OPEN SOCIETY
FOUNDATIONS

The Modern Agreement of Amity and Commerce

Toward a New Model for Trade Agreements

Beth Baltzan, Principal, American Phoenix Trade Advisory Services

October 2020

Contents

Introduction ... 3
The Ten Chapters of the Modern Agreement of Amity and Commerce ... 6
- Chapter One: Market Access ... 6
- Chapter Two: Rules of Origin ... 7
- Chapter Three: National Treatment ... 10
- Chapter Four: Labor ... 11
- Chapter Five: Environment ... 12
- Chapter Six: Tax ... 14
- Chapter Seven: Competition and Public, Private, and Small- and Medium-Sized Enterprises ... 15
- Chapter Eight: Transparency ... 16
- Chapter Nine: Administrative and Institutional Provisions ... 17
- Chapter Ten: Enforcement and Settlement of Differences ... 18

Conclusion ... 20

© Open Society Foundations
Some Rights Reserved

224 West 57th Street
New York, NY 10019
P. +1 212-548-0600
opensocietyfoundations.org

Introduction

As globalization comes under fire for serving the needs of corporate elites rather than ordinary citizens, it is important to recall that trade does not have to aggravate inequality. The rules of globalization matter. If we have better rules for trade, trade will produce better results.

Since the 1990s, trade rules have promoted what economist Dani Rodrik has referred to as "hyperglobalization." The focus has been on liberalizing capital flows with few—or no—constraints on where that capital goes. However, liberalizing capital flows without rules to foster fair competition incentivizes countries to vie for capital investments—and to engage in race-to-the-bottom policies to secure them. Many countries lower costs through labor rights suppression, environmental deregulation, and *de minimis* tax rates. They may also use subsidies and currency manipulation to further rig cost structures.

This suite of rules is essentially laissez-faire in its orientation. Any government effort to promote competition is disparaged as a protectionist undertaking. The only goal worth pursuing, in this arrangement, is low cost and high returns, regardless of how they are achieved.

However, this low-cost model is expensive. It pits workers in one country against workers in another, as returns to capital increase while returns to labor decrease; it promotes the degradation of the environment; and it robs nations of sufficient revenues to fund the basic needs of their people. Increasingly, these policies are seen as part of a broader violation of the social contract.

Because of these rules, the global trading regime, and bilateral and regional trade agreements, benefit certain sectors, and certain classes, within each country. Yet, these rules do not benefit all sectors, or all classes. We have papered over these structural concerns by relying on the axiom that trade provides an aggregate good. Yet by focusing on the aggregate good, we ignore that the rules of trade decide, at an individual level, *for whom* trade is good.

This axiom has also blunted our ability to appreciate the validity of the critiques of globalization, which we too easily attribute to misplaced populist grievances. Increasingly, we assure ourselves that if we simply do a better job in domestic policy areas, such as training and the social safety net, we will address any negative consequences arising from trade. While better domestic policy is certainly important, it is no substitute for reforming the rules of globalization, which themselves favor the elite at the expense of the working class.

It is possible to structure the rules of trade differently. Rather than writing rules to allow corporations maximum flexibility to exploit artificially low costs, we can write rules that promote fair competition. We can write labor and environmental standards that frustrate the ability of corporations to press a race to the bottom. We can write rules that prioritize the sovereign right to regulate over the corporate rejection of governance in the public interest. We can write rules to shine a light around which corporations are paying tax in which jurisdictions.

By writing rules that prioritize fair competition, we cannot only begin to correct the existing imbalance in favor of elites, but we can enable American workers and businesses to compete for customers around the world—all while preserving our values. Indeed, the latter is essential because if we value liberal democracy, we must place greater value on creating markets, both at home and abroad, that support the middle class and strengthen, rather than erode, its purchasing power. The facile argument is that purchasing power is enhanced through cheap consumer goods. However, more thoughtful analysis, such as that offered by Matthew Klein and Michael Pettis in their recent book "Trade Wars are Class Wars," demonstrates the ways in which government policies promoting income inequality pervert trade and financial flows. These policies promote underconsumption by the people who are most in need, and whose expenditures would do the most to help the economy—the working class. In defending the existing rules of globalization, we focus too much on the consumer, and not enough on the worker.

For decades the prevailing theory has been that trade policy must be insulated from democratic pressures, under the theory that removing such pressures will produce more ideal economic outcomes. However, insulating policy from the influence of the voting public is antidemocratic, and, as we have seen, self-defeating: it leads to a revolt by that same voting public against a regime that, by design, dismisses their views.

Further, far from producing a trade policy free from special interest influence, this approach instead facilitates policy by special interests with preferred access to decision makers—in other words, elites, particularly at financial institutions, pharmaceutical companies, and big tech.

Because of this approach, for many years there have been "one size fits all" bilateral and regional trade agreements. Do these agreements work for developing countries? We have no idea. The U.S. experiment with Central America suggests there is much work to be done to understand the circumstances under which developing countries—and the various classes within those countries—benefit

from trade agreements, and the circumstances under which they do not. Do benefits inure to the elite, with, at best, trickle-down benefits to the working class?

A model that returns to basics allows us to focus on our priorities. The first American trade agreement was with France. Negotiated by Benjamin Franklin and ratified by the Continental Congress, it was called the Treaty of Amity and Commerce.

If trade agreements are meant to serve the overarching goal of improving *amity* between the parties, then it follows that we must focus on crafting rules that build positive relations between the parties. That is not achieved by rules that promote Darwinian behavior by stateless corporations that have no allegiance to any sovereign.

However, if these are truly to be agreements grounded in amity, then we must recognize that neither we, nor our friends, are perfect. Trading partners rarely comply with all their obligations. Usually it is clear in advance *where* they will fall short. The European Union does not want as much American beef or chicken as Americans would like them to want. Canada believes its dairy farmers in Quebec are worth saving, even if it means betraying pure market principles. Our trading partners feel the same way about certain sectors in the United States.

It is partly because of such frictions that the girth of these agreements has expanded. The rules grow ever more detailed as every form of possible cheating (or “chiseling,” as a former negotiator called it) is anticipated and more rules are written to prevent it. As a result, the rules constraining government also grow ever more detailed.

Yet this legalistic approach to trade ignores the reality that, for key sectors, determined governments will inevitably find a way to protect that which they wish to protect.

These elaborate rules are, therefore, both too strict and too porous. The rules are functionally deregulatory, but they do not end circumvention of trade rules in politically sensitive sectors.

It is time to take a more realistic view of what trade agreements can achieve. They can promote amity, if we accept that free market perfection is not achievable and, in any event, not the goal; they can promote values, if we think workers, the environment, and the tax base represent values worth prioritizing; they can promote fair competition, if we believe that competition is more important than phony “efficiencies.”

If we return to a model of amity, then we must also ask who the parties to these agreements should be. Not every trading partner seeks amity with us. Interdependent trade relationships with hostile foreign powers put us in a position of dependence on geopolitical rivals. That does not necessarily mean we should never trade with such countries; rather, it means we must consider under what circumstances we are willing to do so. The United States entered into the Treaty of Amity and Commerce in 1778 with France to solidify the relationship in the face of hostilities with Britain. Britain is, of course, no longer an enemy. Relationships evolve, and so should trade agreements.

As global trade tensions grow, we are now seeing discussion of new forms of cooperation between like-minded democratic allies that have much in common with the historic concept of a Treaty of Amity and Commerce—such as the D-10 grouping of leading democracies formed in 2014. What role can trade agreements like this play in promoting better relationships with countries that share our economic and democratic values, and in weaning our dependence on countries that do not?

This paper provides an explanation of each of the 10 chapters of a Modern Agreement of Amity and Commerce. The agreement sets out a more equitable trading regime with the overarching purpose of fostering positive relations between like-minded parties.

The Ten Chapters of the Modern Agreement of Amity and Commerce

Chapter One: Market Access

A core component of any agreement is reciprocal market access. The United States in recent decades prioritized achieving a zero duty rate on almost all products. Other countries are much more willing to exempt products, and even sectors, from this obligation. A more realistic view of trade accepts that in some cases, taking tariffs to zero may be politically impossible, or undesirable. This emphasis on absolutist liberalization is equally present in the services sector.

Increasing a trading partner's market access can also be used in anticompetitive ways. There has been longstanding concern over export platforms. One party might waive duties on goods imported into its territory on condition that the goods are further processed and then exported to the other party—duty-free. This

is a form of tax-free treatment that is designed to create a false advantage for one trading party at the expense of the other. That kind of unfair competition is not appropriate for parties to this kind of agreement.

Currency devaluation can also be used to nullify the benefits of tariff concessions. While the tariff wars of the 1930s are often blamed on the 1930 Smoot-Hawley legislation, they are more closely related to subsequent competitive currency devaluations. The General Agreement on Tariffs and Trade makes it clear that currency manipulation is subject to countervailing duties. That approach is reflected here.

Market access in agriculture is a universally sensitive subject. In developed economies, the very nature of agricultural production does not lend itself to be well regulated by pure market forces—unless countries are willing to abandon small farming. Absent public sector support, returns to farmers are simply too low compared to those in industrial and service industries. Rather than pushing for such a destabilizing result, we should recognize that there is, indeed, value in preserving family farming, even if it does not result in the most "efficient" production.

Moreover, concentration in agriculture, particularly in the United States, is an anticompetitive force driving political outcomes that lead us to overproduce. We then foist that overproduction on our trading partners—without meeting the goal of reducing poverty or hunger—all while making sure the benefits inure to massive stateless enterprises, instead of small family farmers.

Textiles and apparel also represent a sensitive sector. The United States has a history of sacrificing textile and apparel jobs in pursuit of vague, unquantified foreign policy goals. Under the old trade model, textiles and apparel had their own chapter, in part to highlight the importance of the industry. While this agreement deliberately has no industry-specific chapters, there is a valid counterargument that, due to its unique history, textiles and apparel should continue to have a separate, stand-alone chapter.

Chapter Two: Rules of Origin

Trade no longer fits the 19th century Ricardo model in which goods are wholly produced in just one country. Rather, with trade in intermediate goods—inputs—supply chains cross many borders in the course of manufacturing the final product. Trade agreements are meant to incentivize trade between the parties, but the prioritization of "global value chains" results in pressure on

government officials to permit significant content from non-parties. In this way, the goals of the business community can be at odds with the goals of the parties to the agreement.

Deciding what qualifies for preferential treatment under an agreement is the province of the rules of origin. For many years, rules of origin were ignored, the domain of technocrats more than policymakers. Then, when Canada and Mexico joined the negotiations for the Trans-Pacific Partnership (TPP), it became clear that unless the TPP rules of origin on autos were carefully negotiated, they would undermine the North American supply chain that had integrated as a result of the North American Free Trade Agreement (NAFTA). Rules of origin became a focal point of opposition to the TPP, and a focal point again in negotiating the new NAFTA.

Similarly, for many years, U.S. negotiators operated on the premise that if the United States did not make a particular product here, then it was fine for such products to originate in non-parties to the agreement. That thinking was driven by the overarching goal of prioritizing cheap inputs. Rules of origin are now so opaque that in many cases it is impossible to know just how much content comes from non-parties to a U.S. agreement and, depending on the product, the non-originating content could be up to 99 percent. Much of that content could be coming from China. We simply do not know.

As the United States began to include enforceable labor and environmental rules in its agreements, we did not re-evaluate these rules of origin. In the U.S. agreement with Korea, for example, both Korea and the United States must abide by basic labor and environmental rules. Yet countries like China, which do not have to abide by those basic rules, can supply as much as 65 percent of the content of an automobile that is defined as a U.S.-Korea good. Some of the rules are written in such a technical way that we do not even know how much actual content comes from the parties, versus non-parties. Therefore, the chapter includes a provision for the parties to undertake an analysis of supply chains under the agreement after it has been in force for three years, to provide important data regarding actual sourcing patterns.

In an ideal world, sourcing would be 100 percent from the region, subject perhaps to a waiver for goods that are not regionally available. However, as a practical matter, there are important constraints on the ability of governments to execute strong rules of origin. The tariff rates applicable to non-parties are generally low, as a result of 70 years of multilateral tariff reductions. The average tariff cap for the United States is 3.4 percent; for Japan; 4.7 percent; and for Europe, 5.1

percent. If strong regional sourcing rules raise costs beyond the tariff rate applicable to non-parties, importers may simply choose to pay the tariff, rather than source within the region.

Nevertheless, there is room to strengthen these rules, and governments must do so if they genuinely want to address race-to-the-bottom sourcing. Several principles should govern the crafting of these deeply technical product-specific rules:

- Non-transparent rules must be the exception. Historically, rules of origin have been structured in terms of the percentage of content originating in the region. Thus, a 75 percent "regional value content" requirement generally requires 75 percent of the content to be made in the region. With NAFTA, rules began to be framed based on where particular goods are classified in the Harmonized System—an approach utterly inaccessible to all but a few customs experts. This approach was hailed as a revolution in objectivity, but classifying goods is no more objective than calculating value. Moreover, the tariff-shift approach invites confused producers, who are more familiar with values than tariff classification, to breach the requirements through misunderstanding rather than intent. Therefore, rules of origin should typically be expressed in terms of value, not tariff classification.
- Once we have transparent rules, we can know what these rules are actually incentivizing. Some of the TPP value content rules are as low as 30 percent. If the goal is to build trading relationships with our friends, then surely we want more than 30 percent of the content to come from our combined efforts. The proposal here is to reverse the burden. Rather than starting with low regional value content—a leftover of the mentality that all that matters is cost—start with a high regional value content requirement. If businesses can demonstrate that the content threshold is too high and that they will pay the tariff rather than source regionally, then the rules can be modified.
- The importance of the automotive industry is a frequent rationale for content rules, most recently in the need to have basic manufacturing to deploy toward critical goods such as ventilators, and before that with the auto bailout in connection with the financial crisis. We must prioritize preserving production. The new NAFTA requires 75 percent content, but the new NAFTA also abandoned technical rules designed to ensure that essential components are made in North America. These parts are on a list, called the tracing list. The tracing list must be revived and updated; the new NAFTA rules do not provide a comparable substitute.

- Parties must abide by labor (Chapter 4), environmental (Chapter 5), and tax (Chapter 6) rules. Non-parties should not be able to contribute content while evading these obligations. Therefore, subject to a phase-in period, non-originating content under the agreement will only be allowed if the content is from countries that have agreed to implement these obligations.
- Similarly, non-market economies operate under comprehensive distortions that constitute unfair competition. Subject to a phase-in period, these economies should be barred from contributing content under this agreement.
- Companies may object to having to keep track of content under these rules. However, much as they did not like doing it, companies were able to trace content under the original NAFTA automotive rules. Moreover, companies are already obliged to know their supply chains; they must comply with the obligation not to import goods made in whole or in part with forced labor. Ford, for example, has explained that it can trace sourcing of cobalt in the Democratic Republic of the Congo. If companies balk at being held responsible for knowing their supply chains, it is a tacit admission that they are not committed to ensuring their supply chains are free of forced labor—a concern that the U.S. Congress has expressed in light of recent allegations about the association of American companies with forced labor in China. That is an even bigger issue than complying with rules of origin.

Chapter Three: National Treatment

Market access and national treatment are the cornerstones of trade agreements. National treatment is a requirement that one party not treat nationals of the other party worse than it treats its own nationals. It is, in effect, a requirement to treat your trading partner fairly.

Most of the sector-specific chapters in the old trade agreement model are organized around the principle of national treatment. However, organizing those chapters by sector, rather than unifying them under the common principle of national treatment, allows those chapters to dilute the focus on national treatment and instead become magnets for sector-specific special interest provisions. Many of these provisions have nothing to do with trade. For example, the investment chapter of U.S. agreements has what can only be interpreted as a prohibition on requiring corporate social responsibility. Why should a trade agreement prevent a party from imposing corporate social responsibility requirements, provided it does so even-handedly with respect to domestic and foreign companies?

Similarly, the intellectual property chapter has metastasized into a tome of rules that, with few exceptions, have very little to do with trade and instead are designed to extend monopoly rights extraterritorially. These rules are highly prescriptive regulatory regimes that apply without regard to whether there is any cross-border transaction.

The digital trade chapter is likewise infused with a variety of rules unrelated to trade. Whether platforms are liable for content is not a trade issue: it is a matter for domestic regimes to resolve. That the platforms tend to be considered American companies does not justify including these provisions in trade agreements and only promotes the view that the United States treats these companies as national champions. Trade agreements promoting amity and commerce should not be used to advance the interests of national champions.

These types of departures from the focus on national treatment become more difficult to slip in when the sector-specific chapters are eliminated.

Finally, there has been a longstanding battle among trading partners about whether services should be bound through a "positive list," i.e., identifying the sectors to be bound by national treatment commitments, or a "negative list," i.e., identifying only the sectors to be excluded from the commitments. The latter approach can include any future services, that is, services that have not yet been invented. Trading partners have balked at such commitments. In keeping with the view that we should be realistic about parties' commitments, then we should accommodate parties' desire to use a positive list.

Chapter Four: Labor

Labor has widely been dismissed as a "social" issue unrelated to trade. That is wrong. Labor is a factor of production. The liberalization of capital flows without adequate protections for labor has incentivized the suppression of labor rights as a means of attracting capital. Trading partners should not engage in beggar-thy-worker policies to secure investment.

Because of the long history of dismissing labor issues as social issues, there is much work to be done to persuade the trade establishment that labor rights are appropriate subjects for trade agreements. Thus, while much of the agreement proposed here rejects prescriptive rules, labor is an exception. Until labor rights are respected as a core issue, they require greater prominence and greater detail.

This chapter draws on the agreement recently concluded among Canada, Mexico, and the United States. The agreement passed the U.S. Congress with broad, bipartisan margins in both chambers.

The agreement sets out core labor rights, recognized by the International Labor Organization. Parties may not compromise those rights for the purpose of attracting trade or investment. Parties may not simply protect those rights as a matter of law, and never enforce that law. For that reason, the chapter includes a special mechanism to ensure that nationals have access to tribunals to enforce those laws.

Parties must not allow the importation of goods made in whole or in part with forced labor. Violence against workers—a common intimidation tactic associated with the exercise of labor rights—is proscribed. Migrant workers are to be protected, whether they are nationals or not. Discrimination in the workplace is not tolerated.

Parties can always consult, on any topic they wish. Therefore, many of the specific cooperation authorities in existing trade agreements are not necessary. However, because of the chronic problems with labor rights, special mechanisms are detailed to increase the likelihood that cooperation on labor will be a reality.

When the United States began including labor chapters in its trade agreements, claims could only be brought if the complaining party could prove a nexus between the breach, and trade or investment between the parties. This kind of procedural obstacle to enforcement cannot be justified for parties that share the goal of seeking to strengthen the welfare of workers in all jurisdictions.

For many years, the labor community has pressed the United States to be more comprehensive in the scope of labor rights included in these agreements. In some cases, these rights would require changes to U.S. statutory law. Achieving a more equitable balance between labor and capital may require such changes, including adoption of certain ILO conventions. There are also proposals for countries to commit to increasing union density through a series of targets. These concepts are an appropriate topic for domestic—and international—debate.

Chapter Five: Environment

As environmental concerns have grown, resulting in no small measure from industrial pollution, so has the desire to mitigate the race-to-the-bottom that can

be promoted by globalization. Furthermore, given that the environment reflects the global commons, common action is required to address the harm.

The environmental chapter reflects significant work done by the United States over the past 15 years to craft anti-arbitrage rules for trade agreements. These rules are in many ways analogous to those involving labor.

Existing agreements require the parties to implement the rules they have agreed to in certain multilateral environmental agreements (MEAs) to which they are mutual signatories; this chapter expands the provision to cover all MEAs to which the parties are mutual signatories. Further, parties may not compromise their environmental commitments for the purpose of attracting trade or investment. For that reason, these provisions apply not only to agreements to which the parties are currently signatories, but also to those agreements to which parties have been signatories in the past. This is further to the idea that parties should not roll back the level of environmental protection they afford. In addition, parties may not simply protect environmental rights as a matter of law, and then fail to enforce that law; the chapter includes a special mechanism to ensure that nationals have access to tribunals to enforce those laws.

The new NAFTA includes innovations, particularly with respect to air quality and marine litter. These provisions are included here. The TPP also included innovations, including with respect to fisheries, and those provisions are also included here. In some cases, hortatory language has been strengthened so that the obligations are enforceable, rather than aspirational: parties should no longer use agreements to suggest they are committed to doing more than they really are.

One important example of strong language pertains to trade in illegally harvested wild fauna and flora. The TPP language was watered down from the U.S. initial proposal. However, illegal “take and trade” is not only harmful to the environment, but it is used to fund illegal activities, including terrorism. There is no excuse not to prohibit, and enforce the prohibition against, such trade.

Both the original NAFTA and the revised NAFTA included a provision noting that in the case of a conflict between a multilateral environmental agreement and the NAFTA, the multilateral environmental agreement would prevail. That is included here.

Finally, the revised NAFTA permitted the parties to encourage corporate social responsibility. This agreement authorizes parties to require corporate social responsibility, provided the party does so consistent with the obligations of national treatment.

There are other environmental trade initiatives under consideration that might be appropriate. If the parties want to guarantee policy space for a carbon tax, they can include a provision to that effect in the national treatment chapter, given that national treatment is often invoked—not necessarily correctly—as a potential legal obstacle to such a tax. The Paris Agreement is frequently invoked as a candidate for coverage by trade agreements, and it is captured here by the provision holding parties to multilateral environmental agreements to which they are, or have been, signatories.

The agreement encourages parties to participate in environmental goods negotiations. However, it stipulates that environmental goods are only environmental goods if they are made sustainably. At present, environmental goods tariff negotiations tend to focus only on the tariff treatment of the good, and not the manner in which the good was made. Under that approach, environmental goods can be made using, for example, coal-based electricity. To be a sustainable product, the product should be made in a sustainable way.

Chapter Six: Tax

Tax policy is, for each government, a sensitive subject. Nevertheless, evidence consistently demonstrates the growing problem of tax arbitrage, both as a source of trade distortion, as well as an important corrosion of the national tax base. Trade agreements tend to avoid the subject.

However, it is possible to begin to address tax arbitrage without impinging on national tax policy. The Global Reporting Initiative has undertaken a project to create a public reporting system. The initiative's approach is incorporated here.

Drawing on the state aid rules within the European Union, this chapter also addresses transparency around tax incentives to lure investment to a particular region. There should be greater public scrutiny of the incentives deployed to lure investment to one region versus another. Too often, these deals are secret.

Parties will likely resist making substantive policy commitments on tax in a trade agreement until there is confidence that enforcement of the agreement will not result in the imposition of obligations to which the parties did not agree. Therefore, these provisions focus on transparency, but over time, parties may decide that they can agree to more substantive commitments.

Finally, the chapter addresses the relationship between stateless enterprises and nationality. These companies can be resident for tax purposes in multiple

jurisdictions and shift profits to limit tax liability. This form of tax arbitrage puts downward pressure on tax rates and deprives jurisdictions of important tax revenue. Yet even as stateless enterprises use multiple jurisdictions for tax purposes, they are also able to invoke the flag of the jurisdiction where they are organized—and where they may be minimizing their tax liability—to allege discrimination on the basis of national treatment.

Stateless enterprises that are able to use the trade system to shift profits and deprive jurisdictions of revenue should not then be able to use trade agreements as a shield when trading partners seek to address the problem. For stateless enterprises with tax residency in two parties to the agreement, the agreement denies the availability of national treatment for those stateless enterprises with respect to those parties. The agreement further provides that, based on the information disclosed pursuant to the transparency provisions, which may foster a more equitable global tax regime, this rule can be modified.

Chapter Seven: Competition and Public, Private, and Small- and Medium-Sized Enterprises

Countries seeking to establish a framework of cooperation around fair competition need rules to promote such competition. Mitigating labor, environmental, and tax arbitrage is part of the solution, but rules designed to preserve and promote competition are also important.

Indeed, rules to preserve competition were intended to be the cornerstone of the multilateral trading system because of the founders' experience with income inequality, concentrated industrial power, and the ability of authoritarian regimes to deploy that concentrated power in pursuit of anti-democratic ends. The founders did not want authoritarian powers to be able to exploit a liberalized trading system in furtherance of illiberal ends. The business community, however, rejected this undertaking. Even today, U.S. trade agreements do not include substantive competition rules; they are instead generally oriented around due process for merger candidates.

The rules in this chapter are largely drawn from the founders' work. These rules define and prohibit restrictive business practices, with an illustrative list of such practices. The founders did not favor one system for administering competition policy, but instead focused on the anticompetitive practices themselves.

Much good work has been done over the past decade with respect to the kinds of subsidies that facilitate anticompetitive behavior. While these rules have largely been confined to state-owned enterprises, the distinction between state-owned enterprises and non-state-owned enterprises is largely irrelevant when it comes to companies receiving such subsidies. In these cases, it is the subsidy that is anticompetitive, not the identity of the recipient. Thus, these rules are incorporated into the chapter, but are applied to all enterprises, not just state-owned enterprises.

Small- and medium-sized enterprises (SMEs) typically have their own chapter. Yet, this approach minimizes the challenges SMEs face with respect to much larger competitors. Trade should not favor the big over the small, and placing these provisions in the same chapter as competition more broadly illustrates the importance not just of facilitating SME participation in trade, but the ability of SMEs to survive competition with bigger rivals.

Chapter Eight: Transparency

Transparency is an underappreciated element of fair global competition. To exercise the market access provisions, the parties and their nationals must have basic access to laws, regulations, and procedures.

Moreover, while the United States has the Administrative Procedures Act to provide some transparency around process, many other countries have regulatory processes that are more opaque. Such opacity allows discriminatory undertakings to be hidden. Thus, the chapter provides for a basic level of transparency in the development of regulations having a significant impact on trade.

Transparency should not, however, present an obstacle to the ability of governments to regulate. There have been considerable efforts over the past several decades to use trade agreements to limit the ability of governments to do so, pursuant to the misguided notion that increasing the volume of trade flows is itself the principal goal of a trade agreement. The goal of increasing trade for its own sake should not supersede the ability of governments to exercise their core sovereign functions.

If governments believe that regulatory cooperation is an important undertaking in a particular sector, nothing stops them from negotiating agreements in those areas. It does not follow, however, that such technical understandings belong in trade agreements. Trade agreements set the basic terms of cooperation and fair

competition between the parties. The goal of increasing trade flows is not a justification for compromising the right to regulate.

Part of fair competition and transparency is that government decisions should be made on the merits, not because of distortive inducements. Therefore, the chapter includes core rules prohibiting corruption, including a financial reporting requirement. The Foreign Corrupt Practices Act has, through the U.S. financial reporting framework, provided a transparency mechanism for reporting corrupt activities. The chapter also includes anti-bribery obligations. These mechanisms contribute to confidence in the overall business climate of the parties.

Chapter Nine: Administrative and Institutional Provisions

This chapter includes the architecture for administering the agreement. It establishes a trade commission to oversee implementation of the agreement and to provide a forum for addressing any issues that may arise.

In the past, U.S. trade agreements have included committees for individual chapters, to facilitate work in those sectors. Such committees may be appropriate. They can be established by the commission itself.

This chapter also includes a termination date for the agreement, which the parties can agree to extend. There is a prevailing view that trade agreements must be permanent in order to provide "certainty." However, the United States already recognizes that the terms of trade evolve and benefit from review and updating. In renewing certain trade programs for developing countries in 2016, the United States considered that 10 years was an appropriate term, giving investors sufficient time to recoup their investments. There is no reason to treat trade agreements any differently. While parties *may* always renegotiate terms, there was a deep reluctance to renegotiate NAFTA in earnest.

Furthermore, a clear time frame for these agreements may induce better compliance by the parties. If parties realize they will be accountable for their promises, they can avoid overcommitting on some issues, while effectively meeting their commitments to others.

To ensure that the term of the agreement is used constructively, the chapter requires the trade commission to meet every two years to discuss the operation of the agreement. To provide the public with a role in the review of these agreements, the chapter requires each party to solicit public comment on the

operation of the agreement. The commission must also publish a report that provides data on trade flows between the parties, identifies issues discussed in connection with the joint review, and notes any proposed modifications to the agreement.

Chapter Ten: Enforcement and Settlement of Differences

The enforcement chapter begins with a joint safeguard mechanism. Many trade agreements will include safeguard mechanisms that protect one party from a surge of imports from another party. This approach is different. It allows the parties to *jointly* address harmful imports from outside the region. This agreement is designed in part to mitigate the race-to-the-bottom incentives built into the global trading system. To do so, it has core standards that the parties must meet. However, as discussed above, global tariffs are so low that it may prove cost-effective for importers to pay the standard tariff rate and *not* comply with the standards in the agreement. Should such a circumstance reach the point where it is causing economic, societal, or environmental difficulties, the parties could jointly take action to address it. The broad scope of the language, reaching “economic, societal, or environmental difficulties,” is drawn from the safeguard provision of the European Free Trade Association convention. This provision allows for enforcement of the agreement by parties not against each other, as is normally the case with dispute settlement chapters, but against erosion of the agreement’s standards by third parties.

With respect to dispute settlement between the parties, it is worth recalling that for the first 70 years of its existence, the multilateral trading system did not have a binding state-to-state dispute settlement mechanism. Although there were complaints about the operation of the system, parties generally adhered to their obligations. Some cheating is to be expected, and it did occur. However, the reaction to cheating was to try to eradicate it, including through binding state-to-state dispute settlement. The rules that are enforced reflect the mentality that liberalization—measured by ever-increasing trade flows—is the overriding goal of the system and that government regulation is presumptively protectionist. Therefore, the WTO’s dispute settlement system has been criticized for prioritizing liberalizing trade flows over such issues as children’s health, the environment, and unfair trade.

Perhaps paradoxically, empirical data indicate that binding state-to-state dispute settlement does not in fact increase trade flows. Thus, the WTO is criticized for enforcing a regime that is deregulatory in orientation, yet seems to deregulate without actually influencing trade flows. Moreover, a litigious posture can promote rancor between the parties, rather than amity.

In light of the foregoing, there is a valid argument that the non-binding state-to-state dispute settlement regime that prevailed under the GATT may be as useful as the binding dispute settlement regime of the WTO. The U.S.-Israel trade agreement, for example, does not have a binding dispute settlement mechanism, and the parties have generally complied with the terms of the agreement. A conversation about the value of these types of dispute settlement mechanisms is worth having. However, the prevailing view is that binding state-to-state mechanisms in these types of agreements are beneficial, and one is included here.

More important than cheating by the parties themselves is the pecuniary incentive for individual traders to avoid compliance with the rules of these agreements. These incentives highlight the importance of having enforcement measures applicable at the firm, rather than the state, level. These incentives can induce fraudulent claims of origin, suppression of labor rights, and violations of environmental rules. These breaches undermine the overarching goal of the agreement, which is to promote amity and commerce between the parties.

Trade agreements include claims not just for breaches of obligations, but for "nullification or impairment" of benefits under the agreement. This standard is vague and provides panels with extensive latitude to find that a party, having lived up to its legal obligations, has otherwise undermined the agreement. In light of controversy over whether panels have misused their discretion, this provision remains, but is not enforceable with sanctions.

In general, this agreement shifts the emphasis on enforcement from the states to traders, in furtherance of a 15-year trend. The U.S. agreement with Central American countries includes an innovative mechanism to permit governments to verify compliance with textile and apparel claims by conducting visits to the sites where the goods are made. That construct formed the basis for provisions in the U.S. agreement with Peru to enforce rules against trade in illegally harvested lumber. In turn, that provision formed the basis for rules in the new NAFTA to permit on-site inspections of facilities alleged to be in violation of labor requirements.

These types of provisions permit the parties to an agreement to work cooperatively to address cheating by companies. Therefore, this chapter includes on-site verifications in the areas of customs compliance, textiles and apparel, labor, and the environment. It also includes border mechanisms for enforcing intellectual property rights. While the majority of intellectual property rules in trade agreements have nothing to do with trade, trade in counterfeit goods is problematic and thus appropriately enforceable at the border.

Conclusion

As the foregoing shows, it is possible to craft a set of trade rules that promotes a race to the top, rather than a race to the bottom. It is possible to build a trade relationship based on a pragmatic assessment of friendly nations' capacity for liberalization. And, it is possible to move away from elevating cheap inputs and returns to capital above the needs of populations with common goals and shared values.

These rules show us that there is no need to be for or against globalization itself. We can be for a version of globalization that promotes not just amity and commerce, but equity.