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Are World Trading Rules Passé?

*Sungjoon Cho and Claire R. Kelly**

ABSTRACT

This Article probes previously under-explored failure of the world trading rules to keep abreast with the global marketplace. It argues that the global trading system, despite its well-documented contribution to the spectacular expansion of postwar trade, has never in fact fully moved away from the mercantilist past; its mono-linear conception of production and trading patterns; and its state centric, top-down paradigm of rule making. The inevitable anachronism precipitated by the out of date trading rules structure is seriously ill-suited to the contemporary non-territorial international business transactions defined by global supply chains. Consequently, while the trading rules officially seek to help facilitate trade consistent with the theory of comparative advantage, they often entail diametrically opposite effects, i.e., clogging the arteries of global commerce. The Article concludes that burgeoning "trade networks" can offer an answer to these problems as these networks vigorously co-opt relevant epistemic communities and devise practical tools to confront the complex challenges faced by global businesses nowadays.

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INTRODUCTION

This Article probes the under-explored failure of the world trading rules to keep abreast with the global marketplace. It argues that certain trade rules are out of date, and the means of updating them are out of date as well. Three factors, *inter alia*, have led to this impasse: persistent mercantilism; unacknowledged changing global trade patterns; and a rigid (top-down) negotiation process for trade rules. As a response to this flaw, we propose that trading nations mobilize regulatory networks to help the trade regime keep pace with practical realities. Network actors can work across issue areas and play a needed problem-solving role to confront complex trade barriers.

First, while the postwar trade rules embraced the principle of comparative advantage, they did not fully implement it. In other words, the Bretton Woods architects, in order to transition from a mercantilist system, adopted rules which preserved that mercantilist system, at least to some extent.[1] States did not relinquish primarily protectionist stances vis-à-vis each other but agreed to lower levels of protection through negotiations over time.[2] The transition to free trade has never been fully completed. True, trade is more open and fewer barriers now exist than the interwar period. Nonetheless, the current system is still a *managed* trade system[3] with a *quid-pro-quo* negotiation structure that pits one party against

[1] Sanford Gaines, *The WTO's Reading of the Gatt Article XX Chapeau: A Disguised Restriction on Environmental Measures*, 22 U. PA. J. INT'L ECON. L. 739, 833 (2001) (stating that the "principal function of the GATT" was to "preserve the basic principles and to further the objectives underlying this multilateral trading system").

[2] *Id.* ("The GATT is replete with qualifications and exceptions that soften the effect or limit the reach of even its central tenets.")

[3] Robert Howse, *From Politics to Technocracy--and Back Again: The Fate of the Multilateral Trading Regime*, 96 AM. J. INT'L L. 94, 97(2002).

another.[4]

Second, the underlying logic of trade rules developed under the old General Agreement on Tariffs and Trade (GATT) and the current World Trade Organization (WTO) was based upon single country production, a "mono-location production" model of trading patterns, while the contemporary equivalent is by far more complex as it involves value-added production in multiple countries, *i.e.,* a "multi-location production" model.[5] Until relatively recently, most products were harvested or manufactured entirely in a single country and shipped to another country.[6] Wheat was produced in Argentina and shipped to England as if Argentina exported and England imported. Under this unsophisticated trading paradigm, trade policies were prone to capture by domestic producers as trading nations competed against each other to maximize net exports (exports minus imports). Now, the old trade-production model has increasingly become unsustainable with the advent of new trade realities, such as the global factory. For example, Indian textiles may be shipped to China, turned into clothes and eventually exported to the U.S. Recent technological innovations and other logistic breakthroughs have facilitated this new trend. In this new production/trade pattern, global business is "non-territorial, de-centralized yet integrated space-of-flows, operating in real time"![7] Here, private businesses, not states, are main players. In fact, it is now against any trading nation's interest for whatever reasons – be it a financial crisis or a mercantilist trade policy – to disrupt these tightly-knitted global supply chains.[8] While the global business has acknowledged these changing

[4] Daniel Ikenson, *Made on Earth, How Global Economic Integration Renders Trade Policy Obsolete*, CATO INSTITUTE, TRADE POLICY ANALYSIS NO. 42 at 9 (December 2, 2009), *available at* http://www.cato.org/publications/trade-policy-analysis/made-earth-how-global-economic-integration-renders-trade-policy-obsolete.

[5] *See Made in the World*, WTO, http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm (last visited Feb. 20, 2012); *see* Paul R. Krugman, *The Move Towards Free Trade Zones, in Policy Implications of Trade and Currency Zones*, *available at* http://www.kansascityfed.org/publicat/sympos/1991/S91krugm.pdf (as part of a symposium, *Policy Implications of Trade and Currency Zones*, sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming on Aug. 22–24, 1991).

[6] *Id.*

[7] John Gerard Ruggie, *Territoriality and Beyond: Problematizing Modernity in International Relations*, 47 INT'L ORG. 139, 157 (1993); Sungjoon Cho, *Linkage of Free Trade and Social Regulation: Moving beyond the Entropic Dilemma*, 5 Chi. J. Int'l L. 625, 667 n.187 (2005).

[8] Fredrik Erixon, *The Twilight of Soft Mercantilism: Europe and Foreign Economic Power Conference Paper* 3 (Beijing, July 2009) (observing that serious disruptions of global commerce based on dense production networks tend to threaten economic welfare of

patterns, the trade rules have *not*.

Third, the framers of the Bretton Woods system (and subsequently the WTO architects) relied predominantly upon a state-centric, top-down, treaty-based system to navigate their way out of their mercantilist past. At the time, this choice made sense. The system generated formal rules negotiated among states and committed to in a hard law (treaty) instrument.[9] The adoption of a treaty-based regime made it easy to identify cheaters.[10] State-to-state negotiation also aligned well with the old single-country production mode of trade: it was relatively easy to barter market access in the form of tariff concessions under the old trade pattern. However, this top-down system now struggles to address the complex problems that stem from trade driven less by the titular "national" interest, but more by diffused, diverse interests of individual global economic players located all over the world.[11]

These three factors combine to create a system that officially claims to embrace free trade, yet still pits one political interest against another in a quest to seize protectionist rents.[12] In other words, powerful lobbies, such as domestic producers, capture trade negotiators and replace national interests with those of their own. They have every incentive to maintain managed trade and use the rules for their benefit.[13] Finally, even where there is a desire to streamline the trade rules or eliminate barriers to trade, the system of changing the trade rules based on a state-to-state framework is out of touch, cumbersome and easily manipulated.[14]

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trading nations).

[9] *See* Chris Brummer, *How International Financial Law Works (And How It Doesn't)*, 99 GEO. L.J. 257, 261 (2011).

[10] *Id.*

[11] *See, e.g.*, Richard Eglin, *The Doha Round Negotiations on Trade Facilitation in The Global Enabling Trade Report 2008*, 2008 WORLD ECONOMIC FORUM, *available at* https://members.weforum.org/pdf/GETR08/Chap%201.2_The%20Doha%20Round%20Negotiations%20on%20Trade%20Facilitation.pdf (discussing the need to address transaction costs that are imposed on international trade by poor-quality border management and logistics).

[12] The preamble of GATT 1947 describes "the substantial reduction of tariffs and other barriers to trade" as a purpose of the agreement while Article XXVIII bis lays out the broad scope of a Contracting Party's power to negotiate tariff concessions individually, stating that the "varying needs of individual contracting parties are of great importance . . . ." General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11 at pmbl. & art. XXVIII bis, 55 U.N.T.S. 194 [hereinafter GATT].

[13] *See* Brummer, *supra* note 9, at 282.

[14] Dr. Arie Reich, *From Diplomacy to Law: The Juridicization of International Trade Relations*, 17 NW. J. INT'L L. & BUS. 775, 776 (1997) (stating that the elimination of trade

In response, this Article offers a new insight on the global trading system. The Article questions the traditional state-centered paradigm on trade. While not entirely debunking the conventional paradigm, it nonetheless argues in favor of bottom-up solutions to some of vexing trade problems, in particular those related to customs regulation. Trade networks formed among issue-specific professionals who work on a variety of trade problems can offer assistance. Trade networks will be a *hybrid* of public and private networks composed of customs officials, transnational businesses, practitioners, and policy makers. Based on shared knowledge and beliefs on particular technical issues, these networkers may generate certain regulatory prototypes (soft law) that can both reflect and guide their future behaviors in this area. In the long-term, these network activities may even pave groundwork for future treaty amendments.[15]

To substantiate our argument, we submit two empirical confirmations for trade networks. First we explore the network actors who have coalesced around the related-party "transfer pricing" problem. For at least 20 years, customs and tax lawyers have confronted complex and costly customs and tax regulations that prescribe contradictory rules for the exact *same* transfer of goods between related companies.[16] These practitioners have formed various networks in which they have attempted to concoct practical solutions to this problem at multiple national venues as well as the Organization for Economic Co-operation and Development (OECD) and the World Customs Organization (WCO). Second, we look at the nascent trade networks in the recent initiatives on the reform of "trade statistics." In conjunction with like-minded academia and other international organizations, the WTO has recently launched a powerful campaign to reform the conventional way of formulating trade statistics that has failed to reflect contemporary global production/trade patterns.[17]

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barriers comes in the form of individual compromise and that internal political interests tend to weaken and exploit the system).

[15] *See* Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 Va. J. Intl. L. 1, 92 (2002).

[16] In the United States for example Section 1059A of the Internal Revenue Code has since 1986 restricted businesses from declaring a greater basis or inventory cost for merchandise than was declared for the purpose of customs valuation. I.R.C. § 1059A (1986).

[17] *See "Made in the World" Initiative: Lamy suggests "trade-in value" as a better measurement of world trade*, WTO.ORG (June 6, 2012) [hereinafter *Made in the World*], *available at* http://www.wto.org/english/news_e/news11_e/miwi_06jun11_e.htm.

Our thesis on trade anachronism and a proposed remedy proceeds in the following sequence. Part I examines three sources of trade anachronism that now combine to hamper meaningful progress towards truly free trade. First, it outlines the rules of managed trade tracing back to the Bretton Woods architects. The architects needed these rules to manage gradual trade liberalization negotiated amongst countries. The rules at their core reflected and preserved a mercantilist system that basically favors export over import. Part I then recounts the drastic shift in trading patterns and global integration that has lead to production fragmentation since 1945. Finally, it describes the traditional preference for a top-down, treaty-based approach to trade rules. Part II then documents how these three factors (managed trade, the unacknowledged shift in trading patterns, and a top-down negotiation process) combine to exert mounting tolls within the global trading system, in particular private businesses, drawing on practical dilemmas involving such issues as valuation and country of origin rules.

Part III proposes a modest yet workable solution. It notes that while any amendments of the current trading rules (*i.e.,* the WTO agreements) are unlikely, the emergence of trade networks can at least alleviate some of the paralysis caused by trade anachronism. The article concludes that trade networks may signify a new way of approaching international trade. They might supply a new mode of conceptualizing trade by breaking the artificially defined disciplinary divide between international trade law as embodied in the state centered top-down rules of trade, and the business level solutions which emerge from epistemic communities trying to find practical tools to confront complex problems. If we were able to break the divide between the state level and business level actors in the trade arena, perhaps we could envision a new way of thinking about international law. Part IV concludes by analyzing where trade networks might thrive as useful supplements to the treaty negotiation processes dominating the current trade regime.

Finally, some words of caution are in order. First of all, this Article does not argue that the current customs rules are obsolete in their entirety. One might surmise that the current rules are reasonably effective given that the global trade volume is ever-increasing. What the Article does contend is that a certain normative tension nonetheless exists around the new trade reality, such as global supply chains, due to the anachronism precipitated by the mercantilist legacy within the trading system. Moreover, the Article harbors no illusion on the prospects of trade networks. It acknowledges that

this novel concept still awaits a rigorous theoretical and empirical scrutiny both on its efficacy and legitimacy. As is widely documents, the network phenomenon, old and new, is not without controversies.[18] At the same time, however, the trade networks deserve a serious opportunity of being considered as a policy option to address what the conventional bargaining model is incapable of tackling. The initial success of networking within the context of G20 tends to support the position that this Article takes.[19]

I. THREE SOURCES OF TRADE ANACHRONISM

While the Bretton Woods architects rejected mercantilist policies, they could not step away from them completely and immediately. Mercantilism's goal of expanding national wealth by encouraging exports protected domestic industries.[20] Although the Great Depression proved this goal a flawed one, the protection afforded to domestic industries with political power would not be easily relinquished. Truly, trading nations could not execute free trade in an instant; they had to negotiate it incrementally.[21] The GATT provided the framework to negotiate and monitor compliance, but the negotiation itself was a vestige of mercantilism. Each country held onto its protection until it got something in return.[22] States could easily trade "concessions," i.e., the lessening of protection, in part, because trade was fairly linear, products moved from one country to another. But countries no longer trade goods per se; they instead trade *tasks*.[23] Vertical integration, global sourcing, cross-border investment and technological innovation combine to create very different trading patterns than those that existed in 1945.[24] Rules tethered to the

[18] Sungjoon Cho & Claire R. Kelly, *Promises and Perils of New Global Governance: A Case of the G20*, 12 CHI. J. INT'L L. 491, 501–05 (2012).

[19] *Id.* at 516-26 (2012) (discussing the network coordination of the G20).

[20] Lars G. Magnusson, *Mercantilism*, *in* A COMPANION TO THE HISTORY OF ECONOMIC THOUGHT 46–47 (Warren J. Samuels, Jeff E. Biddle & John B. Davis eds., Blackwell Publishing Ltd., 2003).

[21] CHAD P. BROWN, SELF-ENFORCING TRADE: DEVELOPING COUNTRIES AND WTO DISPUTE SETTLEMENT 12–13 (Brookings Institute Press, 2009) (listing the various rounds of negotiation under GATT and depicting the increasing number of countries and subjects covered at each round).

[22] *Id.* at 13 (countries used the political trade-off between extending market access abroad for exporting industries and increased market access granted at home to foreign industries and thus losses to those industries competing against these imports).

[23] GENE M. GROSSMAN & ESTEBAN TOSSI-HANSBERG, *Trading Tasks: A Simple Theory of Offshoring*, *in* AMERICAN ECONOMIC REVIEW, 1978–1997, 1978 (December 2008); *see also Made in the World, supra* note 17.

[24] Ikenson, *supra* note 4, at 5.

1945 trading patterns are a leftover from mercantilist times. Finally, the global trading regime established a structure to work itself out of managed trade to free trade. That structure was necessarily a state-centered, treaty-based structure. It consisted of rules that bound states to the negotiate bargain they had made. But that bargain, as already indicated, was a mercantilist bargain, and the system of binding states is to some extent a remnant of that age as well.

A. Mercantilist Tools in Pursuit of Free Trade

In its original meaning, mercantilism refers to a set of trade policy doctrines pervasive throughout Europe mostly in the 17th and the 18th century.[25] Its basic tenets are as follows: (1) a state must expand its national wealth, and eventually its power,[26] by controlling its trade balance ("Exportation is gain, but all Commodities Imported is loss.")[27]; (2) to discourage imports, a state must protect domestic producers from foreign competition via tariffs and quotas; (3) to increase the volume of exports, a state must subsidize domestic producers; (4) a state may increase its exports only at the expense of another state; and (5) to cultivate colonies is important since they provide both raw materials for production and export markets.[28]

From today's vantage point, one need not labor to expose mercantilism's flaws. [29] The fundamental flaw in the mercantilist theory

[25] Magnusson, *supra* note 20, at 46.

[26] Lars Magnusson, *Eli Heckscher and His Mercantilism Today*, *in* ELI HECKSCHER, INTERNATIONAL TRADE, AND ECONOMIC HISTORY 234 (Ronald Findlay et al. eds. 2006) [hereinafter ECONOMIC HISTORY] (submitting that the ultimate goal of mercantilism was to maximize the state power).

[27] "The Wealth of every Nation consist[s] chiefly in the share which they have in the Foreign Trade with the whole Commercial World." CAREW REYNELL, A NECESSARY COMPANION OR, THE ENGLISH INTEREST DISCOVERED AND PROMOTED 12 (1685) (quoted in DOUGLAS A. IRWIN, MERCANTILISM: POWER AND PLENTY THROUGH THE LENS OF STRATEGIC TRADE POLICY, *in* ECONOMIC HISTORY, supra note 26, at 252).

[28] James Scott, *Mercantilism, in* ENCYCLOPEDIA OF GOVERNANCE 560–61 (Mark Bevir ed., SAGE 2006).

[29] Historically, the rise of mercantilism overlapped with that of the centralized and bureaucratized nation state. Mercantilist policies were essential to absolute monarchs who desperately needed money to secure their armies and officials. It was no coincidence that the French Finance Minister Jean-Baptiste Colbert espoused mercantilism. Since the ultimate goal of mercantilism was to augment the national power and in particular, colonies were instrumental to mercantilism, mercantilist states were destined to clash with each other ("All trade [is] a kind of warfare."). ECONOMIC HISTORY, *supra* note 26, at 254 (quoting Josiah Child). Beyond a historical fact, this Hobbesian character embedded in

was that trade was a *zero*-sum game. Mercantilists saw wealth as finite. There were winners and losers. They failed to recognize that restricting trade in an attempt to export more and import less actually impeded wealth. If wealth brings power, adopting mercantilist policies leads to less, not more, power. Trade in fact is a *positive*-sum game.[30] Adam Smith, David Ricardo and others clearly showed that free trade could increase wealth for all countries involved.[31] By the end of the eighteenth century mercantilist doctrine was in decline.[32]

Then, the tragic collapse of the New York stock market in 1929 heralded the Great Depression.[33] Desperate to escape the unprecedented economic misery, the United States' government under the Hoover administration, despite the unified protest of more than 1,000 economists, passed the infamous Smoot-Hawley Act of 1930.[34] As a striking reincarnation of mercantilism, the Act raised the import duties of more than

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mercantilism is a source for a perennial risk of international conflicts. Malmgren, *supra* note, at 143 (observing that "neo-mercantilism will be its scourge, driving nations into international conflicts"). One might state that mercantilism is destined to generate conflicts since all economies could not maintain a trade surplus simultaneously. *See* Paolo Guerrieri & Pier Carlo Padoan, *Neomercantilism and International Economic Stability*, 40 Int'l Org. 29, 33 (1986); *see also* Howard W. Barnes, *The Roots of Neo-Mercantilism* (Center for International Business Education and Research, Working Paper No. 999, 1992) (arguing that mercantilism is not so much a historical incidence as the "motives" of domestic producers and regulators).

[30] *See* Sungjoon Cho, *Trade Is Not about Winners and Losers*, FIN. TIMES, Mar. 23, 2012 (observing that every participant in the project of global trade could potentially be a winner).

[31] Robert Howse, *The Boundaries of the WTO: From Politics to Technocracy--and Back Again: The Fate of the Multilateral Trading Regime*, 96 AM. J. INT'L. L. 94, 94 (Jose E. Alvarez ed., 2002) ("[T]he modern idea of free trade originates from the theories of absolute and comparative advantage developed by the classical political economists, Adam Smith and David Ricardo. . . . . They concluded that, with some qualifications or exceptions, a policy of liberalizing restrictions on imports would maximize the wealth of that sovereign.").

[32] Nonetheless, mercantilist policies subsequently re-emerged from time to time. The British Corn Law of 1815 reflected such recidivism. By the early twentieth century the mercantilist sentiment had faded into the background. The "roaring Twenties" seemed to usher in a new era of prosperity. It was in this period that the modern prototype of globalization had manifested itself. Global trade expanded dramatically and world business events, such as the Paris Exposition of 1925, represented the triumphant spirit of world capitalism. Angus Maddison, *Monitoring the world economy, 1820-1992* (Development Centre of the Organization for Economic Co-operation and Development 1995).

[33] *See generally* JOHN A. GARRATY, THE GREAT DEPRESSION (1986).

[34] Judith Goldstein, *Ideas, Institutions, and American Trade Policy*, 42 INT'L ORG. 179, 179(1988).

20,000 items[35] and immediately invited reciprocal measures from major trading partners, starting from the United Kingdom.[36] The spiral effect of economic balkanization was indescribable: the world trade had been shrunk by three-thirds.[37] Furthermore, economic miseries bred totalitarianism and eventually led to the Second World War.[38]

The mercantilist battle in the interwar period and its tragic consequences provided trading nations, in particular the Allies, a moment of enlightenment, which is similar to that emerging among the Founding Fathers after the collapse of the Articles of Confederation.[39] Based on a Kantian proposition that free trade brings world peace,[40] the Allies created the archetype of the modern global trading system, i.e., GATT with a view to "raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand."[41] The GATT, as a sovereign contract, was to monitor the tariff reduction negotiations and more importantly ensure that the result of these negotiations (tariff concessions) would be preserved.[42] In other words, GATT contracting parties aimed to prevent enhanced market access from being neutralized by subsequent government measures of importing countries.

Ironically, however, the GATT in its very architecture betrayed a mercantilist nature despite its ostensible anti-mercantilist (trade liberalization) mission. First of all, contracting parties' way to fight

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[35] *See* FRANK W. TAUSSIG, THE TARIFF HISTORY OF THE UNITED STATES 498-500 (1931).

[36] DOUGLAS A. IRWIN, PEDDLING PROTECTIONISM: SMOOT–HAWLEY AND THE GREAT DEPRESSION (2011).

[37] Edward C. Luck, *American Exceptionalism and International Organization: Lessons from the 1990s*, *in* U.S. HEGEMONY AND INTERNATIONAL ORGANIZATIONS: THE UNITED STATES AND MULTILATERAL INSTITUTIONS 25, 39 (Rosemary Foot et al. eds., 2003) (quoting remarks by the former U.S. Trade Representative Charlene Barshefsky on the U.S. trade policy and the WTO on Mar. 2, 2000).

[38] *Id*.

[39] LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 1044 (3d ed., vol. 1, 2000).

[40] Immanuel Kant, *Perpetual Peace: A Philosophical Sketch (1795)*, *in* KANT'S POLITICAL WRITINGS 93, 114 (Hans Reiss ed., H.B. Nisbet trans., 2d ed. 1991); *see also* Fernando R. Tesón, *The Kantian Theory of International Law*, 92 COLUM. L. REV. 53, 76-7 (1992) (observing that "Kant's views have been confirmed by the success of the European Economic Community and even by the global system of international trade regulated by GATT and similar institutions").

[41] GATT, *supra* note 12, at pmbl.

[42] Robert E. Hudec, *The GATT Legal System: A Diplomat's Jurisprudence*, 4 J. WORLD TRADE L. 615, 624 (1970).

mercantilism, *i.e.,* reduce trade barriers (tariffs), was in fact driven by mercantilist considerations. Tariff reduction negotiations were based on reciprocal bargains: Country A would cut its own tariffs on goods that Country B exports to have the latter cut its tariff on goods that the former exports. In other words, each country's market opening (tariff concession) is a price that the country pays to gain its own market access to its trading partner. Under these circumstances, each trading nation is most eager to minimize its tariff concessions (cost) and maximize its market access (benefit). A good negotiator would have his or her counterparts promise to cut more tariffs while he or she offers little in return. In sum, exports are virtue and imports vice. This starkly mirrors the mercantilist past.[43]

The GATT also provided its contracting parties a legal mechanism to monitor cheating – discriminatory government measures – that would subsequently neutralize hard-fought tariff concessions. For example, an importing country could effectively undermine its earlier concession to cut its tariffs on a certain product by erecting a new import ban on that product for whatever regulatory reasons. The GATT via its legal obligations, such as the National Treatment principle,[44] would prevent such trade restrictions from eroding the value of earlier tariff concessions.[45] In this sense, legal obligations under the GATT existed as tools to preserve and facilitate tariff negotiations.[46] Without these safeguards, few incentives would have

[43] Of course, multilateralism symbolized by the Most-Favored Nation (MFN) principle tends to mitigate the mercantilist nature of reciprocal bargains. Even though WTO members initially conduct reciprocal bargains for tariff reduction on a bilateral basis, the outcome (tariff cuts) of such bargains is multilateralized "immediately and unconditionally" under GATT Article I. Therefore, any enhanced market access due to reciprocal bargains is to be shared with the rest of WTO members that were not parties of the original (bilateral) bargains. Nonetheless, the value of such newly created market access might be highest to the original bargainer since that member would not have initiated the bargain in the first place had the member had no interest in that particular market access. In other words, the new market access might not be so valuable to other WTO members absent in the original bargain, at least in the short-term. To this extent, the logic of tariff negotiations still remains mercantilist. Without mercantilism, most WTO members could have reduced or eliminated their tariffs unilaterally without any negotiations.

[44] GATT, *supra* note 12, at art. III.

[45] *See* Report of the Panel, *ECC – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins,* ¶ 148, L/6627 (January 25, 1990), GATT B.I.S.D. (37th Supp.) at 86 [hereinafter *ECC Oilseeds*]; *see also* Report of the Panel, *United States – Taxes on Petroleum and Certain Imported Substances*, ¶ 5.1.9, L/6175 (adopted 17 June 1987), GATT B.I.S.D. (34th Supp.) at 34S/136 (1988).

[46] *Id.* (stating that if no legal right to redress were given then parties would be reluctant to make tariff concessions).

existed to continue tariff reduction negotiations. Therefore, if a contracting party (importing country) were ever accused of cheating, a complaining party (exporting country) would demonstrate the existence of damages, i.e., the loss of the latter's market access that had been guaranteed at the time of tariff negotiation.[47] Just as a private contract, a complainant was supposed to prove the existence of damages in addition to a defendant's breach of certain terms.[48] Under the GATT, those damages were the so-called "nullification or impairments"[49] of benefits accruing to the complainant from tariff concessions.[50] In fact, the breach part, i.e., a violation of certain GATT obligations, was so marginalized that under certain circumstances even no violation could still entitle the complainant with compensation from the defendant if the former could prove the existence of damages (nullification or impairment).[51]

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[47] *See* Report of the Panel, *Japan – Measures Affecting Consumer Photographic Film and Paper,* ¶ 10.82, WT/DS44/R (adopted April 22, 1998) (explaining that one element of a claim for nullification or impairment is that the benefit of market access in the form of tariff concessions is upset by the counterparty).

[48] *Id.* The report further explains that "it is up to the United States [complainant] to prove that the . . . measures that it cites have upset the competitive relationship . . . ." There must be a "clear correlation between the measures and the adverse effect . . . ." *Id.*

[49] GATT, *supra* note 12, at art. XXIII.

[50] *See e.g.*, Report of the Panel, *Italian Discrimination against Imported Agricultural Machinery*, Oct. 23, 1958, GATT B.I.S.D. (7th Supp.) at 60, ¶ 17, 20 (1959) [WTO Doc. Symbol BISD/75/60]. In this case, the panel focused on "whether the operation of Law No. 949 had *caused injury to United Kingdom commercial interests*, and whether such an injury represented *an impairment of the benefits* accruing to the United Kingdom under the General Agreement." *Id.* ¶ 17 (emphasis added). The panel recommended that Italy should eliminate the "adverse effects" which Law No. 949 had caused to the UK. *Id.* ¶ 20.

[51] *See generally* Sungjoon Cho, *GATT Non-Violation Issues in the WTO Framework: Are They the Achilles' Heel of the Dispute Settlement Process?*, 39 HARV. INT'L L.J. 311 (1998) (discussing and critiquing non-violation provisions of GATT/WTO dispute settlement system). *See also* Sungjoon Cho, *The Nature of Remedies in International Trade Law*, 65 U. PITT. L. REV. 763, 766-67 (2004) (discussing the multilateral trading system (GATT/WTO)'s institutional evolution from a negotiated contract to a legalized regime). GATT dispute panels fossilized this "nullification or impairment" requirement by presuming its existence (nullification or impairment) in case of a violation. Thus, when a complainant establishes that a defendant violated a GATT provision, the former need not demonstrate separately that such violation also nullified or impaired its benefits accruing from the GATT. Nonetheless, the mercantilist relic of nullification or impairment re-surfaces at a later stage of dispute resolution. Suppose that the defendant refuses to comply with an Appellate Body report condemning its violative measure. In this situation, the WTO authorizes the complainant to impose retaliatory tariffs on imported goods from the defendant to the extent of the formers' nullified or impaired market access to the latter.[51] This retaliatory mechanism might be viewed as a progress from the old GATT in that it gave the WTO teeth (enforcement).[51] Yet, the mechanism still reveals its mercantilist trait in that its primary operational equation is comprised of exports as utilities (gains) and

More recently, the deep-rooted mercantilist relic has been painfully confirmed in the Doha round trade negotiations. The Doha Ministerial Declaration emphasized that the Doha round is a "development" round that should focus on eliminating the chronic agricultural protection practiced by developed countries.[52] However, this normative (development) mandate had quickly evaporated as main stakeholders in developed countries increasingly considered the Doha mandate as mere charity.[53] To most developed countries, the Doha round is simply yet another "commercial" deal in which they should increase their access (export) to emerging markets.[54] Under this mercantilist logic, the U.S. conditioned the reduction of its own agricultural protectionism (such as farm subsidies) on the similar reduction of other developing countries' special protection. Importantly, however, many, if not all, of developing countries (such as China and India)'s protection derived from "non-mercantilist" purposes (such as food and livelihood security concerns).[55]

Perhaps, the mercantilist obsession is inevitable in a representative

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imports as disutilities (pains). In other words, upon the WTO's authorization of countermeasures the winning party artificially improves its mercantilist leverages by decreasing the defendant (the losing party)'s exports (gains) and also reducing its own imports (pains).[51] Unfortunately, this mercantilist equation is a mirage. As is well known, the retaliation would eventually deteriorate the overall economic welfare of the complainant because any tariff increase tends to inflict pain on its broader business base, including retailers and consumers.[51] The only business that would actually benefit from the retaliation is those domestic producers competing with their imports. CITE

[52] "International trade can play a major role in the promotion of *economic development* and the *alleviation of poverty*. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The *majority* of WTO members are *developing countries*. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration." Doha Declaration, *supra* note _, para. 2 (emphasis added).

[53].*See* David S. Christy, Jr., '*Round and 'Round We Go* . . ., WORLD POL'Y J., Summer 2008, at 19, 24 (contending that "affixing the label 'development' to the Round may have warmed a few hearts, but it has not filled any bellies."); Simon J. Evenett, *What Can Researchers Learn from the Suspension of the Doha Round Negotiations in 2006?*, at 5 (Univ. of St. Gallen Discussion Paper No. 2007-17, 2007) (observing that the ambiguous and confusing "development" mandate of the Doha Round discouraged corporate executives from attending WTO Ministerial Conference).

[54]*Political Positioning Dominates Opening Day of WTO Talks*, BRIDGES DAILY UPDATE (Int'l Ctr. for Trade and Sustainable Dev.), July 22, 2008 [hereinafter *Political Positioning Dominates*].

[55].*G-6 Ministers Agree to Work to Conclude Doha Round by End of 2007*, 11 BRIDGES WKLY. TRADE NEWS DIG. (Int'l Ctr. for Trade and Sustainable Dev.), Apr. 18, 2007, at 2 [hereinafter *G-6 Ministers Agree to Work*].

democracy. Domestic politicians whose electoral success hinges on parochial interest might not embrace non-reciprocal market opening on political terms. Even when the Doha round staggers, those politicians continued to pressure trade negotiators into adhering to mercantilist terms. For example, Charles Grassley, a powerful U.S. Senator from a farming state of Iowa urged the U.S. negotiators "pack their bags and come home" if other trading nations failed to offer the U.S. substantial market access in agricultural and industrial goods.[56]

At this juncture, one might be tempted to find in the "public choice" theory some useful insights as to why mercantilism still prevails. After all, the modern global trading system emerged from the Kantian moment of enlightenment triggered by the very same vice, *i.e.,* the interwar economic balkanization. According to this theory premised on the "politics without romance,"[57] legislators are not "public-regarding guardian angels."[58] They simply endeavor to maximize their narrow self-interests, such as reelection. Therefore, a political marketplace simply "reflect[s] a political equilibrium that in turn reflects the relative strengths of rival groups."[59] Useful as it may be as a positive theory that provides a rich description of the legislative process, the public choice theory nonetheless reveals the "glaring gap" in its normative contribution.[60] The characteristic "narrow calculus" of the public choice theory tends to "implicitly deny[] the capacity of law and politics to articulate national values and to transform preferences."[61] Just as a purely mechanistic public choice analysis on the "Civil Rights Act" would trivialize the Act's true value,[62] an oversubscription to the public choice

[56]. Doug Palmer, *U.S. Farm Programmes Spared as WTO Talks Collapse*, REUTERS, July 29, 2008, http://www.reuters.com/article/idUKL950898920080729.

[57] J. Buchanan, *Politics Without Romance: A Sketch of Positive Public Choice Theory and Its Normative Implications*, *in* THE THEORY OF PUBLIC CHOICE-II, at 11 (J. Buchanan & R. Tollison eds. 1984).

[58] Jonathan R. Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 476 (1988); Kalt & Zupan, Capture and Ideology in the Economic Theory of Politics, 74 Am. Econ. Rev. 279, 279 (1984).

[59] Macey, *supra* note 58, at 477. See also A. BENTLEY, THE PROCESS OF GOVERNMENT 258-59 (1967) ("Pressure . . . indicates the push and resistance between groups. The balance of the group's pressure is the existing state of society.").

[60] *Id*. In fact, even public choice theorists emphasize its "positive" nature. Posner, Economics, Politics, and the Reading of Statutes and the Constitution, 49 U. Chi. L. Rev. 263, 263 (1982); Buchanan, Comment, 18 J.L. & Econ. 903, 904-05 (1975).

[61] William N. Eskridge, Jr., *Politics without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275, 321 (1988).

[62] *Id*.

theory might slight deep-rooted normative failures of mercantilism in the contemporary trading patterns, as discussed below.

In sum, while the Bretton Woods architects rejected mercantilism in principle, they had to tolerate it in practice, in order to incrementally negotiate free trade. Thus, the trade rules and the negotiation process enshrined some mercantilist stances (*e.g.,* bargaining for concessions and retaliating for violations). These stances persist despite the fact that the patterns of global trade change drastically the calculus each nation now needs to employ to measure its benefits from trade liberalization, as discussed in the next section.

B. The Path Away from Single Country Production: Changing Trade Patterns

The economic institutions created at the end of World War II stood as a framework for future economic integration. International trade patterns before 1945 were fairly consistent and somewhat stagnant.[63] As noted above, mercantilism did little to stimulate actual wealth. Trade is needed to create wealth. Yet the early 20th century trade patterns did not look much different from 18th century trade patterns.[64] The Western world exported manufactured goods while the rest of the world supplied raw materials and agriculture.[65] Prior to 1945, trade, other than colonial trade, had very little impact on the world economy.[66]

The Bretton Woods system, in particular the GATT, certainly contributed to the postwar prosperity. Global economic growth after the end of World War II was astounding, with GDP growing at 5 per cent on average between 1950 and 1973: in this period trade actually grew more rapidly than production.[67] The growth in transnational corporations also tells the tale of increasingly changing patterns of global trade. While trading companies basically moved goods between domestic markets before World War II, the postwar economy saw the dramatic rise of those companies that own and manage assets in *multiple* countries to produce

[63] John Ravenhill, *The Study of Global Political Economy*, at 3 in John Ravenhill (ed.), GLOBAL POLITICAL ECONOMY [3rd edition], Oxford: Oxford University Press, pp. 3-28. available at http://www.oup.com/uk/orc/bin/9780199570812/ravenhill3e_ch01.pdf

[64] *Id.*, at 4-8.

[65] *Id.,* at 18-19.

[66] *Id.,* at 13-19.

[67] *Id.*

goods.[68] Increases in foreign direct investment have been breathtaking as well.[69]

Against this background, the patterns of trade have changed. Previously, trade was nation to nation, raw materials to manufacturing bases.[70] Throughout the post-war period a shift began that led to the trade of industrial goods.[71] First, this changed in trade occurred amongst industrialized countries and to a great extent in *intra*-firm trading,[72] but more recently it has shifted again to integrate the developing world.[73] By the turn of this century, seventy per cent of developing countries' total exports accounted for manufactured exports.[74] At the same time, one can see a dramatic shift in the share of world exports from developed countries to emerging (developing) countries in the period from 1955 to 2006.[75] Along this ground-breaking trend has how we think about trade also changed:

> "Long gone are the days when we should be thinking about trade as a world of "them" and "us" — their exports and our imports, and vice-versa. We have allowed this way of thinking to miss-specify the true nature of international trade relations for far too long. It has created an adversarial mind-set, driven by spurious concern for reciprocity, thus missing the true nature of our inter-dependency and the gains from trade among nations."[76]

The nature of exported products has changed as well. Exports used to be finished products made in one country. Throughout the second half of the twentieth century, and particularly at the turn of this century exported products were increasingly inputs for other products.[77] Manufactured materials are used in the further manufacturing of goods. Fragmentation of

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[68] *Id.,* at 18-19.

[69] *Id.*

[70] TAMIN BAYOUMI, CHANGING PATTERNS OF GLOBAL TRADE 6 (discussing the declining share of commodity trading); Ravenhill, *supra* note ___ , at 18-19.

[71] Ravenhill, *supra* note 63, at 18-19.

[72] *Id.*

[73] *Id.,* at 18.

[74] *Id.*

[75] World Trade Report 2008, Trade in a Globalizing World, Globalization and Trade at 17 available at http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf.

[76] Pascal Lamy, *Changes in Trade Challenge How We Manage Trade Policies*, Mar. 16, 2012.

[77] Ravenhill, *supra* note 63, at 18-19.

production in some sectors contributed to this trend.[78] Importers and exports now source from multiple countries, sell in multiple countries and are themselves incorporated in multiple countries.[79] The classical model of trade in (final) goods should be replaced by trade in (intermediate) *tasks*[80] or trade in *value-added*.[81] Note that even in the United States (not China), nearly a half of all imported goods are not directly headed to consumers but streamed into supply chains and often re-exported after further processing.[82] Reflecting this unprecedented trend, trading companies even rely on computer software designed exclusively for supply chain management ("product lifecycle management") to optimize their sourcing decisions.[83] For example, Boeing has planned to source nearly a half of all components for its new 787 aircraft from foreign countries, while Airbus, Boeing's European rival, has planned to source to the same extent for its new A380 aircraft from none but U.S. suppliers![84] Nowadays, this phenomenon of global sourcing, carrying varying labels with it, such as "unbundling,[85] "trade in tasks,"[86] or "trade in value-added,"[87] is no longer a mere subject of

[78] World Trade Report 2008, Trade in a Globalizing World, Globalization and Trade at 18 available at http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf. (parenthetical)

[79] BAYOUMI, *supra* note 70, at 6 (discussing trade interconnecdedness).

[80] Lamy *Says More and More Products Are "Made in the World," WTO News:* Speech, Oct. 15, 2010; *See generally* WTO & Ide-Jetro, Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks.

[81] See Andreas Maurer, *Made In The World, Trade in value added: what is the country of origin in an interconnected world?* Available at http://www.wto.org/english/res_e/statis_e/miwi_e/background_paper_e.htm (noting that the concept of trade in value added is more than a mere statistical change, it is a change that implicates trade policy.)

[82] *Bureau of Economic Analysis, U.S. Department of Commerce, Operations of Multinational Companies, Product Guide for Foreign Direct Investment in the U.S.*, 2002 Benchmark Survey, "U.S. Imports of Goods Shipped to Affiliates and Intended Use."; Doug Karmin, Imports as Inputs**,** PPI | Front & Center, Jan. 5, 2009.

[83] *See e.g.*, PLM software takes off in apparel supply chain (24 July 2008 | Source: just-style.com**),** http://www.just-style.com/article.aspx?id=101477.

[84] Barry Lynn, *The Trade Row over Aircraft Is Missing the Point*, FIN. TIMES, Jun. 3, 2005. See also John Gapper, A Cleverer Way to Build a Boeing, Fin. Times, Jul. 9, 2007, at 9 (reporting Boeing's recent efforts for global sourcing).

[85] Baldwin, Richard E. (2006), GLOBALISATION: THE GREAT UNBUNDLING(S)., *in* GLOBALISATION CHALLENGES FOR EUROPE, Helsinki: Office of the Prime Minister of Finland

[86] Gene M. Grossman, *Fragmentation of Global Production and Trade in Value-Added, Panel Discussion at World Bank Workshop*, Jun. 9-10, 2011, at 2.

[87] *OECD & WTO, Trade in Value-Added: Concepts, Methodologies, and Challenges*, Jun.6, 2011

admiration. One must no longer equate "production" as "manufacturing" that is only a partial stage of the former in the new trade pattern.[88]

These revolutionary changes characterized by global supply chains challenge the conventional territoriality-based production patterns. In fact, some scholars such as John Ruggie witnessed this transformative phenomenon nearly two decades ago. Ruggie observed that:

Consider the global system of transnationalized microeconomic links. Perhaps the best way to describe it, when seen from our vantage point, is that these links have created a nonterritorial "region" in the world economy- a decentered yet integrated space-of-flows, operating in real time, which exists alongside the spaces-of-places that we call national economies.[89]

In a historical verdict for Ruggie's clairvoyance, the unprecedented innovations in the transportation, telecommunication and other logistical fields have revolutionized the new production pattern. The proliferation of global sourcing or global supply chains ("multi-location" production)[90] in tandem with capital market liberalization has witnessed diversified trade interests among various groups of economic players, including not only exporters and importers but also retailers, wholesalers, distributors, bankers, forwarders, shippers and consumers.[91] As one commentator aptly observes, "the distinction between what is and what isn't American or Finnish or Chinese has been blurred by foreign direct investment, cross-ownership, equity tie-ins, and transnational supply chains."[92]

In sum, in this "postnational constellation," as Jürgen Habermas put it, in which non-territorial entities are more inclined to communicate, rather than compete, with each other, the old realist-mercantilist paradigm becomes increasingly obsolete.[93] The anachronistic gap between an altered

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[88] Henrik Isakson, *Adding Value to the European Economy: How Anti-Dumping Can Damage the Supply Chains of Globalised European Companies* (Swedish National Board of Trade), at 30.

[89] John Gerard Ruggie, *Territoriality and Beyond: Problematizing Modernity in International Relations*, 47 INT'L ORG. 139, 172 (1993).

[90] *Made in the World; Message from the Director-General Pascal Lamy*, WTO MIWI HOMEPAGE (April 4, 2011), http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm.

[91] Daniel Ikenson, *Made on Earth: How Global Economic Integration Renders Trade Policy Obsolete*, Trade Policy Analysis, Cato Institute, Dec. 2, 2009 at 5 available at http://www.cato.org/publications/trade-policy-analysis/made-earth-how-global-economic-integration-renders-trade-policy-obsolete.

[92] *Id.* ,at 5.

[93] JÜRGEN HABERMAS, THE DIVIDED WEST 176 (Ciaran Cronin trans., 2006) ("In

social context and a maladaptive paradigm is taking a mounting toll on the world trading system. Technology, political forces and liberalized economic policies have promoted trade integration and source diversity.[94] All of these events have drastically changed the 1945 picture of trade. The trade rules however, have failed to keep up.[95] Part of this failure stems from how they are established in the first place, as discussed in the next section.

C. Top-Down Law Making in an Increasingly Bottom-Up World

International law, and certainly international trade law has by and large been the product of state-center, top-down treaty making. The treaty making process has its costs and benefits that have been more than adequately explained by others.[96] In short:

> [A] treaty-making process requires an enormous amount of diplomatic and political effort in order to reach both consensus and compromise among the parties concerned. Lobbies from interested and affected constituencies are legion. Naturally, it is not only a painstaking but also a treacherous process. Often, the process loses its initial passion or momentum as it develops. Moreover, a treaty's legally "binding" nature tends to make negotiating parties reluctant to nail down any definite texts, because they want to leave themselves enough flexibility for future contingencies. Likewise, treaties are often accompanied by reservations, understandings, and declarations that practically qualify

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spatial, social, and material respects, nation-states encumber each other with the external effects of decisions that impinge on third parties who had no say in the decision-making process. Hence, states cannot escape the need for regulation and coordination in the expanding horizon of a world society that is increasingly self-programming, even at the cultural level.")

[94] World Trade Report 2008, Trade in a Globalizing World, Globalization and Trade at 20-22 available at http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf.at (parenthetical)

[95] BAYOUMI , *supra* note 70, at 11 (with rising vertical specialization and intraindurty trade, gross exports may not appropriately capture the extent of domestic value added exports).

[96] *See* Andrew Guzman, *The Design of International Agreements*, 16 EUR. J. INT'L L. 579 (2005) (Discussing the costs and benefits of potential design elements in international agreements); Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements and Antagonists in International Governance*, 94 MINN. L. REV. 706 (2010) (discussing the costs and benefits of hard law and soft law instruments).

> their initial legal effects. Finally, just as a treaty-making process is tortuous, so is its amending process. Therefore, a regulatory treaty, once fixed, is hard to keep abreast of the subsequently changing regulatory environment.[97]

The difficulties of treaties stems from what is perceived as a benefit: the creation of hard law. For example, states may believe that compliance mechanisms will only be useful where there is *hard* treaty law as opposed to *soft* norms.[98] States may also perceive trade regulation as purely a *public* law issue focusing on the rules which bind states as states, and discounting the importance of the *private* sector.

In other areas of law such as financial regulation the use of soft law and the participation of the market is more common, and in fact, encouraged. [99] Chris Brummer has explained part of the popularity of treaties "lies in the democratic trappings."[100] For trade, in particular though, treaties address a problem of trust and the need for hard law to lock participants in to obligations compliance with which can be objectively monitored. They are capable of:[101]

> [M]aking commitments to liberalization more credible and by developing institutions that make defections from commitments more costly. Because treaties require significant levels of governmental involvement, including leadership by heads of state and usually ratification by legislatures, states may face considerable reputational costs where they do not honor their treaty obligations. Simply put, states that tend to honor their commitments develop strong reputations that help them coordinate with parties when they need to advance their national interests. On the other hand, where countries fail to honor their commitments, they send a signal that they cannot be trusted, and thus gain reputations that hamper their future prospects for cooperation from and with others. [102]

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[97] Cho and Kelly, *supra* note 18 at 497-98.

[98] Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements and Antagonists in International Governance*, 94 MINN. L. REV. 706, 718 (2010) (noting that treaties often create the mechanisms for resolving disputes).

[99] Chris Brummer, *Why Soft Law Dominates International Finance—And not Trade*, 13 J. INT'L ECON. L. 623, 624 (2011).

[100] *Id.,* at 624.

[101] *Id.,* at 624-25.

[102] *Id.,* at 625.

In general, the hard law (treaty) mechanism appears justifiable in binding trading nations' liberalization commitments. Nonetheless, certain aspects of treaty-making process, such as a top-down, state-centered approach, may not be as adequate in *some* areas of trade law, in particular those areas requiring sophisticated, technical regulations such as customs regulations. While one might argue that trade, as compared with finance, is more stable and therefore less in need of flexible soft law approaches, that argument has weaknesses.[103] True, while shifting trade patterns may move more slowly than financial markets,[104] they still move fast enough to make the treaty and treaty amendment process overly cumbersome and ineffective. Certain (although not all) areas of trade law, such as customs regulations, could particularly benefit from flexible and informal soft law commitments that allow innovation without explicit delegations and high sovereignty costs. Trade regulators and domestic legislators share the same angst as financial regulators in committing to complex rules ex ante in an uncertain world. Soft law commitments may sacrifice some potential compliance pull, but they may nonetheless allow regulators and innovators to overcome their initial angst in developing rules.[105] Financial regulation may be particularly well-suited for soft law approaches as it is technical and complex, [106] but so are some areas of trade law. Classification and valuation are enormously complex endeavors that are only understood by a handful or practitioners, bureaucrats and industry experts.[107]

Finally, the global trade regime needs innovative bottom-up approaches as the top-down statist model has increasingly become ill-suited for many of the challenges facing the trade regime. Under the new (multi-location production) model characterized by global supply chains, the old bargain-oriented model loses its relevance. Here, the conventional concern for reciprocity becomes "spurious," as the head of the WTO Pascal Lamy aptly observed.[108] Under the old (mono-location production) model, it was

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[103] *Id.,* at 636-37.

[104] *Id.*, at 637.

[105] Kenneth W. Abott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 439 (2000).

[106] Chris Brummer, *Why Soft Law Dominates supra* note 99, at 636-37.

[107] Admittedly, one important difference between the finance and trade realms is the industry motivations for a bottom-up approach. In financial regulation the industry may push for bottom-up approaches. The trade industry may do the same, but the trade industry is split into importers and exporters where the financial industry tends to be a more homogenous group.

[108] Pascal Lamy, *Changes in Trade Challenge How We Manage Trade Policies*, Mar. 16, 2012.

clear where an imported product originated.[109] Thus, domestic producers would easily target an exporting state and lobby an importing state into imposing trade barriers, such as tariffs, against the foreign product from *that* exporting state. As most trading nations were prone to this mercantilist politics, the conventional *modus operandi* of trade negotiation was mutual tariff reduction based on reciprocal bargain. [110] The quantifiable nature of tariffs was also instrumental to this operation.

Under the new trade reality, however, more than half of global exports in manufactured products are in fact inputs (parts and components) to other unfinished goods.[111] Under this altered situation that befits the new model, not only has it become difficult to locate an origin of a particular product but also consuming industries' interest has increasingly countered domestic producers' lobbying power. At the same time, one should take the changing nature of trade barriers seriously. The titular administrative barriers, i.e., various domestic regulations, have recently replaced the traditional mode of trade barrier, i.e., tariffs, which are generally in decline after a series of trade rounds.[112] Critically, these non-tariff barriers tend to exert multiple impacts to trade when these barriers arise at an early (upstream) stage in the global production chain.[113] In other words, such barriers "will have an augmented impact every time affected components or services cross a frontier."[114]

II. EMPIRICAL CONFIRMATIONS OF TRADE ANACHRONISM: VALUATION AND COUNTRY OF ORIGIN RULES

The relics of the mercantilist system obstruct the trade regime's ability to address complex challenges of global trade. As a result of changing global trade patterns the rules relating to, *inter alia,* valuation,[115] customs

[109] Regis McKenna, *Technology, Enterprise, and Freedom*, in THE TECHNOPOLIS PHENOMENON: SMART CITIES, FAST SYSTEMS, GLOBAL NETWORKS, 19, 22 (David V. Gibson, George Kozmetsky, and Raymond W. Smilor eds., 1992).

[110] J. Michael Finger et al., *Market Access Bargaining in the Uruguay Round: Rigid or Relaxed Reciprocity?* 2-4 (World Bank, Policy Research Working Paper No. 2258, 1999).

[111] Pascal Lamy, *Trade Improves the Lives of People*, Apr. 12, 2012.

[112] *See* Daniel Y. Kono, *Optimal Obfuscation: Democracy and Trade Policy Transparency*, 100 AM. POL. SCI. REV. 369, 371 (2006) (viewing that democracy reduces incentives to employ tariffs while increasing incentives to employ less transparent NTBs).

[113] Pascal Lamy, *Changes in Trade Challenge How We Manage Trade Policies*, Mar. 16, 2012.

[114] *Id.*

[115] *See also* Daniel Ikenson, *Made on Earth: How Global Economic Integration*

clearance,[116] product standards,[117] and country of origin,[118] all contain anachronistic components that often become trade barriers themselves under new trade realities. Addressing these complexities in the typical top-down, state-centered forum offers little hope of a solution. Here, we explain the customs valuation and country of origin rules which preserve the mercantilist relic of tariff protection. We then detail how valuation of related-party transfers, a common necessity with emergence of the global factory, creates new barriers to trade. Likewise, the amorphous and confusing country-of-origin rules hamper free trade because they fixate on identifying a single country of origin even though as a practical matter many products have significant value added in different source countries. The complexity, uncertainty and manipulability of some origin rules highly distort trade incentives.

A. Valuation

The trade regime provides a system by which products are assigned a value so that duties may be levied when they pass through national customs. In 1979, as part of the Tokyo Round negotiations, the contracting parties adopted the GATT Valuation Code which was later incorporated into the WTO, although changed slightly, with the Agreement on the Implementation of Article VII of the GATT 1994 (Valuation Agreement).[119] The Valuation Agreement establishes principles of

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Renders Trade Policy Obsolete, Trade Policy Analysis, Cato Institute, Dec. 2, 2009 at 8 available at http://www.cato.org/publications/trade-policy-analysis/made-earth-how-global-economic-integration-renders-trade-policy-obsolete (noting the misleading nature of terms such as "import value.")

[116] Andrew Grainger, *Customs And Trade Facilitation: From Concepts To Implementation*, World Customs Journal, Vol. 1 at 17 http://www.worldcustomsjournal.org/media/wcj/2008/1/customs_and_trade_facilitation_from_concepts_to_implementation.pdf.

[117] Product standards, in an increasingly integrated world, could easily become significant trade barriers. As Robert Howse has argued there is a "common critiques of globalization is that it increasingly constrains the ability of democratic communities to make unfettered choices about policies that affect the fundamental welfare of their citizens." Robert Howse, *Democracy, Science, and Free Trade: Risk Regulation on Trial at the World Trade Organization*, 98 MICH. L. REV. 2329 (2000). Howse's thoughtful response is that the trade rules should be used to "enhancing the quality of rational democratic deliberation about risk and its control." *Id*. at 2330.

[118] *Made in the World; Message from the Director-General Pascal Lamy*, WTO MIWI HOMEPAGE (April 4, 2011), http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm.

[119] GATT Multilateral Trade Negotiations, Group "Non-Tariff Measures" Sub-Group "Customs Matters," Customs Valuation: Agreement on Implementation of Article VII of

appraising merchandise,[120] *i.e.,* setting a unit value of the merchandise at the time of importation so that duty can be calculated for the merchandise.[121] Establishing standard principles to value merchandise matters since most, but not all, tariffs are expressed as an *ad valorem* charge, *i.e.,* they are a certain percentage of value.

The Valuation Agreement provides several permissible methods of appraisement, but generally speaking, appraisement should be based on "transaction value," which is "the price paid by the buyer to the seller for the goods when they are sold for exportation."[122] In reality, however, fixing a single transaction value is more daunting than this ostensibly self-evident definition. For example, any given "transaction" between an exporter and an importer may involve several intermediate steps. Or, such a transaction may be somewhat different from a normal situation due to a special relationship between an exporter and an importer. Therefore, the agreement also specifically lists certain "adjustments" to this value.[123]

In particular, where the buyer and seller are "related," transaction value may still be used, although the importer must demonstrate that it is appropriate to do so.[124] The importer may demonstrate that the value was not influenced by the relationship (*i.e.,* that it was an arms-length sale) by using either a "circumstances of the sale" test or another method of appraisement as a test value.[125] For example, Acme Co. in the United

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the General Agreement on Tariffs and Trade, [Revision], MTN/NTM/W/229/Rev.1 (Apr. 9, 1979). Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S 154 [hereinafter Marrakesh Valuation Agreement].

[120] *Id*., arts. 1 - 7.

[121] *Id*., art. 1.

[122] *Id*.

[123] For example, where an importer provides an "assist" (*i.e.*, some component or object used in the production of the good) free of charge or at a reduce cost the value of that assist not included in the transaction value must be added. Assists include things such as components, parts and similar items incorporated in the imported goods but they also include engineering work undertaken elsewhere than in the country of importation. See Marrakesh Valuation Agreement at Article 8(1).

[124] Marrakesh Valuation Agreement, *supra* note 119, art. 1 (2).

[125] *Id*., art. 1(2), 19 USC 1401a(b)(2)(B). The Statement of Administrative Action (SAA) for the TAA provides with respect to the circumstances of the sale::

> ". . . the Customs Service will examine relevant aspects of the transaction, including the way in which the buyer seller organize their commercial relations and the way in which the price in question was arrived at, . . . If it is shown that the buyer and seller, although related, buy and sell to each other as if they were not related, this will demonstrate that the price has not been influenced by the relationship and the transaction value will be accepted." "Statement of Administrative Action," H.R. Doc.

States may buy and import computers from its related entity Best Co. in Portugal. It may supply Best Co. with LCD screens from another related affiliate Computer Co., in Singapore. Further, it may supply engineering work to Computer Co. The engineering work might have been produced in both United States and Portugal. Acme would probably be able to use the transaction value method of appraisement if it could show that the circumstances of the sale warranted it (that it was an arms-length transaction).[126] It would declare the value paid to Best Co. plus the value of the LCD screens, plus the value of the engineering work done in any country other than United States.[127]

No. 153, 96 Cong., 1st Sess., Pt II, at 449 (1979). Specific examples are given and they include "that the price is settled in a manner consistent with the normal pricing practices of the industry in question, or with the way the seller settles prices with unrelated buyers; or, the price is sufficient to ensure recovery of all costs plus a profit equivalent to the firm's overall profit over a representative period of time in sales of merchandise of the same class or kind. "Statement of Administrative Action," H.R. Doc. No. 153, 96 Cong., 1st Sess., Pt II, at 449 (1979).

[126] Marrakesh Valuation Agreement, supra note 119, art. 1(2)(b).

[127] *Id*., art. 8. In determining the customs value under the provisions of Article 1, there shall be added to the price actually paid or payable for the imported goods:

(a) the following, to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the goods:

(i) commissions and brokerage, except buying commissions;

(ii) the cost of containers which are treated as being one for customs purposes with the goods in question;

(iii) the cost of packing whether for labour or materials;

(b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:

(i) materials, components, parts and similar items incorporated in the imported goods;

(ii) tools, dies, moulds and similar items used in the production of the imported goods;

(iii) materials consumed in the production of the imported goods;

(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of

The problem, however, is that the current Valuation Agreement has become increasingly unbefitting to the contemporary trade practices. In a multi-country sourcing production pattern, a product crosses multiple borders back and forth in various stages as it gradually adds value and reaches its final form.[128] Moreover, a number of service transactions (engineering, advertisement, intellectual property) are added throughout the life-cycle of such a globally sourced product.[129] The Valuation Agreement basically determines value under a *single*-country production model and raises numerous problems to global businesses that are exporters and importers even regarding one single product. One recent report on the global supply chain of the iPhone 4 explained that it contains numerous different components from around the world.[130] The breakdown of component costs is revealing:

Apple, for instance, pays Samsung about $27 for flash memory and $10.75 to make its (Apple-designed) applications processor; and a German chip maker called Infineon gets $14.05 a phone for chips that send and receive phone calls and data. Most of the electronics cost much less. The gyroscope, new to the iPhone 4, was made by STMicroelectronics, based in

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importation and necessary for the production of the imported goods;

(c) royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable;

(d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

[128] Robert C. Johnsony and Guillermo Noguera *Accounting for Intermediates: Production Sharing and Trade in Value Added* (May 2011) available at http://siteresources.worldbank.org/INTRANETTRADE/Resources/Internal-Training/287823-1256848879189/6526508-1283456658475/7370147-1308070299728/7997263-1308070314933/PAPER_4_Johnson_Noguera.pdf ("Trade in intermediate inputs accounts for as much as two thirds of international trade").

[129] Robert C. Johnsony and Guillermo Noguera *Accounting for Intermediates: Production Sharing and Trade in Value Added* (May 2011) available at http://siteresources.worldbank.org/INTRANETTRADE/Resources/Internal-Training/287823-1256848879189/6526508-1283456658475/7370147-1308070299728/7997263-1308070314933/PAPER_4_Johnson_Noguera.pdf At 23 ("The upshot is that Services are far more exposed to international commerce than one would think based on gross trade statistics.")

[130] Supply Chain for iPhone Highlights Costs in China available at http://www.nytimes.com/2010/07/06/technology/06iphone.html.

Geneva, and added $2.60 to the cost. The total bill of materials . . .is $187.51, according to iSuppli.

But the *ad valorem* duties are based on specific trading bargains made between countries for specific products and assume a single country production situation. The customs value does not reflect in what countries value was added.

Increasingly prominent conflicts of valuation rules with other regulatory considerations, such as international taxation, further compound the aforementioned inadequacy. Unsurprisingly in a related-party transaction, such as the one described above, customs authorities might be concerned that importers like Acme Co. might deflate the value of the goods in order to pay lower customs duties.[131] But in addition to dealing with customs valuation, MNEs, like Acme Co., worry about corporate taxation.[132] For corporate tax purposes however, the state taxing authority typically has the reverse concern, namely that the importer is declaring too high a value to show a high cost of goods resulting in lower corporate taxation. The problem is complicated by the fact that each country has its own rules for protecting against perceived vulnerabilities for both corporate and customs taxes.[133]

For example, the United States has Section 482 of the Internal Revenue Code which permits the Internal Revenue Service to reallocate income amongst related companies.[134] The IRS will only reallocate if it

[131] Michael E. Murphy & Holly E. Files, *The Intersection of Transfer Pricing and Customs Valuations: Challenges (and Opportunities) for Multinational Enterprises*, 15 SWEET & MAXWELL'S INT'L TRADE LAW & REGULATION (Issue 5) 149 (Sept. 2009); Nick Raby, *International Transfer Pricing*, PriceWaterhouseCoopers International Limited (2010); Ganapati Bhat, *Transfer Pricing, Tax Havens, and Global Governance*, German Development Institute (July 2009).

[132] *Id.*

[133] Global Tax Report, January (2010) available at www.whitecase.com/files/Publication/f07f85db-a407-4e34-9329-ef62eb0f2607/Presentation/PublicationAttachment/bd2018e9-cf46-45ed-bc9b-f663fe086ea8/newsletters-Tax-GlobalTaxReport-Jan10-v12.pdf .

[134] See 26 U.S.C.A. § 482, I.R.C. § 482. "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within

finds that the transfer price was not arms-length, *i.e.,* if the results would have been the same if the taxpayers were not related. There are several methods by which the taxpayer could set transfer prices (comparable uncontrolled price, resale price, cost plus, comparable profits method, and profit split) and the taxpayer is suppose to use the "best method" (*i.e.,* the one that would most reliably reflect an arm's length transaction).[135] The taxpayer will bear the burden of proof that any determination by the IRS is incorrect.[136] There are significant penalties for the failure to properly set transfer prices resulting in a Section 482 adjustment.[137]

MNEs have faced the possibility of inconsistency between their transfer prices for tax and customs purposes for years.[138] The inconsistency results not only from the very nature of the problems that taxing and customs authorities face (*i.e.,* concerns over-valuation for tax purposes and under-valuation for customs purposes, respectively) but also from different applications of their respective rules. For example, the IRS "does not focus on correct valuation, but only that the ultimate result of any underpayments and overpayments achieves the proper income result."[139] Moreover the agencies determine the transfer price at different times: customs value goods upon entry, while taxing authorities wait until the end of a reporting

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the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible."

[135] Section 482-1 (c) of the transfer pricing regulations:

> (c) Best method rule--(1) In general. The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm's length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm's length result, such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm's length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm's length result. See Sec. 1.482-8 for examples of the application of the best method rule. See § 1.482–7 for the applicable method in the case of a qualified cost sharing arrangement.
>
> Treas. Reg. § 1.482-1(c)(1) (2012)

[136] Tax Ct. R. 142

[137] *See* Section 6662(e) and (h).

[138] Murphy and Files, *supra* note 131, at 149 (Sept. 2009).

[139] William M. Methenitis & Steven C. Wrappe, *The Growing Need for Harmonization of Transfer Pricing and Customs Valuation*, 17 TAX MNGT. TRANSFER PRICING REP. (No. 8) (BNA) S3, S9 (Aug. 28, 2008).

period.[140] The taxing authority typically allows for aggregation while customs authorities do not.[141]

Perhaps the biggest problem for MNEs is not the different application of the rules but measures that government take to ensure that taxpayers do not whipsaw the government. For example, Section 1059A in the United States to prevents importers from claiming a higher basis on their taxes than the "dutiable" customs value of their merchandise.[142] Thus, it thwarts the taxpayer who would attempt to use the different rules under each system from declaring a low value for customs duty purposes and a high value for tax basis deductions.[143] The rule has unintended side effects. For example, it undermines the usefulness of otherwise legitimate transfer pricing studies or Advance Pricing Agreements in the tax regime.[144] Tax authorities regularly accepted transfer pricing studies to account for post importation price changes. Customs authorities, until recently, were far less open to such studies.

Moreover, Section 1059a is incapable of addressing the converse possibility that a taxpayer may pay duty on a high transfer price and yet be saddled with a low transfer price for tax basis purposes. If the value of a product increases after importation, the importer might have to pay more duty, but it will be precluded from increasing its basis for tax purposes by 1059A. Conversely, the price decreases after importation, the importer may be required to decrease its tax basis but would have no mechanism to decrease its customs liability (because any post-importation decrease in price is generally considered a rebate and irrelevant for customs valuation purposes). In other words 1059A prevents the government from being whipsawed by the taxpayer, but does nothing for the taxpayer who might be whipsawed by the government.[145]

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[140] Lui Ping & Caroline Silberztein, *Transfer Pricing, Customs Duties, and VAT Rules: Can We Bridge the Gap*, 1 WORLD COMMERCE REVIEW (Issue 1) 36, 37 (2007).

[141] William M. Methenitis & Steven C. Wrappe, *The Growing Need for Harmonization of Transfer Pricing and Customs Valuation*, 17 TAX MNGT. TRANSFER PRICING REP. (No. 8) (BNA) S3, S10 (Aug. 28, 2008).

[142] *See* Brittingham v. Comr., 66 TC 373 (1976) aff'd 598 F2d 1375 (5th Cir. 1979).

[143] Section 1059A permits certain adjustments and does not apply in cases where the goods would be entered duty-free in any event.

[144] *Mayra O. Lucas Mas,* Section 1059A: An Obstacle to Achieving Consistent Legislation?, available at http://www.oecd.org/dataoecd/5/26/42867242.pdf

[145] *See* Marc M. Levey & Robert L. Eisen, *The Transfer Pricing And Customs Duties Practice In The United States*, 947 PLI/Tax 299-1: "On its face, Section 1059A appears to align the values used for both tax and customs by prohibiting an importer from claiming a higher tax basis for imported merchandise than it claims for customs purposes. However,

In sum, the current valuation rules become increasingly unsuitable to the contemporary trade realities. Furthermore, in today's complex world of MNEs the rules may conflict with other concerns such as international taxation rules. The trade regime alone, based on the conventional treaty-making mode, appears to be ill-equipped to address such conflicts.

B. Rules of Origin

Rules of origin are essential to preserve the mercantilist bargain of managed trade. Rules of origin, like valuation rules, are required in order to apply duty rates. There are two types of rules: Non-preferential (which apply in the ordinary course where there is no claim of special treatment under a regional trade agreement (RTA)) and preferential (which are applied when special treatment is claim under an RTA). Non-preferential rules of origin were meant to protect bargain trade amongst GATT members. All GATT (and subsequently WTO) countries were entitled to the same tariff rate under the most favored nation (MFN) principle.[146] Thus, a product of a GATT or WTO got the benefit of the negotiated bargain while a non GATT or non WTO might not.[147] Countries would use "non-preferential" rules of origin to determine whether products were entitled to the MFN rate.

Preferential Rules of origin allow countries to favor certain countries by according better market access (such as zero tariffs) to imports from these countries. This discriminatory mechanism is a must in administering a RTA.[148] In other words, RTAs are sustainable only when RTA members can screen out those goods from member countries eligible for duty-free treatment from those from non-member countries still subject to tariffs

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the actual application of Section 1059A is significantly more complicated, and any apparent similarities drawn between the two systems veil important differences, particularly for timing. Indeed, the tax basis under Section 1059A may differ from a customs value because of legitimate differences between the tax and customs valuation rules. Customs value may allow for increases in imported values by freight charges; insurance charges; construction, assembly and technical assistances after importation; and any other amounts not included in the customs value which are appropriately included in cost basis for income tax purposes." *Id*. at 299-18.

[146]GATT, *supra* note 12, art. 1.

[147]*Id*.

[148] *See* Moshe Hirsch, *Rules of Origin as Trade or Foreign Policy Instruments?: The European Union Policy on Products Manufactured in the Settlements in the West Bank and the Gaza Strip*, 26 FORDHAM INT'L L.J. 572, 574-76 (2003).

How an importing country determines where a particular import originated was not addressed in GATT 1947.[149] In 1994 the WTO established the Agreement on the Rules of Origin (ROO) to ameliorate this deficit.[150] Under the WTO ROO Agreement, the country of origin:

Is either the country where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country where the last *substantial transformation* has been carried out.[151]

Some version of the "substantial transformation" test has been used for non-preferential rules of origin in the United States and the European Union for some time. In the United States, a substantial transformation occurs when by means of manufacture a new and different article emerges, "having a distinctive name, character, or use."[152] Thus, mere assembly of parts will not result in a substantial transformation.[153] What will suffice is a contextual matter determined on a case by case basis.[154] They may incorporate the substantial transformation test but also add local content requirements (U.S. GSP rules),[155] or they may require conformity with complex "tariff shifts"[156] as do the rules of origin for the NAFTA.[157]

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[149] "The draftsmen of the General Agreement stated that the rules of origin should be left:
"...within the province of each importing country to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-nation provisions (and for other GATT purposes), whether goods do in fact originate in a particular country"." See Technical Information on Rules of Origin available at http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm

[150] Agreement On Rules Of Origin, available at http://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm. These rules only attempt to harmonize "non-preferential" rules of origin and thus do not cover "preferential" origin rules for free trade areas or the Generalized System of Preferences (GSP) system.

[151] *Id.*, art 3 (emphasis added)

[152] U S v. Gibson-Thomsen Co., Inc., 27 C.C.P.A. 267 (1940).

[153] *See* T.D. 76-100, 10 Cust. Bull. & Dec. 176, 178 (1976); Texas Instruments v. United States, 2 C.I.T. 36, 520 F. Supp. 1216, rev'd, 681 F.2d 778 (CCPA 1982)

[154] *Cf. Bestfoods v. U.S.*, 165 F.3d 1371 (Fed. Cir. 1999) (addressing whether the NAFTA rules abrogated the case by case substantial transformation test for origin).

[155] *See* 19 U.S.C. § 2461 (1996).

[156] "Tariff Shifts" require that "for any given classification, to change the country of origin of a . . . product there must be a shift from one Harmonized Tariff System (HTS) classification to another as listed in the tariff shift rules and/or the processing which occurs must meet any other requirement that is specified in the tariff shift rules." What Every Member of the Trade Community Should Know About: Textile & Apparel Rules of Origin, U.S. Customs and Border Protection, An Informed Compliance Publication

The preferential rules of origin explicitly support a mercantilist bargain. As "gate keepers" that sustain the discriminatory trading mechanism, origin rules are a "strategic" instrument to restrict import competition.[158] They create new trade barriers by limiting, often prohibitively, foreign producers' sourcing options in manufacturing final imported products.[159] Preferential rules of origin are designed in a way which maximizes protectionist interests of domestic producers. In a world of global supply chains and multi-located production, this protectionist design often takes a huge toll on both domestic economy and international trade. The manipulative, and messy,[160] rules of origin in most RTAs, often dubbed "spaghetti bowls,"[161] have deprived many developing countries of their comparative advantages stemming from both their natural endowments (such as good quality raw materials) and cheap labor.

For example, Mexican textile producers are not eligible for a duty free access to the U.S. market under NAFTA if they source the Indian yarns for their production: they are required to use those yarns from NAFTA countries (the "yarn-forward" rule).[162] Undoubtedly, such a quixotic rule goes against the spirit of free trade since it strips Mexican textile producers, Indian yarn producers and American textile consumers of considerable

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Revised April 2004, available at http://www.cbp.gov/linkhandler/cgov/trade/legal/informed_compliance_pubs/icp006r3.ctt/icp006r3.pdf

[157] *See* Annex 401 of the North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

[158] *See notably* Moshe Hirsch, *International Trade Law, Political Economy, and Rules of Origin: A Plea for a Reform of the WTO Regime on Rules of Origin*, 36 J. WORLD TRADE 171, 177-81 (2002).

[159] In this regard, the legal vacuum under the current WTO system over rules of origin is unfortunate. / "no oversight" given that regional mercantilism had been prevalent during the Uruguay Round negotiations Hirsch (JWT), pp 183-84; BERNARD HOEKMAN & MICHEL KOSTECKI, THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM 104 (1995).

[160] They are often more than 100 pages long! See the Mexico-Japan FTA has over 100 pages of rules of origin under the title of the "Annex 4 referred to in Chapter 4: Specific Rules of Origin."

[161] JAGDISH BHAGWATI, A STREAM OF WINDOWS: UNSETTLING REFLECTIONS ON TRADE, IMMIGRATION AND DEMOCRACY 290 (1998).

[162] 19 U.S.C. § 3332 (1998). Interestingly, Customs has advised that the yarn forward rule is not a "rule". NAFTA (the North American Free Trade Agreement) for Textiles and Textile Articles, Informed Compliance Document, 1996 WL 769281 (1996). See also North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

economic welfare.[163]

On top of this idiosyncratic nature, the origin rules themselves in general are so complicated and unintelligible, rife with "a facade of technical and seemingly innocuous details."[164] The textile rules of origin in the U.S.-Jordan FTA[165] offer a case in point. The following is an excerpt from the FTA.

> 9. Textile and apparel products
>
> (a) General rule. A textile or apparel product shall be considered to be wholly the growth, product or manufacture of a Party, or a new or different article of commerce that has been grown, produced, or manufactured in a Party; only if
>
> (i) the product is wholly obtained or produced in a Party;
>
> (ii) the product is a yarn, thread, twine, cordage, rope, cable, or braiding, and,
>
> (1) the constituent staple fibers are spun in that Party, or
>
> (2) the continuous filament is extruded in that Party;
>
> (iii) the product is a fabric, including a fabric classified under chapter 59 of the Harmonized Commodity Description and Coding System, and the constituent fibers, filaments, or yarns are woven, knitted, needled, tufted, felted, entangled, or transformed by any other fabric-making process in that Party; or
>
> (iv) the product is any other textile or apparel product that is wholly assembled in that Party from its component pieces.
>
> (b) Special rules.
>
> (i) Notwithstanding subparagraph (a)(iv), and except as provided in subparagraphs (b)(iii) and (b)(iv), whether this Agreement shall apply to a good that is classified under one

[163] *See* Sungjoon Cho, *Change Distorted Rules*, 5/7/2007 NAT'L L. J. 27 (2007).

[164] Lan Cao, *Corporate and Product Identity in the Postnational Economy: Rethinking U.S. Trade Laws*, 90 Calif. L. Rev. 401, 410 (2002).

[165] US-Jordan FTA Annex 2.2 http://www.sice.oas.org/Trade/us-jrd/anx22.asp (emphasis added) [hereinafter USJFTA, Annex 2.2].

> of the following HTS headings or subheadings shall be determined under subparagraphs (i), (ii), or (iii) of subparagraph (a), as appropriate: 5609, 5807, 5811, 6209.20.50.40, 6213, 6214, 6301, 6302, 6304, 6305, 6306, 6307.10, 6307.90, 6308, or 9404.90.
>
> (ii) Notwithstanding subparagraph (a)(iv), and except as provided in subparagraphs (b)(iii) and (b)(iv), this Agreement shall apply to a textile or apparel product which is knit to shape in a Party.
>
> (iii) Notwithstanding subparagraph (a)(iv), this Agreement shall apply to goods classified under HTS heading 6117.10, 6213.00, 6214.00, 6302.22, 6302.29, 6302.52, 6302.53, 6302.59, 6302.92, 6302.93, 6302.99, 6303.92, 6303.99, 6304.19, 6304.93, 6304.99, 9404.90.85, or 9404.90.95, except for goods classified under such headings as of cotton or of wool or consisting of fiber blends containing 16 percent or more by weight of cotton, if the fabric in the goods is both dyed and printed, when such dyeing and printing is accompanies by 2 or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing.
>
> (iv) Notwithstanding subparagraph (a)(iii), this Agreement shall apply to fabric classified under the HTS as of silk, cotton, man-made fiber, or vegetable fiber if the fabric is both dyed and printed in a Party, and such dyeing and printing is accompanied by 2 or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing.
> (…)[166]

As is widely documented, most textile products are nowadays manufactured in global supply chains. Producers can now execute various production processes, such as weaving, knitting and needling, in multiple countries in a way which optimizes their logistical needs.[167] Therefore, a

[166] *Id.*
[167] Hildegunn Kyvik Nordås, *The Global Textile and Clothing Industry post the*

Jordanian textile producer might want to ship half-finished products to an African country to complete the rest of the production stage with a lower wage cost and then ship final products back to Jordan. However, to benefit from the duty-free access to the U.S. market under the FTA, the "constituent fibers, filaments, or yarns [must be] woven, knitted, needled, tufted, felted, entangled, or transformed by any other fabric-making process"[168] in nowhere but Jordan. Therefore, to the extent that the Jordanian producers must comply with these eccentric rules of origin they are deprived of better business opportunities, such as outsourcing. They might be exempted from these taxing requirements, only if they satisfy other stringent conditions, i.e., if they trade "silk, cotton, man-made fiber, or vegetable fiber" products, and if "the fabric in the goods is both dyed and printed, when such dyeing and printing is accompanies by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing."[169] In sum, these rules of origin exist not to create but to suppress trade. They are a relic from the mercantilist system because they served the function of protecting the benefit of the negotiated bargain. However, since nearly every country is entitled to MFN, the non-preferential rules no longer serve that need in any meaningful way.[170] The preferential rules of origin are overtly mercantilist. Just keeping track of inputs so that a country of origin determination can be made adds significant cost.

While one can point to other uses for country of origin rules ("marking" for example), we would argue that these functions serve questionable ends. For example, many countries require not only that a country of origin determination be made for the purposes of tariff treatment, but also that imported products be marked so that the ultimate purchaser know the country of origin. But even assuming that purchasers care enough about the country of origin determination to bear the added costs, for any product where value is added in more than one country the marking will be misleading.

Imagine a manufacturer of bath and beauty products. It may have hundreds of products with thousands of components and it is possible that each component could be sourced from more than one, and perhaps several,

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Agreement on Textiles and Clothing, WTO Discussion Paper No. 5, at 8 (2004).

[168] USJFTA, Annex 2.2, *supra* note 165 (emphasis added).

[169] *Id*. (emphasis added).

locations. Assume, as is likely the case, that all of the components originate wholly from WTO member countries and no matter what the country of origin determination the product will be entitled to the same rate of duty. That importer will nonetheless have to keep track of each component, even though its choice of where to source the component is likely driven by pricing, timing, and availability, rather than country origin marking requirements. And even if purchasers of the product might care about the origin of the product and might not want a product from a particular country, the country of origin marking is not necessarily telling her what she thinks. "Made in France" does not mean that there are no components from China or Turkey or El Salvador. Lastly, this manufacturer, desiring a certain label of origin, *i.e.* Made in France, might distort its behavior just enough to acquire that label. So you can have a manufacturer distorting comparative advantage principles to obtain a label that stands a good chance of being misleading.

We believe that the outdated rules of origin stem from a fundamental conception of trade that simply no longer holds true: the single-country production model. Only when negotiators and policy makers break free of this framework will we be able to cast off the weight of these anachronistic rules.

III. MODERNIZING GLOBAL TRADING RULES: A CASE FOR TRADE NETWORKS

As discussed above, the ever-salient multi-location production patterns and the increasingly obsolete notion of reciprocity render the conventional top-down treaty-making approach ill-equipped in addressing new complex problems such as transfer pricing or reform of the country of origin rules. Here, a bottom-up approach, such as trade networks, merits serious consideration as an alternative mode of norm-making. First of all, the state-centric model of negotiation easily stalls when the political stakes are involved. Changes that require breaking the mercantilist frame is often politically infeasible. Second, these are complex issues that span multiple issue areas (*e.g.* tax and customs, or economics and statistics). Groups of problem solvers well-versed in these issue areas will be necessary to develop nimble yet nuanced approaches. In the transfer pricing arena we have already seen tax and customs professionals – from governments, international organizations, and private businesses – working in a variety of venues to solve the conundrum. We can also identify a similar phenomenon in a trade statistics network, which, although not directly aimed at country

of origin rules reform, clearly lays the groundwork for such reform.

A. Trade Networks as a Bottom-Up Approach

The anachronism of some trade rules necessitates a prompt policy response. However, the conventional method of international cooperation in the trade regime, treaty-making, does not appear to offer a workable solution here. First, even after six decades of trade liberalization a mercantilist specter still haunts the domestic politics in major countries.[171] In particular, amid the crisis-borne recession, trade policies remain politically sensitive issues: exports and imports are loaded terms these days.[172] This is a barren environment in which one might not expect any political capital necessary to launch and sustain negotiations with a view to amending the relevant WTO agreements on the customs regulation. Moreover, disentangling the labyrinthine rules rife with incomprehensible technicalities via trade negotiation is questionable.[173] One should not negotiate over what one could not understand. Even if negotiators could somehow deliver a newly harmonized set of customs rules, they might be equally unintelligible.[174]

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[171] Mercantilism in Latin America, Fin. Times, March 20, 2012 available at http://www.ft.com/intl/cms/s/0/878bab8a-729d-11e1-9c23-00144feab49a.html#axzz235FGL9Kc; Daniel Ikenson, *Made on Earth: How Global Economic Integration Renders Trade Policy Obsolete*, Trade Policy Analysis, Cato Institute, Dec. 2, 2009 at 9 available at http://www.cato.org/publications/trade-policy-analysis/made-earth-how-global-economic-integration-renders-trade-policy-obsolete; Annie Lowrey, An Increase in Barriers to Trade Is Reported, N.Y. Times (June 22, 2012), http://www.nytimes.com/2012/06/23/business/global/rise-in-trade-protectionism-is-noted-by-the-wto.html. European Commission, Press Release, EU sounds alarm over sharp rise in protectionism across G20 (June 6, 2012), http://trade.ec.europa.eu/doclib/press/index.cfm?id=804. Paul Taylor, In France, Old Protectionist Idea Reawakened, N.Y. Times (Apr. 18, 2011), http://www.nytimes.com/2011/04/19/business/global/19inside.html.

[172] *See e.g.*, Protectionism Concerns Intensify as G-20 Summit Approaches, 16 Bridges Wkly Trade News Update, No. 22, Jun. 6, 2012 (quoting the WTO Director-General Pascal Lamy who warned against "a clear revival of protectionist rhetoric" in recent times).

[173] The need for "administrative simplicity" but "negotiability" (hard to negotiate) Patricia Augier et al., *The Impact of Rules of Origin on Trade Flows*, Economic Policy 567, 603 (2005).

[174] Henry Wai-chung Yeung, *Organising Regional Production Networks in Southeast Asia: Implications for Production Fragmentation, Trade, and Rules of Origin*, 1 J ECON GEOGR (2001), 299, 315 (2001); W. Keizer, *Negotiations on Harmonized Non-Preferential Rules of Origin: A Useless Task from a Trade Policy Perspective?*, 31 J. WORLD TRADE 145, 149-50 (1997); Antoni Estevadeordal et al., *Multilateralizing Preferential Rules of*

Even assuming the political will and technical expertise, the nature of some problems are not suitable for treaty-based solutions; they need more holistic and nuanced treatment. Sometimes, as is the case with rules of origin, the complex customs regulations are themselves "non-tariff barriers".[175] Reciprocal bargains cannot adequately address these barriers because they cannot be mutually cancelled off as tariffs can. Only customs professionals can decipher those mercantilist terms behind innocuously sounding provisions. At the same time, only through epistemic dialogue they can better understand different regulatory positions of the other parties. This mutual understanding begets mutual trust, which can translate into regulatory toleration, if not a full-blown harmonization.[176] Trade networks are instrumentally more suitable to address the complex trade problems emerging as a result of the global factory.

For the purpose of this Article, a trade network is defined as a "hybrid" of public and private networks composed of customs officials on the one hand, and private lawyers, academics and transnational businesses on the other. It is a conceptual expansion of government networks or transgovernmental regulatory networks (TRNs).[177] A TRN is composed of like-minded working-level professionals who share the common belief in regulatory problems and responses across the state lines.[178] It is a process, rather than an entity: what matters is that those networkers (professionals) continuously interact and communicate with each other, not necessarily that they are affiliated with a distinct institutional form.[179] A trade network is a hybrid in that those networkers include both public (regulators) and private players (regulatees). Based on shared knowledge and concerns on particular technical issues, these networkers as "policy entrepreneurs"[180] may generate certain soft law, i.e., regulatory prototypes in the form of guidelines and recommendations, which can both reflect and guide their future behaviors in this area. In fact, many scholars have already

Origin around the World, Conference Paper Prepared for the WTO/HEI/NCCR Trade/CEPR Conference ("Multilateralizing Regionalism"), Sep. 2007, at 53.

[175] http://www.uscib.org/index.asp?documentID=814

[176] *See generally* David J. Gerber, Global Competition: Law, Markets and Globalization (2010) (introducing the notion of "commitment pathway" that prioritizes the commitment in regulatory engagement over actual output of convergence)

[177] *See* Cho and Kelly, *supra* note 18, at 501 (discussing networks).

[178] *Id.*

[179] *Id.*, at 503-04 (discussing the importance of day to day interactions).

[180] JOHN KINGDON, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES 188-93 (2d ed., 1997).

documented this network-driven soft norm-making process, in particular in the area of banking regulation.[181] In the long-term, these network activities may pave groundwork for possible hard law-making, i.e., treaty amendments.[182]

B. Transfer Pricing Networks

In response to the aforementioned transfer pricing challenges, networks of regulatory officials, business lawyers and international actors have emerged. First, private actors struggled at the national level to deal with a variety of transfer pricing challenges. These efforts then spread internationally to a variety of organizations including the OECD and WCO, which in turn provided guidance to national regulators with input from those regulators and private attorneys.

The earliest initiatives to deal with the complexities of related party transfer pricing issues came from the private sector tax professionals. Taxpayers and professionals approached the IRS in the United States to establish the Advance Pricing Agreement (APA) Program as a means to settle transfer pricing issues outside an adversarial process.[183] The program began in 1991.[184] Essentially an APA is a transfer pricing study, a document that establishes the appropriate methodology to determine the transfer price between entities over a period of time. An APA is an agreement between the IRS and a taxpayer. The transfer pricing study methodology may allow for certain adjustments that can result in increases or decreases to the price depending on different variables. The taxing authority and the taxpayer agree upon a methodology in advance and in a non-adversarial setting.[185]

While taxing authorities in the United States and elsewhere routinely

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[181] *See* Chris Brummer, *How International Financial Law Works (And How It Doesn't)*, 99 GEO. L.J. 257, 261-62 (2011); Stavros Gadinis, *The Politics of Competition in International Financial Regulation*, 49 HARV. INT'L L.J. 447, 460-61 (2008).

[182] Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 VA. J. INTL L 1, 81 (2002).

[183] Announcement and Report Concerning Advance Pricing Agreements, Issued Pursuant to Pub. L. 106-170, Section 521(b) available at http://www.irs.gov/pub/irs-drop/a-00-35.pdf

[184] *Id.*

[185] *See* Treas. Reg. § 1.482-1 et se. The IRS has set out its procedures for APAs in two Revenue Procedures. Rev. Proc. 2008-31, 2008-23 I.R.B. 1133, at 1. Rev. Proc. 2006-9, 2006-1 C.B. 278, at 1.

accepted transfer pricing studies as binding agreements as to value, customs authorities did not for a variety of reasons. Customs' rejection of APA (not always, but often) stemmed from its fundamentally different perspectives on transfer pricing.[186] Customs authorities in the United States and elsewhere sought to identify the correct "transaction" value for each single importation of merchandise.[187] The Valuation Agreement which binds all WTO members speaks to valuation of related-party sales and requires that it approximate certain test values, the most important of which is transaction value.[188] Transaction value is defined by the Agreement as the price "that is the price actually paid or payable for the goods when sold for export to the country of importation"[189] with certain adjustments. Thus, customs value is conceived of a single price paid or payable for a product. The customs office must ensure that such a price be correct for each transaction. Therefore, an artificial value that an APA formula creates is seemingly inconsistent with the Valuation Agreement's preference for a price per transaction. Thus, in the United States Customs, for example, regularly held that a transfer price study alone was insufficient to validate a related-party transfer price.[190]

On the other hand, however, tax law practitioners consider the customs' refusal as unfair, especially in the face of Section 1059A. Customs authorities appraise value at the time of importation. While customs regulations in the United States allow for importers to employ formulas to determine customs value, those formulas were only acceptable when the indeterminate variables are beyond the control of the parties (e.g., currency fluctuations).[191] Where the parties control the variables as they often do in APAs, then subsequent reductions in prices are considered post importation "rebates" which are irrelevant for customs valuation. Therefore, typical post importation decreases in value under an APA would be precluded under Section 1059A.

In short, APAs allowed taxpayers and tax authorities to work out a

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[186] *Customs Valuation: Transaction Value and Related Parties*, Customs and Int'l Trade Alert (Blank Rome LLP, New York, N.Y.), Oct. 2008, *available at* http://www.blankrome.com/index.cfm?contentID=37&itemID=1685

[187] 19 C.F.R. § 152.103 (2012).

[188] Marrakesh Valuation Agreement, *supra* note 119, art. 1.

[189] *Id.*

[190] Headquarters Ruling Letter (HRL) 546998 dated January 19, 2000 (explaining that a transfer pricing study alone is insufficient to support a transfer price).

[191] *See* 19 CFR §152.103(a); 2011 U.S. CUSTOM HQ LEXIS 272 (U.S. CUSTOM HQ 2011).

mutually acceptable transfer price formulas. If customs authorities would accept such a formula, many of the conflicts between most tax and customs regimes would go away. The timing of valuation would not be a problem because the valuation would be constructed using a formula that recognized that some variable of the formula might occur post-importation. The differences in methodologies would be resolved because the agreement would provide the formula. Most importantly, however, the ability to use a formula would allow customs value to capture post-importation variables so that a tax basis would not be artificially limited by Section 1059A, as discussed above.[192] The problem was how to get customs officials in the United States and elsewhere to re-conceive their approach to valuation. The solution was networks.

Networks emerged nationally and internationally on this issue. Many other jurisdictions had the same or similar rules to the United States, causing significant headaches for MNEs who sought relief from national regulators and attracted the attention of other national jurisdictions and the WCO and the OECD. Tax professionals and customs practitioners first worked on a case by case basis to convince regulators to accept agreed upon valuations for tax and customs purposes. Accounting and law firms regularly petitioned national customs authorities to accept prices established through APAs as valid transactions values.[193] Bar associations held programs exploring the need to reconcile the tension between tax and customs valuation.[194] Efforts were made to establish norms reflecting this agreements and pressure was added by the efforts of the OECD and WCO.[195] The process was incremental.

The WCO Committee on Customs Valuation (CCV) and the Technical Committee on Customs Valuation worked closely with the OECD and private partners to address transfer pricing and the lack of

[192] *See supra* note 191 and accompanying text.

[193] *See* 2000 U.S. CUSTOM HQ LEXIS 688 (U.S. CUSTOM HQ 2000)(successful); 2002 U.S. CUSTOM HQ LEXIS 1012 (U.S. CUSTOM HQ 2002)(unsuccessful).

[194] *See e.g.*, ABA Tax Meeting, Committee on Transfer Pricing, available at http://meetings.abanet.org/webupload/commupload/TX357000/sitesofinterest_files/2009_Midyear_Meeting_Handout_2nd_Hour.pdf; Advanced Singapore Summit On Asia Customs Compliance available at http://www.americanconference.com/2011/968/advanced-singapore-summit-on-asia-customs-compliance/workshop

[195] *Second Joint WCO-OECD Conference on Transfer Pricing and Customs Valuation* http://www.wcoomd.org/files/2.%20Event%20files/PDFs/Valeur/Conference%20Brochure.pdf (Second Joint Conference calling for national tax and customs authorities to coordinate).

consistent treatment between taxing and customs authorities.[196] In 2006 and 2007, the OECD and the WCO formed a Joint Focus Group on Transfer Pricing addressing both tax and customs valuation issues.[197] For example the 2007 Meeting of the Focus Group on Transfer Pricing recommended:

> Consideration of the Customs valuation treatment of situations where a Transfer Pricing agreement indicates that the declared Customs value will be adjusted as necessary at a later date to achieve a pre-determined profit margin (known as price review clauses).[198]

This group enlisted the help of industry as well[199] and encouraged augmented dialogue between the customs and tax administrations.[200] The OECD and the WCO sponsored conferences on the transfer pricing issue in an effort to improve certainty for businesses. As a result of these meetings, in 2011 the WCO endorsed efforts to link tax and customs transfer pricing.[201] Specifically, in Commentary 23.1 to the Valuation Agreement, the WCO "provide guidance on the use of a transfer pricing study, prepared in accordance with the OECD Transfer Pricing Guidelines, and provided by importers as a basis for examining "the circumstances surrounding the sale", under Article 1.2 (a) of the Agreement."[202] It concluded that customs authorities should be willing to consider transfer pricing studies on a case by case basis. These efforts have built off of private sector and national regulatory efforts to confront transfer pricing challenges and they themselves are now influencing national regulatory regimes.

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[196] *Joint WCO-OECD Conference on Transfer Pricing and Customs Valuation*, OECD (April 24, 2006), http://www.oecd.org/document/39/0,3746,en_2649_33753_36541927_1_1_1_1,00.html

[197] *Meeting of the Focus Group on Transfer Pricing, Summary of the Proceedings*, WCO (October 26, 2007), http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Valuation/Recommendations_Transfer_Pricing_pub(E).pdf [Hereinafter 'Recommendations Transfer Pricing'].

[198] *Id*., at 2.

[199] *Id* ("Members of the Focus Group from the Private Sector could contribute to TCCV discussions on these issues, via the ICC or by the invitation of the Chairperson").

[200] *Id* ("Greater dialogue between the Customs and Tax administrations to be encouraged").

[201] *World Customs Organization: Converging Transfer Pricing and Customs Valuation Rules*, KPMG TAX NEWS FLASH (June 20, 2011), http://www.us.kpmg.com/microsite/taxnewsflash/Customs/2011/Jun/TNFTC11_253.html.

[202] *Examination of the Expression "Circumstances Surrounding the Sale" Under Article 1.2 (a) in Relation to the Use of Transfer Pricing Studies*, WCO, 1 (October 2010), http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Valuation/Commentary_23.1.pdf.

Recently, the U.S. customs office revoked its long standing ruling which prohibited post-importation downward adjustments in transfer pricing cases. [203] As indicated above, U.S. customs office had long held that it would not accept a value (as a transaction value) which was based on a non-objective formula (as are many APA values). [204] In issuing its new ruling, it now allows for the use of APAs (under certain circumstances) as the basis for customs values. Critically, a treaty did not bring this rather dramatic policy change. It was none but a set of various transfer pricing networks which created a new norm in this technical area.

C. Trade Statistics Networks

A compilation of actors have made meaningful progress to break free from the single-country production model and formed what may be coined the trade statistics network. In comparison with the previous transfer pricing network, the trade statistics network is in an earlier stage in its formation and thus much looser in its organization. It may better be coined a "proto-network," rather than a full-blown network. Nonetheless, it certainly demonstrates some common attributes of a network. This network of actors includes members of international organizations such as the United Nations (UN), the OECD, and the WTO, national regulators (for example the United States Commerce Department, quasi-governmental agencies such as the Japan External Trade Organization, academics and civil society (participants in the World Input Output Database). [205] This network has been working to re-conceptualize how we measure and present trade statistics. [206] A necessary first step in this work is shifting from a "trade in goods" framework to a "trade in tasks" framework, a shift that has significant implications for outdated rules of origin and their trade-distorting effect, as discussed above. [207]

The trade statistic network has its origins in the work of several

[203] *Notice of Revocation of a Ruling Letter HQ 547654 Relating to Post-Importation Adjustments; Transfer Pricing; Related Party Transactions; Reconciliation*, 46 Cust. B. & Dec. 1, 2 (May 16, 2012); 2012 WL 2339437, at *2 (May 16, 2012).

[204] *See id*. at 2.

[205] *WTO and OECD to Develop Statistics on Trade in Value Added*, WTO NEWS ITEMS (March, 15 2012), http://www.wto.org/english/news_e/news12_e/miwi_15mar12_e.htm.

[206] *Id.*

[207] *Made in the World; Message from the Director-General Pascal Lamy*, WTO MIWI HOMEPAGE (April 4, 2011), http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm.

international organizations. The United Nations Statistical Commission[208] both standardizes and collects statistical information on international trade as well as a number of other topics.[209] Working with the WTO in 1995, the Statistical Commission generated a report entitled "National reporting practices in International Merchandise Trade Statistics"[210] and sought to revise its "International Trade Statistics: Concepts and Definitions" in connection with a number of goals, including the WTO and the WCO's work on the rules of origin.[211]

More recently, the EU sponsored the World Input-Output Database (WIOD) as part of the 7th Framework Program, on Socio-Economic Sciences and Humanities. The WIOD is dedicated "analy[zing] the effects of globalization on trade patterns, environmental pressures and socio-economic development across a wide set of countries."[212] The WTO, partnered with the OECD, the U.S. International Trade Commission, the World Bank, the Institute of Developing Economies (IDE) and the Japan External Trade Organization (JETRO), plans to modernize trade statistics in a way that takes account of globalization and moves away from bilateral notions of trade.[213]

The WTO brought the issue to the public's attention with its "Made

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[208] *UN Statistical Commission*, UNSD HOMEPAGE, http://unstats.un.org/unsd/statcom/commission.htm. (last visited July 15, 2012) (Established in 1947 the Commission has 24 elected UN member countries).

[209] *The United Nations Statistics Division*, UNSD ABOUT US, http://unstats.un.org/unsd/aboutus.htm. (last visited July 15, 2012).

[210] *International Merchandise Trade Statistics National Compilation and Reporting Practices: Survey Results 2006 and 1996 Introduction*, UNSD (JULY 25, 2008), HTTP://UNSTATS.UN.ORG/UNSD/TRADEREPORT/INTRODUCTION_MM.ASP.

[211] *See id*. (Textual footnote on IMTS 2010 and revised Compilers manual).

[212] *The World Input-Output Database (WIOD)*, WIOD (July 6, 2012), http://www.wiod.org/database/index.htm (accessed by clicking "Database" on the toolbar at the top of the WIOD homepage). (In April of 2012, the WIOD made its database available to the public for the analysis of the data it had accumulated. This information came from 27 EU Countries and 13 others from across the world, excluding Africa. European Union: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom. North America: Canada, United States. Latin America: Brazil, Mexico. Asia and Pacific: China, India, Japan, South Korea, Australia, Taiwan, Turkey, Indonesia, Russia).

[213] Richard A. McCormack, *Everything is 'Made in the World': WTO is One Step Closer to Eliminating Country-Of-Origin Labels*, MANUFACTURING NEWS (May 14, 2012), http://www.manufacturingnews.com/news/madeintheworld514121.html.

in the World Initiative." In October of 2010, Director-General Pascal Lamy gave a speech to the French Senate in which he coined the phrase "Made in the World" as a way to differentiate the system of measuring value added by country, rather than using the current system of country of origin labeling. During the speech, he referred to a 2009 report published by the French Senate which stated, "traditional measurement of foreign trade alone no longer suffices to explain how [the country] fits into the world economy". [214] Concerned with how advocates for state sovereignty might be concerned with a(nother) system of global governance for international trade, Lamy said, "…we are certainly not "deconstructing" the national and international statistical system or "displacing" certain elements of that system. On the contrary, we are trying to "relocate" and "reorganize" in a more integrated context the sparse information available today…"[215] This statement reflects the WTO's support of the activities of the WIOD and similar regional projects directed at reaching a critical mass of new statistics on trade flows, with careful attention paid to value add at each stage in the global supply chain.

During the course of 2011, Director-General Lamy and others within the WTO began pushing this notion of "Made in the World" and evaluating trade based on value added rather than country of origin. At the Global Forum on Trade Statistics in February of 2011, leaders from the WTO posed the question to trade statisticians from all over the world, as to whether current measurements of trade (based on country of origin) adequately reflected the "new reality of global production." [216] In June 2011, when announcing the WTO and IDE-JETRO publication "Trade Patterns and Global Value Chains in East Asia," Lamy emphasized the core message of the book and the philosophy behind it: "by focusing on gross values of exports and imports, traditional trade statistics give us a distorted picture of trade imbalances between countries"; "The picture would be different if we took account of how much domestic value-added is embedded in these flows." [217] It was also at this point that the WTO announced the launch of it's "Made in the World" website, devoted to

[214] *Lamy Says More and More Products are 'Made in the World'*, WTO NEWS (October 15, 2010), http://www.wto.org/english/news_e/sppl_e/sppl174_e.htm

[215] *Id.*

[216] *Opening Statement by DDG Alejandro Jara: Global Forum on Trade Statistics*, WTO, 5 (February 3, 2011), http://www.wto.org/english/res_e/statis_e/forum_feb11_e/jara_e.pdf.

[217] *Lamy Suggests 'Trade in Value-Added' as a Better Measurement of World Trade*, WTO NEWS (June 6, 2011), http://www.wto.org/english/news_e/news11_e/miwi_06jun11_e.htm.

facilitating dialogue on this growing concept of new measurements of international trade, now guided by the WTO.

By the end of 2011, a broad consensus began to emerge around the notion of measuring international trade based on value added, rather than country of origin. [218] In particular, the APEC Conference on using input-output tables for economic modeling was a significant landmark in this regard. It successfully transferred the concepts introduced by the WTO, JETRO, WIOD, and other policy organizations into the hands of finance ministers from major economies. However, the political concerns of such a major shift in trade policy somewhat eclipsed this success. Participants in the conference agreed to move forward in "incremental ways," [219] indicating that progress may be possible in the future, but almost certainly not in the near term.

The WIOD and the larger WTO initiative take notice of the global nature of supply chains and the difficulty in determining a country of origin for products with elements drawn from a multitude of countries before their final sale. The WTO in promoting its "Made in the World," initiative has said that "attributing the full commercial value of imports to the last country of origin can skew bilateral trade balances, pervert the political debate on trade imbalances and may lead to wrong and counter-productive decisions."[220] By seeking to alter or eliminate the current system of country of origin labels, the WTO appears to be attempting to reframe the issue of global trade in a way to avoid many of the political pitfalls associated with products labeled as "Made in XXXX." Now even some politicians have begun to echo this revelation. Karel De Gucht, the European Commissioner for Trade, speaking at the WIOD conference this past April, criticized the current labeling scheme when he said it "is a bit like the final runner in a relay team getting a gold medal while his team-mates get silver and bronze. It doesn't take account of the fact that the final result is the product of a joint effort."[221]

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[218] *APEC Conference "Building APEC Economies' Capacities of Employing Input-Output Tables for Advanced Economic Modeling*", INTERNATIONAL INSTITUTE OF STATISTICAL EDUCATION, (November 24-25, 2011), http://miso.hse.ru/en/2011apec.

[219] *Building APEC Economies' Capacities of Employing Input-Output Tables for Advanced Economic Modeling*: *Summary*, INTERNATIONAL INSTITUTE OF STATISTICAL EDUCATION, 2 (November 24-25, 2011), http://www.hse.ru/data/2011/12/02/1270898220/Summary%20of%20the%20Conference.doc.

[220] *Id.*

[221] De Gucht, Karel. "Trading in Value and Europe's Economic Future." Brussels,

The new conceptualization of trade and in particular the shift to trade in task has many legal and non legal implications. First, as a practical matter, the new framework may simply be just a better reflection of what is actually going on in the world. Second, the new cognitive framework that provides policy makers with useful information regarding nations trading partners. For example, while the U.S. trade balance in iPhones vis-à-vis China in 2009 under the traditional trade statistical model is approximately minus $2 billion, the new model based on value added is merely minus $73 million, most reflecting labor costs incurred in China.[222] In fact, certain shared epistemic grounds have already existed over this particular issue.[223]

The work of the trade statistics network has opened a new way to thinking about country of origin. The trade statistics network can help break the conceptual single country production frame. Once that frame is broken, policy makers can assess the value or current country of origin determination and perhaps adopt new ones that better reflect the true origins of products.

April 16, 2012. Both De Gucht and WTO Deputy Director General Alejandro Jara, speaking at the April conference, took the position that the improved statistics would help demonstrate to countries of the fallacy of the notion that more imports mean a weak economy, or more exports a strong economy. In an attempt to rail against this antiquated and mercantilist concept of trade, one journalist referred to the oft-mentioned example of the iPhone as an example of a product "Made in China" but only a small fraction of the its value is added there, compared to a much larger share in the United States, as the home of Apple. http://www.just-style.com/comment/is-garment-production-coming-home_id114354.aspx?d=1

[222] Andreas Maurer, *Trade in Value Added: What Is the Country of Origin in an Interconnected World?,* Apr. 20, 2011 (WTO: Made in the World site).

[223] *See e.g.*, Daniel Ikenson, Lies, Damned Lies and Trade Statistics, Dec. 16, 2010, http://www.cato-at-liberty.org/lies-damned-lies-and-trade-statistics/ (observing that global economic integration calls for a new way of understanding trade statistics based on , value-added); Greg Linden et al., *Who Captures Value in a Global Innovation System: The Case of Apple's iPod*, June 2007, http://escholarship.org/uc/item/1770046n#page-1 (warning that trade statistics can mislead the public); Yuqing Xing & Neal Detert, *How iPhone Widens the US Trade Deficits with PRC*, GRIPS Discussion Paper 10-21 (Nov. 2010) (concluding that traditional trade statistics tends to inflate bilateral trade deficits between a manufacturing platform country (such as China) and its destination countries (such as the United States); WTO, *Lamy Says More and More Products Are "Made in the World*," WTO News, Oct. 15, 2010 (arguing that WTO members should embrace a new way of understanding ("debilateraliz[ing]") trade statistics in an era of "multi-located" production based on added values in each stage of production).

D. Using Trade Networks to Cast Off the Remnants of Mercantilism

The existence of the transfer pricing network and the trade statistics networks offers more than an anecdotal account of bottom-up, issue-specific problem solving. These trade networks can offer opportunities to re-conceptualize trade rules free from mercantilist dispositions. This re-conceptualization in turn presents a more holistic account of the problems that trade rules must address. Some problems are ill-served by a process that excludes or marginalizes various non-state actors. Networks provide access to lawyers, academics, civil society and business interests. Networks focus more on problem solving rather than quid pro quo trading for gains. Networks bring actors together from a variety of issue areas.

The consultative nature of networks allows them to holistically approach complex problems. Network regulators develop approaches, principles, standards. The fact that they are not developing hard law frees them to incrementally develop norms over time with all different types of actors, from private enterprises to civil society or with other network actors. In fact, it is this lack of strong "accountability" to any particular group that has been leveled as a criticism of networks. But it is also one of the strengths of networks. The flexibility of networks to consult a wide array of policy makers and other problem solvers can allow them to look at a problem holistically. Thus, norm entrepreneurs from both the tax and customs background, be they academics, business people or governmental officials, may hang together to creatively think about complex policy challenges such as transfer pricing issues. Likewise, statisticians and economists may work with trade lawyers to confront the changing patterns of trade.

Networks, as problem solvers, do not focus on a reciprocal bargain, but rather on facilitating business more generally. State to state negotiation of trade has typically concerned itself with reciprocal concessions. For example, lower tariffs on various products can be traded. Some problems do not lend themselves to such bargaining. The conflict between national tax authorities and customs authorities is not a problem that requires a bargain – it is a problem that requires a dialogue. Other emerging trade issues involving trade facilitation, or standards harmonization, likewise need these kinds of discursive solutions, not necessarily negotiated concessions. Networks are well-equipped to provide these discursive opportunities.

Networks are also better suited at confronting development problems. The complexity and variety of global supply chains call for adequate government policies, in particular by developing countries, to overcome the "logistics gap" and harness such chains for their developmental needs.[224] According to a recent study commissioned by World Bank logistics specialists, Morocco was able to better capitalize on its geographical proximity to Europe to obtain better access to the European market by implementing a comprehensive program to advance its trade logistics. Reforming border management in conjunction with large infrastructure investments in the Tangier-Med Port facilitated its "just-in-time" exports to Europe, in particular for its strategic sectors, such as auto parts, electronics and textiles. Morocco's achievement is testimonial to the potential of logistics reform in terms of economic growth and development for developing countries.[225]

Admittedly, networks will not replace state to state negotiation of concessions. Nor will they replace the state created hard law embodied in treaties. Nonetheless, networks can certainly complement the conventional rulemaking process and provide an avenue in which to handle new, complicated trade-regulatory problems and challenges.

CONCLUSION

Importantly, trade anachronism leaves its trace also in the current pedagogical divide between (public) international trade law and (private) international business transactions. Basically as a statist curriculum that addresses state-to-state legal relations on trade affairs, International Trade Law seldom discusses what actually constitutes international trade, such as sales, distribution and marketing. Therefore, this state-oriented structure of International Trade Law, although faithful to the traditional public international law framework, has increasingly become inadequate in fully capturing, and governing, contemporary international commerce.

In this regard, the WTO as an institution should redouble its efforts to reach out to those micro players, such as retailers and consumers, who collectively comprise the global trading system. Social marketing should be an important tool for the WTO to connect the aforementioned public/private

[224] Jean-François Arvis et al., Connecting to Compete: Trade Logistics in the Global Economy iii (2012).

[225] *Id.*, at 2.

divide. With more direct presence, and participation, of these individual actors in the WTO decision-making process, its anachronistic trading norms can change, not necessarily in a traditional top-down fashion (such as treaty-making) but rather in a diffused, bottom-up manner (such as networking). Importantly, this paradigm shift will also transform the nature of trading norms, from a fiat to a communication manual. To trading nations and traders alike, this manual will assist them in mapping out their optimal economic activities, rather than normatively boxing them in. Eventually, this new norm-making, and subsequently norm-sponsoring, process will construct the WTO as the true global trading *community*.