# On the Rule-Oriented Approach to Fair Trade

*By Suzumura Kotaro*

## Introduction

There is something irresistible about colorful phrases such as free and fair competition, free and fair trade, and the international harmonization of domestic sets of rules. However, we should not succumb to the temptation of embracing these concepts uncritically. For one thing, freedom, fairness, and harmonization are multifaceted concepts, and there is a danger of discussing things in these terms amongst ourselves without realizing that we have something completely different in mind. For another, there is no guarantee that freedom and fairness are compatible, as "'freedom for the pike is death for the minnows'; the liberty of some must depend on the restraint of others".[1]

Photo : Kyodo News

*The headquarters of the World Trade Organization, Geneva, Switzerland*

It was in full awareness of these difficulties that the Sub-Committee on Unfair Trade Policies and Measures under the WTO Committee of the Industrial Structure Council embarked on the annual report on the fairness of trade policies and measures by major trading partners of Japan. Naturally, the first item on the agenda of the Sub-Committee was to make the meaning of fair trade crystal-clear and objective. The first report was made public in 1992 when the Uruguay Round negotiation, which eventually resulted in the advent of the World Trade Organization, was still under way. The basic framework of the report has remained intact ever since, and the ninth report was made public on March 31, 2000. Taking this opportunity, I would like to explain the theoretical background of the rule-oriented approach to fair trade, so-called, which is the unique feature of our report.[2] I would also like to crystalize en route what I believe is wrong with bilateralism outside the GATT/WTO regime with or without the threat of unilateral sanctions. This is a full agenda for a short paper. Let me begin without any further ado.

## What We Should Minimally Know About Competition Policy

How to distinguish the private sphere, over which private agents are free to compete with each other, from the public sphere, over which the state is within its jurisdiction to take public action by itself, or regulate the actions of private agents in accordance with public objectives, is a deep and old problem; it can be traced back to John Stuart Mill's *On Liberty*. Although Mill himself suggested a simple principle to separate these spheres, this problem does not seem warranted of any universally applicable resolution. It is no wonder that the design and implementation of fair rules of competition have been the subject of harsh dispute.

Suppose that a boundary between the private and public spheres could be somehow drawn. Even then, it does not follow that the state could be indifferent to what private agents would do within their respective private spheres; the state still has the major task of designing a fair game of competition, which private agents are entitled to play, and see to it that private agents faithfully observe their obligation of fair play. To cope with this task efficiently and effectively, competition policy authorities must

legislate competition laws, monitor and, if need be, enforce the fair play of market participants.

In contrast to this standard view of the nature and role of competition policy, according to which competition law and policy are nothing but the intangible infrastructure provided by the state to enable private agents to pursue their own objective, there is other school of thought which maintains that the role of competition law and policy is to pursue some social objectives. It should be clear that the standard view focuses on the procedural fairness of the game of free competition, whereas the alternative view focuses on the consequences of market processes judged in terms of some social objective. This sharp contrast between procedural fairness and consequentialist fairness deserves careful attention more generally.

**Procedural Fairness versus Consequentialist Fairness**

Turning to competition among trading nations, let us note the ambiguity of the concept of fair trade.

All nations participating in multilateral trade have their own idiosyncratic conception of fair trade, which embodies the nation's indigenous idea of fairness, as well as the nation's perception of the costs/benefits of free trade which reflect the stage of its economic development. These nation-specific conceptions of fair trade are reflected in multilateral negotiations in pursuit of fair rules of free trade and dispute settlement. This process of multilateral negotiations will consist of many stages of mutual persuasion and concession under pressure of limited time, imperfect information, and pressure imposed by domestic interest groups, so that the final agreement will have to be reached through piecemeal concessions at various stages of a long negotiation process. Thus, there is no reason to expect that the set of rules that are agreed to will satisfy anything like an overall consistency from the rational designer's point of view. There may well be many unexpected consequences of the ex ante agreement, which are almost impossible to foresee. Therefore, we should be ready to observe that the agreed set of rules may bring about consequences which some trading nations may find unfair ex post. This is the crucial point where two contrasting stances on fair trade surface.

According to the first results-oriented stance on fair trade, trading nations are not bound by ex ante agreement when the consequential outcomes which result from the agreed set of rules turn out to be ex post unfair, where judgements on ex post unfairness are made in terms of some results-oriented criteria of their own. In contrast, the second rule-oriented stance on fair trade takes the ex ante commitment to the agreed set of rules far more seriously, and does not automatically endorse the legitimacy of ex post resistance to ex ante agreement. Those who adopt this rule-oriented stance on fair trade emphasize that the results-oriented criteria are arbitrary, and should be given no legitimacy in the GATT/WTO regime.

Several remarks on the contrast between these two stances on fair trade are necessary.

Firstly, the dual conceptions of fairness, viz., the obligation of fair play and the design and implementation of fair game, can be invoked in the present context. According to this point of view, member nations of the GATT/WTO regime are bound by the following dual obligations: (1) To agree on the set of rules is an ex ante commitment, and it is an outright infringement of the obligation of fair play if, due to the unfavorable consequences of the agreement, any member nation refuses to comply with the outcomes of the trade game; any complaint about the outcomes of trade should be processed, not by any bilateral mechanism (with or without the pressure of unilateral sanctions), but by the multilateral dispute settlement mechanism within the agreed set of rules; (2) Once it is revealed that complaints made by any player(s) on the outcomes of the game are attributable to the intrinsic defect of the prevailing set of rules, rather than to the failure or negligence of the complaining player(s) or to an infringement on the agreed set of rules by other player(s), all member nations are obliged to take prompt and appropriate action towards rectifying the lack of fairness in the prevailing set of rules; they can do this by redesigning the fair game of trade and dispute settlement. The rule-oriented stance on fair trade accepts not only the primary obligation of fair play, but also the secondary obligation of re-designing the fair game of trade if the prevailing set of rules is demonstrated to lack legitimacy.

Secondly, the reason why the rule-oriented stance requires GATT/WTO member nations to comply with an agreed set of rules is that it is the only way to help ensure enforcement of the agreed-on set of rules; the exercise of benign neglect toward any resistance towards an agreed set of rules will not only disrupt the spirit of fair play, but also worsen any reliance on such a set of rules. Likewise, any modification of an agreed set of rules is legitimate only when it is made through multilateral negotiations and agreement. The rule-oriented stance on fair trade is not one which ignores the consequences of trade altogether, or one which rigidly insists on the agreed set of rules uncompromisingly. In contrast, the results-oriented and unilateral stance on fair trade is deeply problematic, as it justifies resistance to the agreed set of rules, as well as the denial of the enforceability of the agreed set of rules, when the results of the game are found disadvantageous to the subject nation in terms of unilaterally defined criteria.

Thirdly, the insidious nature of the results-oriented stance on fair trade is worthwhile to pinpoint, which may go as follows: (1) It judges the fairness or unfairness of outcomes on a particular nation's standard, which has no basis in the agreed set of rules. In this sense, it lacks objectivity, and represents a pretentious, self-righteous, and defensive approach; (2) It focuses exclusively on the results and makes

Photo : AP/WWP

*President Clinton signed the General Agreement on Tariffs and Trade (GATT) about the establishment of the WTO in 1994*

backward inference to the fairness or unfairness of trade policies and measures taken by trading partners. Thus, a nation's trade policies and measures are deemed unfair if they co-exist with the results of trade that is deemed unfair even when there exists no causal link between the trade policies and measures in question and the disadvantageous results of trade; (3) There is a clear danger that the results-oriented stance on fair trade may pave the way toward managed trade, which is diametrically opposite to free and fair trade, no matter how the latter concept is defined; (4) It requires equality in consequence rather than equality in opportunity. As such, it may deprive the competitive mechanism of many outstanding functions such as (a) the efficient allocator of scarce resources, (b) the incentive mechanism for introducing innovations, and (c) the Hayekian discovery procedure.[3] In order for the market mechanism to function effectively, private agents should be assured of equal opportunity, of which they may make use at their own risk and on their own reponsibility, rather than being assured of equal consequences irrespective of what they endeavour.

**What's Wrong With Bilateralism in the Multilateral World?**

I now want to pinpoint the reason(s) why I think the bilateral dispute settlement procedure outside the GATT/WTO regime with or without the threat of unilateral sanctions is wrong. Note that there are two basic methods which we may use to evaluate the performance of an economic system. The first consequentialist method evaluates the performance of an economic system favorably or unfavorably according to whether its consequences are good or bad. The second non-consequentialist method does not confine attention exclusively to the consequences of an economic system; it assesses the performance thereof by paying due attention to its non-consequential features such as procedural fairness and opportunity for choice, which lie behind the actual consequences. A special class of the non-consequentialist method that judges the performance of an economic system exclusively in terms of the intrinsic value of its procedural characteristics in neglect of its consequences is called the deontological method of evaluation. The traditional method of evaluation, called welfarist-consequentialism and used extensively in the standard welfare economics, is a special case of the consequentialist method, where the assessment of consequences is made exclusively in terms of people's welfare. Although it is less familiar among economists, the non-consequentialist method has much to recommend itself in assessing alternative economic systems.[4] To bring this point home, a look at the following domestic example may be useful.

***An Example of Cake Division***: A father is to divide a homogeneous cake fairly among his three daughters. In Method I, the father divides this cake into three equal pieces, and tells his daughters to take a piece each, or leave it altogether. In Method II, the three daughters are offered an opportunity to discuss how the cake should be divided fairly amongst themselves, and cut it into three pieces in accordance with their decision. If they happen to agree that an egalitarian division should be the fairest outcome, and if we are told only of the consequences of this cake division, we cannot but conclude that these two methods of division are the same. It should be clear, however, that this identification is completely wrong. Indeed, in Method I, the daughters do not have the right to participate in the process through which their distributive shares are determined, whereas in Method II, they have autonomous rights of participation. This crucial aspect will have to be left uncaptured if we focus only on the consequences of cake division.

The moral of this example is that the consequentialist method of evaluation loses sight of some important attributes of an economic system such as respect for individual rights or procedural fairness because of its preoccupation with consequences.

These alternative methods of evaluation allow us to identify several distinct assessments of the bilateral dispute settlement mechanism outside the GATT/WTO regime. The first

assessment, which is deontological in nature, emphasizes that such a method is a clear infringement of the GATT/WTO rules, which should be resisted at all costs as an obligation of "fair play" irrespective of whether or not the consequences of bilateral agreements are favourable. The threat of unilateral sanctions which lurk behind further strengthens the appeal of this deontological assessment. The second assessment, which is consequentialist in nature, emphasizes that favourable consequences which result from such a mechanism will not only benefit the subject nations in negotiation, but also the benefits thereof will diffuse to all other member nations due to the principle of most-favoured-nation treatment. An infringement of the GATT/WTO rules notwithstanding, it is claimed, the bilateral dispute settlement mechanism serves us well after all. Note, however, that the third parties affected by a bilateral agreement are excluded from the process through which such agreements are designed and implemented. Those nations which are thus excluded from the process of bilateral negotiations may feel so strongly about this exclusion that the diffused benefits may fail to compensate for the loss due to the procedural unfairness of the bilateral mechanism. Hence the importance of the procedural viewpoint.

### To What Extent Should We Harmonize Domestic Rules?

The international harmonization of domestic rules requires that the domestic rules of the game prevailing in nation A must be in basic harmony with those prevailing in nation B. It has no root in the two basic principles of the GATT/WTO regime, viz., the principle of most favoured-nation treatment and the principle of national treatment. Note that the first principle requires the member nations to accord the most favourable tariff and regulatory treatment, given to the product of any one nation, to all other member nations at the time of import or export of like products, and the second principle requires member nations not to accord any discriminatory treatment between imports and like domestic products. As far as the same domestic rules are applied indiscriminatingly by each member nation to domestic and foreign agents, and to domestic and imported products, there is no outright infringement of the two basic principles of the GATT/WTO regime. Why, then, don't we retain the domestic rules of the game and leave things to be settled by international competition among alternative economic institutions? What is wrong with this mutual recognition approach?

Even when we agree that the international harmonization of domestic rules is necessary in some areas such as the implementation of competition policies, there are two approaches we may choose from. The first approach, to be called the big-bang approach, is that of designing and implementing a new international set of rules once and for all. The second approach, to be called the piecemeal approach, avoids a radical switch and allows idiosyncratic domestic rules to survive and adapt over time. If we adopt this second approach, we need to implement the interface mechanism which allows different domestic rules of the game to function together harmoniously.

My personal belief is that there are legitimate reasons to call for the international harmonization of domestic rules in some areas such as the implementation of competition policies rather than to acquiesce in the mutual recognition approach, but the radical convergence to the so-called global standard is neither obligatory nor efficient. In other words, there is essentially no real alternative to the sensible piecemeal approach with the deliberately designed interface mechanism between different economic institutions.

### Concluding Remarks

As I recollect it, what I described in this essay underlies the conceptual framework of the annual report of the Sub-Committee on Unfair Trade Policies and Measures. It flatly rejects the results-oriented stance on fair trade; it emphasizes procedural fairness rather than consequentialist fairness; it resists the imposition of the hegemonic nation's domestic set of rules, but it clearly recognizes the need for deliberate design of the interface mechanism between different economic institutions. I hope that the message of the report will be carefully examined by those who are in the position to decide on the nation's trade policy in the globalized world economy.

### Footnotes

1 Berlin, I., *Four Essays on Liberty,* Oxford: Oxford University Press, 1969, p.124.

2 Throughout the last nine years, I have been a member of the Sub-Committee and participated in the design and evolution of the rule-oriented approach to fair trade. Although I owe a lot to the members of the Sub-Committee for factual as well as conceptual clarifications, this essay is my personal account of what underlies the annual report of the Sub-Committee, and it does not represent the official view of the Industrial Structure Council.

3 Hayek, F. A., "Competition as a Discovery Procedure," in his *New Studies in Philosophy, Politics, Economics and the History of Ideas,* London: Routledge & Kegan Paul, 1978, pp.179-190.

4 For further clarifications, those who are interested are referred to Suzumura, K., "Welfare Economics Beyond Welfarist-Consequentialism", *Japanese Economic Review,* Vol.51, 2000, pp.1-32. JJTI

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