

The New Rules of the Road: A Progressive Approach to Globalization

By Jared Bernstein and Lori Wallach

Introduction

The emergence of trade as a top election issue shows that the economic and social costs imposed by our current trade policy model have reached a tipping point. For purveyors of the status quo, this is a crisis, as the inherent inequities in their approach to trade have finally surfaced. For those of us who have long recognized such inequities, the current moment presents an opportunity to craft a new model, a new set of “rules of the road.” Far from trying to set back the clock on globalization, it is only through this new, far more inclusive, non-corporate-centric approach that we can rebuild American support for expanded trade.

This will not occur by continuing to assert that, despite their experiences, those who perceive themselves and their communities as having been hurt by exposure to the forces of globalization are just plain wrong. Or that the next trade agreement will be the one that fixes everything. Or by offering the increasingly large portion of the population who find themselves on the losing side of the current rules some temporary adjustment assistance.

It will only change if we change the content of our trade agreements and, in turn, the process by which we negotiate them. The “new rules of the road” must reflect the economic realities and needs of a much broader group of stakeholders. Crucially, to achieve such rules will require much greater transparency and inclusiveness in the policymaking process, helping to ensure that the resulting substantive rules represent the needs of the majority. This memo focuses on the substantive and procedural changes needed to realize these goals.

Globalization will surely proceed apace. Neither Donald Trump, Brexit voters, nor anyone else can put that toothpaste back in the tube. Nor should they. It is through expanded trade that we seek new markets for U.S. products, expand the supply of goods and services, and provide emerging countries with opportunities to grow by trading with wealthy countries.

But trade and contemporary free trade agreements (FTAs) are far from synonymous. The recent U.S. International Trade Commission (ITC) report on the “likely impacts” of the Trans-Pacific Partnership (TPP) underscores that these agreements are not mainly about cutting tariffs to expand trade nor about jobs, growth, and incomes here in the United States. Rather, they’re about setting expansive rules that determine who wins and who loses.

For years, those advocating for the “winners” that have been able to capture the negotiating process essentially said to those hurt by the resulting agreements: “Don’t worry, this will be great for you too. And, hey, if it isn’t, we will make it all better with adjustment assistance and some training.” The hollowness of these false promises is finally evident to the broad electorate. The rules must be written for all the cars on the road, not just the Lamborghinis.

Our new framework starts from the premise that the current “trade” agreement process has been co-opted by corporate interests whose goal is to establish binding, enforceable global rules that protect their investments and profits. This corporate capture comes at the expense of both peoples’ rights to democratically govern their own affairs and the ability of sovereign governments to effectively enforce worker, consumer, and environmental safeguards.

What follows describes a new set of rules of the road, one that puts the economic needs of working families at its core while excising corporate, protectionist influences from the rules. Achieving such inclusive policies will require a new policymaking process to replace the current system of opaque negotiations, a system heavily influenced by hundreds of official corporate trade advisors while the Fast Track process limits Congress’ role and the public is largely shut out.

Initiatives That Must Be Part of the “New Rules of the Road for Trade”

Enforceable currency disciplines

When the rules are fair, Americans can benefit from expanded trade. But when trade partners are free to lower the value of their currencies to gain trade advantages, the negative effects are twofold. First, with the “terms of trade” artificially tilted against us, countries with large and persistent trade surpluses subsidize a flood of imports into the United States while unfairly pricing our goods out of their markets. Second, the capital flows that facilitate this imbalance have given rise to underpriced credit, bubbles, and ultimately, recessions. Therefore, we must include enforceable rules in the core texts of our trade agreements and enact domestic legislation that triggers automatic action against currency manipulators, rather than simply triggering reports or dialogue.

The fact that our current crop of trade negotiators tells us that the inclusion of actionable rules against currency manipulation is impossible should be taken not at face value, but as a clear sign that the present negotiating system is broken. If the current “highway crew” is unable to build a road that facilitates this critical change, we need a new crew. The International Monetary Fund’s definition of currency manipulation, accepted by countries worldwide, provides important elements of a blueprint for this critical measure.

Enforceable and substantive labor and environmental rights and standards

Global corporations engaging in global commerce absent a floor of enforceable international labor and environmental standards incentivize a race to the bottom between nations in wages, working conditions, and environmental and health safeguards. Globally accepted labor and environmental standards exist, but they lack effective enforcement and should also be strengthened. Trade partners' implementation and consistent enforcement of domestic laws that provide the labor standards set forth in the International Labor Organization Conventions and the environmental standards provided by a more robust list of Multilateral Environmental Agreements must be the minimum requirement that is included in the core text of our trade agreements.

With respect to wage levels, there are various mechanisms that could be included to establish minimum wage standards that reflect the differing levels of development of trade partners but that also set a floor, such as some percentage – preferably, close to 50 percent – of the median wage.¹ Agreements going into effect in the first instance and then countries' continuing trade benefits must be conditioned on maintaining on-the-ground *compliance* with such terms.

This last point regarding a different sequencing must be incorporated into the new rules of the road. If rules are unenforced or require a one-time, check-the-box review of whether changes to policies have been made on the books, it of course makes no difference how progressive they are. And given the nature of international trade, there will always be uncertainty regarding the extent to which trading partners will enforce agreements to which they've signed on. So any benefits to partners in terms of market access must be conditioned on confirmation that labor and environmental rights are enforced – meaning sustained evidence that conditions on the ground have improved and withdrawal of trade benefits for backsliding.

Tighter terms regarding “rules of origin”

In order for the benefits of our trade agreements to flow to the workers in the countries that sign the pacts and play by the rules, we must have clear “rules of origin” that can't be easily gamed. Under the TPP, a majority of a car's parts could come from China, but a car assembled in a TPP country still could enter the United States with the duty-free privileges reserved for those in the TPP. By tightening “rules of origin” such that only goods with a solid majority of member-country content are treated as originating from member countries, the benefits of the deal will more appropriately flow to its signatories and their workers.

Facilitating export opportunities and combatting transshipment

Trade agreements should focus on the basic logistics of trading goods and services across borders rather than investor protections that subsidize job offshoring, extended patents and other rent-seeking devices that increase consumer prices, and/or other elements of the agendas of large

multinational corporations. This includes facilitating trade flows with rules to standardize and reduce unnecessary Customs paperwork. Currently, even with average tariff rates at a historic low, only 3 percent of U.S. small and medium enterprises export any good to any country. In contrast, 38 percent of large U.S. firms are exporters. And under past FTAs, small businesses – which are least able to deal with Customs complications – have lost export share.

It is also necessary to tighten measures against transshipment. These measures prevent non-trade partner countries from enjoying the benefits of a trade pact by *illegally* shipping goods they produce into the United States through a trade partner country (i.e., they prevent such countries from getting away with violations of “rules of origin” or other rules). Even the best rules of the road will not deliver benefits if they are not strongly enforced.

Selecting appropriate trade partners

The goal of U.S. trade agreements should be to facilitate trade flows, create jobs, and raise wages. Having the right trade partners is as important as having the right rules of the road. Moreover, sequencing matters. We reject the notion that bad actors that violate workers’ and human rights will become good actors if we simply invite them to trade more with us. Sadly, there is considerable empirical evidence on past U.S. trade initiatives with China, Vietnam, Russia and other nations that supports our view.

Therefore, we must select trade partners based on their countries’ records of compliance with the terms of past trade agreements and international labor, environmental and human rights; their record of meeting safety and inspection requirements with respect to food and other products imported into the United States; their compliance with prohibitions on the transshipment of goods that are ultimately imported into the United States and dumping, subsidies, and circumvention; their records with respect to currency management; their enforcement of effective measures to combat and prevent public and private corruption, including measures with respect to tax evasion and money laundering; and any potential concerns to our national security.

While no country has a perfect track record on these issues, there is a well understood continuum of compliance, and known bad actors should be barred from the negotiating table until they’ve made proven, effective efforts to begin cleaning up their acts.

Initiatives That Should NOT be Part of the “New Rules of the Road”

Investor privileges and investor-state dispute settlement

At the heart of the current U.S. FTA model are expansive investor rights. By lowering the risk

premium associated with shifting investment to low-wage countries with weak rule of law, these terms actually incentivize offshoring of production that would not make economic sense absent the subsidy the investor protection regime effectively provides.

We understand the view that, absent some form of investor protections, there is a potential for sub-optimal investments in developing economies where investment risk is high. But the Investor-State Dispute Settlement (ISDS) process and the broad substantive investor rights and privileges it enforces sacrifice the hard-won institutions of sovereign democracy. Through the backdoor of trade agreements, the ISDS process imposes extreme property rights' concepts rejected repeatedly by Congress and U.S. courts, such as the notion that governments should pay "regulatory takings" compensation to property owners for the right to enforce environmental, health and other safeguards that could undermine the value of their property or investment.

We must not solve the problem of weak rule of law among our trading partners by having the broad public bear investment risk or by changing fundamental principles of U.S. law. Instead, investment risk must be borne by the investors themselves; it is their skin, not ours, that should be in the game. Operationally, this means that international investors must self-insure against the risk engendered by trading with countries whose legal systems they do not trust. Surely, today's innovative capital markets could handily price such insurance.

This is a much more democratic solution than the current ISDS process, which exposes a nation's policies and treasury to broad liability to protect individual investors' offshore activities. Moreover, this exposure is growing, as recent research reveals considerable speculation by financial investors in ISDS cases. Such investors either purchase companies with the express purpose of filing an ISDS claim or directly bankrolling the cases in order to claim a share of the fine. (Investors refer to this practice as "third-party funding of international arbitration against foreign sovereigns".) Gus van Harten, a law professor who has studied these activities, finds that investors "...can get an award for billions of dollars when that award would never come out in domestic law. It's just a jackpot for speculators."

At a time of rising anger about the growing influence corporations have over governments and the decisions that shape our daily lives, the ISDS regime represents an audacious consolidation and formalization of corporate power. Individual foreign firms and investors are elevated to equal status with sovereign nations and given new powers to privately enforce a public treaty via an extrajudicial arbitration tribunal staffed by three private sector attorneys. In these tribunals, commercial interests can claim that new substantive rights and privileges provided to them in an agreement have been violated and initiate actions against governments to demand taxpayer compensation.

Under ISDS, governments can be ordered to pay damages that include not only actual losses that resulted from a policy, but also "future profits" an investor would have accumulated absent the challenged policy. That a policy applies equally to domestic and foreign firms or that it was

enacted by Congress and reaffirmed by U.S. courts is irrelevant if a tribunal decides that it violates the investor rights provided in an agreement. And there is no outside appeal on the merits of ISDS tribunals' decisions. Even when a case is dismissed, the tribunal has sole discretion to determine costs and governments are usually charged with half of the tribunal expenses, which average \$5 million per case. Thus, merely *filing* an ISDS case can have a chilling effect on policymaking.

The ISDS regime and the broad, vague investor rights it enforces must be recognized as a massive risk shift from powerful, deep-pocketed corporate interests onto the rest of us. There is no way it could withstand a balanced cost/benefit analysis. The simple solution is for multinational firms to stop externalizing the costs of these risks and finally internalize them.

Almost all of the existing 50 past U.S. ISDS-enforced pacts are with developing nations with few investors here. That is why the United States largely has managed to dodge ISDS attacks to date. (The handful of ISDS challenges to U.S. policy have been launched by Canadian firms under the North American Free Trade Agreement (NAFTA), as Canada is currently the only major capital exporting nation with ISDS rights against the United States.) But under the TPP, more than 10,000 Japanese, Australian and other corporations and their subsidiaries in TPP nations would be newly empowered to launch ISDS cases against the United States. Were the Transatlantic Trade and Investment Partnership (TTIP) to be completed and include ISDS, it would empower an additional 27,000 subsidiaries of European firms operating here to use ISDS against U.S. local, state and federal policies and government actions.

We must avoid such a dramatic expansion of ISDS liability, especially at a time when the types of policies being attacked and the number of ISDS cases are surging. Just 50 known cases were launched in the regime's first three decades combined, while *more than 50* claims have been launched in *each* of the last five years. The early cases largely pertained to firms seeking compensation after governments expropriated real property such as mines, factories, oil facilities and the like. But today, an array of new cases² are being filed monthly relating to health, environmental, energy, toxics, financial, land-use or other regulatory policies unrelated to expropriation of real property. As a result, major developing countries have begun to extract themselves from their investor-state agreements and developed countries, such as Germany, are revisiting their willingness to be submitted to ISDS liability.

Constraints on food safety and consumer product protections

We must eliminate the rules in our trade agreements that require us to import food and products that do not meet our safety standards, that limit border safety inspection, and that limit labelling regimes that provide consumers with information to make knowledgeable choices in the marketplace. With respect to food and products standards, trade rules should not set a ceiling on environmental, health or other requirements nor require us to accept imports that meet rules the exporting country claims are equivalent, as required under current pacts. Rather, the rules should

only prohibit less favorable treatment for imports, meaning imports must meet the same rules as domestic products (with the level of consumer protection determined through democratic processes involving those who will live with the results).

Patent and copyright protections

Trade agreements are not an appropriate instrument for requiring countries to establish “rent seeking” protections for intellectual property rights. Given the World Trade Organization already requires signatory countries to enact strong patent and copyright protections, certainly future trade agreements must not further limit the competition that brings down the prices of medicines and ensures affordable access to life-saving drugs. Nor should they limit the ability of governments to negotiate prices with pharmaceutical firms for bulk purchases of medicines (to be used through government healthcare programs such as Medicare and Medicaid). They also must not grant extended copyrights, which raise the price of access to information and textbooks. To the extent that intellectual property rights-holders seek more protection, they should do so through separate agreements that do not condition trade rights on extending potentially monopolistic conditions.

Rules that limit financial regulation

Inadequate oversight of financial markets was a widely recognized cause of the Great Recession. This realization created the political space, against an extremely well-funded opposition lobby, to pass Dodd-Frank financial reform. We must not allow trade agreements to undermine this process or foreclose future improvements, and therefore must eliminate rules that limit financial regulation. Specifically, we must avoid bans on the use of capital controls and other macro-prudential safeguards and constraints on domestic regulatory policies that limit the size of financial institutions, ban especially risky financial products or require firewalls to limit the spread of risk across financial products. In contrast, the TPP includes all of these constraints and additionally extends beyond any past U.S. FTA the grounds under which financial services firms can attack U.S. financial regulations in ISDS tribunals.

Rules that privatize public services and limit service sector regulation

Our current trade agreements limit federal, state, and local governments’ abilities to maintain essential public services, establish new ones, and to regulate services provided to consumers. These limits must be eliminated. Trade pacts must include requirements that all service providers who operate within the United States – whether those providers are domestic or foreign – comply with U.S. environmental, land use, safety, privacy, transparency, professional qualification, and consumer access laws and regulations. Trade agreements must not require the privatization of public services in any country that is a party to the agreement, limit the reversal of past privatizations, or limit the regulation of a service. They also must not subject local governments to

service sector obligations.

Constraints on government procurement policy

Corporate interests have developed a narrative that falsely equates government procurement to private sector trade. As a result, our current trade agreements typically require us to waive government procurement policies while exposing procurement rules that condition contracts on certain environmental, labor, or other practices to legal challenges. But the choices made when governments use citizens' tax dollars are policy choices determined through democratic processes and should not be constrained in trade agreements.

If Americans want their tax dollars reinvested at home when the government purchases goods, as has been U.S. "Buy American" procurement policy since the Roosevelt administration, or that workers on government construction projects be paid "prevailing" wages, as has been law for decades, then taxpayers should be free to make such determinations. This freedom is especially important during recessions, when stimulus dollars on infrastructure projects, the intent of which is clearly to boost domestic demand, may otherwise leak out in goods' purchases from other countries. Similarly, if Americans want to create a new market for an environmentally beneficial good or service (e.g., long-existing laws that require government energy purchases to include a percentage from renewable sources) or forbid contracts from being granted to firms with unacceptable human rights records (e.g., the anti-apartheid ban on procurement with South Africa), then trade agreements should not prohibit such policy choices.

The Process by Which Trade Agreements Are Negotiated Must Change

The new rules of the road proposed above represent a new model for American trade agreements that can deliver benefits for more Americans. Such ideas will not become reality without a new trade policymaking process, however. A more transparent process with opportunities for meaningful engagement, accountability and oversight by the public and Congress – rather than the current regime that privileges the commercial interests that have long captured these negotiations – is needed.

Greatly enhanced transparency

From the choice of prospective trade pact partners to the formulation of initial U.S. negotiation positions to years of back and forth on agreement texts to final trade-offs to conclude a deal, the trade agreement process is uniquely secretive and exclusive. Trade negotiators from the countries

in on the deal hammer out the agreement in private, with strict rules against releasing information or preliminary drafts to the public – including elected officials. Negotiators can meet with outside interest groups, and they do, but these groups are rarely allowed to see the agreement in progress and thus have no way of knowing if their input is heeded. In fact, the process in the United States has gotten worse over time, as in recent years trade documents have been subjected to national security classification rules. The European Union has begun publicly publishing its proposed positions on pacts when they submit them to negotiating partners, but the United States has intensified the secrecy of its trade policymaking.

This must end. At issue is not the nuclear codes but the formulation of policies that will affect the everyday lives of every American. U.S.-proposed text and then the texts of agreements after each negotiating round must be made publicly available. The argument for the current process is that, were negotiators to be more transparent, stakeholders and political bodies would constantly be challenging negotiators' decisions and they'd never make progress. But this is clearly an untenable, undemocratic position: "If the people or their congressional representatives knew what we were doing, they'd never leave us alone!"

In fact, under the maxim that sunlight is the best antiseptic, it makes far more sense to open up the process, both in terms of transparency and, equally important, who's at the table. The secretive negotiating process that has prevailed over the years has facilitated corporate capture and the hijacking of "trade" agreements to implement non-trade policies that face broad opposition. These non-trade policies have cost low- and middle-income people, thus diminishing public trust and giving rise to the current backlash against trade and trade agreements. The only way to regain the people's trust is to pull back the curtain and involve them in negotiations.

Democratic, accountable policymaking processes

Our current trade agreement policymaking process was designed in the 1970s, when trade agreements focused mainly on traditional trade matters such as cutting tariffs and opening quotas. Whether or not providing an exclusive, privileged role to commercial interests in such negotiations was a good idea then, it is not today. It has enabled wholesale corporate capture of the process and thus the morphing of "trade" agreements away from a focus on trade and towards a focus on harmful non-trade, often protectionist, policies.

During the debate over the Trade Act of 1974, some prescient policymakers cautioned against the Fast Track process for trade pact negotiations and approval, arguing that it significantly limited Congress' role in favor of the executive branch. They also contended that the system of private sector trade advisors established by the Act could lead to an erosion of democratic policymaking over a broad array of issues.

Their fears have been realized, and extensive process reform is required. Even if the scope of "trade" negotiations were refocused on actual trade expansion and the use of trade agreements to

implement other policies was stopped, as recommended in this paper, the current advisory system is indefensible. The vast majority – 85 percent according to the Washington Post – of those who gave input to our trade negotiators on the TPP were from “corporate interests and their trade associations.” The U.S. Trade Representative (USTR) response to this imbalance has been to add new committees, for instance on the environment, which are comprised of industry *and* public interest advocates. Predictably, these committees simply deadlock on recommendations while the committees focused on specific industries or issues remain corporate-dominated. Meanwhile, the detailed, worker-oriented input of the one non-corporate-dominated committee, the Labor Advisory Committee, has been systematically dismissed.

Rather than tinkering with the advisory system’s composition, we should eliminate it entirely. If proposed U.S. texts and draft texts from negotiations are made publicly available, the main official advantage of the committee system – access to that information – would disappear. Absent the committee structure, U.S. positions on trade deals can be formulated the way other U.S. federal regulation are: through the on-the-record public process established under the Administrative Procedure Act to formulate positions, obtain comment on draft texts throughout negotiations, and seek comment on proposed final texts.

We must also enact strict conflict of interest rules such that those representing an industry with an interest in negotiations are barred from serving as negotiators for at least five years after leaving their companies. Likewise, public officials should be barred from representing an industry with an interest in negotiations for a similar time period after serving as a negotiator.

Finally, the Fast Track process must be replaced. To obtain agreements that benefit a wider array of interests, we need a process that formalizes the transparency and inclusiveness of the reforms described above. That includes establishing formal criteria with which to select future negotiating partners, setting mandatory negotiating objectives based on the guidelines laid out above, and, rather than the executive branch unilaterally deciding when a “deal” is done, requiring that Congress certify that objectives are met. A congressional vote on an agreement’s text *before* it is signed and entered into is essential to ensuring an open public debate.

Conclusion

Both the process and substance of FTAs have become unacceptably non-democratic and dominated by a narrow group of corporate interests. Though it has taken decades for the fundamental injustice and inequity of this reality to achieve political salience, that has now occurred, and the results are not pretty. Many voters who have long been arrogantly dismissed by political and economic elites as simply too short-sighted to recognize their own interests are rising up against both those established elites and globalization itself.

Yet there is nothing inevitable about this version of globalization nor the current U.S. trade

agreement model. Developing countries can raise their living standards through trade with wealthier nations and advanced economies like our own *can* benefit from access to export markets and the increased supply of goods that trade *can* bring. But we will not see better outcomes unless we derive and implement a new set of rules of the road.

We have presented a blueprint for these new rules in terms of what should henceforth be in FTAs and what should never again be included, along with process reforms that conform to representative democracy. Others will have different ideas in this spirit. Our hope, especially in the context of a presidential election wherein our current FTA regime has been broadly and negatively implicated, is that these ideas begin a debate that leads to a new and very different approach to trade and globalization.

¹ Arin Dube of the *University of Massachusetts Amherst* notes that minimum wages at 50 percent of the median are in line with international practices. (Arindrajit Dube, "Hamilton Project Proposal 13: Designing Thoughtful Minimum Wage Policy at the State and Local Levels Available at http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/state_local_minimum_wage_policy_dube.pdf)

² For new cases, see eg, the case list website of the International Centre for Settlement of Investment Disputes (ICSID) at <https://icsid.worldbank.org/apps/ICSIDWEB/Pages/default.aspx>. This is not a comprehensive list of new ISDS cases. Such a list is not available because many cases remain secret, which is permitted under some ISDS arbitration venues' rules. However, ICSID provides a set of arbitration rules commonly used for ISDS cases and is the only arbitration facility that provides a public list of cases using its facility. For a sample of existing cases see Public Citizen's summary of ISDS cases against environmental, financial, health and other public interest policies organized by subject matter at <http://www.citizen.org/documents/egregious-investor-state-attacks-case-studies.pdf>.