features are:

- (1) Trade Facilitation

The *ENFORCE Act* increased the *de minimis* threshold from \$200 to \$800, meaning CBP no longer would collect tariffs on any shipment of merchandise valued at below that threshold. Interestingly, \$800 is the same level for individuals U.S. citizens and permanent residents returning from overseas. By raising the threshold for commercial transactions, legislators hoped to minimize administrative burdens on CBP and facilitate cargo shipments. The amount of tariff revenue from such small transactions was

not worth the cost of collection.

(2) Duty Evasion

The *ENFORCE Act* strengthened rules on duty evasion to help CBP fight circumvention of AD-CVD remedies. “Duty evasion” refers to bringing merchandise into the customs territory of the U.S. in a materially false manner, or a way that leads to the diminution or elimination of applicable AD duties or CVDs. Any “interested party,” *i.e.*, an importer, producer, wholesaler, exporter, union, or trade association, or a Federal agency, can ask CBP to look into duty evasion. CBP has 15 days to decide to initiate an investigation about alleged AD-CVD duty evasion, which it must do if the information provided to it “reasonably suggests” merchandise subject to an AD-CVD order is entering the U.S. avoiding the duties, or has entered the within 1 year prior to the allegation of duty evasion.

If CBP cannot decide whether the affected articles are subject merchandise under an extant AD-CVD order, then it must refer the issue to DOC, which has 300 days (from the date an investigation is initiated, with a possible 60 day extension) to determine if duty evasion is occurring. The DOC determination is subject to judicial review. In instances in which CBP finds duty evasion, the remedy is to collect the duties that ought to have been paid. Such collection may be had through suspension of liquidation of entries (for the duration of the evasion investigation pending a DOC determination of duties owed), posting a cash deposit or single entry bond, or a civil or criminal investigation by DHS (specifically, ICE). If the party liable for the duties disputes them, then it may request a *de novo* duty evasion review by CBP, and ultimately appeal to the CIT.

(3) IPR Enforcement

The *ENFORCE Act* boosted efforts to fight IP piracy. It authorized CBP to share information with the owner of copyrighted or trademarked merchandise that CBP suspects is infringed on by imported articles. That information can include samples, pictures, labels, or packaging of the dubious imports.

(4) Child Labor Enforcement

Following widespread calls to end the “Consumptive Demand Exception,” (discussed in a later Chapter), the *ENFORCE Act* strengthened enforcement provisions to ensure products made from convict, forced, indentured, or child labor do not enter the U.S. In particular, it closed the Exception under the 1930 *Tariff Act*, meaning that even if U.S. production of an article is insufficient to meet domestic demand, that article cannot be imported if it is made with child labor.

(5) Trade Remedy and IPR Enforcement Structures

The *ENFORCE Act* set up new institutional structures to sharpen trade remedy enforcement. It established the Trade Enforcement Trust Fund, Trade Remedy Law Enforcement Division within the CBP Office of Trade, and an Interagency Center on Trade Implementation, Monitoring and Enforcement housed at USTR. It also created a National Intellectual Property Rights Coordination Center within ICE at DHS, and a new USTR position with the rank of Ambassador, the Chief Innovation and Intellectual Property Negotiator, to negotiate and enforce IPR agreements.

(6) Currency Manipulation

Currency manipulation to punitive CVDs were not linked in the *ENFORCE Act*. Instead, the *Act* mandated that Treasury Department specify criteria for “currency manipulation,” and provide biannual reports to Congress about international FX policies. It also required the President to negotiate with countries allegedly manipulating their currency. If such talks fail, the President may impose certain remedies, such as prohibiting firms from a currency manipulating country that failed to rectify its undervalued currency or trade surplus from government procurement goods or services contracts, and financing of new projects by OPIC. Further, the *Act* established a new institutional structure to deal with currency manipulation, namely, an Advisory Committee that must counsel the Treasury Department on international exchange rate policy.

(7) Climate Change

The *ENFORCE Act* amended previously-enacted TPA legislation (the 2015 *Act*). The changes weakened the ability of a President to use a trade agreement as a device to combat climate change or human trafficking. As regards climate change, the amendment clarified that provisions on greenhouse gas emissions may not be included in any trade agreement evaluated by Congress under the TPA fast-track procedures. Indeed, as a negotiating objective, a trade agreement must not obligate the U.S. to adopt any greenhouse gas measures.

(8) Human Trafficking

The *ENFORCE Act* also amended the TPA legislation on human trafficking. The amending language weakened the TPA rule that barred the U.S. from entering into a trade agreement with a Tier 3 country categorized in Tier 3 under the *TVPA*, *i.e.*, a country that does not “fully comply with the minimum standards” of the *TVPA*, and is not “making significant efforts to do so.” Instead, the U.S. could consummate a trade deal under fast-track

authority with a Tier 3 country if that country “has taken concrete actions” to implement the “principal” of the State Department recommendations for changes.

In February 2016, the Senate approved the *ENFORCE Act* by a 75-20 margin, the third of the three unbundled elements. Thus ended the bipartisan consensus practice since the 1960s and 1970s of enacting an integrated, balanced package covering negotiating authority, TAA, and customs matters.

Chapter 20

GATT ROUNDS THROUGH 1970s⁶⁸²

I. 1929-1945: Depression, Isolationism, and War

- 1941 *Atlantic Charter*

GATT was neither an accident nor an afterthought. The U.S. Department of State had conceived a design for a post-Second World War international economic order that included a multilateral trade body. An early version of the blue print was published as *U.S. Proposals* in DEPARTMENT OF STATE PUBLICATION NUMBER 2411 (1945). A subsequent version came out as *U.S. Suggested Charter* in DEPARTMENT OF STATE PUBLICATION NUMBER 2598 (1946).⁶⁸³ In drawing up such plans, the U.S. worked closely with its steadfast ally, the U.K.

Meeting on the *U.S.S. Augusta*, which was anchored in Placentia Bay, off the coast of Ship Harbor, Newfoundland in August 1941, President Franklin Delano Roosevelt (1882-1945, President, 1933-1945) and Prime Minister Winston S. Churchill (1874-1965, Prime Minister, 1940-1945, 1951-1955). It was their first meeting. Their agenda was to write down goals for the post-Second World War World. FDR hoped for self-government among colonized and occupied countries. Churchill hoped FDR would commit America fully to the War effort. The result was the *Atlantic Charter*, which Churchill said would “reassure the world of our righteous purpose in wartime.”

Among the eight points of the *Atlantic Charter* were the seeds for GATT. America and Great Britain sought:

⁶⁸² Documents References:
 (1) *Havana Charter Preamble*
 (2) *GATT Preamble*
 (3) *WTO Agreement Preamble*

For an excellent two-volume collection of classic publications (articles and book chapters), authored principally by economists, on world trade history from approximately the early 1800s to the birth of GATT, see Kevin H. O’Rourke ed., *The International Trading System, Globalization and History* (Cheltenham, U.K.: Edward Elgar Publishing Limited, 2005). Volume One covers Overviews, War and Peace, Late Nineteenth-Century Backlash, and Contemporary Views of Interwar Disintegration. Volume Two covers Hegemony, Non-Discrimination and Reciprocity, Customs Unions and Preferential Trading Agreements, and Trade Wars and Trade Rivalry. Concerning the origins and development of GATT and Bretton Woods institutions (i.e., the IMF and World Bank), see Orin Kirshner ed., *The Bretton Woods-GATT System – Retrospect and Prospect After Fifty Years* (Armonk, New York: M.E. Sharp, 1996). For a fascinating oral history by 35 U.S. trade policymakers of GATT and the Kennedy and Tokyo Rounds, see Alfred E. Eckes, Jr. ed., *Revisiting U.S. Trade Policy – Decisions in Perspective* (Athens, Ohio: Ohio University Press, 2000).

⁶⁸³ See *Suggested Charter for an International Trade Organization*, United States Department of State, Commercial Policy Series, Number 93 (1946).

“the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic development and social security” and, “with due respect for their existing obligations,” aim “to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade in the raw materials of the world which are needed for ... economic prosperity.”⁶⁸⁴

That the two wartime leaders could focus on a post-Second World War economic order, and plan for it, at a time when victory over the Axis Powers hardly was assured, is a testament to their great vision. Indeed, America had not yet even entered the War: Pearl Harbor did not occur until 7 December 1941. In August, Britain stood alone against Nazi tyranny, and upper most in the mind of the Prime Minister was to persuade the President, and by extension, isolationists in Congress, to join the fight.

- **Not for India, Though**

To be sure, Churchill never meant for the *Atlantic Charter* principles to apply to India. He said so himself, the next month – September 1941 – in a speech to the British Parliament:

The *Joint Declaration* (the *Atlantic Charter*) does not qualify in any way the various statements of policy which have been made from time to time about the developments of constitutional government in India, Burma, and other parts of the British Empire (...)

At the Atlantic meeting we have had in mind, primarily, the restoration of the sovereignty, self-government, and natural life of the states and nations of Europe now under the Nazi yoke, quite a separate problem from (...) regions and peoples which owe allegiance to the British Crown.⁶⁸⁵

Indeed, Churchill bellowed, in the context of the 1943 Bengal Famine:

I hate Indians. They are a beastly people with a beastly religion. The famine was their own fault for breeding like rabbits.⁶⁸⁶

⁶⁸⁴ See *Atlantic Charter*, 14 August 1941, 55 Stat. 1600, E.A.S. No. 236.

⁶⁸⁵ Quoted in Shefali K. Chandan, *How Churchill's Denial Of The Atlantic Charter Rewards To India Pitted Him Against Roosevelt*, SWARAJYA, 29 April 2018, <https://swarajyamag.com/blogs/how-churchills-denial-of-the-atlantic-charter-rewards-to-india-pitted-him-against-roosevelt>. [Hereinafter, *How Churchill's Denial*.]

⁶⁸⁶ Garikai Chengu, Global Research, *I Hate Indians, They are a Beastly People with a Beastly Religion: Winston Churchill*, POSTCARD, 27 December 2017, <https://postcard.news/hate-indians-beastly-people-beastly-religion-winston-churchill/>; also quoted in Maya Oppenheim, “Winston Churchill is No Better than Adolf Hitler,” *Says Indian Politician Dr. Shashi Tharoor*, Independent, 21 March 2017, www.independent.co.uk/news/world/world-history/winston-churchill-adolf-hitler-no-better-shashi-tharoor-indian-politician-post-colonialist-author-a7641681.html. [Hereinafter, *Winston Churchill is No Better*.]

(Upwards of four million Indians starved to death in the Famine. At the time, Churchill diverted food to British soldiers in Greece and other countries.⁶⁸⁷)

And, in a telling interchange, FDR and Churchill clashed over India, and Colonialism generally:

FDR:

“I am firmly of the belief that if we are to arrive at a stable peace it must involve the development of backward countries. Backward peoples. How can this be done? It can’t be done, obviously, by eighteenth-century methods. Now –”

Churchill:

“Who’s talking eighteenth-century methods?”

FDR:

“Whichever of your Ministers recommends a policy which takes wealth in raw materials out of a colonial country, but which returns nothing to the people of that country in consideration. Twentieth-century methods involve bringing industry to these colonies. Twentieth-century methods include increasing the wealth of a people by increasing their standard of living, by educating them, by bringing them sanitation – by making sure that they get a return for the raw wealth of their community.” (...)

“Those (British) Empire trade agreements are a case in point. It’s because of them that the people of India and Africa, of all the colonial Near East and Far East, are still as backward as they are.” (...)

Churchill:

“There can be no tampering with the Empire’s economic agreements.”

FDR:

⁶⁸⁷ See *Winston Churchill is No Better*. Indeed, Dr. Tharoor explains:

Ships laden with wheat were coming in from Australia docking in Calcutta and were instructed by Churchill not to disembark their cargo but sail on to Europe. ... And when conscience-stricken British officials wrote to the Prime Minister in London pointing out that his policies were causing needless loss of life all he could do was write peevishly in the margin of the report, “Why hasn’t Gandhi died yet?”

Quoted in id.

“They’re artificial. . .”

Churchill:

“They’re the foundation of our greatness.”

FDR:

“The peace, cannot include any continued despotism. The structure of the peace demands and will get equality of peoples. Equality of peoples involves the utmost freedom of competitive trade. Will anyone suggest that Germany’s attempt to dominate trade in central Europe was not a major contributing factor to war?” (...) ⁶⁸⁸

So, if Churchill had had his way, India would not have been an original contracting party to GATT. It was, with Mr. S. Ranganathan signing for India. ⁶⁸⁹ Note that Churchill did not lose the entire battle – GATT Article I:2 preserved the imperial preference scheme as an exception to the general MFN obligation in Article I:1.

- **Depression Experience**

Setting aside Churchill’s “blinkered imperialism” (to borrow a characterization from Shashi Tharoor (1956), an Indian MP, former U.N. Under Secretary General, and author of *Inglorious Empire: What the British Did to India* (2017)), manifest in his obstinacy about hanging on to the Empire, the vision Churchill shared with FDR was based in part on the experience of the Great Depression. ⁶⁹⁰ While certainly not a cause of the October 1929 stock market crash and the subsequent global decline in output, employment, prices, and wages, trade protectionism exacerbated these miseries.

On 17 June 1930, President Herbert C. Hoover (1874-1964, President, 1929-1933) signed the *Tariff Act of 1930*, which contained the *Smoot-Hawley Tariff Act*, named after its sponsors, Senator Reed Smoot (1862-1941, Republican-Utah), Chairman of the Finance Committee, and Congressman Willis Hawley (1864-1941, Republican-Oregon), Chairman

⁶⁸⁸ This conversation is recorded in Elliott Roosevelt, *As He Saw It* (New York: Duell, Sloan & Pearce, 1946), and reprinted in *How Churchill’s Denial*. Captain Roosevelt, the son and military aid of FDR, was present in his father’s meetings with the Prime Minister.

⁶⁸⁹ The photo of Mr. Ranganathan signing GATT is available at World Trade Organization, *GATT 1947 and the Grueling Task of Signing*, www.wto.org/english/tratop_e/gatt_e/task_of_signing_e.htm. Though GATT entered into force on 1 January 1948 and India is numbered among the 23 original contracting parties dating from the conclusion of negotiations on 30 October 1947, India’s GATT membership (as listed on the WTO website) took effect on 8 July 1948. See World Trade Organization, *India and the WTO*, www.wto.org/english/thewto_e/countries_e/india_e.htm. Pakistan’s membership took effect on 30 July 1948. See World Trade Organization, *Pakistan and the WTO*, www.wto.org/english/thewto_e/countries_e/pakistan_e.htm.

⁶⁹⁰ For an excellent economic study of the linkages between trade and finance, including discussions of the Great Depression, financial crises in the 1970s-1990s, and the 1997-1999 East Asian Economic Crisis, see J. Michael Finger & Ludger Schuknecht, Trade, *Special Study: Trade, Finance, and Financial Crises* (Geneva, Switzerland: World Trade Organization, 1999).

of the Ways and Means Committee.⁶⁹¹ The *1930 Act* passed the House easily, and scraped through the Senate by 44 to 42 votes. Ironically, the legislation originally was intended to help American farmers, who faced hard times in the 1920s with the Dust Bowl, a slump in commodity prices, and export competition.⁶⁹² The initial idea was to assist them through price supports and export subsidies. Protection was not the essence of that idea, because American farmers faced little competition from agriculture imports. President Hoover's predecessor, Calvin Coolidge (1872-1933, President, 1923-1929), vetoed all proposals to assist the farmers.

The idea behind the legislation then transformed, albeit illogically, to one of trade protection. Could American agriculture get the same high level of tariff protection as American industry? Tariffs on manufactured merchandise on average were twice that of duties on farm goods, so tariff equality became the rallying cry. That cry could have meant lowering industrial tariffs, but instead it meant raising farm tariffs. After his inauguration in March 1929, President Hoover called a special session of Congress to revise America's tariff schedule, and Congressman Hawley's Ways and Means Committee took 11,000 pages of testimony across 43 days and five nights, not only from farmers, but also small- and medium-sized industrial enterprises.

Thereafter followed a considerable amount of unprincipled horse-trading occurred among Senators, whereby industrial-state Senators agreed to raise duty rates on agricultural and mined goods in return for farm- and mining-state Senators acquiescing on increases in tariffs on manufactured products. Partisanship played a modest role. Republicans generally advocated economic isolation. Many Democrats abandoned their free-trade ideology in favor of economic interests of vocal constituencies. The final, enacted version of the *Smoot-Hawley Tariff Act* increased tariffs on 890 categories of goods (and cut duties on just 235 categories), and affected about 22,000 imported articles. That version was a compromise forged by raising duty rates in the Senate version of the bill rather than lowering rates in the House version.

To counter the slump in business investment and consumer spending, economists debated the merits of Keynesian fiscal stimulus measures (government spending, tax cuts, and consequent unbalanced budgets), expansionary monetary policy (increasing the money supply and lowering interest rates), and foreign exchange regimes (namely, whether to adhere to the gold standard). But, they did not debate the *Smoot-Hawley Tariff Act*: it was entirely wrong-headed. A petition against the measure was signed by 1,028 American economists, including Frank W. Taussig (1859-1940, former chief of the Tariff Commission, the forerunner of the ITC), Paul Douglas (1892-1976, known for the Cobb-Douglas Production Function, and who served later as a Senator), and Irving Fisher (1867-

⁶⁹¹ This discussion draws on: Douglas A. Irwin, *The Battle Over Protection: A History of U.S. Trade Policy* (2009); *The Battle of Smoot-Hawley*, THE ECONOMIST, 20 December 2008, 125-126.

⁶⁹² But see BERNARD C. BEAUDREAU, MAKING SENSE OF SMOOT-HAWLEY: TECHNOLOGY AND TARIFFS (2005). Professor Beaudreau argues protectionist legislation was a response to low income levels. In turn, those levels were caused by a technology shock in the early 20th century from (1) electrification and (2) the implementation (at Ford, for example) of continuous-flow production techniques. This shock increased production capacity faster than gains in income and expenditure. Revising tariffs upward was conceived as a device to protect income levels, at least from further erosion.

1947, renowned for his scholarship on monetary theory and indexing). The Hoover Administration made bad fiscal policy choices, the Federal Reserve choose poorly on monetary policy, and America stayed on the gold standard. These mistakes were the principal causes of the Depression, but ignoring the petition and signing protectionist legislation made matters far worse than they otherwise might have been.

Under the *Smoot-Hawley Tariff Act*, despite an average per tariff increase of 20%, the overall average American tariff increased from just 40% to 48%, which led to an average import price rise of only 6%. The overall average *ad valorem* duty rate rose to 52.8%. To be sure, America already had high tariffs, thanks to the *Tariff Act of 1922* and *Tariff Act of 1913*, through which Congress had hiked duty rates, and the volume of imports into the U.S. had fallen by 15% in 1929. The new, higher *Smoot-Hawley Act* levies, coupled with output declines and asset price deflation, led to a further drop in American imports of 40% by 1932. Moreover, at the time most of America’s tariffs were specific duties (levied on the volume of trade, such as cents per bushel), not *ad valorem* rates (based on the price of an imported article). With price deflation, the effective rate of protection increased, thereby discouraging imports all the more. Even if the price of imported merchandise fell, as long as the volume of a particular shipment remained the same, the effective duty rose, because it was levied on that volume, and because the money to pay the tariff was dearer in the deflationary environment. In 1932, the effective average duty rate hit the second highest level in American history – 59.1% (the highest average was in 1830, following the 1828 *Tariff of Abominations*).

Economic isolationism spread like a contagious disease around the world in the early 1930s. Country after country raised trade barriers. Specifically, 26 of America’s major trading partners retaliated with tariff boosting measures and QRs of their own. Even Britain, which had championed free trade since the mid-1800s, turned protectionist. Other countries also engaged in competitive devaluations, lowering the value of their currency relative to the currencies of other countries, to stimulate their exports by making them cheaper as denominated in the currencies of other countries.

Known as a “beggar-thy-neighbor” strategy (a term coined by Cambridge University economist Joan Robinson (1903-1983)), increasing tariffs and cutting relative foreign exchange values was a short-term way to protect output and employment from import competition. In the importing country, the usual fiscal and monetary policy tools to increase production and jobs are ineffective, so that country resorts to protectionism and devaluation, thereby transferring the slump to the “neighbor” countries.⁶⁹³ But, with all major countries pursuing this strategy, the result was collective doom. Any hope of a tariff truce, a possibility the League of Nations floated, was scuppered. In any case, America was not a League member, and cared little about overseas reaction to the *Smoot-Hawley Tariff*

⁶⁹³ Note that export management, or export-enhancing measures, such as bailouts, export subsidies, local content requirements, and tax rebates can constitute a beggar-thy-neighbor strategy. First, such measures consume domestic resources that could be used for alternative purposes, and make the cost of exports cheaper for foreigners to purchase. Second, export incentives allow exporters to lower their prices, which compel exporters from other countries to follow suit so as not to lose out profits or market share. Both reasons indicate export-enhancement seeks to benefit one country (specifically, its exporters) at the expense of another (*i.e.*, harming exporters from other countries).

Act. In the *Congressional Record*, debate over American tomato tariffs occupied 20 pages, yet concern about reciprocal retaliatory behavior by trading partners took up almost no space.

- **Unwinding *Smoot-Hawley***

Franklin Roosevelt had opposed the *Tariff Act of 1930* and *Smoot-Hawley* tariffs, as had Progressive Republican Senators like Robert LaFollette, Jr. (1895-1953, Wisconsin). Both favored internationalism. Both were disgusted at the vote-trading on unrelated goods needed to pass the *1930 Act*. When FDR entered the White House as President in March 1932, and power in Congress changed hands, efforts to unwind the protectionist legislation began.

In 1934, thanks in part to the tireless efforts of FDR's Secretary of State, Cordell Hull (1871-1955), who articulated a vision of world peace through prosperity generated by trade, did Congress pass the *Reciprocal Trade Agreements Act of 1934*.⁶⁹⁴ The *1934 Act* delegated to the President the ability to negotiate bilateral reductions in tariffs. Within a few years, the FDR Administration entered into bilateral accords with dozens of countries. The world slowly climbed out of the Depression, an ascent accelerated by the massive stimulus to aggregate demand wrought by the Second World War.

II. 1946-1948: Birth of GATT, Stillbirth of ITO

GATT was supposed to be a provisional accord, a bridge between the immediate post-Second World War period and the subsequent years in which the *Charter for the International Trade Organization* (ITO) would govern. It was this *Charter*, not GATT, which was to be the Constitution for the post-Second World War world trading system. When the *Charter* failed, largely because President (and former Missouri Senator) Harry S. Truman (1884-1972, President, 1945-1953) opted not to submit it to the Senate for advice and consent, GATT was left to govern that system.

It was not for lack of trying. In his January 1950 State of the Union Address, President Truman declared:

World prosperity also requires that we do all we can to expand world trade. As a major step in this direction we should promptly join the International Trade Organization. The purpose of this Organization, which the United States has been foremost in creating, is to establish a code of fair practice, and an international authority for adjusting differences in international commercial relations. It is an effort to prevent the kind of anarchy and irresponsibility in world trade which did so much to bring about the world depression of the 1930's. An expanding world economy requires the improvement of living standards and the development of resources in areas

⁶⁹⁴ Hull holds the record as America's longest serving Secretary of State, 11 years (1933-1944), and was awarded the 1945 Nobel Peace Prize for helping to establish the United Nations.

where human poverty and misery now prevail. Without such improvement the recovery of Europe and the future of our own economy will not be secure. I urge that the Congress adopt the legislation now before it to provide for increasing the flow of technical assistance and capital investment in underdeveloped regions.

However, the President came to realize the Senate would look askance at the *Charter*. Politicians had many reasons to oppose the *Charter*. One was the plethora of exceptions to trade-liberalizing rules in the *Charter*. In examining the *Charter* in relation to GATT and contemporary WTO texts, is this a fair criticism?

Another basis for opposition was ideological. Since President George Washington's *Farewell Address* (17 September 1796), in which he advised against unnecessary entanglements with foreign powers (declaring "[i]t is our true policy to steer clear of permanent alliances with any portion of the foreign world..."), there has been an isolationist tendency among prominent national leaders. Senator Henry Cabot Lodge (1850-1924, Republican-Massachusetts) championed isolationism following the First World War, and led the successful fight against American participation in the League of Nations. Senator Robert Taft (1889-1953, Republican-Ohio) picked up that mantle following the Second World War. Followers of the Lodge-Taft tradition had little interest in, and considerable suspicion of, committing America to yet another international organization (in addition to the Bretton Woods institutions, the International Monetary Fund and the World Bank).⁶⁹⁵

As for the text of GATT, it was drafted in two sets of pivotal meetings of delegates from many countries that took place in 1946-1947:

- (1) First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in London (at Church House) from 15 October to 20 November 1946, and known as the "London Preparatory Conference."
- (2) Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in Geneva from 10 April to 30 October 1947, and known as the "Geneva Preparatory Conference."

On 30 October 1947, delegates from 23 countries signed the GATT.⁶⁹⁶

The conventional wisdom about the new multilateral trading system GATT founded is its primary purposes were to provide stability, transparency, and fairness, and

⁶⁹⁵ The *Bretton Woods Agreement* was negotiated in July 1944 and took effect on 27 December 1945.

⁶⁹⁶ The official citation to the original publication of GATT is *Final Act*, Geneva, 55 U.N.T.S. 194 (1947).

those purposes remain as valid today as they were in 1947.⁶⁹⁷ That is true, but incomplete. The conventional wisdom is dominated by the rich, developed world, and fails to accommodate a Post-Colonial Theory approach. As passages in the August 1941 *Atlantic Charter* and March 1948 *Havana Charter*, and GATT itself, suggest, development mattered, too. With such diversity (discussed below) among the original contracting parties, how could poverty alleviation through liberalized trade not be relevant? It was relevant even to the war-ravaged nations of Europe. And with billions of people living in absolute poverty or in the fragile middle class, development is still a central concern.

In any event, if GATT – by default – became the Constitution of the post-Second World War trade order, then these original contracting parties, and in particular the London and Geneva Preparatory Conference delegates who drafted GATT, are the Founding Fathers of that system. In retrospect, the spring, summer, and fall in which they worked would define many contours of the political economy in which we still live: the Partition of British India (and soon thereafter, of Palestine), the Marshall Plan for reconstructing Europe, the Communist-Nationalist civil war in China, and the strengthening movement for independence in less developed regions. On 1 January 1948, GATT entered into force, and the modern multilateral trading system was born.⁶⁹⁸

For almost the next half century, GATT as a document and an institution would go about making the world safe for free trade. It would get little attention or credit outside of trade *aficionados*, as the attention of international diplomats and lawyers focused on the weighty matters of the Cold War, and decolonization. And yet, the theory of world peace through world trade – a theory articulated by (*inter alia*) Cordell Hull, the Secretary of State to President Roosevelt, and manifest in the *Reciprocal Trade Agreements Act of 1934* – was never lost.

The drafting history of the *ITO Charter* is largely parallel to that of the GATT. For the *Charter*, the key drafting conferences, which occurred between 1946-1948, were:

- (1) The 1946 London Preparatory Conference (as above).
- (2) The 1947 New York Preparatory Conference, held from 20 January to 25 February 1947.
- (3) The 1947 Geneva Preparatory Conference (as above).

⁶⁹⁷ See Alan Wm. Wolff, *The Crisis of the Liberal International Order – Thoughts on the Future of the Multilateral Trading System* (Remarks of Alan Wm. Wolff Peterson Institute for International Economics (PIIE), Mt. Pelerin Society Oslo, 5 October 2022), www.piie.com/sites/default/files/2022-10/2022-10-05wolff.pdf.

⁶⁹⁸ Almost immediately after its entry into force, the United States published two studies:

- (1) *Analysis of GATT* in DEPARTMENT OF STATE PUBLICATION NUMBER 2983 (1947).
- (2) *The Geneva Charter for an International Trade Organization* in DEPARTMENT OF STATE PUBLICATION NUMBER 2950 (1947).

These documents provide helpful explanations into certain textual provisions, and also lend insight into the thinking of drafters, and positions of the Americans.

- (4) The Havana Conference, held from 21 November 1947 to 24 March 1948.

Because the text of the *ITO Charter* was finalized in Havana, the document also is referred to as the “*Havana Charter*.”

All of these sessions took place under the auspices of the United Nations Conference on Trade and Employment. The *Charter* remains important as a legal document in no small part because of express references to it in various Interpretative Notes (the *Ad Articles*) of GATT. It also provides a window to what would come – on 1 January 1995, when the WTO was born, and the *WTO Agreement* entered into force.⁶⁹⁹

That *Agreement* has four Annexes – the core texts that form the legal foundation of modern international trade law. Technically, “GATT 1947” – now known as “GATT 1994” – is item (1) in Annex 1A to the *WTO Agreement*. Article XVI, entitled “Miscellaneous Provisions,” of the *WTO Agreement* contains two Paragraphs that emphasize continuity. Paragraph 1 ensures a continuing role for GATT decisions, procedures, and customary practices, and Paragraph 2 essentially continues the position of the GATT Director-General of the GATT Secretariat through to the WTO Director-General. In brief, the first accord, in the first Annex, is none other than GATT, and notwithstanding the proliferation of multilateral trade law, especially during and after the 1986-1994 Uruguay Round of trade negotiations, GATT remains the true Constitution.

To be sure, no longer is the GATT the pre-eminent document, in terms of priority. Article XVI:3 of the *WTO Agreement* explains the hierarchy between the *Agreement*, and all other annexed accords, including GATT:

In the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, *the provision of this Agreement shall prevail to the extent of the conflict*.⁷⁰⁰

As Article XVI:4 of the *WTO Agreement* sets out, WTO Members are obligated to make their trade measures consistent with the *Agreement* and all annexed accords, including GATT. But, to say GATT is an “annexed” agreement and thereby incorporated by reference into the *WTO Agreement* is to understate its contemporary importance.

No longer is GATT the constitutive document in the senses of setting up the institutional infrastructure for the WTO and its dispute settlement mechanism, or containing trade-liberalizing principles for new frontiers like services, FDI, and IP. But, even these features of the WTO draw on, or are inspired by, GATT provisions – for example, Article XXIII on dispute settlement, Article XXV on joint action, and Articles I, II, III, and XI on trade liberalization obligations. In the sense of laying out trade-liberalizing

⁶⁹⁹ All annexed agreements in the *WTO Agreement* took effect on this date, save for (1) the *TRIPs Agreement*, which entered into force on 1 January 1996, and (2) deferred effectiveness under S&D treatment provisions for developing countries and LDCs.

⁷⁰⁰ Emphasis added.

principles the WTO oversees, and that have been extended to new frontiers because they are so valuable, GATT is the Constitution.

This point is evident not only in the indirect influence of GATT on the development of *GATS*, but also several specialties. For instance, in AD law, GATT Article VI is the font of AD rules in the WTO *Antidumping Agreement*. In customs law, Article VII, which deals with valuation, is the foundation for the WTO *Customs Valuation Agreement*. There is no endpoint to the influence of GATT. For example, Article XIX, which establishes a general safeguard action, is the conceptual basis for special safeguard actions, such as the remedy in Article 5 of the WTO *Agreement on Agriculture*. It is hard to conceive of disciplines on agricultural support (or, for that matter, non-agricultural support) without the GATT Articles VI and XVI rules.

The extensions from GATT into specialty areas of international trade law adduce there is no adamant distinction between many of Articles in GATT, on the one hand, and one or more of the large number of agreements and understandings reached in multilateral trade rounds, on the other hand. In other words, the scope of international trade law has expanded well beyond the text of GATT. But, language in that text has provided a basis or inspiration for this expansion. The treatment of SOEs is just one of multiple examples.

Disciplining SOEs to ensure a level competitive playing field with foreign importers and direct investors is an important goal of American trade negotiators. They pursue that goal through (*inter alia*) FTAs like *TPP*. But, they work with the inspiration of GATT Article XVII, which establishes principles for the treatment of STEs, like non-discrimination (Paragraph 1(a)), and the mandate that STEs engage in import or export transactions “solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation, and other conditions, ... and ... afford the enterprises of the other [WTO Members] adequate opportunity, in accordance with customary business practice, to compete for participation in such” import-export deals.

III. Poor, Islamic, and Development-Oriented Diversity

The 23 signatories to GATT are the original “contracting parties” to GATT. But for the withdrawal by Josef Stalin (1878-1953, General Secretary of the Communist Party of the Soviet Union, 1922-1952), the U.S.S.R., which participated in early negotiations, would have been the 24th original contracting party. Following the November 1989 collapse of the Berlin Wall and December 1991 dissolution of the USSR into 15 separate countries, the largest, Russia, acceded to the WTO on 20 August 2012.

Four key facts about the original contracting parties typically are forgotten in the Western World. First, they were not all rich. Of the 23, 11 were poor countries: Burma, Ceylon, Chile, China, Cuba, Southern Rhodesia, and South Africa, plus India, Lebanon, Pakistan, and Syria. The nexus between trade liberalization and economic growth, and onward to poverty alleviation, mattered.

Second, they cared about development. The original contracting parties did not view international trade, and certainly not free trade, as an end in itself. Rather, trade liberalization in a rules-based framework was an instrument for economic growth and enhanced living standards. Freer, but not necessarily completely free, trade was a, but not the only, means to raise incomes and generate jobs. After all, they understood no nation in history has achieved sustained economic success through autarky, though a few of them would pay the price of relearning this lesson, as did Burma between 1962-1988 and China from 1949-1979.

Third, the original contracting parties did not agree on one model of development. They did not, for example, mandate that each of them pursues *laissez-faire*, American-style Capitalism. Interventionist models were in practice already:

[O]n the point that the GATT did not pre-suppose market economies, remember that other countries [other than the U.S.] had fairly Socialist economies in 1947. In 1947, in Australia, a government department was the exclusive provider of telecommunication services and remained so for the next 30 years; the Commonwealth Bank (one of the big four banks in Australia today [March 2020]) was owned by the Commonwealth government; only two airlines were permitted to fly, and one of them was owned by the Commonwealth government; production and sale of blood products and biochemistry products was probably exclusively or almost exclusively done by a governmental organization; electricity was supplied by government bodies in each State of Australia that had complete monopolies over the generation, distribution and retailing of electricity; and, all of the railway tracks and all of the railway carriages were owned (by State governments). It is perhaps true that the government was less involved in supply of goods than services, though there were exclusive marketing boards for many agricultural products, and licensing controls on who could produce some products (*e.g.*, eggs, bread for commercial sale). It is evidence that supports the view that there was no general assumption in 1948 that [original contracting] parties to the GATT contemplated that [they or new] parties to the GATT were supposed to be market economies with minimal government intervention.⁷⁰¹

There is yet further evidence that the original contracting parties did not intend to bar non-market economies from the “club.” After all (as just noted), the Soviets participated briefly in GATT negotiations, and they included a recognition of possible NME-related issues (in *Ad Article VI*, concerning AD-CVD cases, discussed in a separate Chapter). Consider the implication of this point with respect to the 11 December 2001 accession of the WTO and the pattern of its subsequent trade disputes with other Members.

Fourth, Islam influenced the original contracting parties. Four of the countries – India, Lebanon, Pakistan, and Syria – were Muslim or had sizeable Muslim communities.

⁷⁰¹ Brett Williams, Honorary Professor, University of Sydney Faculty of Law, E-Mail Communication to Raj Bhala, 5 April 2020 (on file with author).

So, half of the countries founding the modern multilateral trading system in the wake of the Second World War were developing or least developed, and nearly 20% of them embodied Islam in a significant way. These figures understate both points because Belgium, France, Netherlands, and U.K. all held sway over vast poor and/or Muslim territories when GATT entered into force on 1 January 1948.

IV. *Trends in Rounds*

In modern international trade history, *i.e.*, since the birth of GATT on 30 October 1947, there have been a total of nine sets, known as “rounds,” of MTNs aimed at reducing trade barriers.

- (1) *Original GATT negotiations* in Geneva in **1947**, known as the ***Geneva Tariff Conference***:
The 23 original contracting parties participated. The 24th country involved (to a limited degree) in preparing the *ITO Charter*, the former Soviet Union, declined to join. Negotiations covered roughly 45,000 tariff concessions and \$10 billion worth of trade (measured in 1938 prices).
- (2) *Annecy Tariff Conference*, known as the ***Annecy Round, 1948-1949***:
The Round involved 33 countries and roughly 5,000 tariff concessions.
- (3) *Torquay Tariff Conference*, known as the ***Torquay Round, 1950-1951***:
This Round involved 34 countries. About 8,700 concessions were negotiated, resulting in tariff reductions of 25% compared to the 1948 level.
- (4) *Geneva Tariff Conference*, known as the ***Geneva Round, 1955-1956***:
This Round involved 22 countries and \$2.5 billion of trade.
- (5) Another *Geneva Tariff Conference*, known as the ***Dillon Round, 1960-1962***:
This Round involved 37 contracting parties, 23 of which offered concessions. There were 4,400 tariff concessions covering \$4.9 billion of trade.
- (6) ***Kennedy Round, 1964-1967***:
The Round, which also transpired in Geneva, involved 76 contracting parties, though only 31 of them, including the six-member EEC, granted tariff concessions. The negotiations covered \$40 billion worth of trade, or roughly 75% of world trade at the time.
- (7) ***Tokyo Round, 1973-1979***:
The Round involved 85 contracting parties. Yet, just 36 of them, including the 10-member EC, granted tariff concessions. The talks, which happened in Geneva, covered \$300 billion worth of trade, and was the most ambitious to date.
- (8) ***Uruguay Round, 1986-1994***:

This Round involved 118 contracting parties and covered \$3.7 trillion of trade. Launched in September 1986, the last day of substantive negotiations was 15 December 1993 (though bargaining, in fact, continued well beyond then). This Round easily eclipsed the Tokyo Round as the most far-reaching and complex. Most negotiations occurred in Geneva. However, a Mid-Term Review was held in Montreal in 1990. In addition, an accord on farm support (particularly export subsidies) was hammered out between the U.S. and EU at Blair House in Washington, D.C. (the “*Blair House I Accord*”) in November 1992, a deal on industrial tariffs was reached in July 1993 in Tokyo among the “Quad” countries (Canada, Japan, U.S., and EU), and another accord between the U.S. and EU at Blair House focusing on oilseeds subsidies (the “*Blair House II Accord*”) was reached in November 1993.

(9) *Doha Development Agenda, 2001-2012:*

At its outset, this Round involved roughly 150 WTO Members and roughly \$ 3 trillion of trade. Known as the “*Doha Round*,” it was launched in Doha, Qatar, at the Fourth WTO Ministerial Conference, held from 9-13 November 2001. Agreeing to an agenda, in the dark shadow of the terrorist attacks of 11th September, and the reality of competing interests among not only Members, but also NGOs, was a major achievement. Yet, the Round abandoned its founding principle of development, through poverty alleviation, with a view to reducing vulnerability to Islamist extremism. After over a decade of highly technical negotiations, resulting in hundreds of pages of draft agreements on topics such as agriculture, NAMA, and services, the Round collapsed. It produced precious few notable achievements: an amendment to Article 31 of the *TRIPs Agreement* concerning imports of generic pharmaceuticals manufactured under a compulsory license in a third country; a *Trade Facilitation Agreement*; and discussions of Green Box reform for public stockpiling of farm goods for domestic food security. Otherwise, in terms of fulfilling the original DDA and its underlying purpose, the Round was a failure – the first one in multilateral trade history.

How did each Round obtain its appellation? The name of the first four Rounds is based on the place in which all or most negotiations transpired, such as Annecy, France, and Torquay, England. The name of the next two Rounds is named after individuals who inspired the Rounds. Most poignantly, the Kennedy Round is named after the late President John Fitzgerald Kennedy (who was assassinated on 22 November 1963). The recent practice is to name a Round after the location in which trade ministers adopt a *Declaration* to launch it, such as Tokyo for the Tokyo Round.

Observe also the historical record, in terms of the number of Rounds in a reasonably short span of modern economic history, is remarkable. It should not, however, be inferred from this record that commencing a round is easy. It is not. A mix of political and economic factors must come together.

In particular, trade policy makers, heads of government, and domestic constituencies must agree on a common agenda. The mix of factors world leaders must

marshal to trigger a round is ever-more complex. That is because the membership of the multilateral trading community grows in number and diversity, hence the range of topics that members seek to discuss, and their perspectives and interests on the topics, expand. To some degree, leadership from the GATT Secretariat, and now the WTO, in the person of the Director General, affects the launch and course of a round. However, as Dr. Supachai Panitchpakdi of Thailand (1946-), who served as Director General in 2002-2005, was fond of saying, the WTO is a “Member-driven organization.” Strong and charismatic leadership can compel Members to compromise on an agenda to some degree, but pushing the Members too far when the political and economic environment is not ripe for a round may marginalize the Director General.

What general trends emerge from the many Rounds of multilateral trade negotiations? The question is asked amidst living history, as MTNs continue. The following six broad observations, however, might be offered:

(1) *More Countries:*

The successive Rounds involve an increasing number of countries, reflecting new accessions to GATT and the WTO. Consequently, the WTO Membership is far more diverse, in terms of levels of economic development and nature of political systems, than the original GATT contracting parties of 1947.

(2) *More Money:*

The successive Rounds cover a greater dollar value of world trade. This coverage is partly a mark of success. It reflects growth in world trade made possible in part by liberalization from preceding Rounds. It also is owed to the ambition of trade negotiators to cover a larger number of product categories.

(3) *More Complexity:*

The successive Rounds, particularly since the Kennedy and Tokyo Rounds, expand well beyond the traditional topic of tariffs. Trade negotiations no longer are just about tariff reductions (if, in reality, they ever were). Depending on the Member and its perspective, they relate to matters from agriculture to national security, and from dispute settlement to sanitary standards.

(4) *New Participants:*

Especially since the Uruguay Round, many NGOs have “participated” in trade talks, in one way or the other. Sometimes, the “participation” is observation and reporting. Other times, it is providing technical advice, or advocacy of a position. Still other times, it is protest, which not always is respectful or peaceful.

(5) *Reduced Policy Space:*

Much of the “optionality” of participation that characterized Rounds up to the Uruguay Round has disappeared. In the Geneva, Annecy, Torquay, Geneva, and Dillon Rounds, technically, it was necessary for a contracting party to participate if it sought a concession, and a contracting party could seek a concession only if it held an INR or had a principal supplying interest. As a practical matter, if trade

flows were small, then contracting parties tended not to exchange concessions. And, less developed countries (abbreviated “LDCs,” though during and after the Uruguay Round the acronym can connote the narrower category of “least developed countries”) sometimes observed from the sidelines. However, in the Uruguay Round, every contracting party had to schedule concessions on goods. In effect, no free riding was permitted.

- (6) *Continued Demands for Reciprocity:*
 Reciprocity is perhaps the most fundamental operating principle in multilateral trade negotiations. In searching for an overall balance of rights and obligations in any proposed trade liberalization plan, representatives of different countries always ask a bottom line question – what are they receiving in exchange for what they are conceding? To what extent is reciprocity a legal obligation, expressly or implicitly, in GATT, such as Article XXVIII *bis*?

The obvious inference from these trends is multilateral trade rounds have become increasingly comprehensive, time consuming, and difficult.

V. 1948-1961: Early GATT Rounds

The framework for an MTN round is set forth in Article XXVIII *bis*, coupled with the provisions of Article XXV on joint action. In addition, brief mention is made in Article III:2 of the *WTO Agreement* of the supporting role the WTO plays. Still the framework is skeletal. It provides no details regarding the mechanics or procedures for conducting negotiations. Further, Article XXVIII *bis* was not added to GATT until 7 October 1957, following its preparation through a 1954-1955 Review Session.

Not surprisingly, then, during the first three Rounds, the contracting parties followed procedures laid out in the *ITO Charter*, particularly Article 17, even though it was clearly dead letter law by the time of the second Round. The essential features of these procedures were as follows:

- (1) Negotiations to cut tariffs were conducted on products selected by one or more contracting parties, and the offers and counter-offers were made on a product-by-product basis.
- (2) A contracting party could ask for a reduction in a tariff on a product only if that party was a principal supplier of the product to the country from which it sought a concession.
- (3) Every contracting party had full autonomy to grant, or not grant, a concession on any particular product.
- (4) If a contracting party already maintained duty free treatment with respect to a product, or a low rate of duty on that product, and if it agreed to bind the tariff on that product against increase from the zero or low rate, then the other contracting parties accepted this concession as, in principle, equal to

- either the substantial reduction of a tariff from a high level, or the elimination of a preference.
- (5) Bargaining was based on reciprocity. No contracting party was obliged to offer or grant unilateral concessions.

After three Rounds of using these procedures, the contracting parties gained a level of comfort that comes only from experience. Not surprisingly, then, they crafted Article XXVIII *bis* of GATT by incorporating these features from the *ITO Charter*. The brief Interpretative Note to this Article makes no reference to the *Charter*, nor need it, precisely because of this incorporation.

The Geneva Tariff Conference of 1947 occurred in the context of finalizing the GATT document itself and preparing the *ITO Charter*. In 1946, the U.S. invited all 24 countries represented on the “Preparatory Committee for the *Charter for the International Trade Organization*” to enter into negotiations to reduce tariff and other trade barriers. The U.N. Economic and Social Council appointed them to the Committee. When the Americans circulated a *Suggested Charter* for the ITO in 1946, this draft:

included two articles that would have facilitated Soviet participation. Article 28 included a variant of the quantitative import commitment inserted into many bilateral agreements with the Soviet Union in the interwar years. The clause specified that a country with a complete or substantially complete monopoly of its import trade should undertake a global import commitment, of an amount to be agreed upon, in reciprocation of the tariff concessions granted by market countries. A commercial considerations clause, designed to ensure that the increased trade arising from the import commitment be conducted in a non-discriminatory manner, was simultaneously inserted in the *Suggested Charter* as article 26.⁷⁰² [These two articles were not carried through to the *ITO Charter*, given the Soviet decision not to participate in the final two drafting conferences for the *Charter*.]

U.S. encouragement extended to the preparation of charters for the World Bank and IMF. The Soviet Union participated in these exercises, and in the Bretton Woods Conference of 1944 (at which the articles of agreement for the Bank and Fund were finalized), and signed the *Bretton Woods Agreement*. Nevertheless, the political relationship between the allies of the Second World War deteriorated. The Soviet Union abstained from joining the World Bank and IMF, elected not to engage in the last two conferences at which the draft *ITO Charter* was debated and completed, and never joined GATT.

Accordingly, of the 24 countries on the U.N. Committee, 23 of them accepted the American invitation, the former Soviet Union being the notable exception. The acceptance by 23 countries led to what became known as the first Geneva Round, which was completed

⁷⁰² LEAH A. HAUS, GLOBALIZING THE GATT – THE SOVIET UNION’S SUCCESSOR STATES, EASTERN EUROPE, AND THE INTERNATIONAL TRADING SYSTEM 89 (1992).

in August 1947. Why they accepted the American invitation is evident from a *Report* emerging from the Geneva Preparatory Conference:

*Considering that the objectives underlying the endeavor to set up the I.T.O. would be promoted if concrete action were taken ... to enter into reciprocal negotiations directed to the substantial reduction of tariffs and other barriers to trade ... the governments represented on the Preparatory Committee adopted a resolution ... regarding the carrying out of such negotiations. ... [These governments currently are] in the final stages of negotiations [i.e., of the first Geneva Round].... It is expected that the concessions resulting from these negotiations ... will shortly be incorporated in a General Agreement on Tariffs and Trade.*⁷⁰³

In brief, the 23 countries thought they would advance their shared interest in establishing an ITO, with its central mission of liberalizing trade, if they commenced expeditiously to cut tariff barriers even before they finished drafting the *Charter*. (In all likelihood, some of them may have appreciated the possibility the *Charter* never would take effect.)

In the Geneva Round, the 23 countries achieved tariff reductions using a selective, product-by-product methodology, on which they had agreed at the 1946 London Preparatory Conference, and in 1947 in New York. In turn, this methodology, coupled with the principal supplier rule, was drawn in large part from American practice, namely, the way in which the U.S. had conducted negotiations under its reciprocal trade agreements program up to 1945. After all:

The General Agreement was conceived as a *product* of the negotiations, not as a framework for conducting them. The *ITO Charter* contained the framework for future negotiations.⁷⁰⁴

Thus, having negotiated successfully, the 23 countries logically sought to implement their trade liberalizing deals, even before they finalized the *ITO Charter*. Consequently, the countries not only drafted GATT, completing it on 30 October 1947, but also agreed to its effective date as of 1 January 1948. These countries became the original GATT contracting parties. The results of the bargains on lowering tariff and other trade barriers they reached during the first Geneva Round also took effect at that time.

Following the initial GATT talks, the “Early Rounds” of multilateral trade negotiations – specifically, Annecy, Torquay, Geneva, and Dillon – focused on the reduction of tariffs. There appears to be no standard definition of “Early Rounds.” One convention, followed here, is to consider the Rounds completed during the first 15 years following the entry into force of GATT on 1 January 1948, as “Early.” That would mean the first five Rounds (up through the Dillon Round, which ended in 1962) are “Early.”

⁷⁰³ *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, United Nations Document EPCT/186 at 6 (1947).

⁷⁰⁴ JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF GATT* §10.4 at 220-221 (1969). (Emphasis original.) [Hereinafter, JACKSON 1969.]

During the first three Rounds, *i.e.*, until the Dillon Round, the contracting parties exchanged offers and counter-offers on a bilateral basis. (In the Annecy and Torquay Rounds, the contracting parties used the rules of Article 17(c) of the *ITO Charter*. Essentially, these rules stated that reduction of an MFN tariff rate on a product automatically operates as a reduction in the margin of preference on the same product, and *vice versa*, and no margin of preference could be increased.) Moreover, high priority in the first three of these Rounds was placed on the gradual elimination of Colonial-era trade preferences. The reason for commencing the 1948-1949 Annecy Round was to create an opportunity for tariff negotiations between the 23 original contracting parties and 11 countries seeking accession to GATT. That is, the Annecy Round dealt with the possible accession of 11 more countries as GATT contracting parties under the auspices of Article XXXIII. Of the 11 applicant countries, nine joined GATT: Denmark, the Dominican Republic, Finland, Greece, Haiti, Italy, Nicaragua, Sweden, and Uruguay.

It was in 1950, at the start of the Torquay Round, when the U.S. publicly declared – through a press release of the Department of State – it would not submit the *ITO Charter* to the Senate as a treaty for its advice and consent (nor to both Houses of Congress as a Congressional – Executive agreement). The small but growing body of contracting parties then clearly understood the GATT “was to become an *institution considerably different* from that originally contemplated.”⁷⁰⁵ During the 1950-1951 Torquay Round, the contracting parties negotiated tariff reductions among themselves and with six other countries that had applied for accession pursuant to Article XXXIII – Austria, Germany, Korea, Peru, the Philippines, and Turkey. Four of the six became contracting parties at the end of the Round. Korea and the Philippines did not join until after further negotiations years later.

A noteworthy feature of the Torquay Round was the challenge posed by countries (whether existing or potential new contracting parties) that had relatively low tariffs. This challenge is called “tariff dispersion,” or “tariff disparities,” across countries (as distinct from the phenomenon of widely varying tariff rates maintained by one country). As a 1952 study on the operation of GATT observed, several European countries felt themselves disadvantaged from the outset of the Round. They had bound their tariffs in the 1947 Geneva Round and 1948-1949 Annecy Round, so by the start of the Torquay Round, they had low tariffs in comparison with other countries. This earlier trade liberalization meant they had less to offer, to induce reciprocal concessions, than higher tariff countries. The latter group refused to grant concessions they perceived as unilateral and unrequited. So, high tariff countries generally avoided making major tariff cuts in exchange for prolongation by low tariff countries of bindings of duties at low rates.

Unfortunately, the Torquay Round ended without a solution to the problem of negotiations involving a mix of low and high tariff countries. The tariff cuts were neither as broad nor deep as hoped when the talks began. France responded with a plan that, after modifications, the CONTRACTING PARTIES adopted on 13 October 1953. (The original French Plan called for an automatic, across-the-board cut of tariffs by 10% (phased in over

⁷⁰⁵ JACKSON 1969, §10.4 at 222. (Emphasis added.)

a three-year period), with a ceiling rate on each of 4 broad categories of products, and with exceptions to give credit to contracting parties that already had low tariffs.) This “GATT Plan,” as it was dubbed, set forth modalities to deal with tariff dispersion.

In brief, the GATT Plan contained the following features:

- (1) Classification of traded products into ten categories; calculation of a “demarcation line” (in effect, a target for the average incidence of the weighted average of duties in 10 European and North American countries).
- (2) Use of an across-the-board (not a selective, product-by-product) method to cut tariffs by a fixed rate of 30%.
- (3) A phased reduction of tariffs to the demarcation line or below (with lower reductions, and even exemptions, for countries that already had tariffs below the line).
- (4) Ceiling rates on individual product categories; measurement of reciprocity on an overall basis (not in a product-by-product way).
- (5) S&D treatment for poor countries.

Before ever trying it, the contracting parties shelved the Plan. They failed to achieve a consensus to use their 1953 Plan as the modalities for the 1955-1956 Geneva Round.

In the Geneva Round, only 25 of the then 39 contracting parties agreed to engage in negotiations. Only 22 of the participating countries made concessions. Many less developed countries declined to participate. The ones that did elected not to make concession offers. Contracting parties fell back on a selective, product-by-product approach, and followed the modalities laid out in the predecessor to Article XXVIII *bis* (i.e., the former Article XXIX). Worse still, because the CONTRACTING PARTIES adopted procedures whereby any two or more of them could begin talks at any time, and because several countries did not participate at all, it is more accurate to eschew the label “Round” for what really was a Tariff Conference. But, the label is applied because participants included the major trading powers, all of which exchanged concession lists.

The Geneva Round was disappointing in terms of the scope of coverage of tariff reductions. It affected only \$2.5 billion in trade. The reason was the delegation from the Congress gave the American trade negotiating team a limited mandate (which it made nearly full use of). But, in two other respects, the Geneva Round was a success. For the first time, the contracting parties recognized the importance of trade liberalization in the agricultural sector, which (in practice) remained at the margins of the disciplines of GATT. Agricultural protectionism among developed countries was having adverse trade effects, and something had to be done.

Moreover, the contracting parties acknowledged the need to tackle the trade and development needs of LDCs. They memorialized their plan by publishing a report, *Trends in International Trade* – informally known as the *Haberler Report* (in honor of the chair of the panel of experts who wrote it, Gottfried Haberler, Professor of Economics at Harvard). The *Report* set forth the first-ever GATT guidelines for how the contracting

parties could help LDCs. In turn, it led to a “Program for the Expansion of Trade,” which was adopted by the contracting parties in October-November 1958. Pursuant to the Program, the contracting parties established three committees: Committee I, which focused on the agenda for the next Round; Committee II, which reviewed the domestic agricultural policies of each contracting party; and Committee III, which addressed the concerns of LDCs in the world trading system.

As for the 1960-1962 Geneva Tariff Conference, or Dillon Round, the American Under-Secretary of State, Douglas Dillon, is said to have proposed it because of two threats from the EEC, which formed in 1957 with six member states. The Round was the first one in which the EEC negotiated as a single bloc. The first threat was the CET of the EEC. Under Article XXIV:6, large-scale tariff negotiations were required of the EEC to compensate individual contracting parties for any imbalance that would result when the EEC replaced the variegated tariffs of each EEC member with a single external tariff. Thus, the first part of the Round was dedicated to renegotiating tariffs with the EEC under Article XXIV:6. The balance of the Round was spent on new tariff concessions among the contracting parties. During the second phase, countries applying to join GATT carried out tariff negotiations in connection with their accession.

The second threat concerned agricultural subsidies under the Common Agricultural Policy. The Geneva Round and Committee III had drawn attention to trade-distorting agricultural policies. The new Dillon Round was an opportunity to discuss these distortions. The contracting parties could not meet the threat. For the most part, they left agricultural and other politically sensitive products out of the final deal.

For three further reasons, the Dillon Round results disappointed expectations of the contracting parties. First, effective participation was limited. Of the 37 contracting parties at the time, just 23 of them offered concessions. Second, nothing was done to combat NTBs, even though the rules for the Dillon Round expressly mentioned barriers under Article XI:2(c) (which has exceptions to the Article XI:1 rule against quantitative restrictions). Third, tariff cuts could have been deeper. The EEC offered to slash tariffs on a linear basis. The fixed rate would be 20%, though there would be some exceptions to the across-the-board cut. The EEC had legal authority for this ambitious offer. The Dillon Round was the first set of multilateral trade talks conducted with Article XXVIII *bis* in force, and the contracting parties adhered to its terms. The EEC suggested they follow the first sentence of Paragraph 2(a) of this Article, which empowers them to agree on the application of procedures other than a product-by-product approach. The U.K. matched the EEC offer. But, because of limited negotiating authority, the U.S. could not accept the offer. Consequently, the contracting parties stuck by the language in this sentence empowering them to use the old-fashioned selective, product-by-product method.

In the Early Rounds, negotiations to cut tariffs were conducted on a product-by-product basis. The product-by-product method was implemented according to the principal supplier rule. The principal supplier of a particular product is expected to entertain the possibility of offering concessions only on a product for which another country that also is a major supplier of that product has requested a concession. In this way, negotiations on

tariff reductions for a particular product are held between pairs of principal suppliers. Other countries are kept apprised of the talks, and from time to time are brought into the negotiations. That way, all countries periodically can assess the value of concessions on the table and how those concessions would affect them.

In brief, the theory of the principal supplier rule is only countries that are significant exporters of a product ought to have a right to request tariff cuts in that product. That way, tariff cut requests remain reasonable, and free riding problems avoided. Once principal suppliers agree on concessions on a product on a reciprocal, mutually advantageous basis, the deal is “multilateralized,” by operation of the Article I:1 MFN obligation.⁷⁰⁶ The new, lower tariff is bound under Article II:1(b). Yet, there are obvious problems with this theory as it was practiced in early decades of GATT history.

First, as the number of contracting parties grew, and the range of product categories expanded, the product-by-product approach and principal supplier rule became more cumbersome to implement. The method was not efficient for the organization GATT had become. Conversely, with a large number of countries acceding to GATT, there was less fear of free riding, in the sense of benefits from tariff cuts redounding to non-members that had made no trade reforms of their own.

Second, the approach gradually fell victim to its own success. Having provoked significant cuts by developed countries in industrial tariffs in the late 1940s through early 1960s, there was little more headway to be made using the approach. That is, many of the important industrial product categories had been the subject of a cut.

Third (and following the second point), the product-by-product approach is inherently selective, as it relies largely on the desires and efforts of principal suppliers. If no single negotiating partner is the principal supplier of a particular product, then the result may be no offer on that product is made. The result is a gap in coverage of tariff cuts. A gap also can result because a product is deemed too sensitive to permit an aggressive tariff cut.

Fourth, the approach does not systematically address tariff peaks and tariff dispersion problems (either within or among countries). A tariff “peak” exists in the Schedule of Concessions (*i.e.*, its Tariff Schedule) of a country where there are relatively high tariffs on a few so-called “sensitive products,” but otherwise generally low tariffs prevail. In other words, a tariff peak is a tariff on a particular good that is substantially higher than the average tariff for all goods. For developed countries, a tariff of 15% or above generally is considered a tariff peak. Common examples include tariff peaks on clothing, fish and fish products, and T&A. Tariff “dispersion,” also called tariff “disparity,” refers to the inequality of tariffs within the Schedule of a country, that is, the extent to which there are peaks and troughs within that Schedule.⁷⁰⁷ Those peaks and troughs give

⁷⁰⁶ International Trade Law jargon is full of instances in which adjectives (*e.g.*, “multilateral”) and nouns (*e.g.*, “tariff”) are turned into verbs (*e.g.*, “multilateralize”, “tariffy”).

⁷⁰⁷ See Richard N. Cooper, *Tariff Dispersion and Trade Negotiations*, 72 JOURNAL OF POLITICAL ECONOMY issue 6, 597-603, footnote 3 at 597 (1964),

rise to another term for the phenomenon of dispersion, namely, the “High-Low Problem.” (In statistical terms, there is a mean (average) tariff rate in a Schedule, and from it the standard deviation of tariff rates can be calculated. The greater the number of peaks (highs) and troughs (lows), the greater the variation (dispersion) from that mean.) Generally speaking, it is economically more efficient to smooth out the Highs and the Lows, as opposed to leaving in wildly different duty levels on different products in the same Schedule.

Note that in the run-up to the Kennedy Round, the concept of tariff “dispersion” took on a cross-country comparative dimension, apparently for “tactical and political reasons,” especially in tariff negotiations between the U.S. and EEC.⁷⁰⁸ In other words, “dispersion” can refer to the evaluation of the extent to which different countries impose different tariff rates on the same merchandise. Two countries could have the same degree of tariff dispersion within their respective individual Schedules, but because they impose very different levels of duty on the same merchandise, could represent cross-country tariff dispersion. Here again, there is a “High-Low Problem,” with some countries imposing a high level of duty, and others a low level. A single, harmonized level is sometimes viewed as both economically and politically desirable.

These shortcomings suggested a new approach would be needed. Yet, overall, what might be said of the actual results of tariff cuts in the Early Rounds? On the one hand, “[n]o reliable evaluation of the tariff reductions and other commitments made during the first five rounds of negotiations in GATT 1947 is available.”⁷⁰⁹ Full analyses of the outcomes appear to have begun with the Kennedy Round, typically done by the GATT or WTO Secretariat. On the other hand, reports by the Secretariat, and by the UNCTAD, OECD, and various other institutions, indicate the “the achievement during the last 50 years or so in industrial tariff reduction has been impressive....”⁷¹⁰

VI. 1964-1967: Kennedy Round

The 1964-1967 Kennedy Round was more ambitious and complex than any previous multilateral trade talks. By 1967, there were 76 contracting parties to GATT, though only 32 of them, most of which were developed countries, granted tariff concessions in this Round. Still, a large reduction was achieved on many products.

The *Trade Expansion Act of 1962* gave the American negotiating team the authority to pursue an across-the-board cut of up to 50%, and for some product categories an even deeper cut than 50%. (The only exceptions to the limitation of the 50% cut (*i.e.*, items for which decreases of more than 50% were permitted) seem to be for dicyandiamide and

https://dash.harvard.edu/bitstream/handle/1/13580987/Cooper_TariffDispersion.pdf. [Hereinafter, *Tariff Dispersion*.]

⁷⁰⁸ *Tariff Dispersion*, footnote 3 at 597.

⁷⁰⁹ ANWARUL HODA, TARIFF NEGOTIATIONS AND RENEGOTIATIONS UNDER THE GATT AND THE WTO ¶ J.2 at 70 (2001). [Hereinafter, HODA.]

⁷¹⁰ HODA, ¶ J.6 at 72.

limestone, which are employed in the manufacture of cement, to which 19 U.S.C. § 1821(b)(1) did not apply.)

Six factors made the Kennedy Round particularly noteworthy and established trends that continue to the present day. First, the negotiation process for cutting tariffs changed from the traditional product-by-product approach to an across-the-board or linear method. There is a tension between reciprocity and across-the-board tariff cuts. Reciprocity entails that, with respect to trade barriers on a particular good, contracting party A treats contracting party B in the same way that B treats A. Reciprocity is less demanding, from a free trade perspective, than national treatment, which requires A to treat the goods of B in the same manner as A treats A's own goods. Contracting party A is unlikely to grant across-the-board tariff cuts on goods from contracting party B without reciprocal treatment. In any event, on 21 May 1963, the CONTRACTING PARTIES launched the Round by adopting a *Ministerial Resolution* calling for “substantial linear tariff reductions with a base minimum of exceptions which shall be subject to confrontation and justification” among industrialized countries for industrial products.⁷¹¹ Their goal was a cut of 50% on all products, with precious few exceptions that had passed a rigorous test.

The CONTRACTING PARTIES agreed to this goal for two reasons:

Two main considerations led to the adoption of the linear approach. First, the item by item, request-offer method adopted in past negotiations, with its *dependence on* the extent to which the principal supplier was *willing to reciprocate* the reduction of duty in a particular product, had led to *very small reductions* which were in some cases worthless in commercial terms. Second, with the increase in the number of contracting parties, the traditional method had become increasingly *cumbersome and unwieldy*.⁷¹²

Also, the *Resolution* recommended addressing disparities in tariff levels, and called for “tariff reductions ... based upon special rules of general and automatic application.”⁷¹³

In the end, after repeatedly pushing back the deadline for completion, the talks finished in May 1967, and the protocol embodying the results was signed on 30 June 1967. (Uruguay Round negotiations finished on the day trade negotiating authority of the American president expired – 15 December 1993. The Kennedy Round package was signed on the last day of that authority. The obvious point is multilateral trade negotiations almost invariably “go down to the wire,” with the wire made in America) Kennedy Round negotiators achieved an across-the-board tariff cut of 35%:

⁷¹¹ *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, B.I.S.D. (12th Supp.) at 47-49 (1964) (adopted 21 May 1963).

⁷¹² HODA, ¶ B.8 at 30-31. (Emphasis added.)

⁷¹³ *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, B.I.S.D. (12th Supp.) 47-49 (1964) (adopted 21 May 1963).

During the Kennedy Round, the principal industrialized countries made *tariff reductions on 70 percent of their dutiable imports, excluding cereals, meat, and dairy products*. Although the working hypothesis adopted for industrial products was for a linear cut of 50 percent, because of numerous exceptions, an *effective reduction of 35 percent* was obtained in industrialized countries for these products. The tariff reductions made by the developing countries were *highly selective* and would *not* have made a significant impact on their trade-weighted average tariff.⁷¹⁴

In practice, “across-the-board” meant 60,000 products were covered by the reduction.

To be specific, concessions made by the EEC, Japan, Sweden, Switzerland, the U.K., and the U.S. covered 70% of dutiable imports (worth about \$26 billion) into these countries. Most of their concessions (covering roughly \$18 billion worth of dutiable imports) were tariff cuts of 50% or more, some concessions (covering roughly \$5 billion of dutiable imports) were tariff cuts of between 20% and 50%, and some concessions (covering roughly \$4 billion of dutiable imports) were smaller tariff cuts. On some dutiable imports (worth about \$11 billion), these countries granted no concessions. Professor Dam, then, finds the results of this Round disappointing:

*In the end, 30 percent of the dutiable imports of the major participants were left untouched by tariff reductions, and approximately one-third of the reductions on the remaining imports were of less than the full 50 percent. Just as in earlier rounds the principle equating the binding of a low tariff with the substantial reduction of a high tariff had failed to survive intact the realities of tariff bargaining, so in the Kennedy Round the across-the-board principle was seriously compromised.*⁷¹⁵

Still, the across-the-board method of tariff reductions continues to be used.

The second noteworthy feature of the Kennedy Round was coverage of agricultural as well as industrial goods. For example, agreements were reached on grains and on chemical products. Reducing tariff barriers in agricultural trade did not prove easy. “[T]he linear approach to agricultural goods was abandoned completely,”⁷¹⁶ and:

[i]n addition to excepting individual products [from the linear method of cutting tariffs], it was decided after extensive discussions to *treat the agricultural sector specially*. This special treatment was thought to be justified by the high frequency of quantitative restrictions and other non-tariff barriers in agriculture, a circumstance that tended to make tariffs irrelevant to determining international trade flows for agricultural products. In part, the dispute about agriculture reflected a difference between the national interests of the two major protagonists, the United States and the

⁷¹⁴ HODA, ¶ J.3 at 70. (Emphasis added.)

⁷¹⁵ KENNETH W. DAM, *THE GATT 77* (1970). (Emphasis added). [Hereinafter, DAM.]

⁷¹⁶ JACKSON 1969, §10.5 at 225.

EEC. *The United States was a major agricultural exporter, and its negotiators were committed politically to the Congress to making the successful conclusion of agricultural negotiations a condition for any concessions on industrial products. The EEC was for many agricultural products a major importer and was pursuing a conscious policy of seeking agricultural self-sufficiency.* The United States, although maintaining that the general linear rules should apply to agricultural tariffs of major significance, was successful in seeking the adoption of “*acceptable conditions of access*” as the goal of agricultural sector negotiations. “Acceptable conditions of access” was open to the interpretation that the United States sought a *guarantee of a certain percentage share of the EEC market*, a guarantee that would have been difficult to reconcile with the linear method if not also with the most-favored-nation clause.

In the end, *all agricultural products were excluded from the linear negotiations.* Cereal, meats, and dairy products were the subjects of special discussions oriented toward the creation of international commodity arrangements, and the remaining agricultural products were dealt with through specific offers – that is to say, through *product-by-product negotiations*.⁷¹⁷

Not surprisingly, efforts to liberalize trade in agriculture continued through the subsequent Tokyo and Uruguay Rounds.

Third, no longer was the U.S. the sole driving force in the negotiating rounds. Japan acceded to GATT in 1955, and the EEC was formed in 1957. During the Kennedy Round, both emerged as key players in negotiations. To this day, the U.S., EU, and Japan remain dominant – and, to many participants and observers hegemonic – powers in MTNs. But, they can no longer determine outcomes (if they ever could) on their own. Australia, Brazil, Canada, China, India, Korea, South Africa, and others have joined the rank of the powerful, able to set agendas and shape negotiating outcomes. Roughly 80% of the WTO Membership is comprised of developing countries and LDCs. In the infrequent instances when they behave as a unified bloc, they, too, can “make” or “break” a deal. In sum, the origins of the dispersion of influence can be traced to the Kennedy Round. In turn, this dispersion harkens back to the founding of GATT: the original contracting parties were not all rich, white countries.

Fourth, the Kennedy Round negotiators discussed the interests of LDCs. The *Ministerial Resolution* of 21 May 1963 launching the Round proclaimed, “in the trade negotiations every effort shall be made to reduce barriers to exports of the less developed countries, but that the developed countries *cannot expect to receive reciprocity* from the less developed countries.”⁷¹⁸ (Soon thereafter, nearly *verbatim* language would find its way

⁷¹⁷ DAM, 70-71. (Emphasis added.)

⁷¹⁸ *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, B.I.S.D. (12th Supp.) 47, 48-49 (1964) (adopted 21 May 1963) (1964). (Emphasis added.)

into Article XXXVI:8.) Many LDCs acceded to GATT in the early 1960s. On 1 May 1964, an International Trade Center was created to channel information, and offer advice, to them. (This Center continues in a new incarnation under WTO auspices.) In February 1965, the Committee on Trade and Development was established. (The Committee also continues to the present in its modern-day incarnation under the WTO).

During the Kennedy Round, LDCs were treated as “nonlinear countries,” meaning they participated in tariff reductions through affirmative product-specific offers. They were keenly interested in products such as cereals, dairy, and meat, and the Trade and Development Committee set up working groups to study these commodities. The LDCs did not have to table their offers until they learned about tariff reductions developed countries offered on agricultural products of interest to poor countries.

Many LDCs, pursuant to the non-reciprocity principle, made no tariff reduction commitments. Indeed, because the negotiations among developed countries were rife with confrontation, and so many LDCs were involved in the negotiations, “in the end, only sixteen countries (counting each member state of the EEC separately) participated in the Kennedy Round as linear countries, while thirty-six were in the nonlinear category.”⁷¹⁹ With respect to product coverage, LDCs made no tariff reductions on 21% of their dutiable imports, and cuts in their tariffs of less than 50% on 26% of these imports. LDCs agreed to grant tariff concessions of 50% or more on 49% of their dutiable items, and cuts of more than 50% on 5% of these items.

Furthermore, during the Kennedy Round, a new Part IV entitled “Trade and Development” (Articles XXXVI-XXXVIII) was added to GATT. This Part obligates rich countries to give high priority to reducing their trade barriers to products from poor countries, and eschew erection of new barriers against such products. Article XXXVI:8 states developed countries do not “expect reciprocity” from developing countries. By no means have all major countries put into practice fully these requirements. During the Kennedy Round, tariff concessions granted by developed countries tended to cover industrial products of potential, not actual, export interest to LDCs. Of the dutiable manufactured goods of actual interest to LDCs, 24% of the value of these products imported by major developed countries were not subject to any tariff reduction, 29% of these products were subject to reductions of less than 50%, and 47% were subject to reductions of 50% or more. By comparison, for all manufactured products, 16% were subject to no tariff cut, 29% to a cut of less than 50%, and 55% to a cut of 50% or more. To the present, the meaning, extent, and implementation of S&D treatment for developing countries and LDCs is tremendously controversial.

Fifth, Kennedy Round negotiators worked to reduce NTBs, as well as tariffs. To be sure, they were not the first to identify these barriers. In the 1955-56 Geneva Round, the negotiators put on the agenda “certain regulations and protection afforded through the operation of import monopolies.”⁷²⁰ The *Ministerial Resolution* launching the Kennedy

⁷¹⁹ DAM, 73.

⁷²⁰ *Plans for Tariff Reduction and Rules and Procedures for 1956 Tariff Conference, Annex, Section II (Scope of Negotiations)*, B.I.S.D. (4th Supp.) 80 ¶ 4 (1956) (adopted 18 November 1955).

Round spoke of “deal[ing] not only with tariffs but also non-tariff barriers.”⁷²¹ Apparently, the negotiators appreciated the definition of a NTB ought not to be circumscribed to import licenses, quotas, and other quantitative restrictions. Rather, the definition should embrace abuse of trade remedies, because that abuse constricts or blocks importation of targeted merchandise. Accordingly, the Kennedy Round negotiators established an AD code. However, it was a plurilateral deal. Congress felt the American trade diplomats did not have delegated authority to negotiate this code, thus the U.S. never joined it, and the code had little practical impact.

The final and perhaps most enduring noteworthy feature of the Kennedy Round is its identification of issues that remain on the multilateral trade negotiating agenda. Agriculture products and S&D treatment are examples. Reducing NTBs, and expanding the meaning of the term, are a third illustration of efforts at progressive liberalization of trade. Still another illustration are the discussions that occurred during the Round on customs valuation, leading to an agreement on chemical products and the controversial valuation method used at the time by the U.S. known as the American Selling Price. (The Kennedy Round deal on chemicals called on Europe to reduce its tariffs on chemical products if the U.S. dropped the ASP valuation method.) Modern day negotiators owe gratitude (or blame) to Kennedy Round negotiators for putting these items squarely on the negotiating table.

VII. 1973-1979: Tokyo Round

No doubt tariff reductions achieved in the Dillon and Kennedy Rounds stimulated international trade and enmeshed the contracting parties in a growing network of economic interdependence. In fact, from 1950-1975, merchandise trade among industrial countries grew at an average rate of 8% annually, which was double the growth rate of the gross national product of these countries. However, as impressive as the results of the Dillon and Kennedy Rounds were, more progress was needed on reducing tariff barriers on agricultural goods, managing the special problems of developing countries and – most importantly – combating the spread of NTBs.

In early 1972, the U.S., EEC, and Japan called for multilateral, comprehensive GATT negotiations. They did so in the wake of the international monetary crisis of 1971. The crisis prompted President Richard M. Nixon (1913-1994, President, 1969-1974) to end convertibility of the U.S. dollar into gold (*i.e.*, to close the “gold window”), and abandon the fixed exchange rate system for currencies established in 1944 by the *Bretton Woods Agreement*. As in the Kennedy Round, many tariff negotiations were on a linear across-the-board basis. But, Tokyo Round talks were broader and more ambitious than in the previous Round. They were open to non-contracting parties and, significantly, dealt expressly with NTB reductions.

⁷²¹ *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, B.I.S.D. (12th Supp.) 47-49 (1964) (adopted 21 May 1963).

In retrospect, the Tokyo Round – if not the Kennedy Round – marks an interesting point in the history of Article XXVIII:1 *bis*. This provision (as discussed earlier) clearly condones the conduct of tariff negotiations. It does not expressly mention multilateral trade negotiations on non-tariff topics. Yet, negotiators in the Tokyo Round (indeed, in the Kennedy Round, if not earlier) were not inhibited by this technicality. Nor should they have been, as they had, and continue to have, the authority to negotiate any matter relevant to GATT under Article XXV:1. Accordingly:

[i]n the Tokyo Round, while tariff negotiations were important, the negotiations on non-tariff measures were given equal, if not greater, importance. No tariff conference under GATT 1947 was confined purely to tariffs and even the early rounds envisaged negotiations on quotas and the protection afforded through the operation of import and export monopolies. But it was during the Tokyo Round that a successful attempt was made to negotiate agreements on a range of non-tariff measures.⁷²²

Emerging from the Tokyo Round was a comprehensive package of agreements adopted by 85 contracting parties.

Not all 85 contracting parties agreed to cuts in their Schedules of Concessions. In the end, only 36 of them, most of which were developed countries, including the 10-member EC, did so. Still, over \$300 billion worth of trade was covered by tariff reductions and bindings phased in during a seven-year period.

Specifically, the weighted average tariff on manufactured goods from the 9 major industrial markets declined from 7% to 4.7%, causing a 34% decrease in customs duties collected:

During the Tokyo Round, the level of all *industrial* duties in *industrialized* countries (EC, U.S., Canada, Japan, Austria, Finland, Norway, Sweden, and Switzerland) was reduced by *one-third if measured on the basis of customs collection*, and by about *39 percent if based on simple average rates*. In these countries, the *simple average declined from 10.4 to 6.4 percent*, and the *weighted average was reduced from 7.0 to 4.7 percent* (using import data from MFN origin in 1977, except that 1976 was used in the case of Austria, Canada, and Norway). *No comparable estimates are available for developing countries*, again [as in the Kennedy Round] because of the *selective nature of their bindings and reductions*, but a GATT Secretariat study mentions that the coverage of their tariff reductions was \$3.9 billion of their imports in 1976 and 1977. As for tariffs facing imports of developing countries, the average MFN reduction on industrial products was shallower than the overall cut, about one-quarter compared with one-third. This reflected the fact that important product groups in the exports of

⁷²² Quoted in HODA, ¶ A.6 at 26.

developing countries such as textiles, clothing, footwear, and travel goods were subjected to lower than formula reduction.⁷²³

Put differently, Tokyo Round reductions on industrial tariffs were similar to that achieved in the Kennedy Round. Even developing countries cut tariffs on \$3.9 billion of imports.

How did Tokyo Round negotiators achieve these cuts in industrial tariffs? The *Ministerial Declaration* launching the Round called for the use of “appropriate formulae of ... general application.”⁷²⁴ That is, the *Declaration* envisaged an across-the-board method of some sort, not the selective, product-by-product approach of the Early Rounds. A formula offers five potential benefits *vis-à-vis* the request-offer approach that was used during the early GATT Rounds to cut tariffs on a selective, product-by-product basis:

- (1) *Efficiency* – it is easier to apply a formula (as long as the formula is simple) than to go through the process of request-offer, which is cumbersome.
- (2) *Equity* – cutting a tariff depends on implementing a rule, that is, a formula, rather than on the relative balance of power between countries engaged in reciprocal request-offer bargaining.
- (3) *Predictability* – it is easier to prognosticate the aggregate results of cutting tariffs through a formula than the effects of product-by-product cuts.
- (4) *Problem-Solving* – depending on the precise formula, cutting tariffs with a formula can address the problems of tariff peaks and tariff escalation.
- (5) *Transparency* – every country knows the manner and amount by which every other country is cutting a tariff.

Thus, in the Tokyo Round, a number of contracting parties – notably, Canada, the EEC, Japan, Switzerland, and U.S. – proposed specific formulas, and the Swiss approach was accepted. The “Swiss Formula,” as it became known, is:

$$Z = \frac{(\text{coefficient})(X)}{(\text{coefficient}) + (X)}$$

That is,

$$Z = \frac{(A)(X)}{(A) + (X)}$$

In this formula, the variable “X” represents the initial rate of duty, and the variable “Z” represents the final rate of duty. The contracting parties forge an agreement on the value of the coefficient, which sometimes is abbreviated with the letter “A.” There is an inverse

⁷²³ HODA, ¶ J.6 at 72. (Emphasis added.)

⁷²⁴ *Declaration of Ministers Approved at Tokyo*, B.I.S.D. (20th Supp.) 19 (1973) (adopted 14 September 1973).

relationship between the value of the coefficient and the reduction in tariffs, *i.e.*, the smaller the value of the coefficient, the greater the cut.

In the Tokyo Round, Australia, Austria, the EEC, Hungary, and Nordic countries used 16 as the value in making their tariff cut offers. Czechoslovakia, Japan, Switzerland, and the U.S. used 14. In general, developing countries favored the Swiss Formula, though they argued for particularized treatment to account for their economic needs. Many of them offered concessions later in the Round, after June 1979 when major developed countries concluded their talks.

As in the Kennedy Round, during the Tokyo Round the application of a linear formula was not truly across-the-board on industrial products. There were three significant departures. First, several contracting parties simply exempted certain product categories from the application of the formula. They did so, even though the Ministerial Declaration launching the Round did not refer to exceptions. Second, Canada was permitted to use an equation other than the Swiss Formula. Third, Iceland, New Zealand, and South Africa applied the product-by-product methodology.

Aside from tariff cuts, four other results of the Tokyo Round stand out. First, some reductions in agricultural tariffs occurred. However, no formula was used. Rather, the traditional, selective product-by-product approach was applied.

Second, agreements on reducing NTBs were achieved. For example, codes on customs valuation, import licensing procedures, government procurement, and technical barriers to trade, were reached. Some of these codes formed the basis, even to the extent of *verbatim* texts, for Uruguay Round accords.

Third, Tokyo Round negotiators drew up accords on trade remedies. They approved a code on subsidies and CVDs, and they revised the Kennedy Round *AD Code*. They also codified practices and procedures concerning dispute settlement and the use of trade measures to safeguard the external financial and BOP positions of a contracting party.

Fourth, the legal basis for granting preferential trade treatment to LDCs was made permanent. An “*Enabling Clause*” was agreed to as the legal basis for the *GSP* offered by developed countries. (The *GSP* is a non-reciprocal scheme whereby certain exports from beneficiary developing countries receive duty-free treatment.) Until the Tokyo Round, a waiver from GATT obligations like MFN treatment under Article I:1 provided that basis. Technically, the waiver provision, contained in Article XXV, did not afford certainty and predictability. The waiver standard is both rigorous and subject to contextual interpretation. Article XXV:5 calls for a waiver only under “exceptional circumstances.” A general preferential scheme like the *GSP*, which applies to a large number of developing countries, could not pass muster. At least some of them suffer from “exceptional circumstances,” but not all, and not in all economic sectors. Additionally, during the Tokyo Round, LDCs were afforded more flexibility in enacting trade measures designed to meet their economic growth interests.

VIII. Persistent Problems of Currency Misalignment and Trade Wars

To be sure, GATT, rounds of MTNs in the latter half of the 20th century, and WTO *Agreement* and its annexed accords did not resolve all trade problems that the world witnessed in the economic crucible in which multilateral trade law was forged: the Depression Era and its aftermath. Disputes over FX rates, that is, currency wars that become trade wars, are a prime example.⁷²⁵ In the 1960s, the German *Deutsche Mark (DM)* was undervalued, while in the 1970s, 1980s, and again in the mid-2010s, the Japanese *yen* was below its market value, and in the mid-2000s into the 2010s, so also was the Chinese *renminbi (RMB)*, or *yuan*. Undervaluation resulted from deliberate intervention by the German, Japanese, and Chinese governments, though the exact techniques varied. Some were official devaluations, while others were government-catalyzed market depreciations. (“Devaluation” or “revaluation” are official government acts, while “depreciation” or “appreciation” are the result of changes in market supply and demand conditions.)

These countries sought to make their exports more attractive, when priced in their local currency as against a hard currency. (A “hard” currency, like the U.S. dollar or EU *euro*, is freely tradable and readily acceptable as a means of payment.) So, when one country, for example, Japan, engineers a fall in the value of the *yen* relative to the dollar, Japanese exports become cheaper for Chinese, Korean, and Taiwanese consumers (priced in *yen*, and then converted to *RMB*, Korean *won*, or the New Taiwan dollar). Conversely, Chinese, Korean, and Taiwanese goods (priced in *yen*) are more expensive for Japanese consumers. Yet, China, Korea, and Taiwan can and do respond with trade barriers, by imposing higher applied duty rates, or non-tariff barriers, on Japanese goods. Those barriers protect Chinese, Korean, and Taiwanese goods against Japanese merchandise. They also can respond with devaluations or depreciations of their own, to make their goods relatively cheaper, and Japanese goods relatively more expensive. In turn, Japan may counter-react, by raising its own trade barriers against goods originating from the other three countries, and possibly another competitive devaluation or depreciation. Hence, a currency-trade war occurs.

The GATT-WTO legal regime lacks a clear set of rules for managing such Trade Wars, though (as discussed in separate Chapters), it has specific rules against individual protectionist measures. Stated differently, the regime has proved unable to cope with the Mercantilism that results from a lack of adjustment, or asymmetric adjustment, between countries with weak currencies and balance of trade surpluses and those with strong currencies and trade deficits.

In the early 21st century, large, persistent, bilateral trade deficits associated with currency manipulation, and with other unfair trade practice allegations (such as market access impediments, production overcapacity, unlawful subsidies, and IP theft, and cyber-attacks), has generated considerable trade friction. Indeed, it has led to sector-specific Trade Wars (as discussed with respect to bananas and commercial aircraft), Steel and Aluminum Trade Wars (as discussed in respect of Section 232) pitting the U.S. against

⁷²⁵ See Peterson Institute for International Economics, *The Hyperglobalization of Trade and Its Future* (Working Paper, July 2013); Schrodgers *Global Market Perspective* (July 2013).

many other WTO Members, and a Sino-American Trade War (as discussed in respect of Section 301). With such Wars, too, WTO Members are faced with the challenge of broadening and deepening the multilateral trade regime to end existing conflicts and minimize new ones – or revert to the pre-GATT era and go it alone.

Chapter 21

URUGUAY ROUND (1986-1994) AND BIRTH OF WTO (1995)⁷²⁶

I. Non-Tariff Issues

Despite impressive results in the 1976-1979 Tokyo Round, soon after its conclusion the international economic community faced sluggish economic growth, rapid inflation, and high unemployment. Economists dubbed the vexing phenomenon “stagflation.” Many contracting parties, including the U.S., resorted to protectionist measures like VERs. These measures were subtle but discriminating QRs that circumvented Tokyo Round disciplines because of their voluntary nature. Not until the Uruguay Round were VERs banned (specifically, in Article 11:1(b) of the *Agreement on Safeguards*.)

Moreover, a built-in danger was embedded in some Tokyo Round outcomes that would not be corrected until the Uruguay Round agreements were signed: free riding. The Tokyo Round Codes applied only to signatory countries. Many less developed countries rejected them.⁷²⁷ Thus, a two-tier system was created – one tier of signatories, and one tier of non-signatories. Signatories had to resort to legal devices (*e.g.*, statutory provisions in the legislation implementing the Codes into domestic law) to ensure non-signatories did not free ride on the benefits of the Codes while eschewing the obligations of those Codes.

Why the need for a Uruguay Round? Aside from weaknesses in the GATT dispute resolution system, among the most challenging problems faced by the world trading community after the Tokyo Round were substantive issues of market access in key economic sectors. The Round simply had not dealt with certain sectors adequately, or at all, in terms of providing a framework for market liberalization. By the mid-1980s, it was clear a new, even more ambitious, Round was necessary.

For example, the burgeoning trade in services, and barriers to such trade, remained wholly outside the GATT framework. IPRs required better protection than currently afforded by many NICs and LDCs. Too many contracting parties were protecting their agricultural sectors, through tariffs, NTBs (*i.e.*, any measure other than a tariff that protects a domestic industry), and subsidies, to too great a degree.

Not surprisingly, then, tariff reductions were not the primary motive for launching

⁷²⁶ Documents References:

- (1) GATT Articles XXVI, XXXI- XXXIII, XXXV
- (2) *Ministerial Declaration* on the Uruguay Round (Punta del Este, 20 September 1986)
- (3) *WTO Agreement*

For an eclectic collection of essays on international trade issues (including the WTO, *DSU*, *TRIPs* and *Agriculture Agreements*, ROO harmonization, and Section 301), see Philip Ruttley, Iain MacVay & Carol George, *The WTO and International Trade Regulation* (London, England: Cameron May, 1998).

⁷²⁷ For a collection of technical papers concerning Uruguay Round proposals to help developing countries, published at the mid-point of that Round, see United Nations Conference on Trade and Development, *Uruguay Round: Further Papers on Selected Issues* (New York, N.Y., United Nations, 1990).

the Uruguay Round. Here, again, is an illustration of the Article XXVIII:1 *bis* authorization to start a round of tariff negotiations being used for far wider purposes than just cutting tariffs.

What, in particular, prompted trade policy makers to commence the Uruguay Round? There was no single cause. Aside from the residual problems from the Tokyo Round, among the most challenging problems faced by the world trading community after that Round were substantive issues of market access in key economic sectors. The Tokyo Round failed to deal with certain sectors adequately, or at all, in terms of providing a framework for market liberalization. By the mid-1980s, the need for a new, even more ambitious, set of multilateral discussions was evident.

For example, the perspective of developed countries was shaped by the orientation of their economies in favor of service businesses and products embodying IPRs. Barriers to trade in services were a constraint on the international growth of these economies, yet services trade remained wholly outside the GATT framework. These countries also sought better IPR protection than afforded in newly industrialized countries, like Brazil, India, and Korea (and Taiwan (or, technically, “Chinese Taipei”), which acceded to the WTO on 1 January 2002), as well as in many developing countries, such as Egypt, Indonesia, and Thailand (and China, which acceded to the WTO on 11 December 2001).

From the perspective of many developing countries, particularly net agricultural exporters, and developed country members of the Cairns Group, principally Australia and New Zealand, too many contracting parties clung to various forms of protection for agricultural products. (In addition to these two countries, the 17-member Cairns Group consists of Argentina, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, Paraguay, Philippines, South Africa, Thailand, and Uruguay.) These forms included high tariff and non-tariff barriers, generous domestic support for their farmers, and significant export subsidies for their farm products.

In addition, many developing and least developed countries were concerned about the global system of quotas for T&A products that existed under the 1974 *MFA*. These countries sought to make the economic transition from primarily agrarian economies by moving factors of production into low-value added manufacturing sectors, such as RMGs. To one degree or another, they were following the pattern of industrialization laid out by Walt Whitman Rostow OBE (1916-2003) in his 1960 classic work, *The Stages of Economic Growth* (discussed in a separate Chapter). While faulted for specifying a deterministic path on which the categories of development were not always clear-cut (*e.g.*, in what stage would complex economies like those of China or India be placed?), Professor Rostow’s work served to highlight the significance access to foreign markets potentially can have in advancing along the development path. The *MFA* quotas, by contrast, blocked export growth in certain T&A products of some countries – and, not surprisingly, raised the cost of clothing to consumers in importing countries.

Certain issues cut across crude categories of “First World” and “Third World.” For instance, various contracting parties sought to clarify and amplify trade remedy rules,

namely antidumping duties, subsidies and countervailing measures, and safeguards. Finally, while concerns about infringement on sovereignty existed, and continue to the present, many contracting parties felt the time had come for a permanent multilateral infrastructure to promote trade liberalization and deal with the expanding scope of international trade law and policy. In other words, it was necessary to resurrect the ITO, ultimately under a different name – WTO.

America had a keen interest in the Uruguay Round. It was globally competitive (and in some instances dominant) in services, IP industries, and agriculture. A deal yielding significant market access for American businesses in these sectors was a Round that would be welcome. But, American goals in these sectors were not necessarily consonant with what less developed countries wanted or needed, hence a major North-South confrontation was inevitable.

The Uruguay Round was launched in September 1986 with a *Ministerial Declaration* issued by trade ministers from the contracting parties meeting in Punta del Este, Uruguay. The U.S. successfully advocated the establishment of an agenda for this Round that was even broader and more ambitious than that of the Tokyo Round. The agenda is set forth in the *Declaration*. In contrast, in the Third WTO Ministerial Conference in Seattle, held in November-December 1999, America was far less successful in pushing forward what at the time was billed a “Millennium Round.”

II. Industrial Tariff Cuts

Certainly, Uruguay Round negotiators dealt with tariffs. In contrast to the Kennedy and Tokyo Rounds, in which all developed but few developing countries made tariff cuts, in the Uruguay Round, all contracting parties participated in the Round. Each one of them had to make offers to cut tariffs, *i.e.*, produce a schedule of concessions on goods. For many developing countries and LDCs, the “grant” of a tariff concession took the form of agreeing to a ceiling binding, whereas for developed countries there were true tariff cuts. How did negotiators achieve the cuts, in whatever form?

The *Ministerial Declaration* launching the Uruguay Round did not state whether the linear approach would be used (much less present a detailed formula), or whether the traditional item-by-item would be the methodology. However, it did speak to the problem of tariff peaks and tariff escalation, and appeared to back away from the Article XXXVI:8 non-reciprocity rule:

Negotiations shall aim, by appropriate methods, to reduce or, as appropriate, eliminate tariffs, including the reduction or elimination of *high tariffs* and *tariff escalation*. Emphasis shall be given to the expansion of the scope of tariff concessions among *all* participants. [(Emphasis added.)]

Switzerland proposed a formula to cut industrial tariffs essentially the same as the equation used in the Tokyo Round, *i.e.*, the “Swiss Formula.”

However, Uruguay Round negotiators never agreed on a single formula to be used for all industrial product categories. All they could agree on, which was not insignificant, was a set of guidelines, reached during the 1990 Mid-Term Review Conference in Montréal. The key points of the *Montreal Guidelines* were:

- (1) The *substantial reduction or, as appropriate, elimination of tariffs by all participants*, with a view to achieving lower and more uniform rates, including the *reduction or elimination of high tariffs, tariff peaks, tariff escalation and low tariffs*, with a target amount for overall reductions *at least as ambitious* as that achieved by the formula participants in the *Tokyo Round*.
- (2) A *substantial increase in the scope of bindings*, including bindings at ceiling levels, so as to provide greater security and predictability in international trade.
- (3) The need for an approach to be elaborated to give *credit for bindings*; it is also recognized that participants will receive appropriate recognition for liberalization measures adopted since 1 June 1986.
- (4) The *phasing of tariff reductions* over appropriate periods to be negotiated.⁷²⁸

Despite significant efforts after the Montréal Mid-Term Review, the contracting parties could not reach agreement on a single formula. That is, they gave up the effort to set a common modality, and in January 1990, they essentially turned once again to the traditional approach of making requests and offers to reduce or eliminate, and bind, industrial tariffs on a line-by-line basis.

Fortunately, the contracting parties accepted the *Montréal Guidelines*, and their subsequent discussions, implied an overall target to reduce industrial tariffs by one third, *i.e.*, 33 $\frac{1}{3}$ %. Without a formula, though, each contracting party could decide how it would cut its tariffs. For instance, the EC, Finland, Norway, and Sweden used a three-tiered formula the EC suggested:

- (1) Least developed contracting parties would not have to cut their tariffs, or only do so to the extent they felt able.
- (2) Developing contracting parties would reduce to a ceiling binding of 35% any base (initial rate) above 35%. For base rates at or below 35%, developing countries would negotiate reductions bilaterally in an effort to harmonize duties.

⁷²⁸ Uruguay Round Document MTN.TNC/7(MIN) at 4, *quoted in* ANWARUL HODA, TARIFF NEGOTIATIONS AND RENEGOTIATIONS UNDER THE GATT AND THE WTO ¶ B.23 at 35, ¶ C.10 at 49 (2001). (Emphasis added.) [Hereinafter, HODA.]

- (3) Developed contracting parties would reduce to a ceiling binding of 20% any base rate at or above 40%. For base rates less than 40%, if the base rate were between 30% and 40%, then there would be a 50% flat rate cut.

The third point is exemplified as follows.

If the base rate were 38%, then it would be cut in half to 19%. If the base rate were between zero and 29%, then that base would be reduced via the following formula:

$$R = \text{Base Rate} + 20$$

in which:

“R” stands for the percentage (rate) of reduction applied to the Base Rate.

However, if the base rate were 15%, then the rate of reduction would be 35%, implying a new tariff of 9.75% (the result of 15% minus 35% of 15%, *i.e.*, $15\% - 5.25\%$).

The EC formula attacked the problem of tariff dispersion across countries by requiring deeper cuts on higher tariffs, and not exempting *a priori* any developed or developing contracting party. By contrast, Japan proposed the elimination of all industrial tariffs, with developing countries subject to a less severe obligation (*e.g.*, cutting a proportion of their tariffs). In the end, Japan joined Austria and Canada, and all three contracting parties used a formula proposed by Canada, as follows:

$$R = 32 + \frac{\text{Base Rate}}{5}$$

in which:

“R” stands for the percentage (rate) of reduction applied to the Base Rate, and R cannot exceed 38%,

“Base Rate” refers to the initial tariff rate on the product in question, but with all base rates below 3% to be eliminated (*i.e.*, reduced to zero) on view that such low tariffs have only a nuisance value but no protective effect, and

the term $\frac{\text{Base Rate}}{5}$ is rounded down to the nearest whole number

Yet another formula, which Australia proposed and used, called for the elimination of any base rate of 2% or less. For non-*de minimis* base rates, Australia called for deeper cuts on higher rates:

If the Base Rate exceeds 15%, then:

$$R = \frac{(\text{Base Rate} - 15)(100)}{(\text{Base Rate})}$$

If the Base Rate exceeds 10% but is less than or equal to 15%, then:

$$R = \frac{(\text{Base Rate} - 10)(100)}{(\text{Base Rate})}$$

where in both instances:

“R” stands for the percentage (or rate) of reduction applied to the Base Rate.

For example, applying the Australian formulas, if the Base Rate were 50%, then the rate of reduction (R) applied to it would be 70%, yielding a new bound tariff ceiling of 15%. If the Base Rate were 12%, then it would be reduced by 16 2/3 %, producing a new bound tariff level of 10%.

Even these formulas were not applied in their pure form. Norway modified the EC formula, and Austria did not apply the maximum 38% rate of reduction to any product category. The adulterations are not surprising, given the range of perspectives and objectives animating in the Uruguay Round. From the perspective of different contracting parties, each formula had strengths and weaknesses. For example, contrary to Canada, the EC did not favor the elimination of low tariffs, or at least not if credit were given for such action. The EC claimed they were not mere nuisances, but rather provided a contracting party with a modicum of negotiating leverage.

What about the American methodology on cutting industrial tariffs during the Uruguay Round? As Professor Hoda writes:

The United States advocated the adoption of a request-and-offer approach. It argued that, after the previous rounds, the tariff regimes of countries which had participated in the formula cuts had already been substantially liberalized and little overall protection remained to justify a linear approach. Further, modern data processing techniques made it possible to conduct request-offer negotiations efficiently. Moreover, such procedures were best suited to address tariff peaks and tariff escalation, the reduction of which was an objective of the negotiations.⁷²⁹

Thus, even after the Montreal Mid-Term Review, America adhered to the request-offer, item-by-item method. For many industrial product groups, and several industrial sectors, the U.S. called for the elimination of tariffs.

Accordingly, Uruguay Round negotiators considered American-inspired “sectoral proposals,” also known as “zero for zero proposals,” in areas such as chemicals, clothing

⁷²⁹ HODA, ¶¶ B.16, B.25 at 33, 36.

and textiles, and non-ferrous metals. On selected products, the U.S. made specific reduction offers (except in two instances, namely, where the principal supplier of a product had not asked the U.S. for a concession, and where the U.S. was not negotiating with the country in the Uruguay Round and that country supplied a substantial share of imports to the American market). The U.S. warned it would fight free rider behavior of some contracting parties by refining its concession offers to benefit only the contracting parties that had made serious proposals.

In the end, following not only the March 1992 “Dunkel Text,” but also continuing through the last day of negotiations on 15 December 1993, what did the Uruguay Round negotiators agree upon with respect to industrial tariffs? In brief, they achieved the following reductions:

- (1) All developed contracting parties met the overall target percentage reduction of $33\frac{1}{3}\%$, and some of them exceeded this target. In particular, developed countries cut tariffs on industrial products they import from all sources (whether a developed or developing country, or LDC) by 40%. The cut was from a pre-Uruguay Round trade-weighted tariff average of 6.3% to a post-Round trade-weighted average of 3.8%.
- (2) Developed contracting parties were slightly less generous in cutting tariffs on industrial products they import from developing countries and LDCs. For industrial products imported by developed countries from developing countries, the cut was 37%, from a pre-Uruguay Round trade-weighted average of 6.8% to a post-Round 4.3%. For such products from least developed countries, the cut was 25%, from a pre-Uruguay Round average of 6.8% to a post-Round average of 5.1%. A few sectors explain the difference between these figures, on the one hand, and the figures on tariff cuts on industrial products from all sources, on the other hand. Developed countries reduced tariffs on clothing and textiles, fish, and fish products – all exports from developing and least developed countries – by a lower average amount than on other products.
- (3) Developed contracting parties agreed to extend the scope of industrial products subject to ceiling bindings. With an increase in the number of bound tariff lines from 78% to 99%, virtually every industrial product traded among industrialized countries is subject to a bound rate.
- (4) Developed contracting parties extended the scope of duty-free treatment for industrial products from 20% of these goods to 44% of them.
- (5) Developed contracting parties agreed to reduce, but not eliminate, tariff peaks above 15%. They cut from 7% to 5% the proportion of industrial products subject to a tariff peak.
- (6) To some extent, developing countries agreed to increase the scope of

product categories subject to ceiling bindings, to reduce bound tariffs in key sectors like clothing and textiles, and to narrow gaps between bound and applied rates. Specifically, developing countries increased from 21% to 73% the number of industrial tariff lines subject to bound rates, and transition economies agreed to increase this number from 73% to 98%.

- (7) Little progress was made towards reducing or eliminating tariff escalation, *i.e.*, the phenomenon of a higher tariff applicable to a product at a higher stage of processing a lower tariff applicable to the product in its unprocessed or semi-processed state. Measures as the absolute difference between a tariff at the higher end and at the lower end of processing, the average tariffs maintained by developed countries across all industrial products involved escalation both before and after the Uruguay Round. However, the absolute reduction in tariffs were larger for advanced products than for unprocessed products or products at early stages of production.

In sum, the Uruguay Round negotiators produced reasonably impressive results on industrial tariff cuts.

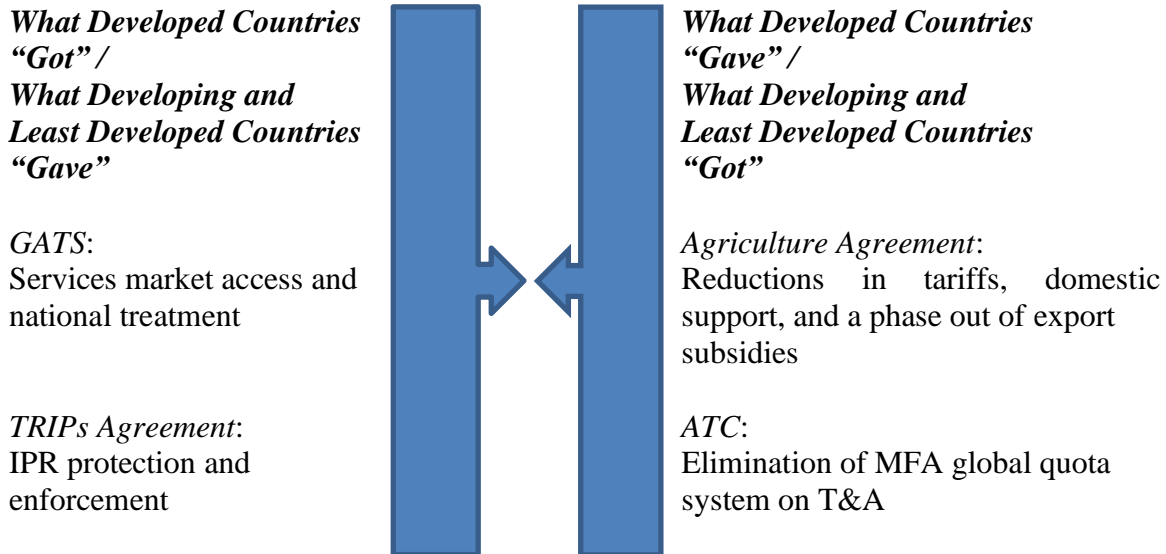
III. “Grand Bargain”

Reductions of industrial tariffs achieved during the Uruguay Round are only part of the story of that remarkable 8 years (1986-1994) of MTNs. The cuts occurred in the broader context of a “Grand Bargain.” Essentially, the U.S., EU, and other developed countries gained for their cherished services and IP sectors the benefits of the *GATS* and the *TRIPs Agreement*.

In exchange, they agreed to grant developed and least developed countries improved terms of entry to their agricultural and T&A markets, on a more even playing field than before. They did so through the *Agriculture* and *ATC Agreements*. Thus was the so-called “landing zone,” a term sometimes used by trade negotiators to connote a consensus on an array of issues, encapsulated in the text of agreements, centered around a core deal.

Put succinctly, and setting aside the many achievements of the Uruguay Round in areas like dispute settlement and trade remedies, the Grand Bargain was this; (1) better market access for services and improved IP protection in exchange for (2) more open agricultural markets and an end to global T&A quotas. Chart 21-1 summarizes the Grand Bargain.

Chart 21-1 Uruguay Round Grand Bargain



IV. WTO Birth and Key Dates

With the Grand Bargain, the Uruguay Round concluded on 15 December 1993, in Marrakesh, Morocco. Not coincidentally, that was precisely the date fast track trade negotiating authority of the American President expired. Formal signing occurred on 15 April 1994, with the signing of the *Marrakesh Protocol*.

The WTO was born on 1 January 1995, succeeding the GATT as an institution. All WTO agreements entered into force on that date, except for the *TRIPs Agreement*, which took effect on 1 January 1996, and except for delayed implementation of that *Agreement* for developing and least developed countries.

V. Deterioration of Grand Bargain

Even before the launch of the Doha Round, for developing countries and LDCs, the Grand Bargain of the Uruguay Round had eroded, if not actually broken down. Some suspected they had been hoodwinked. All had expected dramatic reductions of domestic agriculture support, and an end to agriculture export subsidies, pursuant to the *WTO Agreement on Agriculture*. This expectation may have been unrealistic in light of the many detailed exceptions in that *Agreement* – for example, for Blue Box domestic support (*i.e.*, production set-aside schemes), the exemption of food aid and export credits from the meaning of export subsidies, and the lack of an adamant commitment to eliminate export subsidies. Moreover, the key tariff and domestic support reduction commitments were nowhere to be found in hard-law obligations in the text of the *Agreement*. (Rather, a contemporaneous press release took note of them.)

Moreover, developing countries and LDCs may not have appreciated, nor had the capacity to appreciate, the extent to which they could take advantage of Uruguay Round opportunities – or, for that matter, of potential benefits from any Round. India is a case in point. With a decrepit physical infrastructure, including road and port facilities, to what degree can Indian farmers or manufacturers seize upon lower tariffs and NTBs abroad? With erratic power supplies, what choice do Indian food processing factories have but to shut down episodically, or incur costs of self-generation power (which erodes their labor and materials cost advantages)?

Brazil affords another illustration. For years under military dictatorship, Brazil constrained its own agricultural sector. It focused on industrial development, using agriculture for resources for this development, and inexpensive food for its growing urban populace. The government set prices (and guaranteed minimum prices to producers), controlled quantities that could be exported, and taxed exports.

For instance, it subjected cotton to an export quota to ensure steady, cheap supply to the T&A industry. In the late 1970s, farmers and ranchers began to migrate from the traditional breadbasket area of the country, the south (*e.g.*, the state of *Mato Grosso do Sul*), to the savannah areas of the center-west, where land is comparatively cheaper. Only in the 1990s, following the dictatorship period, did Brazil abolish the official restrictions, and cut subsidies. Agriculture now accounts for 8.8% of Brazilian GDP, but (unlike the usual pattern in other countries) this share is not falling as development in other sectors proceeds. Agriculture accounts for 40% of Brazilian exports, and a huge percentage of its trade surpluses. It is the world's largest exporter of beef, coffee, orange juice, and sugar, and a major participant in world markets for pork, poultry, and soya.

Still, Brazil faces infrastructural and other challenges. Only 10% of its roads are paved (the figure in Argentina is 29%), and its railway network is poor. Some farmers in the south reportedly use GM soya seeds smuggled from Argentina. Some ranchers in the north allegedly hire laborers from questionable contractors, known as *gatos*, resulting in labor rights violations.

To be sure, legal capacity – or, the lack of it – helps determine whether a poor country can maximize benefits under multilateral agreements. Many such countries simply do not have enough specialists in international trade law, even if they have a surfeit of law graduates. They suffer in part from sclerotic educational ministries and bureaucracies that make curricular innovation, such as adding new courses on WTO agreements to law schools, difficult. The result is that senior politicians sign trade deals, but lawyers in the private and public sector have little idea how to implement those deals in practice, and law students do not learn about the provisions of the deals.

Notwithstanding the self-inflicted wounds, the perspective of developing and least developed countries that the Grand Bargain of the Uruguay Round had disintegrated was both earnest and credible. Following the Round, poor country advocates produced empirical and case study research on what they alleged were devastating effects of that Round, especially the *Agreement on Agriculture*. For instance, in December 2005, the

Forum for Biotechnology & Food Security in New Delhi, India published *Trade Liberalization in Agriculture: Lessons from the First 10 Years of the WTO*.

In this *Report*, lead author Devinder Sharma and his colleagues examine the experiences of many developing and least developed countries:

- (1) From 1986-1996, *i.e.*, throughout the Uruguay Round period, government spending on agriculture by developing countries fell by roughly 50%.
- (2) Freer trade in agriculture since the Uruguay Round had negative repercussions for poor countries, essentially creating a new, global farming system that undermines food security in these countries.
- (3) Specific adverse impacts included (1) surges in imports of staple foods, (2) price depression in domestic agricultural markets, (3) bankruptcies and impoverishment of local farmers, (4) takeovers of small farms by large enterprises (*i.e.*, corporate farming), (5) a shift from producing essential crops to growing cash crops for export, (6) chronic hunger for billions of rural inhabitants, who no longer grow their own food and lack purchasing power to buy food, and (7) environmental degradation caused by developed country farmers, who farm intensively a single crop (often getting a subsidy to do so) rather than engage in crop diversification.

The authors were not dispassionate, questioning the intention as well as the effects of agricultural trade liberalization. They indicated the free trade paradigm aims to discourage poor countries from growing staple foods and commercially important commodities like cotton and sugar.

The Indian *Report* contained provocative recommendations. First, there should be a “Multilateral Agreement against Hunger” that enshrines a right to food. This right would be primary in all farm trade negotiations, and enhance food security in developing and least developing countries. Second, these countries should be allowed to protect themselves against floods or surges of cheap farm products. Protective actions should include hiking tariffs, imposing quantitative restrictions, and using special safeguard measures. Third, agricultural subsidies should be re-categorized into two boxes – support benefiting small farmers, and support for large agricultural firms and land owners.

In reflecting on the Grand Bargain of the Uruguay Round, developing countries and LDCs considered non-agricultural sectors as well. They studied the effects on their T&A industries from the end of the global quota scheme associated with the 1974 *MFA*. The gist of the WTO *ATC* was a “suicide” (or, the better characterization may be “murder”) clause whereby as of 31 December 2004 *MFA* quotas were phased out. Large T&A manufacturing countries like China and India led smaller ones like Bangladesh and Sri Lanka to fear foreign garment companies would consolidate their operations in the larger countries. These manufacturers no longer needed to source products from many different locations to

conform to the global quota scheme. Free from the distorted incentives of this scheme, they could make as much as they needed in any country.

The fears of smaller poor countries were borne out. Consolidation of T&A manufacturing facilities in a reduced number of countries, based on business considerations such as labor costs, proximity to markets, and political risk, occurred. Certainly, some of the smaller, least developed countries proved to be worthy, world-class competitors. Bangladesh and Cambodia were examples. But, many of them, such as in Sub-Saharan Africa, could not withstand competition from the likes of China and India unaided by the *MFA* quota system that provided the rationale to source T&A from them.

Here again, there are two sides to the story. The smaller countries had a decade (from the entry into force of the *ATC*, on 1 January 1995, to the final phase out of *MFA* quotas on 31 December 2004) to figure out how to cope, adjust to a more competitive global clothing trade, and commence diversification into other sectors. The leaders in these countries did not all use the time equally wisely. Still, the adjustment costs in the T&A industries of these countries meant real, human suffering, often for millions of young women working in these industries.

Likewise, it was not just poor countries that felt disappointed, even cheated, by the Grand Bargain. For their part, developed countries were not entirely happy with the outcome of the Uruguay Round. NAMA mattered both to their beleaguered rust-belt industries and sophisticated manufacturing sectors. These countries seek sought better market access for their service providers, and look for improved concession offers under the *GATS*. They demanded improved IP protection and enforcement in the Third World through the *TRIPs Agreement*. On all such points – industrial market access, services liberalization, and IP protection – many rich countries felt their less well-off counterparts had not adhered to the letter or spirit of the Uruguay Round texts.

Additionally, a number of other issues concerned developed countries, and – depending on the precise question – cut across simplistic “First World” and “Third World” categories. Among these issues were clarifying AD and CVD disciplines, delineating the relationship between MEAs and GATT-WTO legal regime, reforms to the dispute settlement system of the WTO (that is, to the *DSU*), resolving at least some of the issues from the 1996 WTO Ministerial Conference in Singapore – the “Singapore Issues,” namely, competition policy, FDI, trade facilitation, transparency in government procurement, and enhancing legal capacity and the rule of law in developing countries and LDCs. To clarify or complicate matters (depending on one’s side of the debate), some academics pushed for multilateral trade talks to address substantive authority over a wide array of non-trade or trade-related topics, and in effect turn the WTO into a global governance institution.

Chapter 22

FAILED DOHA ROUND (NOVEMBER 2001-MARCH 2018)⁷³⁰

I. Diversity Schisms from GATT Contracting Parties to WTO Members

The November 2001 Ministerial Conference in Doha, the capital of Qatar, was the fourth such meeting of the senior-most trade officials from WTO Members. Pursuant to Article IV:1 of the *WTO Agreement*, Conferences are held at least once every two years. The Ministerial Conference is the highest decision-making body of the WTO, and its composition bespeaks an institutional hallmark, namely, the WTO is Member-driven. Forceful as the personality of a particular Director General may be, real power lies with the Members, not the head of the WTO Secretariat.

As was true in September 1986 in Punta del Este, Uruguay, when the Uruguay Round began, in November 2001 in Doha, when the Doha Round was launched, tariff negotiations were not the primary impulse. Rather, to simplify, there were two catalysts. At Doha, agriculture-exporting countries, particularly among developing and least developed WTO Members, wanted developed countries, especially the U.S., EU, and Japan, to eliminate export subsidies for agricultural products. Conversely, developed countries, which tend to be net exporters of services, sought enhanced market access for their service providers, such as commercial and investment banks, insurance companies, architecture and engineering firms, health care professionals, and (of course!) lawyers.

Yet, the WTO Membership was larger and more diverse than the totality of GATT contracting parties in the early GATT Rounds. No longer were the players largely homogeneous economies inclined to trade liberalization, at least in manufactured items. Even the familiar distinction between “First World” and “Third World” had broken down. There were schisms within these broad categories, along many issues. The Members crossed from one coalition to another, depending on the topic.

These catalysts bespoke distinctions among countries that appeared at least as early as the Tokyo Round. The distinctions became chasms during and after the Uruguay Round, and continued through the Doha Round. “Developed” countries are not all like-minded. The U.S. and EU are as much strategic competitors in trade as they are allies. Australia and New Zealand incline toward more pro-free trade positions on agriculture than do Japan or Korea. Moreover, some developed countries have underdeveloped regions in them. In brief, the “First World” is not a monolith. Deputy USTR Ambassador Michael Punke summarized the problem thusly:

“For the first time in the history of multilateral trade negotiations, the major players are not like-minded,” Punke declared [at a 12 September 2012

⁷³⁰

Documents References:

(1) *Ministerial Declaration* launching the Doha Round (Doha, Qatar, November 2001)

meeting with journalists at the U.S. Mission in Geneva]. “Systemically, we have not absorbed the implications of what that means.”

Past trade rounds were dominated by the Quad Group – Canada, the European Union, Japan, and the United States – but major developing countries such as Brazil, China, and India play a key role in the Doha talks.

In those earlier rounds, “at the end of the day, the major players came to consensus and then led the rest of the organization towards a broader agreement,” Punke noted.

“The U.S., the EU, Canada, and Japan were commercial rivals, but they were fundamentally like-minded,” he added, noting that the Quad members were all democracies and market economies. “We don’t have that situation today. So what the real question today about moving the trade negotiations forward is: How do we rebuild consensus?”⁷³¹

He would have done well to add the “Third World” is not monolithic either.

The moniker “less developed country,” used through the Tokyo Round, suffices only as a general name to capture all “poor” countries. However, “LDC” is a veil over the line between “developing” and “least developed” countries. What is a “developing” versus “least developed” country? Developing countries are self-identified as such, each one based on its own admixture of objective and subjective factors. That freedom creates tensions, most notably between developed countries, especially the U.S. and Japan, and large emerging countries like China, which America and Japan feel should not be considered “developing” and thereby (as discussed in a separate Chapter) entitled to S&D treatment.⁷³²

In contrast, relatively objective socioeconomic criteria delineate “LDC” status. These metrics include the famous “dollar a day” standard (*i.e.*, a *per capita* GDP of one U.S. dollar – technically, \$1.25 – a day or less, the U.N. classifies about 50 countries as “least developed.” Among them, roughly 41 are WTO Members, several are in the process of acceding to the WTO, and one (Burma) is an original GATT contracting party.

II. November 2001 DDA Items

⁷³¹ Daniel Pruzin, *Punke Calls for Rebuilding Consensus, Citing Absence of “Like-Minded” Membership*, 29 *International Trade Reporter* (BNA) 1508 (20 September 2012) (*quoting* Deputy USTR and U.S. Ambassador to the WTO Michael Punke).

⁷³² *See, e.g.*, Akane Okutsu, *Japan Foreign Minister Calls for U.S. to Join CPTPP*, NIKKEI ASIA, 23 October 2021, <https://asia.nikkei.com/Politics/International-relations/Indo-Pacific/Japan-foreign-minister-calls-for-U.S.-to-join-CPTPP> (reporting that Japan’s Foreign Minister, Toshimitsu Motegi, “criticized China for benefiting from its developing country status in areas such as climate change, the World Trade Organization and development finance. ‘We must correct the distorted structure in which the international community keeps supporting the development of China, which is now the world’s second-largest economy,’ he said.”).

What is both astonishing and heartening is that less than two months after the terrorist attacks of 11 September 2001, WTO Members gathered in the heart of the Persian (Arabian) Gulf, in Doha. After much hard and late-night bargaining at this Ministerial Conference, and urged on by the robust leadership of the WTO Director General, Mike Moore (1949-2020, Director General 1999-2002), the Members agreed to a “Doha Development Agenda.” Agreement in November 2001 on the DDA formally launched the Doha Round.

The essential elements of the DDA are as follows. Manifestly, they are supposed to emphasize the middle “D” in “DDA” – “Development.” Yet, they are not supposed to do so exclusively, so as to take into account the complaints of developed countries in the aftermath of the Uruguay Round. In other words, the DDA was not radical: it was not a unilateral, non-reciprocal proposal to help poor countries, because it envisaged some reciprocal concessions from developed (but not least developed) countries. Yet, it was dramatic, in that it anticipated an un-level degree of bargaining and results in favor of poor countries. Or, at least, that is what they thought the DDA meant.

- **Agricultural Subsidies**

Members agreed (in Paragraph 13 of the DDA) to negotiations on “reductions of, with a view to phasing out, all forms of export subsidies” for farm products and “substantial reductions in trade-distorting domestic” support schemes, but “without prejudging the outcome” of these talks, and taking into account the need for special and differential treatment for under-developed countries.

- **Industrial Products**

Members agreed (in Paragraph 16 of the DDA) to negotiations on NAMA, that is, to eliminate or cut tariff and non-tariff barriers, including tariff spikes (*i.e.*, peaks) on sensitive exports like T&A, which are of importance to poor countries. Reduction obligations need not be reciprocal, to allow special and differential treatment for Third World countries.

- **Services**

Members agreed (in Paragraph 15 of the DDA) to continue negotiations on (1) market access for service providers, particularly in financial, telecommunication, and transport, (2) domestic regulation of services, and (3) easing of immigration rules for employing workers on temporary contracts.

- **Trade Remedies**

In the *Ministerial Declaration* (in Paragraph 28 of the DDA), Members agreed to negotiations on “clarifying and improving disciplines” on AD and CVD rules (including fishing subsidies) as set forth in the Uruguay Round *Antidumping* and *SCM Agreements*, while “preserving the basic concepts, principles and effectiveness of these *Agreements* and

their instruments and objectives....” The meaning of “instruments” was not entirely clear. The U.S. took the position it referred to trade remedy laws of Members (*e.g.*, American AD and CVD rules). Moreover, the U.S. insisted on disciplines against dumping and illegal subsidization, as distinct from restraints on remedial measures to combat these unfair trade practices.

- **RTAs**

Members agreed (in Paragraph 29 of the DDA) to negotiations on “clarifying and improving disciplines and procedures” on FTAs and CUs.

- **E-Commerce**

Members (in Paragraph 34 of the DDA) extended until the 5th Ministerial Conference (in September 2003 in Cancún) a ban (initially imposed at the Second Ministerial Conference in Geneva in 1998) on imposing tariffs on certain kinds of cross-border electronic transactions. Subsequently, they continued the ban at the Hong Kong Ministerial Conference in December 2005, and the Geneva Ministerial Conference in November-December 2009. The Geneva extension carried through until the eighth Ministerial Conference in December 2011 in Geneva. Subsequent renewals ensued.

- **IP**

Members adopted (pursuant to Paragraph 17 of the DDA) a *Declaration* that developing countries will be immune from challenge under the Uruguay Round *TRIPS Agreement* if they seek to obtain medical supplies via compulsory licensing in order to meet a public health crisis. The *Declaration* provided: “*The TRIPS Agreement* does not and should not prevent Members from taking measures to protect public health,” and should be understood and enforced in a way “supportive of WTO Members’ right to protect public health and, in particular, to promote access to medicines for all.”

Additionally, at the Doha Ministerial Conference, developing countries hoped for new provisions in the *TRIPS Agreement* that would mandate disclosure in a patent application of the country of origin of genetic resources and associated traditional knowledge. (This topic, discussed in Paragraph 19 of the DDA, lies at the intersection of the *TRIPS Agreement* and U.N. *Convention on Biological Diversity (CBD)*.) A patent applicant would have to state the origin of genetic material and traditional knowledge used in the invention of that applicant. Bolivia, Brazil, Colombia, Cuba, Dominican Republic, Ecuador, India, Peru, Thailand, and some African countries supported not only disclosure, but also rules that the applicant prove (1) it has obtained consent from the relevant holder of the genetic material or traditional knowledge (*i.e.*, prior informed consent), and (2) will share benefits with that holder on a fair and equitable basis (*i.e.*, fair and equitable sharing). The U.S. argued national legislation and contracts would achieve these objectives. The EU took an intermediate position, favoring disclosure, but leaving the consequences of failure to disclose outside the scope of patent law.

- **GIs**

Members agreed (in Paragraph 18 of the DDA) to discuss GI extension and registry. “GI extension” refers to protection as a geographical indicated item certain foods, beyond wines and spirits. Such items could include ceramics, cheese, coffee, ham and other meat, rice, tea and yogurt. “Registry” concerns the establishment of a global system for registering and notifying geographical indications on wines and spirits, with the possibility of extending that system to cover other items.

- **S&D Treatment on Subsidies**

Members agreed to requests for extension of the period for phasing out export and import substitution subsidies under Article 27:4 of the *SCM Agreement*.

- **Four “Singapore Issues”**

These four issues are FDI, trade and competition policy, trade facilitation, and transparency in government procurement. Preparatory work to continue under WTO Working Groups established at the 1st Ministerial Conference in Singapore in 1996. Negotiations on Singapore issues were deferred until after the fifth Ministerial Conference in 2003, and then only if an “explicit consensus” existed to start. (Any Member could block commencement – an assurance sought at Doha by India, and gained through a statement by the Conference Chairman, Qatar’s Youssef Kamal.) Such talks would deal with technical assistance for, and capacity-building in, developing countries.

Trade facilitation is worthy of special mention. It refers to simplifying customs procedures, and there is considerable empirical evidence to indicate doing so makes trade far more efficient, that is, faster and cheaper. That is especially true in developing countries and LDCs. Weak, incompetent, and corrupt customs authorities bedevil importers and exporters alike, and undermine consumer interests, in many such countries. Accordingly, under the DDA, the focus was on enhancing the operation of GATT provisions relevant to customs matters, particularly Articles V (transit), VIII (fees and formalities), X (transparency), as well as on cooperation among customs officials.

- **Environment**

Members agreed to negotiations on the (1) relationship between WTO obligations and MEAs (*e.g.*, between *TRIPs* and the U.N. *CBD*, or between WTO obligations and *Cartagena Bio-safety Protocol for Genetically Modified Organisms*), (2) information exchange between the WTO and MEA Secretariats, and (3) reduction of trade barriers to environmentally-friendly goods and services. Whether to discuss eco-labeling and other “green” matters was deferred until the fifth Ministerial Conference in 2003, but no formal action occurred then.

- **Fishing Subsidies and Environment**

Fish provide (at least) 2.6 billion people (many in poor countries) with 20% or more of their total animal protein intake. Fish are one of the most traded commodities in the world. Of total world fish production, exports account for 38%. The value of fish exports for developing countries (\$20.4 billion in 2004) is notably higher than any other commodity, including rice and coffee. Commercial trade in fish products is a \$56 billion business (annually, as of 2005). Yet, fishing is at the intersection between subsidies and the environment.

The U.S., along with other Members such as Argentina, Australia, Chile, Ecuador, Iceland, New Zealand, and Peru, worry about the sustainability of this trade. The U.N. FAO reports (as of 2005) that 75% of the fishing stocks in the world are over-exploited, fully exploited, depleted, or recovering from depletion. University of British Columbia scientists calculate (as of 2006) that government subsidies for the fisheries sector aggregate globally to \$30-34 billion per year, with Japan, the EU, and China being the top three subsidizers, and (notes the environmental NGO WWF International) seven developed countries – Japan, the EU, U.S., Canada, Russia, Korea, and Taiwan – accounting for 90% of the subsidies. The UBC scientists report two-thirds of subsidies support activities that are bad, in the sense of promoting over-fishing by supporting construction and modernization of fishing vessels and equipment, and covering operational costs.

Overall, 20-25% of the value of the commercial fishing trade (*i.e.*, \$10-15 billion) is subsidized. The world-wide fishing fleet (reports the advocacy group, Oceana) is 250% larger than the size needed to fish at sustainable levels. In brief, government funds to the fishing industry not only contribute to resource exhaustion, but also wreak havoc on marine ecosystems. The Members agreed to consider ways to eliminate subsidy schemes that cause over-fishing or over-capacity in the fisheries sector. Notably, the U.S. (in May 2007) proposed all WTO Members eliminate subsidies that promote over-capacity, but Asian countries with large fishing fleets – namely, Japan, Korea, and Taiwan – sought to narrow the list of subsidies that would be forbidden.

- **Single Undertaking**

By design, negotiations on all items were conducted as a single undertaking. No accord on any issue could be final until agreement occurred on all other matters.

III. Open Issues

The DDA skipped key details of how to liberalize trade in agricultural and industrial products. WTO Members proclaimed terrorism would not stop the launch of a new round to promote global Capitalism. They professed faith in peace and prosperity that can come from increased trade. Yet, they failed to chalk out how to proceed.

For example, the Members agreed there ought to be a ban on taxing e-commerce. That ban applies to digitized goods, *i.e.*, goods like printed materials, software, music, films, and video games that could be shipped physically, but are transmitted across the internet. However, assuming many such goods are shipped in digitized form, the top 10

potential losers of tax revenue from this ban, other than the EU (the largest loser in dollar terms of foregone customs duties), Canada (6th), and Israel (10th), would be developing countries: India (2nd); Mexico (3rd); Malaysia (4th), Brazil (5th), China (7th), Morocco (8th), and Argentina (9th). How might such countries address this situation?

By no means was e-commerce the only example of an issue left open from the November 2001 Doha Ministerial Conference. Other significant topics were:

- (1) IP and Compulsory Licensing.
- (2) IP and Generic Imports.
- (3) Export Subsidy Phase Outs.
- (4) Dispute Settlement Reform (including specific issues concerning acceptance of *amicus curiae* briefs, possibility of remand by the WTO Appellate Body to a Panel, sequencing in respect of alleged non-compliance and retaliation, post-retaliation matters, sovereignty and Member control, S&D treatment, time frames, and transparency), which expressly was not part of the single undertaking approach in the Doha Round.

In studying the Doha Round, and the particular topic areas of IP, subsidies, and the *DSU*, it is important to realize a definitive solution was reached only on the first of these topics.

In sum, the DDA was both ambitious and ambiguous from the outset. Lest there was any doubt about the difficulties in the road following the November 2001 meeting in Qatar, consider the post-Doha remark of Director General Moore: “We’re setting ourselves up for a difficult fifth ministerial.” His prognostication proved spot on correct.

IV. Grand Bargain Re-Think

Since their November launch, agriculture was at the core of Doha Round negotiations. No horizontal set of texts could be agreed, no new grand bargain would be struck, without fortifying the three pillars of farm trade rules: market access, domestic support, and export subsidies. Why was agriculture so important in the Round?

Possibly the most persuasive reason is the widespread perception among WTO Members that on those issues, more than any other, the Uruguay Round Grand Bargain (discussed in a separate Chapter) was broken. Members questioned whether they benefited, even in a net sense, from the Bargain. Developing and least-developed countries, and some developed countries (*e.g.*, Canada) complained that self-proclaimed free trading nations were hypocritical on agricultural trade matters. Some developed countries retained high average agricultural import tariffs. The EU average farm tariff (as of March 2007), for instance, was 23%.⁷³³ To be sure, there was some hypocrisy in the developing country

⁷³³ See Vir Singh, *EU’s Farm Commissioner Asks India, U.S. to Make Firm Commitments in Doha Round*, 24 International Trade Reporter (BNA) 334-335 (8 March 2007).

position. India imposed duties and taxes, in addition to tariffs, on certain non-staples that led to ridiculously high effective rates. Because of add on levies on wine and spirits, India's true tariff on those products rose from 100% and 150%, respectively, to nearly 500%.

Worse yet, from a poor country perspective, developed nations stymied the substantial market access gains anticipated in the wake of the Uruguay Round *Agreement on Agriculture*. They limited agricultural imports by maintaining Byzantine rules on the allocation of quotas, imposing technical barriers, deploying SPS standards for protective (rather than scientific) purposes, filing trade remedy actions against foreign products, entering into RTA preferences, and – of course – not slashing subsidies. For instance, though they experienced benefits from the Uruguay Round, the Canadian beef and pork sectors complained they were victimized by complex administrative rules in the EU, and safeguard actions and SPS measures in Japan.

Not surprisingly, with differing interests, and with differing views of the outcome of the Grand Bargain, WTO Members pursue divergent agricultural policies. For instance, East and South Asian countries tend to protect their farmers through traditional devices, and have the highest agricultural tariffs in the world. In 2001, India, Japan, Korea, Taiwan, Thailand, and Vietnam were in this group, with the average agricultural tariff in each country exceeding 30%. (China had been in this group before its WTO accession in December 2001, but its terms of entry called for significant agricultural tariff cuts.) Such developing and least developed countries feel threatened by competition – not only in third countries, but in their own domestic markets – from agri-business in North America and, increasingly, in the EU.

Conversely, *EFTA* (the members of which are Iceland, Liechtenstein, Norway, and Switzerland, and EU), and the U.S., rely relatively less on tariffs to protect their farmers. At 2.4% (in 2001), average U.S. agricultural tariffs are nearly the lowest in the world. Agricultural tariffs among *EFTA* countries, as well as the EU, average 13.9%. Instead, developed countries help their farmers with subsidies. Measured as a percentage of total agricultural output (in 2001), *EFTA* countries have the highest subsidy rates in the world. They subsidize the equivalent of between 83% and 140% of their overall farm production. Measured as a percentage of total agricultural output, the U.S., EU, and Japan spend similar sums on domestic farm support – about 37%. But, the EU relies far more than the U.S. on “Amber Box” (*i.e.*, trade-distorting) subsidies, which are the most trade-distorting form of support (save for export subsidies). About 50% of EU subsidies (\$44.7 billion annually) are Amber Box. Only about 20% of U.S. support (\$14.4 billion in 2001) is in this Box, with 70% (\$50.67 billion) in the non-trade distorting category called the “Green Box.” Green Box programs include agricultural research, certain types of direct payments to farmers (namely, support de-coupled from the amount or type of crop grown), disaster relief, disease control, domestic food aid, environmental protection, infrastructure support, regional assistance, and restructuring aid.

When starting positions in any negotiation are based on divergent policy paradigms, which in turn are supported by domestic constituencies with entrenched interests, reaching consensus is a Herculean task. With different tools for agricultural protection

predominating in different WTO Members, by August 2004, when a “Framework Agreement” for further talks was reached, positions in the Doha Round talks on how to lower trade barriers were predictable. Spokespersons for developing countries, like South African President Thabo Mbeki (1942-, President, 1999-2008), called on the U.S. and EU to end domestic farm subsidies within three years, and agricultural export subsidies within five years. Developed countries pushed developing ones to improve market access for foreign agricultural products by slashing tariffs and quotas. The Round stalled.

And it remained stalled. That was clear from a summary the Chairman of the Agricultural Negotiations, Ambassador Gloria Abraham Peralta (Costa Rica), provided in July 2021 on the seven principal discussion topics:

- (1) On domestic support, an agreement on new disciplines may be out of reach: negotiators could instead usefully focus on elements for inclusion in a framework agreement, work program or work plan for post-MC12 negotiations [*i.e.*, the 12th WTO Ministerial Conference in November 2021];
- (2) On market access, negotiators at MC12 may be able to agree on steps to improve transparency as well as a way forward for comprehensive market access reforms post-MC12;
- (3) On export restrictions, members may be able to reach an agreement that food bought by the World Food Program (WFP) for its humanitarian food aid should be exempt from export restrictions. Trade negotiators might also be able to strike a deal on measures to improve transparency and clarify current rules, including through providing advance notice or by enhancing compliance with existing WTO requirements;
- (4) On export competition, negotiators may be able to agree on some steps to improve compliance with existing transparency requirements, and also to enhance them;
- (5) On cotton, the Chair agreed with facilitators that the focus for now should be on improving transparency, while continuing to seek ways to reduce trade-distorting domestic support on cotton after MC 12. The development component of an outcome on cotton should be addressed through the Director General’s Consultative Framework Mechanism on Cotton Process;
- (6) On public stockholding programs for food security purposes, negotiators are looking for a permanent solution to the challenges some developing countries face when buying food at administered prices: here, the challenge is to find the right balance between enabling members to have access to flexibilities in this area while

also establishing well-calibrated safeguards and transparency requirements;

- (7) On the Special Safeguard Mechanism, there is serious divergence “on some fundamental aspects,” with many agricultural exporting countries continuing to link progress on this topic to market access concessions, and proponents of the mechanism arguing it should be a stand-alone outcome.⁷³⁴

(Each of these topics is discussed in subsequent Chapters.) Manifestly, across all topics, the views of Members were incompatible. She identified three challenges the Members needed to meet to bridge their gaps: time (*i.e.*, develop a sense of urgency to complete the negotiations); trust (*i.e.*, it needed to be restored among the Members); and transparency (*i.e.*, the Members needed to appreciate their shared interest in it, and define its parameters). Put bluntly, those negotiations were akin to a zombie, and as the walking-dead talks on a core concern for all WTO Members, cast doubt on the efficacy of the entire Organization.

V. GATT Preamble and Trade as Counter-Terrorism

International Trade Law always has been about economic development. This Law always has been about national security. And, since the advent of Islam in 610 A.D. with the first revelation from Allāh through the Archangel Gabriel (in Arabic, *Jibreel*) to the Prophet Muhammad (PBUH) (570/571-632 A.D.), Muslims have been engaged, in one way or another, in this legal specialty.

Thus, it is a fallacy to think that poor or Muslim countries are newcomers to the modern world trading system. The first two Paragraphs of the *Preamble* to GATT bear repeating:

The Governments of the Commonwealth of Australia, the Kingdom of Belgium, the United States of Brazil, Burma, Canada, Ceylon, the Republic of Chile, the Republic of China, the Republic of Cuba, the Czechoslovak Republic, the French Republic, India, Lebanon, the Grand-Duchy of Luxembourg, the Kingdom of the Netherlands, New Zealand, the Kingdom of Norway, Pakistan, Southern Rhodesia, Syria, the Union of South Africa, the United Kingdom of Great Britain and Northern Ireland, and the United States of America:

Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods,

⁷³⁴ World Trade Organization, *Chair Highlights Key Challenges as Agriculture Talks Enter Critical Phase* (24 June 2021), www.wto.org/english/news_e/news21_e/agri_24jun21_e.htm.

From these Paragraphs, two points are evident.

First, of the 23 original GATT contracting parties, 11 were poor countries (Burma, Ceylon, Chile, China, Cuba, Southern Rhodesia, and South Africa, plus India, Lebanon, Pakistan, and Syria). Second, four of the countries (India, Lebanon, Pakistan, and Syria) were Muslim or had sizeable Muslim communities. Half of the countries founding the modern multilateral trading system in the aftermath of the Second World War were developing or least developed, and nearly 20% of them welcomed Islam. These figures understate both points, because Belgium, France, Netherlands, and U.K. all held sway over vast poor and/or Muslim territories when GATT entered into force on 1 January 1948.

Second, the original contracting parties did not view international trade as an end in itself. Rather, it was an instrument for economic growth and enhanced living standards. International trade was a, but not the only, means to raise incomes and generate jobs. After all, no nation in history has achieved sustained economic success through autarky.

It also is a fallacy to think international trade law is divorced from national security. That is not to say GATT was drafted as a counter-terrorist strategy. It was not. Yet, its promise admits, or embeds the possibility of trade liberalization, as such a strategy through the intervening variable of poverty alleviation.

Since Ancient times, securing trade routes, thereby assuring essential supplies of goods or services not obtainable domestically, has been a critical element in the rise and fall of empires. Sustained imperial development has meant some degree of economic integration and inter-dependence, and a set of rules for commercial intercourse, which in turn has demanded attention to threats to patterns and conduits of imports and exports. The history of empires, from the Roman and Carthaginian, through the Arab-Islamic and Ottoman Turkish, to the British and American, all reveal a link between international trade and national security.

This long-standing nexus among international trade law, economic development, and national security, in which Islam is engaged, is all the tighter in the post-9/11 world. Spread around the world, many Muslim communities, marginalized by poverty, have little hope for a brighter future through opportunities from multilateral trade liberalization. Extremism, even accompanied by violence, is a gravely sinful temptation to which some of the marginalized poor are vulnerable. Weapons technology aided by evil genius has multiplied the force threat posed by VEOs to the global capitalist order, of which the trading system is an essential part.

It was this nexus, in the aftermath of the September 11 terrorist attacks, which drove Members of the WTO to launch the DDA, commonly called the Doha Round, in November 2001. It is this nexus the Members betrayed as the Doha Round ground on. The debacle of the Doha Round is that it was a failed counter-insurgency operation. The Round has lost nearly all links to its original purpose. That purpose was trade liberalization to spur development in a post-9/11 context in which extremism is wrongly perceived by some

disaffected, impoverished, and thus marginalized Muslims as an alternative to stakeholding in the world trading system.

Why this failure? Because the WTO Members succumbed utterly to the pursuit of commercial self-interest, so their Doha Round dealings became a monstrous mishmash of minutiae. The Members produced draft negotiating texts so devoid of vision and so replete with exceptions that the texts were not fit for a dog's breakfast. To use a different metaphor, Members turned the Round into an exercise in Social Darwinism, forgetting the common good – to use multilateral trade liberalization to fight poverty and thereby Islamist extremism.⁷³⁵

Not surprisingly, therefore, in anticipation of the December 2011 WTO Ministerial Conference in Geneva, Members in August 2011, after a decade of Doha Round negotiations, sounded three themes. First, to save face for the WTO, it should be made clear to the international trade community that the Organization and Round are not synonymous. Failure of the Round should not damage the credibility of the WTO.

Second, the single undertaking methodology, by which Members do not officially agree on any item until all of them have agreed on all items (*i.e.*, nothing is agreed until everything is agreed, and all Members must agree to everything, thus horizontal trade-offs across different sectors and topics are required), should be revisited. Possibly, it should be abandoned in favor of a more flexible approach that would account for the size, diversity, and complexity of the Membership. Third, to move beyond the Round without formally declaring it dead, discussions on “21st century issues” should proceed. Such issues would include agricultural export restrictions and food security, climate change, electronic commerce (particularly whether to extend the 1998 *Moratorium on Customs Duties on Electronic Transmissions*, *i.e.*, the moratorium on collecting duties on goods transmitted digitally over the internet), FDI and competition policy, foreign exchange rates and trade, intellectual property protection (particularly whether to extend a moratorium on non-violation nullification and impairment cases under the WTO *TRIPs Agreement*), trade rules and innovation, and transparency in customs facilitation.

All three themes are problematic. The first one is a lie. If the WTO cannot conclude a multilateral trade bargain, then it has failed at one of its essential purposes – multilateral trade liberalization. To be sure, there are other reasons for its existence, most notably, dispute resolution and monitoring and surveillance. But, it no longer is the single, indispensable forum for grand, global, trade bargains. The second theme calls for betrayal of a historic mode of operation, dating from the era of how the Contracting Parties, acting jointly (*i.e.*, the CONTRACTING PARTIES), under GATT worked. It also intimates a betrayal of developing and least developed countries, accusing some them of playing the role of “spoiler,” seeking the “lowest-common denominator outcomes,” or free-riding on the concessions of others.⁷³⁶ In an age when they comprise the vast majority of the

⁷³⁵ See generally RICHARD HOFSTADTER, *SOCIAL DARWINISM IN AMERICAN THOUGHT* (New York, New York, George Braziller, Inc., 1944, rev'd ed., 1955, 1959) (explaining Social Darwinism).

⁷³⁶ Such were the epithets used in Susan C. Schwab, *After Doha – Why the Negotiations Are Doomed and What We Should Do About It*, 90 *FOREIGN AFFAIRS* 104, 111 (May/June 2011). (Emphasis added.) Ms.

Membership, their individual and collective voice, through their ability to join or block a consensus, is suppressed. The third theme is misleading. Several of the issues are not time-bounded, that is, they existed in the 20th century, and Members considered some of them when they debated what to put on the Doha Round agenda.

Regardless of the merits of these themes, what is telling is that WTO Members raised them. Their doing so manifests their loss of purpose. No longer are they dedicated to poverty alleviation and the struggle against Islamist extremism. That is, no longer do they seek to use multilateral trade liberalization as a counter-terrorist weapon.

It was said the Doha Round is:

intended to improve global market access by cutting massive farm subsidies in rich countries and import tariffs in poorer ones....⁷³⁷

That characterization is simplistic: it is true as far as it goes, but it does not go far enough. The Round – intentionally launched in the heart of the Arab Muslim World – was thought to be an important way to fight oppression, and thereby wean people in poor countries, especially ones with significant Islamic populations, away from anti-capitalist thinking and, worse yet, violent action.

Unfortunately, in the Doha Round, the Members, and chiefly among them the U.S., EU, Brazil, China, and India, used legal details to advance their narrow agendas. Since ancient times, city-states and countries have negotiated out of self-interest. Yet in this Round, the dominant Members took self-interest to such a level that it is proper to query whether they are the extremists. They lost all sight of the common good, and sacrificed the broad purpose of the DDA, which might be characterized as an effort to prove once and for all that Francis Fukuyama (1952-), in *The End of History and the Last Man* (1992), not Samuel Huntington (1927-2008), in *The Clash of Civilizations* (1996), was right. The middle “D” bespeaks the purpose of the Round, development, and intimates the follow-on link between boosting development and fighting Islamist extremism.

Yet, as the Round has ground on, to a halt, over the years, the middle “D” went missing, and the link between fighting poverty through trade liberalization, on the one hand, and reducing vulnerability to Islamist extremism, on the other hand, was lost. Thus, International Food Policy Research Institute, a prominent NGO, released a study on 30 November 2009, the second day of the seventh WTO Ministerial Conference, concluding:

Schwab served as USTR from 2006-2009. Yet, Ambassador Schwab notes that “one of the WTO’s most important characteristics is the inclusion of these developing economies in governance and decision-making from its origins as the General Agreement on Tariffs and Trade in 1948.” *Id.* at 117.

⁷³⁷ Tripti Lahiri, *New Delhi “Breakthrough” Sets Restart of Doha Round Ag, NAMA Talks for Sept. 14*, 26 *International Trade Reporter* (BNA) 1191 (10 September 2009).

The Doha agreement ... *has an ambivalent impact on developing countries and does not offer enough to the poorest countries.* ... It has to offer more in terms of market access and reduced trade costs.⁷³⁸

Notably, 110 of the then 153 Members of the WTO – nearly three-quarters of the Membership – are poor, that is, they are self-identified developing countries or classified by objective economic criteria as LDCs. One-fifth or 20% of the Membership (roughly 31 countries) fits into the “least developed” category. Critically, the above-quoted conclusion applies to Muslim countries, insofar as nearly all of them are developing or least developed. Put differently, notwithstanding rhetoric from the WTO about the importance of the Doha Round to poverty alleviation, what the Members did in the Round is enshrine Social Darwinism as trade policy.

Drawing that meta-inference is not persuasive without pouring over the micro-details of the Doha Round texts. Yet, even for seasoned experts, the proposed terms and conditions for a Doha Round bargain were devilishly complex.⁷³⁹

VI. Trade Liberalization, Poverty Alleviation, and Islamist Extremism

No less an authority than the Roman Catholic Church has identified poverty as a cause of violence between nations and peoples. As part of the Second Vatican Council (October 1962-December 1965), the Church issued in December 1965 *Gaudium et Spes* (“Joy and Hope”). Chapter V of this document is entitled “The Fostering of Peace and the Promotion of a Community of Nations. It begins with a definition of “peace:”

78. *Peace is not merely the absence of war, nor can it be reduced solely to the maintenance of a balance of power between enemies, nor is it brought about by dictatorship.* Instead, it is rightly and appropriately called an *enterprise of justice*. Peace rests from that order structured into human society by its divine Founder, and actualized by men as they thirst for *even greater justice*. The *common good* of humanity

⁷³⁸ Quoted in Laura MacInnis, *World Economy has Outgrown Doha, WTO Meet Told*, REUTERS, 1 December 2009, www.reuters.com. (Emphasis added.)

⁷³⁹ Note the argument (1) the Doha Round is increasingly irrelevant because it focuses on issues of declining importance, such as cutting tariffs (when the average worldwide duty rate is about 10%) and domestic agricultural support (when those subsidies are declining in significance), and (2) therefore the agenda of the Round should be enlarged to cover issues like collusion among oil-producing countries, the regulation of sovereign wealth funds (SWFs), and global financial supervision. See Aaditya Mattoo & Arvind Subramanian, *From Doha to the Next Bretton Woods – A New Multilateral Trade Agenda*, 88 FOREIGN AFFAIRS 15-26 (January/February 2009). The argument rests in part on the technically false premise that the Round proposals contain no meaningful guarantees against WTO Members reversing their trade policies or resorting to high punitive import tariffs. See *id.*, 17.

A careful reading of the July and December 2008 Draft Modalities Texts on Agriculture, NAMA, and the November 2007 Draft Trade Remedy Rules Text, evinces such proposals. The argument also rests on the entirely unrealistic premise that broadening, rather than narrowing, the issues for negotiation would help conclude the Round. Amidst all the rhetoric among trade negotiators in the Round, one of the claims not heard is that they are unable or unwilling to reach a successful outcome on trade unless they strike a deal on oil, SWFs, and global finance.

finds its ultimate meaning in the eternal law. But since the *concrete demands of this common good are constantly changing* as time goes on, peace is never attained once and for all, but *must be built up ceaselessly*. Moreover, since the human will is unsteady and wounded by sin, the achievement of peace requires a constant mastering of passions and the vigilance of lawful authority.

*But this is not enough. This peace on earth cannot be obtained unless personal well-being is safeguarded and men freely and trustingly share with one another the riches of their inner spirits and talents.*⁷⁴⁰

Manifestly, a necessary but not sufficient condition for true peace is justice, which includes vigilant attention to constantly changing economic conditions suffered by others. Such justice is required, above and beyond internal self-control.

Section 1 of Chapter V discusses “The Avoidance of War.” It expressly mentions “terrorism” as a form of “war.”⁷⁴¹ It dubs the “arms race” an utterly treacherous trap for humanity, and one which ensnares the poor to an intolerable degree.⁷⁴² That is because vast expenditures go to arms, the opportunity cost of which is alleviation of “multiple miseries” around the world.⁷⁴³ Section 2 discusses “Setting up an International Community.” The key paragraphs from these Sections state:

83. *In order to build up peace above all, the causes of discord among men, especially injustice, which foment wars must be rooted out. Not a few of these causes come from excessive economic inequalities and from putting off the steps needed to remedy them. Other causes of discord, however, have their source in the desire to dominate and in a contempt for persons. And if we look for deeper causes, we find them in human envy, distrust, pride and other egotistical passions. Man cannot bear so many ruptures in the harmony of things. Consequently, the world is constantly beset by strife and violence between men even when no war is being waged. Besides, since these same evils are present in the relations between various nations as well, in order to overcome or forestall them and to keep violence once unleashed within limits, it is absolutely necessary for countries to cooperate more advantageously and more closely together and to organize together international bodies and to work tirelessly for the creation of organizations which will foster peace.*

⁷⁴⁰ *Pastoral Constitution on the Church in the Modern World (Gaudium et Spes)*, in THE SIXTEEN DOCUMENTS OF VATICAN II ¶ 78 at 705-706 (Boston, MA: Pauline Books & Media, 1999). (Emphasis added.) [Hereinafter, *Gaudium et Spes*.]

⁷⁴¹ *Gaudium et Spes*, ¶ 79 at 709.

⁷⁴² *Gaudium et Spes*, ¶ 81 at 709.

⁷⁴³ *Gaudium et Spes*, ¶ 81 at 709.

84. In view of the increasingly close ties of mutual dependence today between all the inhabitants and peoples of the earth, the apt pursuit and efficacious attainment of the universal *common good* now require of the community of nations that it organize itself in a manner suited to its responsibilities, *especially toward the many parts of the world which are still suffering from unbearable want.*
- ...
85. The present solidarity of mankind also calls for a revival of greater cooperation in the *economic* field. Although nearly all peoples have become autonomous, they are far from being free of every form of undue dependence, and far from escaping all danger of serious difficulties.

The development of a nation depends on human and financial aids. The citizens of each country must be prepared by education and professional training to discharge the various tasks of economic and social life. But this in turn requires the aid of foreign specialists, who when they give aid will not act as overlords, but as helpers and fellow-workers. Developing nations will not be able to procure material assistance unless *radical changes are made in the established procedures of modern commerce.* Other aid should be provided as well by advanced nations in the form of gifts, loans or financial investments. Such help should be accorded with generosity and without greed on the one side and received with complete honesty on the other side.⁷⁴⁴

Simply put, avoidance of war requires more than a military strategy. Paragraph 83 calls attention to underlying evils that cause conflict, one of which is gross disparities within and across communities, and which, in turn, emanates from egoism. The insight of the Church is as true today as it ever was. The reference in Paragraph 84 to cooperation through international organization almost augurs the birth of the WTO on 1 January 1995 and agreement on the DDA six years thereafter. The discussion in Paragraph 85 is a reminder of the adage that poverty anywhere is a threat to prosperity and security everywhere, almost prescient about threats from terrorist organizations, and daring in the call for “radical” changes in the conduct of international business.

In the post-9/11 environment, the question the Doha Round presented to the world might be put this way: Why be a courier for Osama Bin Laden, as was the Kuwaiti-born Pakistani, Abu Ahmed (*alias* Arshad Khan), his most trusted messenger, if one can own and operate an import-export business that trades lawful goods and services, or be gainfully employed in such an enterprise?⁷⁴⁵ Admittedly, some Islamist extremists – particularly

⁷⁴⁴ *Gaudium et Spes*, ¶¶ 83-85 at 711-712.

⁷⁴⁵ See M. Ilyas Khan, *Who Was the Courier Who Led U.S. to Osama Bin Laden?*, BBC NEWS, 5 May 2011, www.bbc.co.uk. Interestingly, the business in which the courier engaged to cover his work with Osama Bin Laden is unclear. The theories are dealing in smuggled auto parts, foreign exchange, and running a goods transport company. See *id.* See also Elise Labott & Tim Lister, *Courier Who Led U.S. to Osama Bin Laden's*

leaders within a terrorist organization – are from wealthy or middle-class backgrounds. They have their choice of occupations. Admittedly, too, some extremists are motivated by ideology regardless of their socioeconomic station in life. *Salafi Jihādists* are one example of religious zealots, and their movement originated in wealthy Saudi Arabia. They are determined to overthrow any regime they deem un-Islamic, hence the Doha Round is quite irrelevant to them. But, to start with wealth or ideology is to beg a key question: under what conditions is a person more liable to encounter, receive, accept, and execute an Islamist extremist message?

Not every poor person is a terrorist or even disposed to extremism. If they were, the world would be far less safe than it is, given the roughly one billion people who live on less than U.S. \$1 per day. Equally evident is that not every Muslim is a terrorist or even inclined to violence. Again, the world would be a lot less safe were that not so, as there are about 1.3 billion Muslims. Moreover, Islam is most definitely not susceptible to terrorism. To think otherwise is prejudicial, and like most prejudices, this one is based on ignorance. The genuine, properly interpreted rules of the *Sharī‘a* (Islamic Law) do not support terrorist acts or extremist ideologies. Islam and its legal system is, of course, a beautiful paradigm characterized by considerable diversity within a unity of core precepts. This diversity includes people who hold religiously extreme ideas, but who are non-violent, and also politically active Muslims who are inspired by their faith, but who are not fixated on seizing power by any means in the name of Islam. The sad reality is a tiny minority in any religion can distort genuine doctrines for evil purposes, and each religion has endured dastardly distortion at one juncture or another in its history.

Blaming a religion for sponsoring terrorism is wrong. Accordingly, it would be equally reasonable, though perhaps euphemistic, to refer not to “Islamist extremism,” but rather VEOs and the “Persons of Interest” who run them, and who are recruited as evil minions to serve in them. What is clear is that “Islamic,” as distinct from “Islamist,” is the incorrect adjective: none of the bloodshed wrought by VEOs or their POIs is authentically Islamic.

In any case, there is not a great deal that International Trade Law, or the Doha Round, can do to change religious precepts or their abuse by fanatics. Poverty, however, is a different matter. Trade rules, as shaped by the Round, can make a difference in the lives of poor people. Most obviously, it can create opportunities for new employment and higher income, and thereby help alleviate poverty. The question thus is joined: does poverty alleviation through trade liberalization matter, in terms of reducing proclivity toward terrorism?

That is, is there a link between poverty alleviation and Islamist extremism? Surely the answer is yes. President Barack H. Obama (1961-, President, 2001-2009) declared:

Hideout Identified, CNN WORLD, 3 May 2011, http://articles.cnn.com/2011-05-03/world/bin.laden.courier_1_al-qaida-members-al-qaeda-leader-tora-bora?_s=PM:WORLD (identifying the courier).

Extremely *poor* societies ... provide *optimal breeding grounds* for disease, terrorism, and conflict.⁷⁴⁶

His Secretary of State, Hilary Clinton, therefore categorized economic development as “an *integral part of America’s national security policy.*”⁷⁴⁷

The link is not adamant. The precise causal connection is not entirely clear. But, the basic connection is obvious enough, both self-evident and clear from observed experience: poverty, in the narrow sense of a lack of income, and a broader sense of capabilities deprivation, or an even broader sense of oppression, connotes a lack of status as a stakeholder in the global trading system.⁷⁴⁸ Put succinctly, marginalization, which is a hallmark of poverty, is a contributory factor in vulnerability to violent religious fanaticism. Conversely, a world trading system in which a person finds opportunity through decently-paying jobs, and thereby hope for the socioeconomic advancement of himself and his family, is one – but by no means the only – way to offer the status of stakeholder. Concomitant with that status is the opportunity for better education and health care, both of which, along with a reduction in income poverty, give a person a rational basis for hope in the system.

This affirmative answer also is based on careful academic research. Consider the analysis offered by Oxford economist Paul Collier CBE (1949-) in his acclaimed book, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It* (2007). He identifies an unmistakable link between economic underdevelopment and conflict. The gist of his argument is that the economic health of a country is a primary determinant of its susceptibility to conflict.⁷⁴⁹ The poorer a country, in economic terms, the more prone it is to be mired in civil strife – a “Conflict Trap” – whereas the better its economic performance, the more likely it will not experience, or at least not remain mired in, conflict. While not linking poverty to Islamist extremism in particular, the Collier analysis is applicable: the former is a microcosm of the latter, which is the macrocosm.

To be sure, some Islamist extremists are home-grown in wealthy countries, like the U.K. and U.S. Among them, however, some are from poor or marginalized communities within those countries. Many terrorists are from poor countries – Afghanistan, Pakistan, Somalia, Yemen are proven fertile grounds for recruiting and training *Salafi Jihādis*, who are active in yet other poor countries, such as Jordan and Libya. Pakistan, the population of which is 97% Muslim, rightly has attracted considerable attention. That is for reasons

⁷⁴⁶ Quoted in *Exploding Misconceptions*, THE ECONOMIST, 18 December 2010, 146. (Emphasis added.) [Hereinafter, *Exploding Misconceptions*.]

⁷⁴⁷ Quoted in *Exploding Misconceptions*. (Emphasis added.)

⁷⁴⁸ The link is especially apparent to American military personnel who have served in Afghanistan, Indonesia, Iraq, Philippines, Thailand, and other theaters plagued by Islamist extremism. The author has put the question to such personnel (whose names must remain anonymous for security reasons) who serve(d) as SOF officers. Invariably, the answer is affirmative, typically with an almost quizzical look because the point is so obvious.

On capabilities deprivation, see Amartya Sen, *Development as Freedom* (1999).

⁷⁴⁹ See PAUL COLLIER, THE BOTTOM BILLION: WHY THE POOREST COUNTRIES ARE FAILING AND WHAT CAN BE DONE ABOUT IT 19-20 (2007).

more than its notoriety as the place, specifically Abbottabad, hardly two hours from Islamabad, where Osama Bin Laden was killed by American Special Operations Forces in May 2011.

That also is because all of its regions bordering Afghanistan, from north to south, are scourged by poverty: the Northern Areas (Kashmir), NWFP (renamed Khyber Pakhtunkhwa in 2010), FATA, North and South Waziristan, and Baluchistan. As *National Geographic* put it, these regions, “[w]here the mountains meet the lowlands” are where “the fierce fundamentalism of the Afghan frontier confronts the moderate Islam of the Indian subcontinent.”⁷⁵⁰ Overall in Pakistan, the unemployment rate is 15% (and probably, unofficially, much higher), and 24% of the population ekes out an existence below the poverty line.⁷⁵¹

That defeating Islamist extremism in Pakistan (or Afghanistan) is not purely a military matter is indisputable, as America’s Commander-in-Chief observed. In his acclaimed June 2009 speech at Cairo University, President Barack H. Obama stated:

We [the United States] also know that *military power alone is not going to solve the problems in Afghanistan and Pakistan*. That is why we plan to invest \$1.5 billion each year over the next five years to partner with Pakistanis to build schools and hospitals, roads and businesses, and hundreds of millions to help those who have been displaced. And that is why we are providing more than \$2.8 billion to help Afghans develop their economy and deliver services that people depend upon.

...

I know that for many, the face of globalization is contradictory. The Internet and television can bring knowledge and information, but also offensive sexuality and mindless violence. *Trade can bring new wealth and opportunities, but also huge disruptions and changing communities*. In all nations – including my own – this change can bring fear. Fear that because of modernity we will lose of control over our economic choices, our politics, and most importantly our identities – those things we most cherish about our communities, our families, our traditions, and our faith.

But I also know that human progress cannot be denied. *There need not be contradiction between development and tradition*. Countries like Japan and South Korea grew their economies while maintaining distinct cultures. The same is true for the astonishing progress within Muslim-majority countries from Kuala Lumpur to Dubai. In ancient times and in our times, Muslim communities have been at the forefront of innovation and education.⁷⁵²

⁷⁵⁰ Don Belt, *Struggle for the Soul of Pakistan*, 212 NATIONAL GEOGRAPHIC 32, 43 (September 2007).

⁷⁵¹ See CIA WORLD FACTBOOK, www.cia.gov/library/publications/the-world-factbook/geos/pk.html. Yemen is even worse off, with over 45% of its population below the poverty line. See *id.* at www.cia.gov/library/publications/the-world-factbook/geos/ym.html.

⁷⁵² President Barack H. Obama, *A New Beginning*, Speech at Cairo University, 4 June 2009, http://middleeast.about.com/od/usmiddleeastpolicy/a/obama-cairo-speech-text_2.htm.

But, solving the problem is not purely a trade matter, either. That is, the question is not whether a development-friendly set of rules agreed by WTO Members in the Doha Round would rid Pakistan of its many Islamist extremist groups.

After all, Pakistan – specifically, endemic corruption, poor governance, military interference in politics, dysfunctional public education – is sometimes its own worst enemy. Small wonder why the *Taliban* or its sympathizers reputedly provide social services – they fill a gap a properly functioning state should cover, and they expand their ideological base in doing so. (The scenario is replayed in Lebanon by *Hezbollah*.) Consider, then, the observation of Javed Ibrahim Paracha:

a bearded, heavyset former member of [Pakistan’s] parliament who has been dubbed “*Al Qaeda’s* lawyer” for successfully representing several hundred *jihādists* captured in Pakistan after 9/11. He explains what emboldens these young women [*i.e.*, about 200 female religious students wearing black veils, who in 2007 took over a public children’s library in Islamabad to protest the destruction by the government of mosques run by extremist clerics, which the government said were built without permits] to risk their lives for Islam: This government [of General Pervez Musharraf] has lost all credibility,” he says. “People look at Musharraf and they see a U.S. puppet who’s willing to declare war on fellow Muslims to satisfy America. They also see his generals getting rich, *while they’re getting poorer every day. People are losing hope.* Pakistan and its government are becoming two different things. This will have to change, and soon.”⁷⁵³

Poverty is one among several structural problems to which Mr. Paracha refers that are causal factors as to why a minority of Muslims turn to extremism.⁷⁵⁴ The Doha Round cannot cure all such problems.

But, as the President suggested, there are opportunities worth pursuing, beyond the obvious ones concerning trade rules governing agricultural and industrial products. Consider trade in services, which includes, as a major sector, education. There are over 10,000 Islamic schools (*madrassas*) in Pakistan. Many of them cater to poor students, and are run by moderate Islamic clerics. But, about 60% of the *madrassas* are affiliated with the extremist *Deobandi* sect of *Sunni* Islam. They teach a severe brand of the *Sharī‘a*, calling for a return to its fundamentals, namely, the Holy Qur’ān and *Sunnah* (traditions) of the Prophet Muhammad that were set in the 7th century A.D.

⁷⁵³ Don Belt, *Struggle for the Soul of Pakistan*, 212 NATIONAL GEOGRAPHIC 32, 43 (September 2007). (Emphasis added.) The government later backed down and allowed not only the mosques to be rebuilt, but also the removal from the library of any book deemed to be un-Islamic.

⁷⁵⁴ Similarly, in Somalia, the Minister of Finance, Mohamed Abdullahi Omaar, dubbed international efforts to fight piracy as fatally flawed, because they focused on containment of symptoms rather than the root causes of piracy – state fragmentation, incapacity, and a lack of investment to “improv[e] the stability and prosperity of Somalia.” *Quoted in* Michael Peel, *Somali Minister Hits at Anti-Piracy Policy*, FINANCIAL TIMES, 19 April 2011, 2. In other words, piracy, like terrorism, is symptomatic of deeper causal factors, a key one of which – but not the only one – is poverty.

Pakistani parents tend not to want to send their children to such schools, where their kids memorize the Qur’ān but receive no practical life skills. Typically, they do so for financial reasons. The schools are well-funded, providing free meals, uniforms, and a copy of the Qur’ān. Parents who lose their jobs or suffer income declines – perhaps (if they are cotton farmers) because of competition from subsidized American cotton or high barriers in the EU to T&A merchandise (if they work in a mill or garment factory) – have little choice. Suppose the Doha Round yields not only trade liberalization in primary and secondary educational services, but also assistance to Islamic countries to import first-rate teachers and pedagogies of essential modern skills, like reading, writing, arithmetic, and critical thinking. Might these imports put pressure on extremist *madrasas* by giving them competition? That is, might an increase in the supply of foreign educational services give parents a viable choice?

More generally, the question is whether development-friendly trade rules, if implemented alongside fundamental reforms, would support reforms that Pakistan ought to take. Might they boost employment and incomes for a large swathe of Pakistan’s population at the lower tiers, and thereby help engineer a transformation in Pakistan’s dreadfully skewed socioeconomic order? In turn, would the empowerment of millions dispose them against a radical agenda to convert Pakistan into a strict Islamic state, far distant from the vision of its founder, Mohammed Ali Jinnah (1876-1948), that it be a secular democracy in which Islam imparted its cultural, but not political, influence?

There are other examples. Nigeria, a WTO Member, the population of which is about 50% Muslim, is one. Nigerian Muslims live in the north, where *per capita* income is 50% less than in the predominantly Christian south, and declining, and where literacy rates are two-thirds lower than in the commercial capital, Lagos, which is a port city in the south. In the principal northern city of Kano, two of the nine million residents are beggars, and the industrial zones that once were home to garment manufacturers are abandoned.

Thus, *The Economist* reported in May 2011, “[m]ilitancy is on the rise,” “[i]t is no surprise that extremists thrive in this climate,” and “*Boko Haram*, a local terror group, is roaming ever wider and fine-tuning its methods; a link up with *Al Qaeda* may be next.”⁷⁵⁵ Two months later, these fears were confirmed: In August, this VEO blew up the United Nations Headquarters in Abuja, killing 23 people and wounding more than 80, and the individual who planted the bomb was linked to *Al Qaeda*.⁷⁵⁶ Poor governance, meaning corruption and communal divisions, is the cause. Once again, the relevant question is not whether a successful Doha Round can eliminate the threat of Islamist extremism in Nigeria. It cannot do so. Rather, the question is whether the Round, along with appropriate governmental reforms, can reduce poverty in Nigeria and thereby the appeal of extremism to some alienated Muslims might feel.

⁷⁵⁵ A Man and a Morass, THE ECONOMIST, 28 May 2011, 26-28.

⁷⁵⁶ See Nigeria U.N. Bomb: “*Al-Qaeda Linked Man*” Named as Suspect, BBC NEWS, 31 August 2011, www.bbc.co.uk/news/world-africa-14734738. Loosely translated from Hausa, “*Boko Haram*” means “western education is forbidden,” and this VEO seeks imposition in Nigeria of what it calls the “*Shari’a*.” *Id.*

VII. Implausible Regression Analyses

Certain statistical and multivariable regression analyses suggest the link between poverty and extremism is tenuous.⁷⁵⁷ They argue terrorism results from political oppression and other non-economic factors. But, these studies miss the mark, and in any event do not gainsay a link between poverty and extremism.

First, that suggestion defies common sense, as well as historical and field experience. A person who has nothing to live for has nothing to lose. Recourse to violence in the grossly distorted name of a religion is perceived to hold few offsetting disadvantages. The lack of a decent education, because of poverty, means the ability to think critically, and thereby realize that name is being perverted, is under-developed.

Second, these analyses focus on terrorists who commit violent acts, making much of the fact some terrorists (as on 9/11) are from wealthy backgrounds.⁷⁵⁸ The studies often measure wealth by education, and thus exclaim some terrorists have high school diplomas. *Al Qaeda*, *Hamas*, *Hezbollah*, the *Taliban*, and other VEOs acting in the name of Islam are aware that while they can and do obtain some recruits from educated but disaffected youths, their large, fertile recruiting pool is stocked with the marginalized poor. Moreover, those diplomas mean little.⁷⁵⁹ A diploma from a typical school in many parts of the Arab world does not measure up to one from Western Europe, Japan, or the U.S. All that can be said is that to carry out a spectacularly evil terrorist attack with sophisticated devices or

⁷⁵⁷ For a summary of these studies, see *Exploding Misconceptions* (discussing a 2008 survey of studies by Alan Krueger of Princeton University, plus other individual studies). The discussion here is not a comprehensive review and critique of these studies.

One oft-cited study is Alan Krueger & Jitka Maleckova, *Education, Poverty and Terrorism: Is There a Causal Connection?*, 17 JOURNAL OF ECONOMIC PERSPECTIVES number 4 (Fall 2003), www.krueger.princeton.edu/terrorism2.pdf.

⁷⁵⁸ To be sure, there is no denying some evil-doers are well-off, as in the case of the nine Islamist suicide bombers who slaughtered over 200 innocent victims in Churches in Sri Lanka on Easter Sunday 2019, for which ISIS claimed credit. They were “well-educated” (though that adjective, applied to them, seems tortured) and (according to Sri Lankan junior Defense Minister, Ruwan Wijewardene) “from economically strong families.” Sanjeev Miglani & Joe Brock, *Picture Emerges of Well-to-Do Young Bombers behind Sri Lankan Carnage*, REUTERS, 24 April 2019, www.reuters.com/article/us-sri-lanka-blasts/picture-emerges-of-well-to-do-young-bombers-behind-sri-lankan-carnage-idUSKCN1S00G2. See also *Sri Lankan Attacks: Government Admits “Major Intelligence Lapse,”* BBC NEWS, 25 April 2019, www.bbc.com/news/world-asia-48044636 (observing “[a]lthough poverty and lack of opportunities have steered many down a path to terrorism, there are also numerous examples of individuals abandoning a relatively comfortable lifestyle for a violent cause,” citing “Ziad Jarrah, one of the 9/11 attackers who hijacked United Airlines flight 93, came from a privileged Lebanese family,” and “[m]ore recently, there have been cases of British *jihadi*s who have worked for the NHS, including doctors,” “[t]he late IS executioner Mohammed Emwazi, aka ‘Jihadi John,’ attended the University of Westminster in London,” [a]nd the original co-founder of *Al Qaeda*, Osama Bin Laden, chose to leave behind a luxurious life in Jeddah to go and fight the Soviets in Afghanistan during the 1980s”). Those cases, however, simply indicate poverty is a subset of marginalization, and the well-off can feel as alienated from the *status quo*, and be as vulnerable to violent ideologies and behaviors, as the poor. Regression analyses that focus on poverty, then, are under-inclusive in what they cover.

⁷⁵⁹ Here again, your *E-Textbook* author has put the question to U.S. SOF officers (whose names must remain anonymous for security reasons), who invariably confirm the point.

weaponry, special training is required to master those instruments.⁷⁶⁰ (Flying a plane into a building illustrates the point.)

Third, poor people may facilitate terrorism, but datasets of economists do not register them. For example, some Bedouins in the Sinai Peninsula and tribal peoples in Waziristan trade arms and narcotics, as they have no other lucrative activities.⁷⁶¹ To whom do they sell arms, for example, except terrorists? For such traders, a development-friendly Doha Round, which brought them into the formal trading system, might have done wonders, with the knock-on benefit of cutting off from terrorists some of their intermediaries for weapons. Likewise, trafficking in counterfeit goods (*i.e.*, products that violate a lawful copyright, trademark, or patent) may be tempting to impecunious people eking out a living. Proceeds of such sales may find their way to terrorists.

Finally, empirical analyses may suffer from one or the other of various shortcomings common in econometric research. For instance, one study focuses only on data from the Middle East, but neglects hotbeds of terrorist activity elsewhere, including Afghanistan, Pakistan, Yemen, and both North and Sub-Saharan Africa.⁷⁶² As another instance, one study argues the typical terrorist is not “unusually poor or badly schooled.”⁷⁶³ But, delineating poor or badly educated from “unusually” poor or badly educated people may be difficult in practice – and perhaps not that relevant in terms of policies to promote development and counter-terrorism. As another example, one study considers only male Palestinian suicide bombers recruited by *Hamas* and Islamic *Jihād* from the West Bank and Gaza, while another focuses on militants recruited by *Hezbollah* from the *Shī‘ite* majority region of Southern Lebanon.⁷⁶⁴ These studies urge that the average suicide bomber or militant, respectively, tends to be better educated and less poor than others in their reference group. Yet, terrorists come from far more places than the Levant, from far more nationalities than Palestinian, and may be women and children.

Still another problem concerns definitions. One study contends there is no hard link between the *per capita* GDP of a country and the propensity of that country to spawn terrorists.⁷⁶⁵ But, it defines “poverty” in terms of low literacy rates or residence in a country with a stagnant economy. In truth, broader concepts like capability deprivation or

⁷⁶⁰ See *Exploding Misconceptions* (discussing a study by Claude Berrebi of RAND Corporation and Efraim Benmelech of Harvard University concluding, as *The Economist* put it, that “more educated suicide-bombers are assigned to attack more important targets”). This study is limited to Palestinian suicide bombers between 2000 and 2005.

⁷⁶¹ On the general problem that many poor countries with large Muslim populations cannot effectively police their international boundaries, thus creating a vacuum in which Islamist extremists can operate, see Susan E. Rice, *The Threat of Global Poverty*, THE NATIONAL INTEREST (Spring 2006), www.brookings.edu/articles/2006/spring_globaleconomics_rice.aspx.

⁷⁶² Alan Krueger & Jitka Maleckova, *Education, Poverty and Terrorism: Is There a Causal Connection?*, 17 JOURNAL OF ECONOMIC PERSPECTIVES number 4 (Fall 2003), www.krueger.princeton.edu/terrorism2.pdf.

⁷⁶³ *Exploding Misconceptions* (discussing a study by Alan Krueger of Princeton University).

⁷⁶⁴ See *Exploding Misconceptions* (discussing a study by Claude Berrebi of RAND Corporation and one by Alan Krueger of Princeton University).

⁷⁶⁵ See *Exploding Misconceptions* (discussing a study by Alan Krueger of Princeton University). This study covered 956 terrorist events from 1997-2003.

marginalization may be more appropriate measures to explore the link between poverty and generating terrorists. Likewise, a result in that study (that suicide attackers are less likely to come from the poorest than from relatively better-off countries) may be skewed by restricting the definition of a terrorist event to suicide bombing.⁷⁶⁶

True, quantitative research on causes and causal mechanisms of terrorism must not be categorically dismissed. A worthwhile insight is from a study showing an inverse relationship between (1) the skill level of the average terrorist and (2) economic conditions.⁷⁶⁷ As those conditions improve, educated people have enhanced job opportunities with higher incomes. VEOs thus have a smaller pool of good talent from which to recruit evildoers. Conversely, the average terrorist's skill level rises when job and income prospects are grim. But, this study covers only Palestinian suicide bombers from 2000 and 2006. The point is statistical and econometric methods have limitations.

VIII. Intent of DDA Negotiators

The link between trade liberalization and poverty alleviation, and the follow-on link from poverty alleviation to reduced vulnerability to Islamist extremism, was on the minds of world leaders and their trade ministers when they launched the Doha Round in November 2001 in the Qatari capital. To think otherwise is to deny history.⁷⁶⁸ The Round:

was originally championed as a means of demonstrating *international solidarity and cooperation in the immediate aftermath of the 9/11 terrorist attacks*.⁷⁶⁹

Indeed, in the *Declaration* launching the Round, Ministers made explicit the first step in the link – between trade liberalization and poverty alleviation:

⁷⁶⁶ See *Exploding Misconceptions* (discussing a study by Alan Krueger of Princeton University).

⁷⁶⁷ See *Exploding Misconceptions* (discussing a study by Esteban Klor of Hebrew University in Jerusalem, Efraim Benmelech of Harvard University, and Claude Berrebi of RAND Corporation).

⁷⁶⁸ Countless news stories discuss the launch of the Doha Round “in 2001 in the capital of Qatar with the goal of helping poor countries prosper through greater access to markets in rich countries.” Doug Palmer, *Analysis: WTO Faces Tough Choices After Latest Doha Setback*, REUTERS, 21 April 2011, *posted at* www.reuters.com. Such descriptions draw both an explicit link to poverty alleviation, and an implicit link (by mentioning the launch date and venue) to fighting terrorism. Some accounts are a bit more direct as to the latter link, stating (for example) that “the long-stalled round ... was launched after the Sept. 11, 2001 [attacks]....” Tom Barkley, *U.S. Says Too Early to Declare Doha Round Dead*, MARKETWATCH, 22 April 2011, *posted at* www.marketwatch.com. But, it is unsurprising that explicit mention of Islamist extremism is not always made. Aside from concerns by some observers or commentators about offending Muslim constituencies by linking “Islam” with “extremism,” not every WTO Member stressed this link with equal vigor, either when the Round was launched, or during the subsequent history of the Round.

⁷⁶⁹ Daniel Pruzin, *WTO Members Give Up on Deliverables Pact, To Push for Work Program to Advance Doha*, 28 International Trade Reporter (BNA) 1228 (28 July 2011). (Emphasis added.)

Likewise, in March 2002, world leaders gathered in Monterrey, Mexico, for the United Nations International Conference on Financing for Development. That Conference articulated a goal of increasing economic assistance to poor countries as a way to help prevent future terrorists acts. See Report of the United Nations International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002 (A/CONF.198/11, chapter 1, resolution 1, annex), www.un.org/esa/ffd/MonterreyConsensus.pdf.

1. The *multilateral* trading system embodied in the World Trade Organization has contributed significantly to economic growth, development, and employment throughout the past fifty years. We are determined, particularly in the light of the global economic slowdown, to *maintain the process of reform and liberalization of trade policies*, thus ensuring that the system plays its full part in promoting recovery, growth, and development. We therefore strongly reaffirm the principles and objectives set out in the *Marrakesh Agreement Establishing the World Trade Organization*, and *pledge to reject the use of protectionism*.

2. *International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO Members are developing countries. We seek to place their needs and interests at the heart of the Work Program adopted in this Declaration.* Recalling the *Preamble* to the *Marrakesh Agreement*, we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programs have important roles to play.

- ...
10. Recognizing the challenges posed by an expanding WTO membership, *we confirm our collective responsibility to ensure internal transparency and the effective participation of all Members.* While emphasizing the intergovernmental character of the organization, we are committed to making the WTO's operations more transparent, including through more effective and prompt dissemination of information, and to improve dialogue with the public. *We shall therefore at the national and multilateral levels continue to promote a better public understanding of the WTO and to communicate the benefits of a liberal, rules-based multilateral trading system.*⁷⁷⁰

Why not also make explicit in the *Ministerial Declaration* the second, final step in the link, namely, from poverty alleviation to vulnerability to Islamist extremism?

The answer is a matter for speculation. One possibility is to save face for Islamic countries, *i.e.*, not to single them or the religion of Islam out as uniquely plagued with the

⁷⁷⁰ *Ministerial Declaration on the Doha Development Agenda (DDA) for Multilateral Trade Negotiations*, adopted 14 November 2001 (Doha, Qatar), www.wto.org. (Emphasis added.)

problem of extremism, and thereby not foster Islamophobia. No matter, though, as this next step was obvious enough, and regrettably, the hysteria spread and still exists.

To deny the existence of the link at the launch of the Doha Round also is to ignore a strong, optimistic, and long-standing vision for international trade, summarized by the phrase “peace through trade.”⁷⁷¹ The vision, championed by America’s longest-serving Secretary of State (from 1933-1944, under President Franklin Roosevelt), Cordell Hull (1871-1955), is that trade generates economic prosperity, and sooner or later, directly or indirectly, political democracy. In turn, people who are well off, or who have hope for a better future, are unlikely to want to overturn the *status quo* violently, or support war with people in other well-off democracies.

This vision is not uniquely American. Former Tanzanian President, Benjamin Mkapa (1938-2020, President, 1995-2005), aptly summarized that “it is futile, if not foolhardy to think there is no link between poverty and terrorism.”⁷⁷² In turn, former U.S. Assistant Secretary of State for African Affairs, Susan Rice (1964-), observed Africa is the “world’s soft under-belly for global terrorism,” and VEOs seek to recruit from among its “poor, disillusioned populations.”⁷⁷³

America has not lost faith in the vision of peace through trade. To the present, it is part of the rhetoric of American trade policy. It was a hallmark of that policy when the DDA was launched. America viewed trade policy and multilateral trade liberalization as an important part of its national security strategy. Multilateral trade liberalization was one tool in the kit to be used in the Global War on Terror that had been thrust upon America.

There is no better evidence of this linkage – trade as an element of counter-terrorism – than the official U.S. government report of the 9/11 Commission. It summarizes the relationship of underdevelopment and sense of hopelessness that goes with it to trade liberalization and counter-terrorism:

Economic openness is essential. Terrorism is not caused by poverty. Indeed, many terrorists come from relatively well-off families. Yet, when people lose hope, when societies break down, when countries fragment, the breeding grounds for terrorism are created. Backward economic policies and repressive political regimes slip into societies that are without hope, where ambition and passions have no constructive outlet.

⁷⁷¹ See generally DANIEL GRISWOLD, MAD ABOUT TRADE: WHY MAIN STREET AMERICA SHOULD EMBRACE GLOBALIZATION (Washington, D.C.: The Cato Institute, 2009); Kishore Mahbubani, *Trade in the New Asian Hemisphere*, in PEACE AND PROSPERITY THROUGH WORLD TRADE 6 (Fabrice Lehmann & Jean-Pierre Lehmann eds. New York: Cambridge University Press, 2010) (discussing peace-through-trade theory).

⁷⁷² Quoted in Adam Lusekelo, *Africa’s War on Terror Targets Poverty*, BBC NEWS, 27 February 2003, <http://news.bbc.co.uk/2/hi/business/2797405.stm>.

⁷⁷³ UNITED STATES CONGRESS, HEARING BEFORE THE SUBCOMMITTEE ON AFRICA OF THE COMMITTEE ON INTERNATIONAL RELATIONS, AFRICA AND THE WAR ON GLOBAL TERRORISM, 107TH CONG., 1ST SESS., 2001 (testimony of Susan Rice, Assistant Secretary of State and Consultant on African Affairs).

The policies that support economic development and reform also have political implications. Economic and political liberties tend to be linked. Commerce, especially international commerce, requires ongoing cooperation and compromise, the exchange of ideas across cultures, and the peaceful resolution of differences through negotiation or the rule of law. *Economic growth expands the middle class, a constituency for further reform.* Successful economies rely on vibrant private sectors, which have an interest in curbing indiscriminate government power. Those who develop the practice of controlling their own economic destiny soon desire a voice in their communities and political societies.

The U.S. government has announced [in May 2003] the goal of working toward a *Middle East Free Trade Area*, or *MEFTA*, by 2013. The United States has been seeking comprehensive free trade agreements (FTAs) with the Middle Eastern nations most firmly on the path to reform. . . . *Muslim countries can become full participants in the rules-based global trading system, as the United States considers lowering its trade barriers with the poorest Arab nations.*

Recommendation: A comprehensive U.S. strategy to counter terrorism should include economic policies that encourage development, more open societies, and opportunities for people to improve the lives of their families and to enhance prospects for their children’s future.⁷⁷⁴

To be clear, underdevelopment, of which poverty is a ubiquitous feature, is a condition in which extremist ideas simmer. Neither it generally, nor income deprivation specifically, leads inexorably to terrorism. There are intervening variables, as well as other causal variables. Deprivations of political and social rights, and religious freedoms, operate in either or both senses.

In other words, neither underdevelopment nor poverty is a necessary or sufficient condition for Islamist extremism. But, neither can they be ignored. They are repeatedly observed phenomena connected with this extremism. VEOs like *Al Qaeda* know it, and exploit it to their advantage. As Professor Kevin J. Fandl rightly states:

Poverty is rampant in rank and file Muslim terrorists; however, it is not found in the leadership of these groups. So while the large majority of members of terrorist groups hail from impoverished areas in the Middle East and Southern Asia that do not afford sufficient opportunities for members’ self-sufficiency, the wealthy leadership continue to belong “to an old tradition in which self-serving elites seize upon and manipulate the grievances of the poor.” By manipulating ideas and subsequently the minds

⁷⁷⁴ NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES, THE 9/11 COMMISSION REPORT – FINAL REPORT OF THE NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES 378-379 (authorized ed., 22 July 2004). (Emphasis in bold original, emphasis in italics added.)

of individuals, these power-hungry leaders are able to seize upon the lack of opportunity of these often impoverished and otherwise peaceful citizens, convincing them to rise up and take the lives of others and/or themselves in the name of the leadership's cause – not Islam, but vengeance. ...

...

... This conventional method of warfare [military means], while effective in pinpointing targets in complete darkness, will be useless in eliminating the ideology that fuels terrorism. Terrorists are nonconventional actors using non-conventional means through amorphous concepts that cannot be identified, contained, or labeled. These are actors whose most potent weapon is the communication of ideas among masses of people awaiting an opportunity for a better life.⁷⁷⁵

American trade negotiators involved in the launch of the Round, and the early years of that Round, knew it, too – that to attack poverty through appropriate new trade rules is to attack terrorism. If they did not, then why in May 2003 would the U.S. have launched its *MEFTA Initiative*, the stated goal of which was to stitch together countries in that region into a network of free trade and democracy?

So, successive iterations of the *National Strategy Report*, an analysis of American national security strategy submitted by the President to Congress annually pursuant to Section 108 of the *National Security Act of 1947*, have linked poverty alleviation and broader economic development to reducing the threat from Islamist extremist.⁷⁷⁶ President George W. Bush wrote in the 2002 *National Strategy Report*:

... the United States will use this moment of opportunity to extend the benefits of freedom across the globe. We will actively work to bring the hope of democracy, development, free markets, and free trade to every corner of the world. The events of September 11, 2001, taught us that weak states, like Afghanistan, can pose as great a danger to our national interests as strong states. Poverty does not make poor people into terrorists and murderers. Yet poverty, weak institutions, and corruption can make weak states vulnerable to terrorist networks and drug cartels within their borders.

The United States will stand beside any nation determined to build a better future by seeking the rewards of liberty for its people. Free trade and free markets have proven their ability to lift whole societies out of poverty – so the United States will work with individual nations, entire regions, and the entire global trading community to build a world that trades in freedom and therefore grows in prosperity. ...

...

⁷⁷⁵ Kevin J. Fandl, *Terrorism, Development & Trade: Winning the War on Terrorism Without the War*, 19 AMERICAN UNIVERSITY INTERNATIONAL LAW REVIEW 587, 594 (2004) (quoting Ken Booth & Tim Dunne, *Worlds in Collision*, in *WORLDS IN COLLISION: TERROR AND THE FUTURE OF GLOBAL ORDER* 9 (Ken Booth & Tim Dunne eds., 2002)). (Emphasis added.)

⁷⁷⁶ See 50 U.S.C. § 404a.

We are also guided by the conviction that no nation can build a safer, better world alone. Alliances and multilateral institutions can multiply the strength of freedom-loving nations. *The United States is committed to lasting institutions like the United Nations, the World Trade Organization, the Organization of American States, and NATO, as well as other long-standing alliances.*⁷⁷⁷

Entitled “Ignite a New Era of Global Economic Growth through Free Markets and Free Trade, Section VI of the 2002 National Strategy Report, amplifies the theme of peace-through-trade:

A strong world economy *enhances our national security by advancing prosperity and freedom in the rest of the world. Economic growth supported by free trade and free markets creates new jobs and higher incomes. It allows people to lift their lives out of poverty, spurs economic and legal reform, and the fight against corruption, and it reinforces the habits of liberty.*

...

The concept of “free trade” arose as a *moral principle* even before it became a pillar of economics. If you can make something that others value, you should be able to sell it to them. If others make something that you value, you should be able to buy it. This is real freedom, the freedom for a person – or a nation – to make a living. To promote free trade, the United States has developed a comprehensive strategy:

- *Seize the global initiative. The new global trade rounds we helped launch at Doha in November 2001 will have an ambitious agenda, especially in agriculture, manufacturing, and services, targeted for completion in 2005.* The United States has led the way in competing the accession of China and a democratic Taiwan to the World Trade Organization. We will assist Russia’s preparations to join the WTO.⁷⁷⁸ [These accessions are discussed in a separate Chapter.]

Manifestly, the Doha Round was not completed by the Hong Kong Ministerial Conference in December 2005, and while China and Taiwan acceded to the WTO in 2001 and 2002, respectively, negotiations for Russia to join were incomplete. (As for the remaining 8 of the 9 bullet-point elements in the comprehensive strategy, the U.S. made progress on some of them, but not in any enduring or conclusive manner, in the Bush and Obama Administrations.⁷⁷⁹) In the intervening years, as the Round has dragged on, trade

⁷⁷⁷ President George W. Bush, The White House, 17 September 2002, *National Strategy Report*, 2, www.whitehouse.gov. (Emphasis added.)

⁷⁷⁸ President George W. Bush, The White House, 17 September 2002, *National Strategy Report*, 13-14, www.whitehouse.gov. (Emphasis on “Seize the global initiative” original; other emphasis added.)

⁷⁷⁹ Those other eight elements are: pressing regional initiatives, moving ahead with bilateral free trade agreements, renewing the partnership between the executive branch and Congress on trade, promoting the connection between trade and development, enforcing trade agreements and laws against unfair trade practices, helping domestic industries and workers adjust, protecting the environment and workers, and

negotiators – both American and foreign – have lost sight of the theme, not to mention the fervor of believing trade liberalization to be a “moral principle.”

To be sure, in November 2001, not all WTO Members held the same perspectives on the project on which they were about to embark as did the U.S. Some countries were slower to the mark to appreciate how drastically the world had changed after September 11, and thus to think about links between terrorism and trade. But, to one degree or another, the nexus of trade liberalization – poverty alleviation – fighting Islamist extremism was perceptible. The former USTR, Ambassador Susan Schwab (1955-), wrote:

the [Doha Round] talks have sought to promote economic growth and improve living standards across the globe – especially in developing countries....

...

When the Doha Round finally began *in the wake of September 11, 2001*, negotiators continued to disagree over its objectives and how to achieve them.

*The use of trade liberalization and reform to generate economic growth and help alleviate poverty formed the core of the initiative.*⁷⁸⁰

Ujal Singh Bhatia, the former Indian Ambassador to the WTO, noted:

Consensus on launching the Round emerged under the *extraordinary situation created by the 9/11 events.*⁷⁸¹

That many trade officials at the November 2001 Doha meeting had those events in mind, and weighed how they might do good work to combat evil, is scarcely disputable.

IX. Persistent Threat

One of the oft-used arguments by the U.S. in the Doha Round, particularly in the later years of the Round, was that:

the world has fundamentally changed since the Doha Round was launched in November 2001, with Brazil, China, India, and others becoming world-leading exporters in some sectors of the global economy over the past decade.⁷⁸²

enhancing energy security. See President George W. Bush, The White House, 17 September 2002, *National Strategy Report*, 14-15, www.whitehouse.gov.

⁷⁸⁰ Susan C. Schwab, *After Doha – Why the Negotiations Are Doomed and What We Should Do About It*, 90 FOREIGN AFFAIRS 104, 105-106 (May/June 2011). (Emphasis added).

⁷⁸¹ Letter to the *Financial Times* from Ujal Singh Bhatia, *WTO Members are Lashed to the Mast of the Doha Round*, FINANCIAL TIMES, 16 May 2011, 8. (Emphasis added.) Mr. Bhatia served as Ambassador from 2004-2010.

⁷⁸² Daniel Pruzin, *WTO Chief Calls for Rethink on Doha Talks, Says Differences on Sectorals “Unbridgeable,”* 28 International Trade Reporter (BNA) 686 (28 April 2011). [Hereinafter, *WTO Chief*.]

Thus, American trade officials argue, the key question in the Round is:

to what extent should the major emerging economies take on additional responsibilities to liberalize global trade in order to reflect their growing importance in the global economy [?]⁷⁸³

This argument is not untrue, but rather is made in the wrong venue.

It is not untrue, because the world has changed in the sense of the importance of major emerging powers. The likes of Brazil, India, and China are vastly more important to the U.S. and other developed countries than they once were. The IMF reported that between 1998 and 2001, less than half of the growth in world GDP came from outside of rich countries. Between 2011 and 2014, the countries that are not rich, *i.e.*, developing and (to a lesser extent) least developed countries will account for 75% of the addition to global GDP. That is why:

America sees the Doha talks as its final opportunity to get fast-growing emerging economies like China and India to slash their duties on imports of such [manufactured] goods, which have been reduced in previous [GATT] rounds but remain much higher than those in the rich world. *It wants something approaching parity*, at least in some sectors, because it reckons its own low tariffs leave it with few concessions to offer in future talks. *But emerging markets insist that the Doha Round was never intended to result in such harmonization.*⁷⁸⁴

The emerging markets are right, and it is in their context that the world has not changed.

In fact, even with the death of Osama Bin Laden in May 2011, much of the world has not fundamentally changed since November 2001 when the Doha Round was launched. Islamist extremism remains a global threat,⁷⁸⁵ as the deadly Islamic State (which, in truth, is anything but “Islamic.” shows. The conditions of poverty, and a sense of oppression, both of which incubate Islamist extremists, have not changed. Thus, when the U.S. offers up the argument that Brazil, China, India, and other emerging developing countries must offer concessions commensurate with their enhanced global commercial status, America is not wrong about their new status and what the consequences of it ought fairly to be. Rather, the U.S. is making a reasonable argument in the wrong venue, and betraying the purpose on which it helped launch the Round: counter-terrorism.

The Doha Round never was intended for a re-balancing of trade concessions, although developing and even least developed countries never were told they would have

⁷⁸³ WTO Chief, 686.

⁷⁸⁴ *Dead Man Walking*, THE ECONOMIST, 30 April 2011, 81. (Emphasis added.)

⁷⁸⁵ See, e.g., Daniel Dombey, *Al-Qaeda “Still a Formidable Network,”* FINANCIAL TIMES, 10 May 2011, 3 (reporting that according to the U.S. State Department, *Al Qaeda* remains as deadly as ever, notwithstanding the demise of Bin Laden).

no obligations whatsoever. That is, while the Round never was designed as a one-sided exercise whereby rich countries take on all market access and subsidy reduction commitments, and poor countries do nothing, it was intended to address the single gravest threat facing all nations: terrorism, specifically, Islamist extremism. To be sure, no WTO Member saw the Round as a magic bullet that would end terrorism. But, many if not most of the Members appreciated the role trade liberalization could play in combatting one of the conditions that spawns this extremism: poverty, or put more generally, a sense of oppression.

The facts India is home to the largest concentration of Muslims in the world, and China has a sizeable Muslim population, has not changed. What has changed, for those countries, since November 2001, is they have been struck by Islamist extremism, and had to devote considerable military and security resources to fighting it. The “new” fact China and India have had success in exporting does not alter the “old” fact they are home to roughly 700 and 600 million poor people, respectively, who live in squalid conditions and have little stake in the world trading system, and many of them are Muslim.

Brazil, too, is beset with a large population of poor people, albeit non-Muslim. Yet, even with Brazil, the link with Islamist extremism may exist. Radical Islamist groups, such as *Hezbollah*, traffic pirated intellectual property goods (as well as narcotics and weapons), such as music CDs and movie DVDs. Such pirated goods have been found in South America, and surely are attractive to poor people, who cannot afford authentic items. To what ends do the radical groups put their ill-gotten gains from the sale of counterfeit assets? The answer is not just social welfare projects they sponsor in impoverished places like South Lebanon, but also surely includes terrorist activities.

X. Death, But Four Legacies⁷⁸⁶

⁷⁸⁶ For an analysis of all Doha Round draft texts, and why their specific provisions failed to fulfill the purpose of the Round, see *The Doha Round Trilogy* by your *E-Textbook* author:

- (1) *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part One of a Trilogy – Agricultural Tariffs and Subsidies*, 9 UNIVERSITY OF SAINT THOMAS LAW JOURNAL issue 1, 5-160 (2011, Annual Law Journal Lecture, reviewed in Frank J. Garcia, *Doha, Security, and Justice: A Response to Professor Raj Bhala*, 9 UNIVERSITY OF SAINT THOMAS LAW JOURNAL issue 1, 194-213 (2011), and in Robert J. Delahunty, *Trade, War, and Terror: A Reply to Bhala*, 9 UNIVERSITY OF SAINT THOMAS LAW JOURNAL issue 1, 161-193 (2011)).
- (2) *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part Two of a Trilogy – Non-Agricultural Market Access and Services Trade*, 44 CASE WESTERN RESERVE JOURNAL OF INTERNATIONAL LAW issues 1 & 2, 1-81 (2011, War Crimes Research Symposium on International Law in Crisis).
- (3) *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part Three of a Trilogy – Trade Remedies and Facilitation*, 40 DENVER JOURNAL OF INTERNATIONAL LAW AND POLICY issues 1-3, 237-320 (2012, 40th Anniversary Symposium Festschrift in Honor of Professor Ved P. Nanda, “Perspectives on International Law in an Era of Change”).

See also Raj Bhala, *Modern GATT Law* Chapters 29-36 (2nd ed. 2013) (incorporating and updating these articles).

The Doha Round is dead. WTO Members failed to adopt on the basis of a single undertaking a horizontal set of multilateral agreements covering the DDA topics. It is the first unsuccessful Round in the history of the GATT-WTO system. The Administration of President Donald J. Trump (1946-, President, 2017-2021) declared in March 2018 it “considers the Doha Round to be a thing of the past,” and would not negotiate on the basis of any DDA mandate or text.⁷⁸⁷

From November 2001 onwards, WTO Members produced draft modalities texts, most notably those from December 2008, some of which were supplemented in April 2011. Those drafts are mind-numbingly complex, difficult for even the seasoned professional to access. They are long on *sui generis* rules to benefit one of small groups of Members, and short on simplicity or vision. As the years of the Round ground on after its November 2001, the Members took more care of their own commercial self-interests than they did of their common interest in fighting extremism, particularly Islamist extremism following 9-11.

Few dared to declare the Doha Round “dead” for fear of dooming the WTO to irrelevance. Quite the contrary: honesty would have liberated the WTO of a crushing burden, which could then have move to “do-able” deals. Moreover, the death of the Round hardly vitiated other valuable WTO assets: its dispute settlement mechanism remains its crown jewel; its monitoring function is useful to anticipate inconsistencies between trade measures of individual Members and multilateral rules; and its research wing produces helpful economic studies. Even its negotiating forum encourages dialogue, thereby soothing trade friction and defusing potential trade wars.

Indeed, concerning this latter asset, it is unfair to say the Doha Round was an utter failure. The Round yielded four significant multilateral accords.

- (1) Amendments to Article 31 of the *TRIPs Agreement* concerning compulsory licensing and importation of generic pharmaceuticals, agreed at the December 2005 Hong Kong Ministerial Conference.
- (2) *Trade Facilitation Agreement*, the first text added to the corpus of GATT-WTO accords that emerged from the Uruguay Round, agreed at the December 2013 Bali Ministerial Conference, with final agreement in July 2014 after resolution of a dispute between the U.S and India.
- (3) *Decision on Public Stockholding for Food Security*, also agreed at the December 2013 Bali Ministerial Conference, but with negotiations continuing to finalize the terms of Green Box reform.
- (4) *Decision on Export Competition*, agreed at the December 2015 Nairobi Ministerial Conference, on elimination of agricultural export subsidies.

⁷⁸⁷ UNITED STATES TRADE REPRESENTATIVE, 2018 TRADE POLICY AGENDA AND 2017 ANNUAL REPORT, 41.

The successful implementation and enforcement of these accords (discussed in other Chapters) varies.

As chronicled in several Chapters, the death of the Doha Round is one among several factors contributing to the demise of multilateralism generally in other international legal areas, most notably the United Nations system, and driving initiatives at the regional, bilateral, and national levels, and in the private sector. The death of the Round also has cast doubt on the WTO itself and its ability to fulfill two of its three core functions, namely, as a negotiating and adjudicatory forum. (As to the third such function, research, statistics, and monitoring, they can be – and, indeed, are – fulfilled by other IOs, NGOs, governments, and private enterprises and institutions).

To be sure, there have been no shortages of suggestions as to how to “fix” the WTO. Among them are ones offered by a former WTO Deputy Director General, Ambassador Alan Wolff. He argues “Unilateral measures, in exceptional cases, can be positive [– that is, promote the multilateral trading system rather than degrade international cooperation –] if they are action-forcing,” *e.g.*, the 1971 U.S. import surcharge and 1980s Section 301 cases brought by the U.S. against Japan, and possibly the EU’s CBAM initiative, and U.S.-China exchanges, and further that [u]nilateralism is both a symptom and a cause of the diminished ability of the WTO to resolve pressing problems, hence cures are available through WTO reform).⁷⁸⁸ He also discusses WTO reforms through accessions, and calls for (1) acceptance by all WTO Members of “a rules-based order steered by a market economy, the private sector, and competition” (2) “root and branch” reforms on topics such as agricultural and industrial subsidies, (3) serious negotiations toward an acceptable dispute resolution mechanism, (4) plurilateral accords that no one Member can block, (5) updated rules to keep pace with technological innovations, (6) changes to consensus-based decision making to deal with unyielding Members and their positions, (7) the relationship between the GATT-WTO system and RTAs, (8) greater engagement with Africa, and (9) enhanced S&D treatment).⁷⁸⁹

Whether any such proposals, much less all of them, will be agreed upon by consensus and thereby resuscitate – or dare it be said, resurrect – the WTO is uncertain.

⁷⁸⁸ *State of Multilateral Governance in Times of Increasing Unilateralism*, Remarks of Alan Wm. Wolff, Peterson Institute for International Economics (PIIE) World Trade Institute (Bern, Switzerland, 23 September 2022), www.piie.com/sites/default/files/2022-09/2022-09-23wolff.pdf.

⁷⁸⁹ *Reform of the World Trade Organization*, Remarks of Alan Wm. Wolff, Peterson Institute for International Economics (PIIE), Second Memorial Lecture for Chiedu Osakwe WTO (26 September 2022), www.piie.com/sites/default/files/2022-09/2022-09-26wolff.pdf.

Part Six

INTERNATIONAL RELATIONS FOUNDATIONS

Chapter 23

REALISM

I. Origins

Among all International Relations (IR) theories, Realism is the most widely recognized.⁷⁹⁰ Perhaps that is because it is the oldest, and accords with the most pragmatic, if not baser, instincts of humankind. Realism explains IR through the lens of States, and assumes States base their decisions on the maximization of self-State interest. Realism also assumes States predicate these decisions on the interest of power, which subsequently furthers their self-interest. Put simply, if simplistically, Realism is about the world as it is, and about how it may be shaped to advance national interests; it is not about aligning this realm with an ideal type, or manifesting the Kingdom of God on earth (as far as that might be possible). Realists are a hard-headed lot, though in their defense, they would say they are not naïve.

Before the foundational assumptions of realism were established, notions of Realist thought existed amongst early philosophers and scholars. The Athenian historian and general, Thucydides (*circa* 460-400 B.C.), studied decisions made by Lacedaemon (*i.e.*, Sparta) during the Peloponnesian War (431-404 B.C.), a conflict between Athens (which led the Delian League), and Sparta (which led the Peloponnesian League). Thucydides interpreted decision-making to be based on self-interest. Particularly, Lacedaemon's self-interest was the survival of the State itself. Thucydides writes:

The real cause I consider to be one which was most formally kept out of sight. The growth of power of Athens, and the alarm which this inspired in Lacedaemon, made war inevitable.⁷⁹¹

Observations synonymous with Thucydides only increased following the *Treaty of Westphalia* in 1648. Westphalia marked the beginning of the sovereign State. Subsequently, philosophers such as the Italian, Niccolo Machiavelli (1469-1527), Englishman, Thomas Hobbes (1588-1679), and German, Max Weber (1864-1920), sought to define how the balance of power evolved and changed among sovereign States.

The work of each philosopher contained fragments of Realist thought, but their work did not directly aggregate into a coherent framework for Realism. Thus, Classical Realism ultimately can be attributed to the German-American jurist, Hans Morgenthau (1904-1980). Morgenthau's six principles of Realism encompassed Realist notions from Hobbes and Weber, and furnished a theoretical framework applicable to both 20th century World Wars.

⁷⁹⁰ This Chapter is drawn from a superb December 2022 memo, "Introduction to Realism," by Jacob C. Barefield, J.D., University of Kansas, School of Law (Class of 2023).

⁷⁹¹ ROBERT KEOHANE, *NEOREALISM AND ITS CRITICS* 7 (New York, New York: Columbia University Press, 1986).

Practitioners, such as George Kennan (1904-2005) and Henry Kissinger (1923-2023), applied Morgenthau's Classical Realism to explain international affairs during the Cold War. Other practitioners saw Morgenthau's theory as philosophically dense. Scholars such as Kenneth Waltz (1924-2013) tried to concretize it, explain the interest of power through an empirical lens. In Waltz's 1979 book, *The Theory of International Politics*, elaborated on this train of thought, and produced what is known today as Neo-Structural (or Structural-Neo) Realism.

As with all IR theories, Realism has not escaped its fair share of criticism. Critics point to Realist thought as a means to perpetuate violence, and as cynically assuming all actors are self-interested amidst an anarchic international environment – thus providing excuses for brutish behavior. Critics also point out that recent applications of Realism in the Cold War fail to explain the end of a war with military power. Nevertheless, through all this criticism, Realism has been able to sustain itself as a dominant theory in IR.

II. Definition and Assumptions

Realism emphasizes that States operate in an anarchic world, make policy decisions based on their own self-interest and struggle for power. Anarchy prevails, because there is no true central authority over the states, hence decisions of States are limited only by their capabilities. Within those limits, decisions States make are inevitably dictated by self-interest, because human nature is inherently egoistic and brutish.

Most, if not all, Realists, regardless of variation, lay a foundation of key assumptions on which they operate. In *Contending Theories of International Relations* (1997), the six assumptions of G.E. Daniels are highlighted. They are the ones Realists assume are true (or inevitable), within international politics:

- (1) actors in international politics are nation-States;⁷⁹²
- (2) there is variance in the capabilities of the State;
- (3) decisions made by the State are intended to maximize State interest;
- (4) States and leaders of the State behave, by and large, in a rational manner;
- (5) domestic and foreign politics do not intermingle; and
- (6) power explains and predicates behavior.⁷⁹³

Assumptions (1) through (3) are self-explanatory and need little context.

According to Realists, States are the only actors in international politics, and outside actors such as non-governmental organizations (NGOs) and inter-governmental organizations have little influence or power within the international sphere. (This assumption is manifestly false, as nefarious non-State actors, such as *Al Qaeda*, show.) States, depending on their natural, economic, or human resources, inevitably vary as to

⁷⁹² JAMES E. DOUGHERTY & ROBERT L. PFALTZGRAFF, JR. *CONTENDING THEORIES OF INTERNATIONAL RELATIONS: A COMPREHENSIVE SURVEY* 27 (4th ed., 1997). [Hereinafter, *CONTENDING THEORIES*.]

⁷⁹³ *CONTENDING THEORIES*, 58.

how far their power stretches, or how they sustain their power in comparison to other countries. Lastly, decisions made by a State are not intended to result in a positive sum outcome. Rather, States make decisions to only maximize their own interest, with ill regard for consequences it brings to other states.⁷⁹⁴

Assumptions (4) through (6) raise questions of whether they can be assumed in international politics. Do authoritarian dictators act rationally? Can foreign politics be separated from domestic politics? Have Realists already assumed State interest, and not power, predicates behavior? Troubled by such questions, some Realist scholars, along with critics of Realism, have developed variations of Realism and/or opposing theories. Nevertheless, most Realist thinkers stick with these assumptions, and align with the thought processes laid out by the forerunners of Classical realism.

III. Early Realist Thinkers: Machiavelli, Hobbes, and Weber

Realist thought did not spontaneously arise. Over centuries, philosophers observing inter-State behavior considered the rationale behind the interactions of States. Thucydides' identify the rationale for the entrance of Lacedaemon (Sparta) into war – national security. Philosophical commentators after Thucydides generally did not deviate from his line of thinking. The accumulation of philosophical works built an early foundation for Classical Realism, and for Hans Morgenthau to establish it as the dominant modern approach towards observing international politics. (Note carefully, however, a different narrative may be told with respect to Christian theologians.)

- **Machiavelli**

Machiavelli (1469-1557) predates the *Treaty of Westphalia* (1648), and thus predates the recognition of a sovereign State. Yet, without the existence of the concept of a sovereign State existing, Machiavelli foreshadowed the Realist line of thinking. His works comment on what assumptions a leader must before taking a decision.

For a leader to be successful, a leader must (1) not focus on standards benefitting individuals within their society, (2) but rather emphasize standards concerning survival of society itself, (3) understand political power clash, and (4) accept that human nature is egoistic and brutish. Classical Realist thought essentially adopts these assumptions, and, indeed, furthers the component of State self-interest and competition.⁷⁹⁵

- **Hobbes**

Thomas Hobbes's (1588-1679) commentary occurs after the *Treaty of Westphalia* and observes the establishment of State sovereignty in real time.⁷⁹⁶ Hobbes's work reflects

⁷⁹⁴ See JAMES M. SCOTT, RALPH G. CARTER & A. COOPER DRURY, *INTERNATIONAL RELATIONS: INTERNATIONAL, ECONOMIC, AND HUMAN SECURITY IN A CHANGING WORLD* 71 (3rd ed., 2019).

⁷⁹⁵ See *CONTENDING THEORIES*, 63.

⁷⁹⁶ See *CONTENDING THEORIES*, 58.

many sentiments conveyed by Machiavelli. It highlights the inherent nasty, brutish, and short, nature of individuals, and stresses the importance of the concerns of the State.

Hobbes additionally provides insight on the representation of State interest. He argues this interest should not be conflated with the interests of political groups within a State. Intra-State political groups construe their messaging to seem as if they want what is best for the State. Hobbes emphasizes the power political groups seek is too analogous to the devilish nature of humans, on an individual basis, and not truly aligned with the interest of the State itself. Thus, distinguishing individual group from collective self-interest is vital.⁷⁹⁷

- **Weber**

With respect to its implications for IR theory, the thought of Max Weber (1864-1920) does not deviate markedly from that of Machiavelli or Hobbes. But, Weber's works further the interest of States and Statehood. Arguably, they provide the greatest early substance for modern Realist scholars to embolden Realism. Particularly, Weber elaborates on the (1) ethic of conviction versus the ethic of responsibility and (2) influence of systemic structural issues on State behavior.

First, leaders who adhere to the ethic of conviction are ones who base their actions on universal truths, morals, and principles. Weber says adherence to this ethic of conviction on a State level inevitably leads to the demise of the State. States cannot act on universals: they are concepts humans adopt on an individual basis, but these concepts are not concerned with society and the State. (Christian theologians might beg to differ, suggesting that a *bona fide* universal truth, by definition, is mindful of the collective.)

The ethic of conviction also fails to account for the consequences of actions. The acts or omissions of individuals based on the ethic of conviction have consequences ranging from the minor to the major consequences. The consequences affect only that individual; therefore, the effect of actions typically is limited. But, Weber emphasizes that the leader of a State cannot afford to disregard the consequences for individuals, as there are no limits to the actions that could affect (and thus undermine) a State.⁷⁹⁸

Weber points to the ethic of responsibility as to how leaders should act. Leaders acting based on the ethic of responsibility acknowledge actions and consequences cannot be separated. Each action must be judged on specific merits of the situation, and not a universal truth imploring an action. Weber understands individuals may disagree with a decision of a State leader, and infer their differences are due to rational thought based on the ethic of conviction rather than ethic of responsibility. However, if a leader has the best interest of the State in mind, the leader will disregard notions of absolute truths or universal morality, and act based on the specific circumstances of the situation.⁷⁹⁹

⁷⁹⁷ See CONTENDING THEORIES, 64.

⁷⁹⁸ See CONTENDING THEORIES, 64-65.

⁷⁹⁹ See CONTENDING THEORIES.

Second, Weber points to systemic structural issues as a means to influence State behavior. Such issues include how States are physically divided, and how their geographic location compares with other States. This point connects to Hans Morgenthau's hierarchy of State interest, wherein survival is the number one interest of the State. When a State uses the ethic of responsibility to determine how it will survive, a systemic structural issue likely imposes the heaviest burden on the State's decision. States scrutinize the size and capabilities of neighboring states, and act based on their bottom-line assessment – foreshadowing the Structural Realism of Kenneth Waltz (discussed below).

IV. Leading Theoreticians: Hans Morgenthau

Classic Realist thought begins with Hans Morgenthau (1940-1980). Morgenthau, an American German jurist, laid the foundation for this school of IR theory parallel to the 1939-1945 Second World War. Morgenthau's philosophical approach towards the reality of international politics is woven with ideology from his predecessors. Two of his six pillars of Realism are (1) universal principles cannot be applied to actions of States, and (2) the moral aspirations of one State do not identify the moral aspirations that govern all States. Morgenthau's remaining four pillars paint a clear picture for Realism to be a means of explaining State behavior in international politics, and particularly actions occurring in the early 20th century.

Morgenthau offers four additional pillars:

- (1) Political decisions should be governed by objective standards rooted in human nature.
- (2) Political leaders think and act in terms of the interest of power.
- (3) Survival constitutes the minimum goal of foreign power.
- (4) Political actions need to be judged only by political criteria.⁸⁰⁰

Each of these additional pillars is worthy of book-treatment critique.

Suffice it to say that pillar (1) reprises the age-old debate about human nature (here, again, consider theological perspectives), pillar (2) might not characterize all leaders (consider President Jimmy Carter (1924-, President, 1977-1981), pillar (3) is unobjectionable only insofar as the adjective “minimum” is stressed, and pillar (4) is a recipe to exclude from IR compassion, empathy, and the advancement of social justice.

- **Political Decisions and Historical Data**

Morgenthau's pillar (1) that political decisions need only be governed by objective standards, furthers Hobbes's idea of ethic of conviction and ethic of responsibility. Morgenthau agrees with Hobbes: State leaders should not premise their decisions on universal truths, but rather on circumstantial needs of the State. Morgenthau furthers Hobbes's ethic of responsibility by stating the circumstantial needs of a States can be synonymous with historical data. The data provide objective insight as to the consequences

⁸⁰⁰ See *CONTENDING THEORIES*, 71.

of actions. Therefore, State leaders can make accurate decisions regarding the circumstances by looking for guidance to objective, historical data.⁸⁰¹

- **In the Interest of Power**

Leaders motivated to act based on the interest of power is the foundation for Morgenthau’s Classical Realist thought. But, what is “power”? The definition varies, spanning from the concise to overly broad. “Power,” in its simplest form, and for the purposes of feasibly understanding Morgenthau’s assertion, is “the ability to do so.” Put a bit differently, “power” is the ability to cause an actor to act in a way they are otherwise not inclined to act.

The assertion of States and their leaders to focus on power can be interpreted as meaning States are keen to have the ability to do as they please. Recall, then, the descriptive and prescriptive aphorism, “might makes right,” or the Melian Dialogue (on which Thucydides commented – casting doubt on it) that the strong will do what they do but the weak will suffer what they must. In any event, though the definition of “power” is short, its implications for Morgenthau’s other pillars showcase the importance of the concept in Realist thought.⁸⁰² Consider a scenario in which every State had maximum power – it could do what it wanted, and compel any other State to do what it wanted. Does that scenario, wherein each State operates without constraint, make a jungle seem tame? Is this scenario even possible, *i.e.*, are there inevitably stronger and weaker States?

- **Minimum Goal of Survival**

The ability of one State to do as it pleases is not possible without the sovereignty of that State. Therefore, Morgenthau advises States should prioritize survival before any other foreign policy goals. The ability to “do as you please” is intoxicating. It allows for ill-considered goals. Such goals shroud the need to protect the State itself, and ultimately can lead to the demise of the State.⁸⁰³ The expansion of Adolph Hitler’s (1889-1945) Nazi Third Reich (1933-1945) across the European continent illuminates Morgenthau’s point about survival. This dreadful period of modern history exemplifies how hierarchically placing survival of the State beneath other foreign policy goals can kill a State.

Operation Barbarossa, Hitler’s ultimately unsuccessful invasion of Russia that he ordered in June 1941, occurred after Nazi Germany’s expansion into much of France. Hitler intended to destroy the regime of Joseph Stalin (1878-1953, General Secretary of the Communist Party of the Soviet Union, 1922-1952) and extend the reach of Nazi Germany throughout Eastern Germany and beyond. Hitler’s campaign would result in the capturing of Soviet territories such as Ukraine and Belarus.⁸⁰⁴ Nevertheless, Hitler – intoxicated with power interests – imprudently chose expansion over survival.

⁸⁰¹ See *CONTENDING THEORIES*, 71.

⁸⁰² See *CONTENDING THEORIES*, 71.

⁸⁰³ See *CONTENDING THEORIES*, 72.

⁸⁰⁴ See *Operation Barbarossa and Germany’s Failure in the Soviet Union*, Imperial War Museums, www.iwm.org.uk/history/operation-barbarossa-and-germanys-failure-in-the-soviet-

The Battle of Stalingrad marked the demise of this bad decision. From August 1942 to February 1943, Hitler's Army and Allies suffered over 800,000 deaths and casualties. But for Hitler's mis-conceived foreign policy goals, those people could have been deployed to protect Germany. Small wonder why historians mark this battle as the turning point of the Second World War on the European front, and demise of Nazi Germany.⁸⁰⁵

- **Political Actions and Criteria**

Sovereign State leaders, whether acting to ensure the survival of the State, or to expand the power abilities of the State, enact their decisions through policies. Morgenthau says such decisions are political – full stop. Choosing one policy option over another need not be premised or justified on other criteria, such as economic or humanitarian. Morgenthau classifies these political decisions in relation to power, arguing leaders create policy to (1) keep power, (2) demonstrate power, or (3) increase power.⁸⁰⁶

States, and the actions of their leaders, vary depending on which of these three categories is relevant to a policy decision. First, a State seeking to keep power is not acting expansively, but rather acting content with the *status quo*. Power-keeping is essentially can a defense mechanism in response to a fundamental shift in power relations in the international realm.

Second, States might seek to merely demonstrate their power. Why? One reason is threat. One State may want to threaten another other States, and a display of force allows it to do so. Think North Korea with respect to South Korea, from the perspective of South Korea. A second reason is deterrence. One State may want to deter threats from another State. Displays of force may forewarn adversaries of adverse consequences. Think North Korea with respect to South Korea, but from the perspective of North Korea. Yet, such displays can create a security dilemma: rather than the other State accepting the displays as a deterrence, the other State sees it as danger – a threat. So, the other State displays its own forces, and bolsters them. Think North and South Korea in both directions. Anticipating this spiral, some States resort to diplomacy to demonstrate power, as diplomacy shows they have significance influence in international politics.

Third, a State deciding on a policy to increase power likely has established mechanisms to ensure the survival of that State. Therefore, its political decisions look towards outward action. Alas, outward action often is imperialistic action. Imperialism in its most generic form is military imperialism, where one State introduces military forces into another State for the purpose of takeover.⁸⁰⁷

[union#:~:text=On%20the%2022nd%20of%20June,the%20Luftwaffe%20ruled%20the%20skies.](#)

[Hereinafter, *Operation Barbarossa*.]

⁸⁰⁵ See *Operation Barbarossa*.

⁸⁰⁶ See *CONTENDING THEORIES*, 74.

⁸⁰⁷ See *CONTENDING THEORIES*, 74.

Imperialism takes multiple forms though, including economic and cultural imperialism. Economic imperialism seeks to dominate another State through the supply, demand, and pricing signals, and conditions of competition, in the at other State. Cultural imperialism may be characterized as an attempt of one State to regulate thought processes in another States. Rather than one State directly imposing its will on another State, the first State uses marketing, persuasion, and other forms of rhetoric – as well as sinister tools such as propaganda, fake news, hacking, and cyberattacks – to gain support for another state.⁸⁰⁸

V. Applying Realism

Morgenthau’s Classical Realist catalyzed others to view IR through this lens. In the 20th century, George Kennan (1904-2005) and Henry Kissinger (1923-2023) were among the most influential practitioners of Classical Realism. That was their lens for policy decision-making throughout the Cold War.

- **George Kennan, Cold War Containment, and Romanticism**

George Kennan’s application of Realism drove “First World” (developed, non-Communist States) action toward the “Second World” (the Communist bloc), with implications for the “Third World” (developing and least developing countries). Kennan recognized the Union of Soviet Socialist Republics (U.S.S.R.) as a growing power challenging its erstwhile Second World War Allies (namely, the U.S., U.K., and France). Kennan also understood the importance of the geographic location of States and its relationship to the capabilities of each State. States seeking to increase their power, and enhance their capability to generate more power, look to the geographic feasibility of those goals before taking policy decisions.

Therefore, Kennan builds on Morgenthau’s categorization of political decisions, and proposes a containment strategy as a means for America and its allies to keep power. Containment strategy was not a means to rationalize pre-emptive attacks. Rather, it was “designed to confront the Russians with unalterable counter-force at every point where they show signs of encroaching upon the interest of a peaceful and stable world.”⁸⁰⁹ Containment became the policy adopted by the Western powers, and their justification for their interventions in North Asia (Korea) and Southeast Asia (Vietnam, Laos, and Cambodia).⁸¹⁰

Kennan’s contribution to Realism is not limited to containment in the context of political decision-making, and his analysis of mid-20th century American foreign policy may be extended well beyond those decades. For instance, containment (of China under the CCP headed by President Xi Jinping (1953-, President, 2013-)) is touted as a rationale for *TPP*, which (obviously) is an FTA, not a NATO-like defense treaty.⁸¹¹ Kennan

⁸⁰⁸ See *CONTENDING THEORIES*, 74.

⁸⁰⁹ *Quoted in* *CONTENDING THEORIES*, 74-75.

⁸¹⁰ See *CONTENDING THEORIES*, 75.

⁸¹¹ See RAJ BHALA, *TPP OBJECTIVELY: LEGAL, ECONOMIC, AND NATIONAL SECURITY DIMENSIONS OF CPTPP* (Durham, North Carolina: Carolina Academic Press, 2nd edition, 2019).

emphasizes America's failure to protecting borders, and romanticized a vision of world peace. (Query whether this vision was inspired by Utopianism.) Kennan notes this line of thought aligns more with morality of the individual, even if lacks consideration for the actual need of the State. (Query whether this note is inspired by Kantian philosophy.) Might these aspects of Kennan's views yield unbounded nation-State objectives, and unconditional surrender from opposition reluctant to conform to the romanticized vision of the world?⁸¹²

Mid-20th century Romanticism, from Kennan's perspective, highlights the need for States to revert to prioritizing their needs in their foreign policy decisions. Realists urge that Romanticism erodes border protection. That is, quixotic global objectives cause America to be everywhere except home, and thus leave the U.S. vulnerable. Furthermore, heart and minds overseas are not won by imposing culture on others. Rather, stressing common interests – the survival and retention of power – are what matter to the survival of the State.

- **Henry Kissinger and *Détente***

As the Secretary of State to Presidents Richard M. Nixon (1913-1994, President, 1969-1974) and Gerald R. Ford (1913-2006, President, 1974-1977), Henry Kissinger's application of Realism differed sufficiently to earn him – from his critics – the epithet of a war criminal.⁸¹³ Previous Realist thinkers almost glorified the brutish and egoistic nature of humanity, and self-interest serves as a focal point for them. To put the most favorable “spin” on the matter, Kissinger's approach stressed the advancement of self-interest through cooperation and recognition.

Kissinger aligned with most Realist thinkers. He recognized military capabilities are the determinant of the interest of power.⁸¹⁴ The variation in capabilities did not mean States had to act. States could find ways to gain power without the clashing of militaries. Kissinger's Cold War policy was “*détente*.” Kissinger elaborated on the meaning of “*détente*,” described it as:

“encourag[ing] environment in which competitors, the United States and Soviet Union can regulate and restrain their differences and ultimately move on from competition to co-operation.”⁸¹⁵

Query whether this “regulation and restraint” could be applied to contemporary Russian-American or Sino-American relations.

⁸¹² See CONTENDING THEORIES, 76.

⁸¹³ See, e.g., Spencer Ackerman, *Henry Kissinger, War Criminal Beloved by America's Ruling Class, Finally Dies*, ROLLING STONE, 29 November 2023, www.rollingstone.com/politics/politics-news/henry-kissinger-war-criminal-dead-1234804748/.

; Adam Taylor, *Henry Kissinger: Nobel Peace Laureate, War Criminal?*, THE WASHINGTON POST, 30 November 2023, www.washingtonpost.com/world/2023/11/30/henry-kissinger-war-criminal/.

⁸¹⁴ See CONTENDING THEORIES, 78.

⁸¹⁵ S. Rifaat Husain, *Soviet-American Détente: Theory and Reality*, Institute of Strategic Studies Islamabad, 101 (October-December 1977).

Perhaps Kissinger's *détente* is a Liberal tinge on Realist IR thinking. But his thinking ultimately was Realist: power – military power – mattered most. Kissinger consistently counselled against advocacy for universal values, or one moral standard. He championed the cause of States to their own national interest, and not conform to the needs of the individual. Consider, then, based on the data evincing the effects of the Realist policies he advocated whether his thinking made the world a better place.

VI. “Neo/Structural” Variations

Kissinger's version of Classical Realism enticed others to theorize beyond the philosophical approach towards explaining IR amongst States. Professor Kenneth Waltz (1924-2013) did exactly that. Morgenthau's approach to Realism, in some respects, was normative – he evaluated the customary, habitual behavior of States, *i.e.*, the standards they regularly follow. Morgenthau, along with his predecessors, provide normative assumptions about the morality of human nature: its egoistic, brutish ultimately serve as determinant for foreign policy.

Waltz's Neo-Realism abandons the assumption of egoism and brutishness as the bases for foreign policy decisions. Neo-Realism holds these decisions should derive from two factors. First, States must understand they are constrained by an international anarchic system, meaning States are constrained by their idiosyncratic capabilities and geography. Second, any action taken by a State must be judged through the lens of relative power.⁸¹⁶

Realism and Neo-Realism vary on this second factor. Realism judges political actions by the ethic of responsibility: what is inherently the best decision for the State? Neo-Realism abandons the interest of self, and rather looks empirically outwards. The capabilities of other States are the determinant of action.⁸¹⁷

VII. Criticisms

Realism has plenty of critics. For many, Realism is a means of perpetuating violence, not an authentic way to study foreign policy decision-making. The zero-sum outcomes associated with Realism raise issues of security. One State demonstrating power will not choose to cooperate, but rather opt to bolster its own forces. And, while the Cold War was a defining moment in history for Realist scholars to apply their ideas to international decision making, others find the Cold War as a defining moment in disproving Realism.

- **Perpetuating Violence**

Realist critics see Realism as a means for suffering through brutality. After all, a key Realist assumption is the brutish nature of humanity creates a leeway for leaders to act

⁸¹⁶ Sandrina Antunes & Isabela Camiso, *Introducing Realism in International Relations Theory*, E-INTERNATIONAL RELATIONS (27 February 2018). [Hereinafter, Antunes & Camiso.]

⁸¹⁷ Antunes & Camiso.

brutally. Critics see this assumption as ridiculously pessimistic overstatement of human nature. The assumption downgrades the willingness and ability of States and their leaders to cooperate with respect to the use of force. If States and leaders see foreign policy as a means of taking, rather than a means of sharing, then this view will spread across the globe, perpetuating violence.⁸¹⁸

- **Security Issues**

Critics also focus on Realist scholars emphasizing the desire (lust?) of certain State for power, and how this focus creates a security dilemma for other States. Morgenthau's categorizations of political decisions, whether keeping, increasing, or demonstrating power, all require the use of force in some manner.

So, it must be asked, when States implement force, how will other States perceive that use of force? For Realist critics, many States will perceive the use of force as a threat, and thus the only way for such a State to secure itself from that threat is congruent retaliation. Critics thus say Morgenthau's categorizations stimulate a cycle of force, when security can be secured by other means such as cooperation.⁸¹⁹

- **Cold War, End of Realism, and Importance of Religion**

Many critics note Realist theory is undermined by the actions of global powers during the 20th century Soviet-American Cold War, which ended peacefully. First, critics note during the Cold War, neither the United States nor U.S.S.R. fired one shot at one another. The Cold War ended with the non-violent November 1989 tearing down of the Berlin Wall, and freedom for Eastern Europe.⁸²⁰

Arguably the biggest problem with Realism is its disregard of religion as a force in IR. For example, the role of the Catholic Church, and Pope Saint John Paul II (1920-2005, Pope, 1978-2005), in working behind and undermining the Iron Curtain, has been well documented. Your *E-Textbook* author has read accounts of this Polish Pope's impact, and listened first-hand (as at the November 2023 International Bar Association (IBA) Annual Meeting in Paris) to Lech Wałęsa (1943-), the 1983 Nobel Peace Prize Winner and avowed Catholic – the catalyst for challenge the atheistic Soviet empire. What Realists ignore is that for many around the world, faith not only matters, but changes the world.

VIII. Realism Beyond International Relations

Realism is a lens through which to analyze international politics. What are the implications of Realism beyond IR? Realist thought, although intended for IR, can play a key role in the analysis of domestic politics, trade, and human rights. So, consider asking Realist-inspired questions:

⁸¹⁸ Antunes & Camiso.

⁸¹⁹ Antunes & Camiso

⁸²⁰ See *CONTENDING THEORIES*, 89.

- (1) Did a leader have the interest of State (national interest), or individual goals, in mind?
- (2) Is the action contemplated or undertaken intended to keep, increase, or demonstrate power?
- (3) What criteria is a policy-maker using to make a decision (philosophical standards or empirical)?

Such questions can be applied in a wide variety of contexts.

For instance, when the Governor of Kansas launches an initiative to bring foreign direct investment (FDI) to Kansas, ask whether this initiative is beneficial for the needs of the State, or for the goals associated with the Governor's political party? When India closes the gap between its actual and bound tariff rate, ask whether this action has power implications to bolster the central government? When States infringe on the freedom of speech or expression, ask what standards leaders use to base their decisions?

IX. Future of Realism

Realism has thrived across many decades. Yet, there is still room for Realist thought to sharpen. Realism is a product of observation and inference. What modifications to Realism might be appropriate in the age of the internet and AI? Will Realism prove to be a dynamic paradigm that adapts to new realities?

Chapter 24

LIBERALISM

I. Overview

Suppose 100 International Relations (IR) scholars were placed in a room and asked, “what major IR theory stands in opposition to Realism?”⁸²¹ Quite likely, there would be 100 different answers. Some scholars would say, bluntly, “Liberalism,” and refrain from elaborating, while others would interject with “Idealism” or “Kantianism.” A few scholars (probably toward the back of the room) would mutter, “Utopianism,” and hope no descendants of E.H. Carr (1892-1982) were present. Some younger scholars would stand in their chairs and yell the prefix, “Neo-!” But, they would not provide a subsequent theory to which to affix their prefix. After the chaos subsided, but the academic jargonistic confusion metastasized, someone might re-ignite it by exclaiming, “I did not know there was any major opposition to Realism.”

The tumultuous state of the room represents the current state of IR theory in opposition to Realism. Even before Thomas Hobbes’s (1588-1679) 1651 publication of *Leviathan* (with a revised edition in 1668) scholars provided a framework opposing the fundamentals of realist thought. Dutch philosopher Hugo Grotius (1583-1645) constructed the general theory of law, *jurisprudentia*, in response to the destructive violence and horrific death tolls of the Thirty Years’ War (1618-1648). That War was fought mainly in Central Europe for dominance based on imperial authorities (namely, Austria and Spain, ruled by the Habsburgs versus France, ruled by the Bourbons) and religious affiliation (Catholic versus Lutheran states). The core of *jurisprudentia* stood in opposition to Hobbes’s state of human nature; brutishness and inclination to violence was subsidiary to the inherent validity and rationality of humans. Thus, Natural Law, *i.e.*, rules deduced from the inherent nature of man, could prevent bloodshed.⁸²²

The foundation laid by Grotius did not spawn congruence in IR theory, but rather produced variation and confusion. The label “Liberal” is the place holder for a variety of theories subsequent to Grotius’s *jurisprudential*. Often, the utopianism of Saint Thomas More (1477-1535), natural right theory of John Locke (1632-1704), liberalism of Adam Smith (1723-1790), internationalism of Immanuel Kant (1724-1804), and idealism of President Woodrow Wilson (1856-1924, President, 1913-1921) have been dubbed “Liberal” IR theory. While these theories share recurring themes, such as their perception of the state of human nature and need for cooperation, they vary on important points.

Regardless of their strong stance in contrast to Realism, “Liberal” IR theory – or perhaps better put, theories – have faced heavy criticism, and ultimately confusion among

⁸²¹ This Chapter is drawn from a superb January 2023 memo, “The ‘Other’ Theory: Liberal Theories of International Relations,” by Jacob C. Barefield, J.D., University of Kansas, School of Law (Class of 2023).

⁸²² Yasuaki Onuma, *Hugo Grotius: Dutch Statesman & Scholar*, BRITANNICA, www.britannica.com/biography/Hugo-Grotius.

them remains. Realists such as E.H. Carr exploited the weaknesses within certain theories. Those weaknesses were not miniscule. The flaws exploited were so prominent that academics were ridiculed for the use of a label alone. For instance, a post-Second World War theory that might have been best labelled “Utopian” likely would be called “Liberal” so as to save some face.

The criticism produced should not stop Liberal IR theories from being applied to current affairs. Indeed, it has not done so. Theorists such as Robert Keohane (1941-) and Joseph Nye (1937-) use the conglomeration of these theories to produce Neo-Liberalism. Their modern interpretations of these theories are often applied in a post-Second World War context, and stand as the strongest theories in opposition to Realism.

Beyond the Neo-Liberalism, all the Liberal IR theories can play a major role today. These theories act as a lens through which to observe cross-border relations. An understanding of the varying theories helps for informed opinions, and subsequently may impact the course of international affairs beyond mere political calculations.

II. Recurring Themes in Liberal Theories

- **State of Nature**

IR theories deemed “Liberal” often have share a more optimistic approach to the state of human nature. Grotius’s general theory of law *jurisprudentia*, perceived a state of nature different from his predecessors, *i.e.*, Niccolo Machiavelli (1469-1527). Grotius argued the inherent nature of man carries a high degree of validity and rationality.

John Locke furthered Grotius’s state of human nature. Locke agreed with Realist thought, and humans inherently existed in an anarchical system in which there was no central authority. However, the lack of central authority did not sway human nature to become egoistic and/or brutish. Philosophically, Locke held the nature of humans to be inclined towards independence, rationality, and equality. Because equality exists within the state of human nature, laws and institutions could be implemented and respected, if those laws are created with a rational appreciation for equality for all human beings.⁸²³

Therefore, if presented with a “Liberal” IR theory, it is safe to assume the stance on human nature is rational, independent, and inherently equal. Locke’s Enlightenment theory on the Natural Rights of men is largely a theory used in conjunction with domestic politics.⁸²⁴ Theories after Locke’s adopt most, if not all components of Locke’s assumptions about the state of nature.

- **Nation-State Cooperation**

As against Realism, the same theories upholding a state of human nature rooted in rationality tend to envision nations having the capability to cooperate and prevent war. The

⁸²³ MICHAEL W. DOYLE, *WAYS OF WAR AND PEACE*, 216-218 (1997). [Hereinafter, DOYLE.]

⁸²⁴ DOYLE, 251

17th century Thirty Years' War spurred Grotius not only to develop *jurisprudencia*, but also offer keen observations about war, much like Thucydides (*circa* 460-400 B.C.) did in his observations of Lacedaemonian invading Athens. Thucydides' observations led him to infer the Lacedaemonian invasion was necessary if the state wanted to secure its survival, and thus self-interest of the state's survival was the first and only justification needed for war.⁸²⁵ Grotius's observations broke from the Realist perspective, and held that war is not necessary to ensure survival, but only necessary when there is just cause for conflict.⁸²⁶

What, then, is “just” war (if any war can be said to be truly “just”)? A “just” war is a war in which action is only taken when there is a morally legitimate reason for action. Grotius's state of human nature is one embedded with rationality and restraint, and entrance into war should be an afterthought to cooperation and litigation. Therefore, if war should ensue, it should occur after moral deliberation. Even after careful deliberation, Grotius argued war should be limited to issues of defense and need for restitution.⁸²⁷

Subsequent theories concur with Grotius's analysis of the Thirty Years' War. Philosophers such as Woodrow Wilson aligned parallel with Grotius's perspective, as both Grotius and Wilson (1) tolerated just war and (2) interwove their religious doctrine into their justifications for rationality and cooperation. Other philosophers, such as Locke, have similar justifications for cooperation before war, but refrain from incorporating religion; they focus more on the Natural Right of man. Still, theories deemed Liberal are often incorporated together for their similar perceptions on the human state of nature and rationality for cooperation over conflict.

III. Differing Liberal Theories

The term “Liberal” in IR should serve only as a categorical label for theories holding similar beliefs on the human state of nature and use of cooperation over conflict. Theories sharing these similar perspectives do not create any justification for presuming each theory is identical to one another, or subsequently using the name of one theory to describe the work of another theorist. Through an overview spanning from the political thought of the 17th and 18th century Enlightenment to 20th century Wilsonian Idealism, it is apparent Liberal theories vary in the scope of application to international relations and focal points. Hence, the adoption of “Liberal” IR theory requires specificity to reduce confusion and articulate perspective in a logical manner.

- **Enlightenment Thought**

The “Enlightenment” is the philosophical movement of the 17th and 18th centuries, characterized by the rejection of religious, social, and political ideas, and acceptance of

⁸²⁵ JAMES E. DOUGHERTY & ROBERT L. PFALTZGRAFF, JR., *CONTENDING THEORIES OF INTERNATIONAL RELATIONS: A COMPREHENSIVE SURVEY* 60 (New York, New York: Harper & Row Publishers, 4th ed., 1997). [Hereinafter, *CONTENDING THEORIES*.]

⁸²⁶ *Hugo Grotius: Dutch Statesman & Scholar*. [Hereinafter, *Hugo Grotius: Dutch*].

⁸²⁷ *Hugo Grotius: Dutch*.

Rationalism.⁸²⁸ While Enlightenment thought was not limited to political affairs, most of the Enlightenment thought is marked by the advancement of political thought and rationale, with John Locke and Immanuel Kant among the most prominent of philosophers. History defined both these men as “Liberal” philosophers and used their work in IR, but their work varies enough to differentiate them.

- **John Locke**

Grotius is often credited as the father of International Law. But, Locke’s deliberation on individual freedoms laid the foundation for theories and philosophy in opposition of the Realist perspective. Where Realism perceives individuals within the State as objects, and the needs of the individual are subsequent the survival of the State, Locke’s core principles say that the freedom of individuals should be of the utmost importance to the State. In an anarchic State, where no central government exists, the Lockean state of human nature claims people are rational, equal, and independent. If laws are tailored towards the equality of all human beings, then those subject to laws ultimately will obey those laws, and subsequently create a self-sustained State.⁸²⁹

Locke furthers the self-sustained State centered around individual freedoms by emphasizing threefold rights that solidify the freedom of individuals. First, a State should be free from arbitrary authority. Freedom from arbitrary authority should lead to negative freedoms, which includes freedom of speech, press and conscience. Second, a State should promote equality and opportunity of positive freedoms, which includes access to education, employment, and so forth. Finally, a State should promote democratic participation and representation, which allows the reinforcement of negative and positive freedoms.⁸³⁰

Locke’s analysis of individual freedoms and structure of a self-sustained State does not often make direct implications to international affairs. Locke’s analysis of the structure of sovereign State mostly concerns domestic policy and the relationship between the government and governed.⁸³¹ If Locke is to be applied to the international context, then it must be done through inference. Locke envisions a State that affords individual freedoms on the assumption the state of human nature is rational. When applied to a systemic level, one could infer States composed of rational individuals shall also make rational choices on the international level, so long as the laws and institutions within the State are reflective of the morally free individual.

- **Immanuel Kant and Kantianism**

Where Locke’s Enlightenment philosophy fails to make direct implications to International Law, Immanuel Kant’s *Towards Perpetual Peace* (1795) lays out a

⁸²⁸ William Bristow, *Enlightenment*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Fall 2017 Edition), <https://plato.stanford.edu/cgi-bin/encyclopedia/archinfo.cgi?entry=enlightenment>.

⁸²⁹ *Ways of War*, 216

⁸³⁰ *Ways of War*. 216.

⁸³¹ *Ways of War*, 251

framework guiding international politics and relations.⁸³² Kant's analysis of how States can achieve a state of peace is so comprehensive that it is often noted as "Kantianism," which should be viewed as its own approach within Liberal IR theory.

Kantianism aligns with Realist thought regarding the state of international affairs, and holds States are likely in conflict. However, Kantianism begins to take form as Liberal IR theory by noting a state of conflict is only temporary. IR can be mended into a state of peace through the unionization of states and adoption of like-minded policies amongst the states.

Unionization of States

Kant offers multiple models for the unionization of States, such as a single State ruling over all other States, or all States opting into one organization for solving international disputes. Yet, Kant noted flaws within each of these models. A single State ruling over all other States would struggle in sustaining power over geographically distant States; one organization to solve international disputes would not have coercive power to enforce decisions against States that voluntarily opt out of that organization.⁸³³

The flaws in these models of unionization led Kant to conclude unionization of States best leads to peace when multiple federations exist for States to opt into. Under this model, States can choose a federation of States to opt into, and ultimately that federation controls IR with other federations. This model calls for the pertinent federation to preserve the freedoms a State is already afforded. Furthermore, the international actions of any one federation are only exerted after careful deliberation and discussion amongst its constituent States.⁸³⁴

Note the similarities in Kant's ideal unionization and Locke's domestic statehood approach. First, Locke seeks for positive and negative freedoms to be enforced by the State and for the individual. Likewise, Kant's model of unionization calls for the federation to preserve freedoms that inhere in the States entering that federation. Second, individual freedoms within a State are reinforced through democratic representation within the State in Locke's model. Kant's model also reflects the concept, and the freedoms and interests of a State are reinforced through the democratic representation amongst the states.

Like-Minded Policies and Perpetual Peace

The unionization of states under federations is only one definite article towards a state of peace. Kant lays out other definite articles in *Towards Perpetual Peace* that ultimately create perpetual peace. First, Kant calls for all States to adopt a republican constitution. This call resembles the Lockean lens of domestic statehood, and emphasizes

⁸³² Immanuel Kant, *Toward Perpetual Peace*, in KANT: POLITICAL WRITINGS (H. Reiss, ed., Cambridge, England: Cambridge University Press, 2nd edition, 1991). [Hereinafter, Kant, *Perpetual Peace*.]

⁸³³ Kant, *Perpetual Peace*, 7

⁸³⁴ Kant, *Perpetual Peace*, 7.

(1) freedom for all members of the State, (2) dependence upon a single legislation within the state, and (3) equality amongst everyone.

Kant's rationale for an individual led State relates to the decision to go to war. Individuals of any given state are the ones who bear the biggest burden during war. Thus, if States are structured such that individuals make the ultimate decision on entering, then the likelihood of entering war under the Kantian perspective drastically decreases.⁸³⁵

Second, Kant conveys the need for individuals to have cosmopolitan rights of hospitality. A unique feature of Kantianism and variation from political thought preceding Kant is shared living space amongst human beings. Because humans are within a close geographic proximity of another, they are forced to interact. Indeed, this nature of human existence and forced proximity creates an inherent right for individuals to interact with one another. Therefore, States should not limit human interaction; rather, they should foster hospitality. Hospitality allows an individual to travel freely to another country, instigate trade and commerce with a foreign country, and receive aid in times of ailment. More importantly, hospitality creates trust and cooperation amongst states, and subsequently serves a foundational element for perpetual peace.⁸³⁶

- **Adam Smith and 19th Century Liberalism**

The phrase "19th Century Liberalism" should not be directly equated with Liberal IR theories. Recall that Liberal IR theories are ones that can be characterized as (1) sharing similar views about the state of nature and (2) emphasizing cooperation among nation-states. In contrast, 19th Century Liberalism can be defined as a global movement during the 1800s to promote individual liberties, social order through free markets, and civil institutions within society.⁸³⁷

That said, despite the variation in terminology, many Liberalists during the 19th century can be characterized as contributors towards Liberal IR theory. Adam Smith stands as the essential contributor. Following Kant's definite article calling for hospitality and the possibility of commerce, Smith analyses IR through the lens of economics and commerce. Subsequently, Smith's conclusions stand parallel with, though distant from, his predecessors, and thus lead to another form of Liberal IR theory.

Laissez Faire and Mercantilism

Laissez Faire is the philosophy of free market capitalism that opposes government intervention in commerce and the economy. Smith proclaims *laissez faire* by stating unforeseen forces, which occur as by-products of human self-interest and freedom of production, lead to the advancement of markets and social justice, often referred to as the

⁸³⁵ Kant, *Perpetual Peace*, 6.

⁸³⁶ Kant, *Perpetual Peace*, 8-9

⁸³⁷ *Liberalism in the Nineteenth Century*, BRITANNICA, www.britannica.com/topic/liberalism/Liberalism-in-the-19th-century.

harmony of interest.⁸³⁸ Smith’s famous metaphor for this concept is the “invisible hand.” In the international context, *laissez faire* and the invisible hand represent the freedom of choice through free trade.

Mercantilism (discussed in a separate Chapter) contrasts the idea of international free trade for two reasons. First, Mercantilism calls for government intervention, as only pro-active government policy will balance trade. Second, government intervention includes colonialism and the use of tariffs, as both can lead to the accumulation of wealth and maximization of exports.

Thus, it is in Smith’s critique of Mercantilism that his contribution to Liberal IR theory shines brightest. Smith contends Mercantilist tactics – colonialism and tariffs – lead to a state of war and conflict. Colonialism instigates domestic revolt against a foreign State. Tariffs epitomize lack of cooperation and create economic conflicts among States. Smith’s Law of Absolute Advantage (discussed in a separate Chapter) highlights the faults of the few posited Mercantilist benefits of maximizing exports and limiting imports. Therefore, if the net result of Mercantilist practices is conducive to war, not peace, then those practices should not be the norm in a global economy.

Rather, Smith proposes that the invisible hand that guides a Capitalist economy free of government intervention also guide the international political sphere towards a state of cooperation and peace. Free trade allows for mutual gains to accrue to each State, while simultaneously creating the need to cooperate with States to maximize mutual gains. Such cooperation persuades States to see other States as neighbors (even as allies), rather than enemies, and thus creates a state of peace among them.⁸³⁹

A Stand-Alone Theory?

Smith’s theory of *laissez faire* and an invisible leading to an international economy conducive to peace is incorporated throughout multiple IR theories. Nevertheless, the uniqueness of focusing on the cause-and-effect relationship between (1) freedom of markets and (2) increase in social and moral prosperity can be considered a Liberal IR theory unto itself. When observing an IR issue through the lens of a Liberal IR theorist, Smith’s work may be applied on its own. Such application may provoke thoughtful questions, including:

- (1) How might the relationship between State X and State Y be enhanced if free trade existed between each other?
- (2) Would the freedom of a market within one State likely lead to the moral and social progression of that State, and in turn would it lead to more cooperation with other States?
- (3) Has the drawback of current Mercantilist tendencies in a current event led to more cooperation between states in conflict?

⁸³⁸ *Ways of War*, 231

⁸³⁹ *Ways of War*, 233

These three questions are well-considered in the context of China's 11 December 2001 accession to the WTO, and the Sino-American Trade War (discussed in separate Chapters).

- **Wilsonian Idealism**

“He spoke with a prophetic vision when he said that if we did not set up an agency to prevent war, another and more terrible holocaust would engulf the next generation.”⁸⁴⁰ This quote sums up Woodrow Wilson's approach towards international affairs after the horrors of the 1914-1918 First World War. The quote was a prophesy. As a stand-alone Liberal IR theory, Wilsonian Idealism holds that if the current state of international affairs is in conflict, then there is a chance individuals could be appealed to directly if,

“They in their goodness and innocence would see the truth and pursue the right of course from which they are constantly being turned by disingenuous and evil men.”⁸⁴¹

“Prophetic” describes Wilsonian Idealism.

How does Wilson's proposition of implementing a higher moral order for a state of peace and cooperation vary from Wilson's predecessors? The differences begin with how a state of peace is achieved. Locke, Kant, and Smith all emphasize the freedom of individuals and subsequent effect of individuals making rational, equal, and morally sound decisions. And even though their structures have different focuses (domestic, international, economic), their structures lack a central authority to govern all States.

Wilsonian Idealism drastically differs. Wilsonian Idealism does not leave humans to their devices to create a rational, equal, and morally sound reality of politics, but rather holds that humans must be shown the standard of higher morality to achieve a state of peace. Rationality, equality, and morally sound judgment exists, but a light must exist guide humans towards the path to rationality.⁸⁴²

The light to guide humans exists in the form of a central authority, and thus beacons to a second difference between Wilsonian Idealism and its predecessors. The League of Nations epitomized Wilson's prophetic vision for a state of cooperation, as the sole purpose was to maintain world peace through a central organization. Articles, much like the United States Constitution, guided and mandated behavior from its members, and served as the inherent higher morals which would lead to the establishment of peace. In the short term, peace did follow. The League of Nations, founded in 1920 by the 1919 *Treaty of Versailles* that marked the end of the First World War, led to Woodrow Wilson receiving the 1919 Nobel Peace Prize for his efforts. (The League officially ended in 1946.)

⁸⁴⁰ David McCourt ed., *Sixth Meeting: Wilsonian Idealism, May 18th, 1954*, 211 (in *American Power and International Theory at the Council on Foreign Relations, 1953-54*) (Ann Arbor, Michigan, University of Michigan Press, 2020), <https://escholarship.org/content/qt8q27t1zf/qt8q27t1zf.pdf?t=rm28x1>. [Hereinafter, *Sixth Meeting*.]

⁸⁴¹ *Sixth Meeting*, 211.

⁸⁴² *Sixth Meeting*, 208-213

Nevertheless, Immanuel Kant forewarned his successors of this model of organization. Kant noted one central authority does not have the capability to persuade or invoke change in everyone. The trickle down of a higher morality from a central authority to its subsidiaries requires complete compliance, and without compliance, conflict will loom. The League of Nations struggled to enforce articles concerning disarmament, along with preventing states such as Italy from entering conflict. Thus, the model Kant proposed to be a failure for the purposes of enforcement was happening in real time.

Although the League of Nations dissolved shortly after World War Two, many international organizations correlate with the architecture of Wilson's central authority model, with the United Nations being the most notable. Therefore, idealism, along with preceding theories of IR, can be used as Liberal IR lens for analyzing international affairs.

IV. Utopianism and Its Critics

“Hi, my name is Professor John Doe, and I am a Utopian...” Before the sentence is finished, half of the academics in the room may have got up and left. Utopianism is a Liberal IR theory, but the term itself is sufficiently pejorative its use is infrequent (save for as a criticism concerning naïvete.) So, some IR theorists who are Utopianist assume the label “Liberalist;” others latch onto one of the above-discussed theories. Accordingly, two questions should be considered. First, what is a Utopianist? Second, why would a Utopianist behave this way?

- **What is Utopianism?**

In comparison between Realism and Utopianism, University of Sussex Professor Michael Nicholson (1933-2001) highlighted that Utopianism does not have a coherent theoretical tradition. Utopianists are just those who oppose the Realist idea that humans ineluctably are in a state of conflict and, rather, incline to optimism about international affairs. A sense of what “Utopianism” means comes from its biggest critic, E.H. Carr.

Carr summarized Utopianism best by contending it is the conglomerative descendant of 18th Century Enlightenment, 19th Century Liberalism, and 20th Century Wilsonsonian Idealism. In particular, Utopianists hold similarly to:

- (1) Locke's belief the human state of nature is one where humans are rational and equal.
- (2) Kant and Wilson's stance that humans can make significant improvements if societal factors change.
- (3) Adam Smith's invisible hand that a harmony of interest can be struck to create international peace.
- (4) Wilson's implementation of norms and conduct through international institutions to guide international behavior.⁸⁴³

⁸⁴³ See *CONTENDING THEORIES*, 60

The essential point underlying Utopianism lies in national self-determination.

Utopianists sharply contrast with Realists and believe the highest interest of individual choice coincides with that of a larger community. The concision leads Utopianists to assume States that have not embraced peace are governed by leaders who fail to abide by the people's will. A State that fails to have a representative government is not the true testament of the people, and subsequently does not achieve a harmony of interest towards peace. Hence, in an international setting, Utopianists find it essential for the international system to be comprised of individualistic, representative governments, as they translate their national harmony of interest to the system and provide a framework for a peaceful world.⁸⁴⁴

The E.H. Dagger

If Utopianism is a conglomeration of pre-existing ideology, and its variation lies in its emphasis on national self-determination, why is the term "Utopianism" so harshly criticized? The answer is E.H. Carr. Carr, often known for his 1939 work, *The Twenty Years Crisis: 1919-1939*, was an influential Realist during the 20th century. Yet, his criticism of a counterpart to Realism ultimately impacted the fate of Utopianism – and cemented confusion amongst IR scholars for years to come.

Utopianism found its stronghold IR after riding the coattails of Wilsonian Idealism. Although Wilson was the architect of the League of Nations, the idea of national self-determination ran parallel with the short-lived years (1920-1946) of the League of Nations. Literature during this time emphasized the need for an international government that could not be governed (*i.e.*, manipulated) by State governments; rather, it should be answerable to public opinion existing amongst those member States. Then, the Utopianist ideology of self-determination causing an international harmony of interest could be realized.⁸⁴⁵

While persuasive, and imbued with *ethos* (character) and *pathos*, (emotion), Carr saw the Utopianist perspective to lack *logos* (reason). Carr noted the Utopian perspective was inclined to wish, hoping States would abide by international norms and change to a representative government. Moreover, the inclination of Utopianists to lean on wishes and hope was accompanied by a failure to analyze facts.⁸⁴⁶

Although Realists overwhelming ground themselves in empirical evidence, Carr's criticism was validated by the weaknesses of international institutions. Beyond issues of disarmament, the League of Nations failed to keep peace leading into the Second World War, and subsequently failed to solve disputes arising in Manchuria and Ethiopia. Even after that War, international norms and institutions did little to stem ethnic, ideological, and other conflicts that defined the Cold War.⁸⁴⁷

⁸⁴⁴ CONTENDING THEORIES, 61.

⁸⁴⁵ CONTENDING THEORIES, 61.

⁸⁴⁶ CONTENDING THEORIES, 61.

⁸⁴⁷ CONTENDING THEORIES, 62.

Thus, E.H. Carr's criticism led to some Liberal IR theorists to eschew the term "Utopianism." Self-labelling as a Utopian could be professionally damaging. Nevertheless, many scholars affirm Utopianist ideology, and choose to define themselves as "Liberalists" or "Idealists." Therefore, if a "Liberalist" publishes an essay or publication, then analyze the foundation of their approach. Are they proposing an international order led by public opinion? Is there a conglomeration of previous 17th and 18th century Enlightenment, 19th century Liberalism, and 20th century Idealistic thought? If the answer is "yes," then likely the work is Utopianist.⁸⁴⁸

V. "Neo-" Variations

Although Utopianism and Liberal IR theories suffered from the aforementioned criticisms, reformed Liberal IR theory soon followed, and now stands at the forefront of Liberal IR theory. Often referred to as "Neo-Liberalism," some Neo-Liberals abide by principles of their predecessors, including Utopianism. Yet, the "Neo-" prefix of the term connotes the new variation and perspectives of this Liberal IR theory. These perspectives and variations have led to the high praise for the paladins: Robert Keohane and Joseph Nye. Therefore, Liberal IR theorists, although still subject to scrutiny, have regrouped.

Carr noted the debate which once ensued between Utopianists and Realists now exists between Neo-Realism and Neo-Liberalism. Neo-Liberalism shares commonalities with Neo-Realism: both acknowledge anarchical structure exists in which there is no central international authority. Nevertheless, Neo-Liberalism does not see the lack of central authority as a reason for chaos to ensue. Neo-Liberals often assume States can find means to cooperate and assume cooperation can be a possibility because of Locke's state of human nature to be rational and morally sound.⁸⁴⁹

Joseph Nye cleverly coined the term "soft power." Nye's publication, *Soft Power: The Means to Success in World Politics* (2005), defined the ability to cooperate as "soft power," and the use of coercion as "hard power." Diplomacy, education, cultural programming, and people-to-people exchanges were "soft power" tools. Conventional and nuclear weaponry were "hard power" instruments. Nye argued attraction and peaceful persuasion could be more effective, and less barbaric, than violence and war.⁸⁵⁰ That contrasted with Realists, who put their faith in the ability of a State to meet its IR goals in hard power.

Robert Keohane's contribution to Neo-Liberalism does not establish new terminology. Rather, it focuses on international institutions. Keohane also acknowledges international structure is anarchic. But, he urges that international institutions contribute to the international structure, not engender further chaos. To be sure, States use international institutions to advance their own self-interest. But, says, Keohane, self-interest is not always negative. Rather, if common ground exists among States, then the pursuit of self-

⁸⁴⁸ Ken Booth, *Security in Anarchy: Utopian Realism in Theory and Practice*, 67 INTERNATIONAL AFFAIRS number 3 (July 1991).

⁸⁴⁹ CONTENDING THEORIES, 63.

⁸⁵⁰ Maxime Gomichon, *Joseph Nye on Soft Power*, E-International Relations (8 March 2013).

interest will not exclude the possibility they cooperate. International Organizations (IO), such as the United Nations and NATO affirm Keohane's proposal, demonstrating mutual cooperation is possible amongst self-interested States.⁸⁵¹ Arguably, that is true with respect to the WTO, too.

In the late 20th and early 21st centuries, Nye and Keohane were two of the greatest contributors to Liberal IR theory. Realists abound, but Neo-Liberalists hold prominent ground in IR.

VI. Liberalism Beyond International Relations

Like Realism, Liberal IR theories, although intended for analysis of the international political sphere, can be used in other contexts. In particular, economic – including international trade – issues are not out of the bounds for Liberal IR theory. That is evident from the work of the philosophers who pioneered Liberal IR theories: economic problems (Smith), international trade controversies (virtually all except Locke), and attendant domestic policy matters (Locke), are part of their theories. Thus, when approaching everyday questions from a Liberal IR perspective, consider questions such as:

- (1) What rights are, and are not, engrained in the situation at hand, and would the introduction of a right change that situation?
- (2) What institutions exist within that situation, and what benefit can serve?
- (3) Has common ground been established?
- (4) If a common ground does exist, can it facilitate cooperation?

These questions apply in all facets of relationships among nation-states in the international arena.

For instance, if an embargo does not exist targeting Country X, and thus Country Y may trade freely with X, then how would that right to trade affect a situation in which Y seeks to impose trade sanctions or export controls on X? How do the IMF and World Bank support domestic growth within a country, and how does that affect domestic policy? Do two opposing countries have a common economic market structure? If so, then can their common economic market structure bring opposition to cooperate?

VII. A Mess?

In a room full of liberal IR Theorists, is it easy to differentiate between the variations? The answer is “no.” The reason? Liberal IR theory remains somewhat of a jargon-loaded, woolly-headed mess. Many variations, conglomerations, and supplementations exist. Liberal IR theorists adopt one principle from Kant, disregard a view of Wilson, and then say they are Neo-Liberalist. Would they be wrong to assume that label? No doubt an academic justification of one sort or another will be proposed.

⁸⁵¹ CONTENDING THEORIES, 64.

Nevertheless, confusion within and across Liberal IR theories should not mean they should be discarded. To the contrary. Perhaps they embody the best hope for world peace, especially as against Realism, which seems inclined to, or generative of, incessant conflict. Toward that end, Liberal IR theories can be enhanced by clarifying them, and making them more precise, on topics such as (1) the perception of human nature, (2) whether central authority and institutions should exist, and (3) the role of trade in cooperation. Resolving such questions may mean the Liberal IR room (mentioned at the start of this Chapter), which was once dicey, may become a comfortable one in which to absorb IR theories relevant to International Trade Law.

Chapter 25

CONSTRUCTIVISM

I. Overview

Constructivism is yet another theory of International Relations (IR), as are Realism and Liberalism (discussed in separate Chapters).⁸⁵² But unlike those theories, which focus on material causes and effects,⁸⁵³ Constructivism focuses on *ideas* and *norms*. Although Realism and Liberalism analyzing systemic effects of actions on IR, they often focus on individuals and the choices of individuals coincided within a state. Constructivism, which aims for the same end-result as Realism and Liberalism, focuses on the *structures* and *aggregates* in lieu of decision-making processes, and downplays rational actor explanations for behaviors and events.

Professor Nicholas Onuf (1941-) identified Constructivism as a theoretical framework, proposing that individuals and societies “construct, or constitute, each other.”⁸⁵⁴ In other words, “actors and structures are mutually constituted.”⁸⁵⁵ Professor Alexander Wendt (1958-) adapted and expanded this theoretical framework into a more complete theory of IR.⁸⁵⁶ Wendt writes:

Students of international politics have increasingly accepted two basic tenants of “Constructivism:” (1) that the structures of human association are determined primarily by shared ideas rather than material forces, and (2) that the identities and interests of purposive actors are constructed by these shared ideas rather than given by nature.⁸⁵⁷

Wendt’s supplementation of Onuf’s framework lays the foundation for the systemic and narrow application of Constructivism.

⁸⁵² This Chapter is drawn from a superb January 2023 memo, “Introduction to Constructivism,” by Jacob C. Barefield, J.D., University of Kansas, School of Law (Class of 2023) and Alec Michael Feather, J.D., University of Kansas, School of Law (Class of 2022).

⁸⁵³ Material causes and effects are best exemplified through the idea of observed regularities. A system is composed of elements, each interconnected to form patterns characterizing set of behaviors. These behaviors seek to fulfill a purpose of the system. Therefore, Realist and Liberalist IR theories most often contribute behaviors of seeking power, war, and diplomacy as the material causes towards the end goal of the system (positive sum or zero sum). Observed regularities are the material causes a theorist sees as grounded behavior of the system, and with which the theorist must reconcile for their theory not to be mis-theorized. See Paul Burton, *Material Realism: A System Theory of International Politics 2* (University of Southern Mississippi, 2018).

⁸⁵⁴ Nicholas Onuf, *World of Our Making* 36 (1989).

⁸⁵⁵ Ted Hopf, *The Promise of Constructivism in International Relations Theory*, 23:1 INTERNATIONAL SECURITY 171, 172-173 (1998).

⁸⁵⁶ ALEXANDER WENDT, *SOCIAL THEORY OF INTERNATIONAL POLITICS* (Cambridge, England: Cambridge University Press, 1999). [Hereinafter, WENDT (1999).]

⁸⁵⁷ WENDT (1999), 1.

Wendt's systemic application of Constructivism relies on the scholarship of prominent international philosophers and theorists to categorize the norms and ideas of various structures and aggregates. While those philosophers and theorists are often cited in Realist or Liberalist thought, and their work is used to evaluate the material cause and effects on or from an individual in IR, Wendt brilliantly expands their thought to a sociological level. Thus, this expansion ultimately allows for a deep and thorough understanding of the impact of ideas and norms on structures spanning from the 1939-1945 Second World War to contemporary Saudi-American relations. Wendt's expansion also seeks to incorporate the influence of norms and ideas on meso-levels of organization, and allows for the analysis of specific policies and processes effects on communities and states.

Consider, then, the application of Constructivist theory, per Wendt's expansion, to analyze Iran's Islamic Revolutionary Guard Corps (IRGC):

...[U]nderstanding the IRGC's role in Iran's politics and foreign relations requires an examination of the organization from an ideological perspective. In line with the core convictions of applied Constructivism – that ideas matter and that power is discursive and relational – this study unravels the constructed narratives and meta-narratives – the actual texts and discourses and the underlying legitimation frameworks – that surround the IRGC's power. ... [P]erceptions and assessments of foreign policy are themselves creators of foreign policy in a constructed performative and discursive ideational framework. The ideational nature of foreign policy stems from the fact that states' interpretations of international events are strictly tied to the ideological framework that international actors draw upon to interpret, internalize, and react to external events. Countries' classifications of friends versus foes or partners versus rivals, for example, frequently transcend hard material calculations. Examining such ideational factors, in turn, provides thicker explanatory dimensions for states' foreign policies by accounting for important drivers of social agency that go beyond merely structuralist assumptions of International Relations theory.

While the IRGC's pervasiveness and influence have been comprehensively studied elsewhere, much of this literature focuses on the more quantifiable or structural aspects of IRGC power. Such "hard power" metrics are certainly important to understanding the IRGC's capacity to act, but produce relatively little insight into the Guards' fundamental identity, nor the discursive genealogy of its actions. Scarce attention has been given to the less tangible aspects of the IRGC's identity: its motivations, beliefs, and value systems. ... [A]ddress[ing] this imbalance ... [requires] highlighting the ideational dimensions of the construction of power by the Guards. It [is essential to] question[] *how* the IRGC justifies and legitimizes its narratives of power and the ways it deploys its carefully accumulated resources.

...

At the core of its identity, the IRGC continues to be a deeply ideological organization. The IRGC takes its lead from the ultimate authority in Iran,

the Supreme Leader. Having embraced the duty to protect and promote the guiding philosophy of *velāyat-e faqīh* [Guardianship of the Jurisprudence/Jurists], the IRGC has absorbed the regime's militaristic, isolationist, and religiously hard-line approach to Iran's domestic and international affairs. Maturation, bureaucratization, and entrenchment in economic activities have not dimmed the IRGC's ideological fervor in the post-revolutionary period, while its power and grip on all areas of Iranian society has grown enormously over the last four decades [*i.e.*, since the 1978-1979 Islamic Revolution]. ... [T]he IRGC's ideologically driven policies, both inside Iran and abroad, do not allow the slightest sign of moderation and have even further radicalized in recent years. ...

The IRGC's ideology has several notable strands. The IRGC portrays itself as the guardian of the (*Shī'a*) Muslim community in a momentous struggle against external forces. Interestingly, the ideological narratives have been tweaked in a way to skip over the ideological incongruities with some international powers, notably, Russia and China. The IRGC's teachings call for violence against religious minorities, hostile foreigners, and domestic dissidents. However, the organization's professed piety is paradoxically underpinned by the opportunistic tendencies that facilitate the IRGC's widespread engagement in systematic, economy-wide, self-enrichment. It's anti-competitive and monopolistic behaviors, along with its proficiency at profiting from breaking sanctions and other illicit market activities, strongly incentivize the organization to propagate the regime's core resistance narratives and undermine any moves toward international rapprochement.

[T]he IRGC's ideational and structural might is simultaneously the product of, and the justification for, Iran's projected identity abroad. In Iran's foreign policy, as in its domestic affairs, it is the Supreme Leader and his subordinate institutions who ultimately set the agenda and frame the implementation, which the Guards work to implement. But, as a result of the combination of its political and economic power, religious-social justification, and the good graces of the Supreme Leader, the IRGC appears to enjoy an enormous amount of constructed (*i.e.*, ideological) and material (economic and military) capital, generating significant freedom of maneuver to determine how and where it inserts itself into foreign policy.⁸⁵⁸

(Iran, the IRGC, and U.S. sanctions are discussed in separate Chapters). The above-quoted Constructivist analysis emphasizes the ideology of the IRGC. In so doing, it indicates the resistance of the IRGC to globalization and free-market reforms pose a significant hurdle

⁸⁵⁸ Vahid Nick Pay & Andrew Ormond, *Military Ideology and Foreign Policy: A Constructivist Examination of the IRGC's Ideological Influence*, LIV ASIAN AFFAIRS – JOURNAL OF THE ROYAL SOCIETY FOR ASIAN AFFAIRS, number 1, 18-43, 18-19 (March 2023). (Emphasis original.) For a discussion of *Shī'ite* Islam and *Vilāyat-i Faqīh*, see Raj Bhala, *Understanding Islamic Law (Sharī'a)* Chapters 8-9 and 48-49 (Durham, North Carolina: Carolina Academic Press, 3rd ed., 2023).

to Iran acceding to the WTO. Small wonder why Iran's application to join the WTO, lodged in 1996, remains pending.

To be sure, Wendt's *Social Theory of International Politics* (1999) and other Constructivist works are assailable. Indeed, they have faced hulking criticism from IR scholars. While some critics dwell in traditional IR frameworks, *i.e.*, Realism and Liberalism, the strongest among them are fellow Constructivists. Many resent Wendt's supplementation of Onuf's framework. Such critics argue Wendt's work – mainstreamed Constructivism – fails account for the variation in which scholars utilize Constructivism to evaluate norms and ideas. Owing to these attacks, there is confusion within Constructivism. But, there is a clear dichotomy amongst Constructivists, with Wendt's camp (as just intimated) identifying as “Mainstream” Constructivist, and Onuf's camp being labeled as “Radical” constructivist.⁸⁵⁹

Any confusion surrounding the application of Constructivism has not impeded its use within IR. Rather the aforementioned dichotomy has opened the door to further exploration of IR, and provided scholars the opportunity to view IR through a lens beyond the often deemed “outdated” Realist and Liberalist lens. Hence, the growth of Constructivism is not likely to slow. Rather, it may continue to evolve as a theory, and find itself applied in practical scenarios beyond IR.

II. Assumptions

Any IR theory makes assumptions about the world it conceptualizes. Constructivism assumes ideas and norms, along with structures and aggregates, are conducive to the behavior and identity of sovereignties. Wendt recognizes Constructivist concepts diverge from Realist and Liberalist predecessors. He highlights this contrast as the (1) Materialist-Idealist debate and (2) Individualist-Holist debate.⁸⁶⁰

First, the Materialist-Idealist debate concerns the importance of material forces versus ideals and norms. In other words, this debate asks: “Which is the more important organizing force of international relations, material forces or ideas and norms?” This ontological question concerns the nature of IR.

- **Materialism:**⁸⁶¹ Materialism assumes material forces generally have a greater impact on human affairs than social forces, such as ideas and norms.

Wendt notes Materialism emphasizes *causal relationships*, and he identifies five reoccurring causes in materialist discourses: (1) human nature, (2) natural resources, (3) geography, (4) forces of production, and (5) forces of destruction.

⁸⁵⁹ Hannes Peltonen, *A Tale of Two Cognitions: The Evolution of Social Constructivism in International Relations*, 60 REVISTA BRASILEIRA DE POLÍTICA INTERNACIONAL number 1 (2017). (Hereinafter, “*Tale of Two*”).

⁸⁶⁰ WENDT (1999), 22-40.

⁸⁶¹ WENDT (1999), 23-26.

Materialism is generally accepted as an assumption in international relations literature. For example, Tim Marshall's *Prisoners of Geography* (2016)⁸⁶² examines how natural resources and geography shape contemporary geopolitics. Jared Diamond's *Guns, Germs, and Steel* (1997)⁸⁶³ considers how forces of production and forces of destruction influenced historical colonization.

- **Idealism:**⁸⁶⁴ Idealism assumes social forces, such as ideas and norms, generally have greater impact on human affairs than material forces.

Wendt notes idealism emphasizes *constitutive relationships*, such as the relationships between teachers and students. In this example, teachers do not cause students to exist (or *vice versa*). Instead, teachers and students exist because of their constitutive relationship.

Second, the Individualist-Holist debate concerns the importance of individuals versus structures and aggregates. In other words, this debate asks: "Which view, individuals or structures and aggregates, provides a more logical means of perceiving international relations?" This methodological question concerns the process of studying IR.

- **Individualism:**⁸⁶⁵ Individualism assumes that relationships should be reduced to the properties and interactions of independent individuals, implying a bottom-up ontology. In other words, individualism begs the question: "How do individuals influence structures and aggregates?"
- **Holism:**⁸⁶⁶ Holism assumes that relationships should not be reduced to the properties and interactions of independent individuals, implying a top-down ontology. In other words, holism begs the question: "How do structures and aggregates influence individuals?"

Resolutions of these debates are not necessarily mutually exclusive. They are questions of emphasis.

III. Systemic Applications

Constructivism can be applied generally to describe broader systems of international relations, including how shared ideas and norms influence the culture of

⁸⁶² TIM MARSHALL, *PRISONERS OF GEOGRAPHY: TEN MAPS THAT EXPLAIN EVERYTHING ABOUT THE WORLD* (New York, New York: Scribner, 2016).

⁸⁶³ JARED DIAMOND, *GUNS, GERMS, AND STEEL: THE FATE OF HUMAN SOCIETIES* (New York, New York: W.W. Norton & Company, 1997).

⁸⁶⁴ ALEXANDER WENDT, *SOCIAL THEORY OF INTERNATIONAL POLITICS* 26 (1999). [Hereinafter, WENDT.]

⁸⁶⁵ WENDT, 26.

⁸⁶⁶ WENDT, 26.

international relations. Wendt identifies three cultures in IR: (1) Hobbesian, (2) Lockean, and (3) Kantian.⁸⁶⁷

- **Hobbesian.**⁸⁶⁸ Wendt describes the Hobbesian culture as a kill-or-be-killed culture of international relations. The prevailing collective consensus in this culture is **enmity**, where the other *does not* recognize the right of the self to exist and the other *will not* willingly limit its violence toward the self. This culture roughly comports with the state of nature suggested by Thomas Hobbes.⁸⁶⁹

Possible examples of this culture include the relations between Greeks and Persians during the Greco-Persian Wars (492-449 B.C.), Crusaders and Turks during the Crusades (1095-1291), and Nazis and Jews during the Holocaust (1941-1945). These relations embody the kill-or-be-killed attitude of the Hobbesian culture of IR.

- **Lockean.**⁸⁷⁰ Wendt described the Lockean culture as a live-and-let-live culture of international relations. The prevailing collective consensus in this culture is **rivalry**, where the other *does* recognize the right of the self to exist and the other *will* willingly limit its violence toward the self. However, this does not exempt the self from violence and disputes. This culture roughly comports with the state of nature suggested by John Locke.

A modern example of Lockean culture include relations between America and Saudi Arabia. Both countries recognize the other groups right to exist, and limit violence and disputes between each other. Nevertheless, consider the horrific extra-territorial, extra-territorial murder of U.S.-based journalist Jamal Khashoggi (1958-2018) in October 2018,⁸⁷¹ along with tensions arising from OPEC production. Their bilateral relationship comports with Wendt’s lens of Lockean culture and no exemption from violence/disputes.

- **Kantian.**⁸⁷² Wendt described the Kantian culture as a collective interest culture of international relations. The prevailing collective consensus in this culture is **friendship**, where disputes are settled without warfare (non-violence) and individual threats are addressed collectively (mutual aid). This culture roughly comports with the “perpetual peace” advocated by Immanuel Kant.

Contemporary examples of Wendt’s description of Kantian culture include the relations between America and Great Britain, and relations amongst the members of the European

⁸⁶⁷ WENDT (1999), 246-312.

⁸⁶⁸ WENDT (1999), 260-261.

⁸⁶⁹ To understand better Wendt’s methodology for describing structural relations amongst different cultures, envision the phrase “the other” as one distinct group of people, and “the self” as another distinct group of people. Wendt’s use of “self” symbolizes the uniqueness of each state, as one “self” differs in interest and identity.

⁸⁷⁰ WENDT (1999), 279-280.

⁸⁷¹ *Jamal Khashoggi, All You Need to Know About the Saudi Journalist’s Death*, BBC NEWS, February 2021. [Hereinafter, *Khashoggi, All You Need.*]

⁸⁷² WENDT (1999), 298-299.

Union. These relations embody the collective interest attitude of the Kantian culture of IR, where non-violence and mutual aid are shared ideas and norms.

IV. Narrow Applications

Although Constructivism has historically been applied to analyze IR on a systemic level, this theory also can be used narrowly to describe specific policies or processes. The suppression of slavery and stigmatization of nuclear development and proliferation, albeit not the most recent examples, exemplify the core tenants of constructivism applied more narrowly.

In their article, *Explaining Costly International Moral Action: Britain's Sixty-Year Campaign Against the Atlantic Slave Trade*,⁸⁷³ Chaim Kaufmann and Robert Pape use Constructivism to explain how Great Britain suppressed the international slave trade between 1807 and 1867, despite the high political, economic, and security costs, without material benefits, of doing so. They write:

[The effort to suppress the international slave trade] was very expensive for Britain. Because others did not follow Britain's lead, the effect of its abolition decision in 1807 and emancipation decision in 1833 was to cut off itself, but not others, from the economic benefits of the slave trade and slave labor for the next several decades. Thus, Britain suffered both absolute and relative economic losses. Most serious, British efforts to suppress the slave trade met with suspicion from the other major maritime powers, especially France and the United States, leading to a series of foreign policy disputes that involved at least some risk to British national security. Finally, a number of British sailors, soldiers, and civilian officials lost their lives.⁸⁷⁴

Kaufmann and Pape see ideas and norms, especially those of religious dissidents and revivalists, as driving the domestic political opposition to the slave trade between 1807 and 1867.⁸⁷⁵ Some religious groups viewed the slave trade as inevitably corruptive and degrading in a political and a religious sense, anticipating divine punishment or retribution for their complicity.⁸⁷⁶ This argument places the impact of ideas and norms above the impact of material forces. Put directly, Great Britain suppressed the international slave trade despite its own material interests, not because of them.

In her article, *Stigmatizing the Bomb: Origins of the Nuclear Taboo*,⁸⁷⁷ Nina Tannenwald uses Constructivism to explain how America and the international community discouraged and restrained the development and utilization of nuclear weapons, unlike

⁸⁷³ Chaim Kaufmann & Robert Pape, *Explaining the Costly International Moral Action: Britain's Sixty-Year Campaign Against the Atlantic Slave Trade*, 53 INTERNATIONAL ORGANIZATION issue 4, 631 (1999). [Hereinafter, Kaufmann & Pape.]

⁸⁷⁴ Kaufmann & Pape, 635.

⁸⁷⁵ Kaufmann & Pape, 645-646.

⁸⁷⁶ Kaufmann & Pape, 646-649.

⁸⁷⁷ Nina Tannenwald, *Stigmatizing the Bomb: Origins of the Nuclear Taboo*, 29 International Security issue 4, 5 (2005). [Hereinafter, Tannenwald.]

almost any other new weapon in history. Tannenwald distinguishes the modern attitude toward nuclear weapons as a taboo, “a particularly forceful kind of normative prohibition [...] concerned with the protection of individuals and societies from behavior that is defined or perceived to be dangerous.”⁸⁷⁸ Tannenwald writes:

[T]he rise of a nuclear taboo in world politics and in U.S. policy cannot simply be attributed straightforwardly to superpower self-interest, but instead is the result of a much broader set of factors, including importantly, a significant role for nonstate actors and antinuclear public opinion. Once a situation of mutual capacity to inflict unacceptable damage developed in the late 1950s, a primary factor driving the strengthening of the taboo was superpower self-interest. But in the critical early period of the nuclear era, when important precedents of non-use were set, and continuing in some fashion through to the present, a global grassroots antinuclear weapons movement and nonnuclear states have played a critical role in subjecting nuclear weapons to criticism and castigating them as unacceptable for use. Given that use was what was institutionalized in the U.S. military, the development of the taboo is all the more remarkable.⁸⁷⁹

Tannenwald sees ideas and norms, promulgated by transnational movements, as driving the nuclear taboo.⁸⁸⁰ This argument also places the impact of ideas and norms above the impact of material forces. Nations have declined to develop nuclear weapons (*e.g.*, New Zealand) – and even relinquished them (*e.g.*, South Africa) – consistent with collective norms and ideas rather than separate material interests.

V. Constructive Criticism

Constructivist critics ironically share a common characteristic: they are all mostly Constructivists. IR scholars note Wendt’s 1999 classic, *Social Theory of International Politics*, led to Constructivism replacing Marxism within the holy trinity of IR approaches (Realism, Liberalism, and Constructivism). For others, the “Mainstream” rise of Constructivism purged key tenants of Onuf’s Constructivism. Both Onuf and Wendt affirmed the best form to analyze IR was to study the norms and ideas of aggregates and structures. Yet, are those norms and ideas inherently stagnant, or does the observer of them affect the conception of the norms and ideas themselves – a kind of Heisenberg Uncertainty Principle in IR whereby the measurer affects the measurement?⁸⁸¹

Divergence amongst Constructivist scholars, and subsequent criticism directed towards the opposing side, begins and ends by trying to answer this question. Wendt’s mainstreaming of Constructivism abandons an analysis of those conducting the analysis. Ontological and epistemological applications to each theorist’s conception of a norm, through Wendt’s lens, is not integral to analyzing the reality of international relations.

⁸⁷⁸ Tannenwald, 8.

⁸⁷⁹ Tannenwald, 46.

⁸⁸⁰ Tannenwald, 46-47.

⁸⁸¹ *Tale of Two*.

Rather Wendt's application attempts to mirror a scientific method, as the observer's approach is one of objectivity, thus creating as much of a concrete answer possible in social science.⁸⁸²

Onuf's successors spite this line of thinking and note Wendt's approach is an illusion of hard science. These successors emphasize the importance of the analyzer. Their approach to Constructivism varies on the spectrum. Many skew towards a postmodern Constructivist approach; others lie in the middle at just a modern approach. Onuf's approach emphasizes the need to examine all these theorist's rationales in defining their perceptions of norms and ideas.⁸⁸³ Constructivism, from Onuf's viewpoint, is not a theory built from an analysis of IR. No, Onuf's Constructivism is a theory of theories: a theory which leans on the aggregates, and Constructivism being no exception. To Onuf, only the aggregation of theories and rationales provide the true reality of IR.⁸⁸⁴

That desire to analyze and conglomerate every theorist's rationale for defining norms and ideas is a recipe for an inherently tedious process. Tediousness can be misperceived as unnecessary and/or perplexing. Yet, this association can be ill-conceived. Constructivist theorists who side with Wendt's approach are afforded the opportunity to adopt the term "Mainstream" in front of their title. Yet, those who abide by Onuf's process of Constructivism, albeit tedious, are afforded the labels of "unnecessary," "perplexing" and finally settle upon on "Radical."⁸⁸⁵

VI. Two Streams

Is the divergence in Constructivism negative? After all, there two sides unwilling to compromise on how the perception of norms and ideas creates distrust in Constructivism itself. That perception sees the glass as half empty, not as half full. With two diverging streams of Constructivism, the tools given to understand the nature of IR increase. Constructivism from both lenses will allow oneself to isolate the identity of a structure or norm or aggregate, and create conclusions likely not find through Realist and Liberalist approach.

IR is but one sphere of analysis. The beauty of Constructivism lies in its versatile application. Such applications have been proposed as plausible, but substantive applications, namely, economics, government, and trade. So, Constructivist scholars ponder question like:

- (1) What norms of in the international trade community have led to increase offensive industrial policy?
- (2) Has a shift in norms led to a shift in the structuring of shareholder primacy?

⁸⁸² *Tale of Two.*

⁸⁸³ *Tale of Two.*

⁸⁸⁴ *Tale of Two.*

⁸⁸⁵ *Tale of Two.*

- (3) How have structures during the Biden Administration led to the idea of renewable energy practice?

All such questions, whether approached through a Mainstream or Radical lens, fall within the sphere of Constructivist analysis. Thus, Realism and Liberalism may well remain the core of IR theory and application. Yet, does the curiosity and growth of IR analysis lie within Constructivism?