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# Local Rules and a Global Economy: An Economic Policy Perspective

Dan Danielsen\*

## Abstract

This article explores the growing significance and theoretical implications of ‘local rules’—such as Chinese labour standards, US financial regulation and Swiss bank secrecy rules—in the global economy. In particular, the argument developed is that Ronald Coase’s framework for analysing the effects of legal rules on economic welfare can help to reveal important weaknesses in current international legal approaches to analysing the transnational impact of local rules as well as contribute to a ‘global economic policy perspective’ better attuned to problems of power in the global regulatory order. Such a perspective will help us to see the effects of power differences among political and economic actors in the global economy more clearly, and perhaps also to develop new and more complex notions of economic participation, political pluralism and distributive justice in the creation and operation of both the local and the international rules that comprise the global economic regulatory order.

## 1. LOCAL RULES IN A GLOBAL ECONOMY

The global economic crisis of 2008 and 2009 has forced scholars, activists, policymakers, regulators, the media and ordinary citizens to focus on the importance of local rules in shaping economic activity and welfare across the globe.<sup>1</sup> Of course, even before the crisis

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<sup>1</sup> When using the term ‘local rules’ in this essay, I mean to include rules adopted by any regulatory authority of any nation-state or political subdivision of a nation-state, such as provinces, states, municipalities or administrative agencies of any of the foregoing, but excluding norms or *de facto* rules created by non-state actors or quasi-public bodies such as stock exchanges (eg the New York Stock Exchange), industry associations (eg the National Association of Securities Dealers or the American Bar Association), private standards organisations (eg Underwriters Laboratories Inc or the International Standards Organization) or economic actors (eg firms, partnerships or sole proprietors). Whenever I mean to refer to norms or *de facto* rules generated by non-state actors, quasi-public bodies or economic actors, I will do so expressly.

it was no secret, for example, that the local rules for banking, securities and insurance in the United States, the United Kingdom and Japan established a kind of *de facto* legal order for the global financial system, not only through direct regulatory oversight but also by shaping the behaviour and expectations of economic actors in financial transactions regardless of whether they were formally subject to the rules.<sup>2</sup> Notwithstanding this general sense that some local rules play a role in structuring the global economy, the extent to which particular US state and federal rules and administrative policies—regarding matters like oversight of mortgage lending, access to consumer credit, the creation and distribution of complex derivative securities, the inability of bankruptcy courts to restructure mortgages or the creation of incentives for increasing home ownership among low income and minority buyers—could so profoundly shape economic behaviour across the globe came as an unpleasant surprise to policymakers and regulators around the world.

In this article, I examine insights from the early work of Ronald Coase on the significance of legal rules in the allocation of resources in an economy<sup>3</sup>—work that sparked a sustained and influential scholarly effort to assess the policy desirability of particular legal rules based on their relative effects on economic welfare as a whole<sup>4</sup>—

- 2 See C Randall Henning, *Currencies and Politics in the United States, Germany, and Japan* (Institute for International Economics, 1994) 1–2, 12 (studying monetary policy in the United States, Germany and Japan because of the importance of those jurisdictions to international commerce, finance and macroeconomic affairs); John H Friedland, *The Law and Structure of the International Financial System: Regulation in the United States, EEC, and Japan* (Quorum Books, 1994) 2 (noting that ‘the pattern of US regulation has determined the focus of ... world regulation of financial markets in general’); Henry Hansmann and Reinier Kraakman, ‘The End of History for Corporate Law’ in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (Cambridge University Press, 2004) 33 (theorising that market forces will cause domestic corporate governance laws around the globe to converge around the US model focusing on shareholder interests); Howell E Jackson and Eric J Pan, ‘Regulatory Competition in International Securities Markets: Evidence from Europe in 1999’ (2001) 56 *Business Lawyer* 653, 654–5 (discussing how European institutional investors often demand disclosure standards similar to those required in the US when conducting securities transactions even though such standards are not required under applicable European law).
- 3 RH Coase, ‘The Problem of Social Cost’ (1960) 3 *Journal of Law & Economics* 1, reprinted in RH Coase, *The Firm, The Market, and The Law* (paperback edn University of Chicago Press, 1990) (hereinafter Coase ‘The Problem of Social Cost’).
- 4 Coase is commonly seen as one of the founding fathers of the ‘law and economics’ approach to legal analysis and ‘The Problem of Social Cost’ is among its most cited canonical texts. See eg Richard A Posner, *Economic Analysis of Law* (Aspen, 7th edn 2007) 23 (hereinafter Posner *Economic Analysis of Law*) (attributing the beginning of the ‘new law and economics’ to the publication of Coase’s ‘The Problem of Social Cost’ and Guido Calabresi’s famous article ‘Some Thoughts on Risk Distribution and the Law of Torts’ (1961) 70 *Yale Law Journal* 499). Works of law and economics scholarship building on Coase’s insights are far too numerous to list. For a brief history of law and economics scholarship as it has evolved since the publication of ‘The Problem of Social Cost’, see Posner *Economic Analysis of Law* 23–28. For a critical introduction to ‘The Problem of Social Cost’ and a useful bibliography of Coase’s work as well as some of the most important works of law and economics scholarship critical of Coase, see David Kennedy and William W Fisher III (eds), *The Canon of American Legal Thought* (Princeton University Press, 2006) 356–63 (hereinafter *The Canon of American Legal Thought*).

both to explore how these insights might contribute to the development of a 'global economic policy perspective' on local rules and to draw attention to significant weaknesses in our current international legal approaches to local rules with global effects. In this latter respect, the continued dominance of nationalistic, statist and sovereignty-oriented approaches to the assessment of local rules—even by international legal traditions long advocating the decline of national sovereign prerogatives and the importance of transnational legal arrangements—makes the development of a satisfying framework for the assessment of local regulatory initiatives from the perspective of their impact on global welfare much more difficult. In this respect, our current frameworks for thinking about the global significance of local rules are not up to the important regulatory challenges posed by today's global economy.

In the remainder of this first part, I sketch the global economic and regulatory significance of local rules and the importance of a 'global economic policy perspective' for assessing that significance. I also suggest how Coase's economic policy approach can help us to be more attuned to problems of power in the global regulatory system and the impact of local rules on global economic welfare. In Part 2, I explore Coase's framework for analysing legal rules from an economic policy perspective as a source of insight into some limitations in the international legal frameworks that concern themselves with the transnational effects of local rules. In particular, I argue that our largely territorial notions of sovereignty and our conventional disciplinary focus on formal rather than substantive sovereign equality make it difficult to consider the regulatory and distributional effects of local rules in the global economy in global rather than national terms or to challenge the numerous local rules that produce significant effects on global welfare but fall doctrinally into the category of legitimate exercises of sovereign jurisdictional authority.

In Part 3, I focus on issues raised by power asymmetries among local rulemakers in the global economic regulatory order and the differences those power asymmetries make in states' ability to influence economic activity or to affect their share of resources through domestic regulatory activities. In the increasingly integrated global economy, some jurisdictions will almost always generate transnational economic effects with their local rulemaking, while other jurisdictions may find their regulatory authority swamped by the economic effects of rules made elsewhere.

In such circumstances, I argue that our current approaches to the international legal analysis of local rules can lead not only to important misunderstandings about how the global economic regulatory order actually functions but also to limitations in our ability to engage with real differences in the capabilities of different players in the global economy to influence the content or economic effects of the rules that shape their economic destinies. My hope is that an economic policy perspective that leads us to focus more explicitly on the links between power asymmetries, local rules and global welfare will help us to see power differences among political and economic actors in the global economy more clearly, and perhaps also to develop new and more complex notions of economic

participation, political pluralism and distributive justice in the creation and operation of the local and global rules that comprise the global economic regulatory order.

### A. Parochial Interests and Local Rules of Global Significance

While the crisis has highlighted the transnational economic effects of local rules with particularly graphic severity, the issue is of much greater significance to the ordinary operation of the global economic and regulatory order than may be at first apparent. We already know, for example, that a change in the emissions standards in California affects supply chains, research and development investment and technological innovation in ways that extend well beyond the geographic or jurisdictional boundaries of California.<sup>5</sup> Similarly, it is equally evident that Chinese regulation (and enforcement practices) regarding wage rates and labour standards in manufacturing will have effects on wage rates and labour standards around the world.<sup>6</sup> More prescriptively, we might hope that an increase in the capital reserve requirements for US chartered banks will result in increased financial stability in some parts of the world without producing dramatic capital shortages in others<sup>7</sup>—just as we might fear that regulatory choices regarding mercury emissions from coal burning power plants in China will affect mercury levels in soil and water across the globe with consequent effects on the safety of food and public health

5 See eg Ashley Morris Bale, 'The Newest Frontier in Motor Vehicle Emission Control: The Clean Fuel Cell Vehicle' (1995–6) 15 *Virginia Environmental Law Journal* 213, 226, 229–30, 243, 250–1, 253–4, 264, 269–70 (discussing the significance of California emissions regulations for the development of automotive technology and for federal emissions regulations).

6 See eg Raphael Kaplinsky, *Globalization, Poverty and Inequality* (Polity, 2005) 132–5, 217–18 (hereinafter Kaplinsky *Globalization, Poverty and Inequality*) (noting the significance of China's wage rates in creating its competitive advantage over the rest of the world in textiles manufacturing and shaping patterns of competitive behaviour in respect of wages and production methods around the world). Cf Katherine Van Wezel Stone, 'Labor and the Global Economy: Four Approaches to Transnational Labor Regulation' (1995) 16 *Michigan Journal of International Law* 987, 992–4 (hereinafter Van Wezel Stone, 'Labor and the Global Economy') (noting that a country's labour protection laws can increase or decrease its global competitiveness resulting in a global race to the bottom in labour standards); Louise D Williams, 'Trade, Labor, Law and Development: Opportunities and Challenges for Mexican Labor Arising from the North American Free Trade Agreement' (1996) 22 *Brooklyn Journal of International Law* 361, 370–5 (hereinafter Williams 'Trade, Labor, Law and Development') (noting the competitive pressure on developing countries not to adopt high labour standards); Ranko Shiraki Oliver, 'In the Twelve Years of NAFTA, the Treaty Gave to Me ... What, Exactly? An Assessment of Economic, Social, and Political Developments in Mexico Since 1994 and their Impact on Mexican Immigration into the United States' (2007) 10 *Harvard Latino Law Review* 53, 100–3 (noting that Mexico keeps its minimum wage down to remain competitively globally, which results in an increase in worker migration to the United States).

7 Cf Anthony M Vernava, 'Financial Liberalization in an Emerging Market: Peru's Financial Reforms and the Lima Stock Exchange—with a Focus on Concentration, Emerging Market Institutional Investors and Peruvian Financial Conglomerates' (1999) 6 *Southwestern Journal of Law & Trade in the Americas* 209, 215 (noting that high bank reserve requirements in Latin America prior to the deregulation of its financial markets limited macroeconomic liquidity).

around the world.<sup>8</sup> In short, the transnational economic effects of local rules have become a ubiquitous and unavoidable part of global economic life—a circumstance that seems unlikely to change in the foreseeable future.

To be sure, the international rules embodied in multilateral or bilateral treaties are also important. Yet, notwithstanding a steady increase in the number of intergovernmental, quasi-governmental and even non-governmental institutions offering international legal rules and norms within the scope of their respective jurisdictional mandates, the fact remains that the multitudes of separate and interconnected economic transactions that constitute ‘the global economy’ remain primarily governed by local rules made or enforced by at least one and often several nation-states.<sup>9</sup> In this sense, the recent global economic crisis has only highlighted what has long been true although insufficiently studied: our increasingly global economy is governed principally by local rules created by local institutions designed to serve primarily (if not exclusively) local policy interests and purposes.<sup>10</sup>

The disjunction between the global scale of the economy and local policy focus of the rules might give less cause for concern if there were a plausible theoretical or empirical basis for confidence that the regulatory behaviour of diverse nation-states acting in their national interest would be led by some ‘invisible hand’ to a global economic regulatory order that would maximise global welfare. In fact, few if any observers seem sanguine on this point. Policy elites and citizens everywhere worry that rules made far away will affect them but not take into account, let alone reflect, their interests. This, in part, explains the persistent calls for global rules to temper national behaviour in respect of such diverse substantive areas as humanitarian law, international criminal law, human rights, trade, corporate behaviour, financial services and climate change. Anxiety regarding foreign rules with domestic effects also seems to be reflected in the prevalence of economic nationalism and the correlative tendencies toward trade protectionism in political rhetoric as well as in law and policy choices. Moreover, even among the more cosmopolitan internationalists, the worry remains that, even as (until recently) global trade volumes

8 See Robert V Percival, ‘Environmental Law in the Twenty-First Century’ (2007) 25 *Virginia Environmental Law Journal* 1, 18–19 (discussing how it is estimated that 30% or more of the mercury found in the Western US originates in China, some of it coming from Chinese coal-fired power plants). See also Matt Pottinger *et al*, ‘Invisible Export: The Hidden Cost of China’s Growth: Mercury Migration’ *Wall Street Journal* (New York), 17 December 2004, A1.

9 See eg John Braithwaite and Peter Drahos (eds), *Global Business Regulation* (Cambridge University Press, 2000) 3–6 (hereinafter Braithwaite and Drahos *Global Business Regulation*). See also John Braithwaite, *Regulatory Capitalism: How it Works, Ideas for Making it Work Better* (Edward Elgar, 2008) 1–31 (hereinafter Braithwaite *Regulatory Capitalism*).

10 Compare Gunther Teubner, ‘“Global Bukowina”: Legal Pluralism in World Society’ in Gunther Teubner (ed), *Global Law Without a State* (Dartmouth/Ashgate, 1997) 3–28 (hereinafter Teubner ‘Global Bukowina’) (arguing that national law is being diminished in importance and displaced by semi-autonomous systems of global law generated through the practices and activities of fragmented social networks and institutions).

have steadily increased, international rules, however made, have failed and will continue to fail to respond adequately to the pervasiveness of poverty, extreme income inequality, economic instability, vulnerability to economic cycles in distant locales, extreme price volatility across numerous economic sectors, economic growth pathologies (whether declining, zero, slow, jobless or uneven), environmental degradation and resource-related conflict in many (if not most) areas of the world. It would be difficult, then, to conclude (without considerable despair) that the current global economic regulatory order is leading us (invisibly or otherwise) toward anything close to 'optimality' from the standpoint of global welfare.

Moreover, it is not at all clear that ever more international rules and standards are the best public policy response to the globalisation of economic life. Universal global rules and standards proposed by international institutions seem far more apt to reflect a negotiated balance of sovereign interests—particularly among the most powerful states—than a careful assessment of global welfare.<sup>11</sup> Despite the ambitious rhetoric in the preambles of many international agreements regarding the mutual advantages of co-operation for the states parties and the general welfare, not surprisingly, the agreements in action often mirror the disparities in power and interest among the states that make them.<sup>12</sup> For the global economy to be 'governed' in a satisfactory way, some institutional order would need the political legitimacy, accountability, transparency and authority necessary for co-ordinating functions and objectives among diverse regulatory institutions, balancing (and trading off) policy benefits among diverse constituencies, weighing, selecting and

11 See eg Eric A Posner, *The Perils of Global Legalism* (University of Chicago Press, 2009) 94–99 (arguing that the proliferation of international legal norms reflects efforts by the most powerful states to maintain power in the face of increasing fragmentation of the sovereign order); Anthony Anghie, *Imperialism, Sovereignty and the Making of International Law* (Cambridge Studies in International & Comparative Law Series, Cambridge University Press, 2004) (arguing that since its inception international law has consistently reflected the imperial power and ambitions of the coloniser [later the developed world] in subjugation of the colonised [later the developing world]); Ha-Joon Chang, *Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism* (Bloomsbury, 2008) 19–39 (arguing that the developed world used trade agreements and international institutional arrangements to extract higher levels of growth and prosperity at the expense of the developing world).

12 See eg Dani Rodrik, *One Economics Many Recipes: Globalization, Institutions and Economic Growth* (Princeton University Press, 2007) 213–14 (hereinafter Rodrik *One Economics Many Recipes*) (suggesting that while the preamble to the Agreement Establishing the WTO emphasised trade as a means for increasing global standards of living and achieving sustainable development, increased global trade has come to be seen as synonymous with development leading to liberalisation of trade for many countries without economic growth); M Sornarajah, *The International Law of Foreign Investment* (Cambridge University Press, 2nd edn 2004) 218–19 (hereinafter Sornarajah *The International Law of Foreign Investment*) (noting that every bilateral investment treaty begins with a declaration of purpose regarding the reciprocal encouragement and protection of investments which belies the reality that the agreements are generally entered into under coercive conditions between a developed capital-exporting country and a developing capital-importing country and expressly designed to protect investors from the developed home country from actions by the developing host country).

legitimizing choices among diverse policy options and providing safeguards, interim measures and distributional adjustments to address inequities and promote economic and social objectives. Although I am quite apprehensive about both the feasibility and the desirability of concentrating more state-like regulatory and political power in 'global' institutions, this fear is arguably beside the (present) point: for good or ill, the emergence of a global institutional order able to perform these functions for the global economy is not on the horizon. We all can recognise that these regulatory functions and the orientation toward a general welfare perspective they entail are part of what we understand—and what most of us will continue to understand for some time to come—to be the normal business of the nation-state (however effectively or ineffectively they may be accomplished in particular cases).

We might imagine that co-ordination among local rulemakers could help. Only recently, European states struggled, with some success, to co-ordinate their fiscal policies in response to the recent global economic crisis. A habit of collective rulemaking through the European Union institutions undoubtedly made co-operation easier than it might otherwise have been. While we know that governments consult one another all the time to negotiate about domestic rule changes, it is far from clear that these more or less *ad hoc* consultations will lead to a rule system that can serve the general welfare in a global economy. The effectiveness of co-ordinated rules may be in doubt. Constituencies that will be affected by the rules may not be represented or protected in the interstate co-ordinating processes.

Most importantly for my purposes, when governments negotiate about or 'co-ordinate' their rules from the perspective of their own interests, the international structural norms framing their co-ordinating discussions do little to encourage a transnational perspective. Indeed, quite the opposite is the case: they encourage a focus on sovereign rights and interests. In the absence of an institutional order capable of performing the public function of rulemaking from the perspective of global welfare, it would seem that the global economy will continue to be regulated by a decentralised, largely unco-ordinated, and often conflicting set of local rules and regulatory policy objectives designed to balance and serve parochial interests.

My contention is that scholars, regulators, policymakers and economic actors involved in transnational regulation and governance ought to consider local rules and their potential transnational effects in light of their impact on economic activity and welfare around the globe. Are the local gains worth the transnational costs? When are the transnational effects of local rules positive or benign for others or the globe as a whole? How might we decide? If the transnational costs of a local rule seem too high, in whose interest and on what grounds might the perhaps legitimate regulatory objectives of the local regulator—or the means chosen to secure those objectives—be contested?

To engage these complex issues requires a new approach, one that enables us to identify and assess the economic effects of local rules not only from the by-now-

traditional perspective of their impact on local or national economic activity but also from the perspective of their effects on global production and global social welfare.<sup>13</sup> We should aim to ensure that scholars, regulators and policy analysts evaluate the transnational effects of local rules from an intellectual posture that might approximate a 'global economic policy perspective'.<sup>14</sup> We should not expect, of course, that a universal vision of 'global welfare' will emerge. Such a vision is probably neither possible nor desirable. Just as in national policy debates, people across the globe will differ widely in their values and preferences and the effects and consequences of rules may be hard to predict. Economic policy will not (and should not) provide the sole (or even the predominant) substantive measure of global welfare. Nevertheless, I remain convinced that striving to devise a global economic policy framework and intellectual posture that

<sup>13</sup> For an exploration of the complexities of achieving an appropriate balance between local regulatory autonomy and international constraints on sovereign autonomy when local autonomy limits global economic welfare in the context of trade law, see Joel P Trachtman, *The International Economic Law Revolution and the Right to Regulate* (Cameron May, 2006) 11–12, 71–428 (hereinafter Trachtman *The International Economic Law Revolution*). For analyses of international legal rules guided by economic theory and conceptions of welfare, see eg Joel P Trachtman, *The Economic Structure of International Law* (Harvard University Press, 2008) (hereinafter Trachtman *The Economic Structure of International Law*); Joel P Trachtman, 'The Theory of the Firm and the Theory of the International Economic Organization: Toward Comparative Institutional Analysis' (1996–7) 17 *Northwestern Journal of International Law & Business* 470; Jeffrey Dunoff and Joel Trachtman, 'Economic Analysis of International Law' (1999) 24 *Yale Journal of International Law* 1 (hereinafter Dunoff and Trachtman 'Economic Analysis of Law') (also contains a selected bibliography of articles applying a law and economics analysis to international law in Appendix B); Wilhelm Roëpke, 'Economic Order and International Law' (1954) 86 *Recueil des Cours* 203; William J Aceves, 'The Economic Analysis of International Law: Transaction Cost Economics and the Concept of State Practice' (1996) 17 *University of Pennsylvania Journal of International Economic Law* 995; Eyal Benvenisti, 'Collective Action in the Utilization of Fresh Water: The Challenges of International Water Resources Law' (1996) 90 *American Journal of International Law* 384; Robert D Cooter, 'Structural Adjudication in the New Law Merchant: A Model of Decentralized Law' (1994) 14 *International Review of Law & Economics* 215; William BT Mock, 'Signaling and International Legal Relations' (1992) 26 *George Washington Journal of International Law & Economics* 33; Joel R Paul, 'New Movements in International Economic Law' (1995) 10 *American University Journal of International Law & Policy* 607; Paul B Stephen, 'Barbarians Inside the Gate: Public Choice Theory and International Economic Law' (1995) 10 *American University Journal of International Law & Policy* 745; Paul B Stephen, 'Accountability and International Lawmaking: Rules, Rents, and Legitimacy' (1996–7) 17 *Northwestern Journal of International Law & Business* 681; Alan O Sykes, 'The Economics of Injury in Antidumping and Countervailing Duty Cases' (1996) 16 *International Review of Law & Economics* 5.

<sup>14</sup> For an effort to engage local rulemaking authority from the perspective of global trade policy, see Trachtman *The International Economic Law Revolution* (n 13) 71–428. For some important recent efforts to articulate new visions of a 'global economic policy perspective' on the global economic regulatory order more generally, see Braithwaite *Regulatory Capitalism* (n 9); Braithwaite and Drahos *Global Business Regulation* (n 9); Kaplinsky *Globalization, Poverty and Inequality* (n 6); Rodrik *One Economics Many Recipes* (n 12); Jeffrey D Sachs, *The End of Poverty: Economic Possibilities for Our Time* (Penguin, 2005); Joseph A Stiglitz and Andrew Charlton, *Fair Trade for All: How Trade Can Promote Development* (Oxford University Press, 2005); Amartya Sen, *Development as Freedom* (Oxford University Press, 1999); Roberto Mangabeira Unger, *Free Trade Reimagined: The World Division of Labor and the Method of Economics* (Princeton University Press, 2007).

attempts to distinguish global interests from the interests of any particular national or economic constituency could prove very useful for transforming our analytic approach to and political engagement with the local rules that govern our global economy.

What I have in mind here is not entirely unprecedented or, in terms of analogy, outside of common conceptual approaches to legal representation or judicial decision-making. Rather, I am imagining something analogous to the intellectual posture of the corporate counsel who strives to articulate and protect the interests of ‘the corporation as a whole’ as distinct from the interests of any of its particular constituents or stakeholders<sup>15</sup> or the family court judge who strives to adopt a vision of ‘the best interests of the child’ that is informed by—but independent of—the stated interests of parents, family members, other interested parties, and even the child itself.<sup>16</sup> Of course, as with the intellectual postures of the corporate general counsel and the family court judge, the intellectual posture of a person guided by a global economic policy perspective would provide no foundation for a claim to objectivity—such postures are more orienting aspirations than achievable intellectual positions.

Yet, even with the last caveat in mind, my sense is that policy choices guided by a ‘global economic policy perspective’ might well lead to local rules that are more attentive and responsive to their impact on more effected constituencies around the globe even if crucial ideological and policy differences remain about what a ‘global economic policy perspective’ might mean in concrete cases. Indeed, the fact that the policy conclusions would remain subject to contestation by diverse interests and alternative visions of ‘global welfare’ is a major part of the point. Engaged political debate about the *global* as well as the *local* costs and benefits of particular local rules based on potentially diverse assessments of those costs and benefits is part of what a ‘global economic policy perspective’ may help to foster—debates that might not occur if local rulemaking remains primarily if not exclusively measured in relation to sovereign prerogatives and local effects.

## B. Coase and a Global Perspective on Local Rules

In his groundbreaking and still canonical essay ‘The Problem of Social Cost’,<sup>17</sup> later republished and elaborated in his book *The Firm, The Market, and The Law*,<sup>18</sup> Nobel

15 See eg William T Allen, ‘Corporate Governance and a Business Lawyer’s Duty of Independence’ (2004) 38 *Suffolk University Law Review* 1. See also American Bar Association, *Model Rules of Professional Conduct* r 1.13(a) (lawyer retained by an organisation represents the organisation).

16 See eg Harry D Krause and David D Meyer, *Family Law: In a Nutshell* (Thomson/West, 2007) 202–6 (discussing the factors relevant to a ‘best interests of the child’ analysis); and Michael DA Freeman, *A Commentary on the United Nations Convention of the Rights of the Child: Article 3: The Best Interests of the Child* (Martinus Nijhoff, 2007).

17 Coase ‘The Problem of Social Cost’ (n 3).

18 RH Coase, *The Firm, The Market, and The Law* (University of Chicago Press, 1990) (hereinafter Coase *The Firm, The Market, and The Law*).

laureate Ronald H Coase sought to articulate a framework for economic policy analysis that focused on the effects of legal rules on economic activity with a view to selecting the rules that came closest to maximising the total value of production for the economy as a whole. His approach to economic policy analysis offers a useful starting point not only for exploring the transnational economic effects of local rules but also for beginning to give content to what a 'global economic policy perspective' might entail.<sup>19</sup> Coase's insights are particularly useful as corrective or critique—helping to make visible tendencies within our conventional approaches to the analysis of local regulation which rely, implicitly or explicitly, on state-sovereignist reasoning about tit-for-tat causation and compensation or, as is common in US conflict of laws and private international law frameworks, on an assessment of which country's jurisdictional authority or national interest should predominate, while leaving largely or completely unexplored important questions regarding the impact of local regulation on global economic welfare as a whole. Coase's economic policy framework helps us to see beyond more common lines of analysis in the study of transnational regulation such as jurisdictional authority, geographic boundaries, sovereign interests and institutional levels and forms to reveal a more 'on the ground' view of the impact of local legal rules on global economic welfare and governance.

In particular, I will suggest that Coase's economic policy framework for assessing the critical role of legal rules in structuring domestic economic life can improve our understanding of local rules in the global economy in four ways, each of which is useful as we begin thinking anew about the transnational significance of local rules. First, the framework helps us to see that the global economy, like a domestic one, is legally structured not only by international rules and by national rules with explicit extraterritorial scope, but also by myriad background local rules and regulatory regimes with domestic regulatory aims that affect the global allocation of resources and welfare in the global economy. Second, Coase's focus on assessing the economic effects of local rules regardless of the jurisdictional authority or regulatory intention of their makers helps us to better see how local domestic rules 'travel' across jurisdictional and geographic boundaries in the global economy in ways that are difficult to analyse or address under traditional public international and trade law approaches to local rules. Third, Coase's hypothesis that the effects of legal rules on the allocation of resources in an economy can be altered, in the absence of transaction costs, through market transactions among affected economic constituencies helps us to recognise the myriad global constituencies that, in the absence of costs or other institutional obstacles to bargaining, would assert their interests with respect to the content of the foreign local rules that affect them and how taking account of these diverse interests might lead to better policymaking and increased global welfare. Finally, there is Coase's insight that under real world conditions

<sup>19</sup> Cf the sources listed in n 13 above (applying economic theory and conceptions of welfare to international legal rules).

of positive transaction costs, affected constituencies often cannot or will not adjust the initial allocation of resources created by legal rules through market transactions in ways that enhance general welfare. This insight helps to focus our attention on the significance of and policy implications for the global economy of power asymmetries in the relative ability of states to influence their share of resources in the global economy or to resist the adverse effects of foreign rules with their local rules, as well as on the impact of those asymmetries on local and global welfare that are often missed in traditional international legal regimes focused on formal rather than substantive sovereign equality. In this way Coase may help us to place questions of power and global welfare more squarely in the centre of our analysis of the global economic regulatory order.

For these reasons, Coase provides a useful and illuminating starting point for rethinking our understanding of local rules in the global economy. That said, I do not mean to suggest that Coase's analytic framework provides a solution to the complex challenges of creating a global economic regulatory order focused more on global welfare. Instead, my aim is to use Coase's economic policy framework as a critical tool for focusing more academic and policy attention on the role of local rules in the regulation of the global economy and encouraging regulators, policy analysts, scholars and activists at both the local and the global levels to be more cognisant of the transnational economic effects of the rules and policies they develop. I leave for another day the important question of whether Coase's economic policy framework itself offers a workable analytic model on which to base policy conclusions regarding the optimal legal rule or arrangement in any particular circumstance.<sup>20</sup>

### C. The International Legal Framework for Thinking about Local Rules

To be effective in shaping the content and effects of local rules, a 'global economic policy perspective' would need to be embedded in the disciplinary practices of the institutions and people making the rules, just as perspectives like 'the best interests of the child' or 'the best interests of the corporation as a whole' have become significant in guiding the deliberations of specific actors in the domestic legal context. At present, it is not only our domestic mindsets that stand in the way: our international legal approaches to analysing

<sup>20</sup> The literature critical of one or more aspects of Coase's analytic model for doing economic policy analysis of legal rules is nearly as vast as the literature seeking to apply his insights to establish the relative efficiency of particular legal rules. For a useful bibliography of legal scholarship critical of Coase, see *The Canon of American Legal Thought* (n 4) 362–3. For a comprehensive and sophisticated critique of law and economics from the perspective of Critical Legal Studies, see Duncan Kennedy, 'Law-and-Economics from the Perspective of Critical Legal Studies' in Peter Newman, *The New Palgrave Dictionary of Economics and the Law*, vol 1 (Macmillan, 1998) 465–74 (hereinafter Kennedy 'Law-and-Economics from the Perspective of Critical Legal Studies') (also containing a very useful bibliography of the 'greatest hits' of law and economics scholarship both mainstream and critical).

the transnational impact of local rules also have not internalised a 'global economic policy perspective', whether Coasean or otherwise. In fact, they encourage a perspective that seems quite at odds with a point of view based on global welfare as a whole.

Of course, we should not be surprised to find that most local regulatory institutions are rarely guided by a transnational or global economic policy vision. After all, their jurisdictional mandates and political constituencies are local even if the consequences of their regulatory decisions can extend beyond local borders. It seems more reasonable to expect, however, that a global economic policy perspective would be present in the ways public international law or international trade law encourage policy makers to analyse local rules in the global economy. Indeed, we might expect that it is precisely the function of international legal norms and institutions to encourage local authorities to think globally when they act locally. In fact, public international law generally and international trade law more specifically approach the analysis of the global impact of local rules as primarily a question of the relations among sovereign powers—how to preserve meaningful local authority while encouraging co-operation or non-interference with fellow sovereigns.<sup>21</sup> Further, both fields limit their focus to a subset of the many local

<sup>21</sup> Although written more than 40 years ago, Wolfgang Friedmann's classic work regarding the separation of international rules and institutions promoting 'coexistence' and 'co-operation' among sovereigns remains a powerful description of the international legal system's focus. See Wolfgang Friedmann, *The Changing Structure of International Law* (University of Virginia Press, 1964); Wolfgang Friedmann, 'National Sovereignty, International Co-operation and the Reality of International Law' (1963) 10 *UCLA Law Review* 739. Of course, international lawyers have long lamented the persistence of sovereignty as both a political fact and a central pillar of their discipline. In recent years, a number of scholars have sought to re-imagine the possibilities for international law in light of the impact of globalisation on our understandings of sovereign power. I see my own work as contributing to this growing literature. Leading examples of this work take a number of different approaches to re-situating sovereignty in the global order. See eg Braithwaite and Drahos *Global Business Regulation* (n 9) and Braithwaite *Regulatory Capitalism* (n 9) (focusing on regulation regardless of its origins in traditional sovereigns, private institutions or quasi-public consensus among experts); Benedict Kingsbury *et al* (eds), Symposium, 'The Emergence of Global Administrative Law' (2005) 68 *Law & Contemporary Problems* 1 (focusing on global administration as a governance function regardless of whether it is performed by states, intergovernmental organisations, non-governmental organisations, multinational corporations or other institutions or groups); Gunther Teubner and Zenon Bankowski, *Law as an Autopoietic System* (Social Archeology Series of The European University Institute Press, Blackwell, 1993) and Gunther Teubner (ed), *Global Law Without the State* (Dartmouth/Ashgate, 1997) (hereinafter Teubner *Global Law Without the State*) (re-conceptualising the global legal order as a series of differentiated 'systems' arising from diverse social and institutional sources and displacing the centrality of the sovereign state as the primary force responsible for legal ordering); Abram Chayes and Antonia Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press 1995), Harold H Koh, 'Transnational Legal Process' (1996) 75 *Nebraska Law Review* 181, Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004), Paul Schiff Berman, 'From International Law to Law and Globalization' (2005) 43 *Columbia Journal of Transnational Law* 485, and Kal Raustiala, 'The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law' (2002) 43 *Virginia Journal of International Law* 1 (stressing the significance of networks of non-state actors and sub-national processes in the generation and implementation of transnational norms); Bardo Fassbender, 'The United Nations Charter as a Constitution of the International Community'

rules that have transnational effects and, as we shall see, analyse them from a perspective sharply distinct from the 'global perspective' advocated here. The cumulative effect of these approaches is to sideline or ignore many of the important issues regarding the significance of local rules in shaping welfare in the global economy that Coase's approach helps us to foreground.

For example, in public international law, doctrinal and scholarly attention regarding the role of local rules in the global economy focuses on local rules that are expressly intended to have extraterritorial reach, asking whether they are lawful exercises of sovereign jurisdictional authority.<sup>22</sup> The exercise of extraterritorial jurisdiction is understood to be justified when and to the extent that it rests on a solid basis in sovereign

(1998) 36 *Columbia Journal of Transnational Law* 530, Anne-Marie Slaughter and William Burke-White, 'An International Constitutional Moment' (2002) 43 *Harvard International Law Journal* 1, John O McGinnis and Mark L Mosesian, 'Commentary: The World Trade Constitution' (2000) 114 *Harvard Law Review* 512, Ernst-Ulrich Petersmann, 'Trade Policy as a Constitutional Problem: On the Domestic Policy Functions of International Rules' (1986) 41 *Swiss Review of International Economic Relations* 405, Ernst-Ulrich Petersmann, 'The WTO Constitution and Human Rights' (2000) 3 *Journal of International Economic Law* 19, Jiunn-Rong Yeh and Wen-Chen Chang, 'The Emergence of Transnational Constitutionalism: Its Features, Challenges and Solutions' (2008) 27 *Pennsylvania State International Law Review* 89, and Ulrich K Preu, 'Post-Conflict Studies and State-Building: Equality of States—its Meaning in a Constitutionalized Global Order' (2008) 9 *Chicago Journal of International Law* 17 (situating sovereign states alongside numerous other global actors contributing and subject to a global constitutional legal order). I hope that through a focus on the transnational effects of local rules on global economic welfare I can extend these scholarly efforts to re-situate the sovereign as one among many important sites of power in the global economic regulatory order and thereby contribute to the imagining of a new, more robust and more just global political order.

- 22 For a statement of the general approach in international law to the scope and limits of jurisdiction see Lori F Damrosch *et al*, *International Law Cases and Materials* (American Casebook Series, West, 4th edn 2001) 1090, 1088–111 (hereinafter *Damrosch International Law*) ('Under international law, the jurisdiction of a state depends on the interest that state, in view of its nature and purposes, may reasonably have in exercising the particular jurisdiction asserted and on the need to reconcile that interest with the interests of other states in exercising jurisdiction. The nature and significance of the interests of a state in exercising jurisdiction depend on the relation of the transaction, occurrence, or event, and of the person to be affected, to the state's proper concerns'). For some representative examples of dominant modes of scholarship on the extraterritorial effects of domestic rules, see eg Brice M Clagett, 'The Cuban Liberty and Democratic Solidarity (Libertad) Act: Title III of the Helms-Burton Act is Consistent with International Law' (1996) 90 *American Journal of International Law* 434; Harvey Oyer, 'The Extraterritorial Effects of US Unilateral Trade Sanctions and their Impact on US Obligations Under NAFTA' (1997) 11 *Florida Journal of International Law* 429; Austen L Parrish, 'Reclaiming International Law from Extraterritoriality' (2009) 93 *Minnesota Law Review* 815; Florian Rodl, 'Values: Private Law Beyond the Democratic Order? On the Legitimatory Problem of Private Law "Beyond the State"' (2008) 56 *American Journal of Comparative Law* 743, 748–64; John R Lacey and Kingman Brewster, *Act of State and Extraterritorial Reach: Problems of Law and Policy* (American Bar Association, Section of International Law and Practice 1983); Sondra Roberto, 'The Boeing/McDonnell Douglas Merger Review: A Serious Stretch of European Competition Powers' (1998) 24 *Brooklyn Journal of International Law* 593; Elliott Sulcove, 'The Extraterritorial Reach of the Criminal Provisions of US Antitrust Laws: The Impact of *United States v Nippon Paper Industries*' (1998) 19 *University of Pennsylvania Journal of International Economic Law* 1067; Joseph P Griffin, *Perspectives on the Extraterritorial Application of US Antitrust and Other Laws* (American Bar Association, Section of International Law 1979).

authority and is ‘reasonable’ given the interests of other sovereigns.<sup>23</sup> The issues are sovereign authority and reasonable inter-sovereign relations, rather than global welfare.

Moreover, by focusing on local rules that are intended to have global effects, the public international law framework misses a great deal. While the extraterritorial exercise of national jurisdiction is important, the *de facto* effects of local rules can be far more significant. California auto emissions rules, a Mexican minimum wage law or Chinese regulation of domestic coal-burning power plants all suggest that numerous local rules that aim (expressly, if perhaps not exclusively) to address local issues can and frequently do produce significant transnational effects even when they are not formally ‘applied’ or ‘enforced’ outside the territory in which they are adopted. In fact, it may be precisely because local rules most often are (or appear to be) regular exercises of domestic jurisdiction without formal aspirations to be transnational or universal in scope that they are not generally a focus of scholarly or policy attention in the study of transnational regulation from a public international law perspective. When sociological and economic effects of local rules are considered, international law frames the issue as one of compliance with hierarchically superior universal rules embodied in multilateral treaties and customary norms and of state responsibility for harms caused to a foreign sovereign in violation of an inter-sovereign duty alone.<sup>24</sup> Such inter-sovereign harms can include the creation of a rule that exceeds a state’s lawful jurisdiction, but, as suggested already, the fault standard for such a finding is express intention which would exclude, on most accounts, constructive intention based on a state’s regulating locally with knowledge that its regulation would likely result in serious adverse effects on other states.

By contrast, international trade discourse and doctrine seems more attuned than public international law to the transnational economic effects of local rules. Indeed, trade law can seem to be about little else than the effects of one nation’s rules—tariffs, subsidies or non-tariff barriers—on the international economic opportunities for enterprises from the territory of other states. The overall goal is a general reduction in the number and types of local rules that limit foreign participation in local markets.

<sup>23</sup> See Restatement (Third) of the Foreign Relations Law of the United States ss 402, 403. See also Damrosch *International Law* (n 22) 1090 (‘The classic view has been that a state does not have to establish a valid basis for its exercise of jurisdiction and that the burden of establishing that its exercise of jurisdiction violates international law rests on the person asserting the violation. More recently, the view has been espoused that, especially when it acts extraterritorially, a state must demonstrate affirmatively the existence of an appropriate basis for jurisdiction. An alternative view is that the exercise of all forms of jurisdiction is subject to an overall limitation of reasonableness. This is the position taken in the Restatement (Third) § 403’) (citations omitted); Note, ‘Constructing the State Internationally: Jurisdictional Discourse, the National Interest, and Transnational Norms’ (1990) 103 *Harvard Law Review* 1273.

<sup>24</sup> See ILC, ‘Report of the International Law Commission to the General Assembly’ 53 UN GAOR Supp (No 10) 43, UN Doc A/56/10 (2001), reprinted in (2001) 2 Ybk ILC 31, UN Doc A/CN.4/SER.A/2001/Add.1 (Part 2) (hereinafter ILC ‘Draft Articles on Responsibility of States’). See also nn 53, 54, 55 and 64 and accompanying text below.

John Jackson describes the sensibility of the field as follows: ‘The starting point for any policy discussion for the international economic system today is the notion of “liberal trade”, meaning the goal to minimize the amount of interference of governments in trade flows that cross national borders.’<sup>25</sup> Implicit in this statement is both a general orientation toward local rules and a notion of global welfare—local rules are significant from a trade perspective because of their potential to distort otherwise desirable trade flows between nation-states which, if unimpeded by national interference, would increase gains from trade and hence global welfare. While Jackson recognises that the validity and persuasiveness of the economic policy arguments supporting this perspective are contested, he concludes, ‘there is no question they have been influential.’<sup>26</sup> He continues, ‘The basic liberal trade philosophy is constantly reiterated by government and private persons, even in the context of a justification for departing from it!’<sup>27</sup>

From this orienting ‘liberal trade’ perspective, the most important economic policy questions for each nation-state are whether the national costs of ‘protectionist’ rules designed to favour domestic producers over foreign ones are worth the gains, with a background presumption that they are not. Brian Langille gives a useful summary account of this logic:

Under the classic formulation of the free trade problem, of national producers of goods for export, the logic of an internationalization of the division of labor and the gains from specialization necessitated an internal, domestic adjustment process. This is because the gains to domestic consumers from foreign trade will almost always be greater than the additional gains to domestic producers from purely domestic trade. ... The policy choice for any individual state is, on the logic of the theory, clear—protectionism is not worth it.<sup>28</sup>

At the level of the international trade regime, the main economic policy goal for liberal traders is building and enforcing appropriate regulatory mechanisms for distinguishing ‘protectionist’ local rules from ‘legitimate’ ones and policing the former—a policy goal that is becoming ever more complex as the focus of regulatory attention has shifted from tariff reduction to the elimination of other non-tariff barriers such as subsidies.<sup>29</sup> The liberal trade approach foregrounds the counterbalancing of the advantages of national producers over foreign ones in different states and the corollary of slowing or limiting the ability of states to use law or policy to favour local producers over foreign ones in the broader context of what Langille describes as ‘multilateralism,

25 John H Jackson, *The World Trading System: Law and Policy of International Economic Relations* (MIT Press, 2nd edn 1997) 11 (hereinafter Jackson *The World Trading System*).

26 *Ibid.*, 12.

27 *Ibid.*

28 Brian Alexander Langille, ‘General Reflections on the Relationship of Trade and Labor (Or: Fair Trade is Free Trade’s Destiny)’ in Jagdish Bhagwati and Robert E Hudec (eds), *Fair Trade and Harmonization Prerequisites for Free Trade? Volume 2: Legal Analysis* (MIT Press, 1996) 234 (hereinafter Langille ‘General Reflections on Trade and Labor’).

29 See *ibid.*, 235–8.

reciprocity, negotiation, and neutral enforcement'.<sup>30</sup> National gains and losses are measured against each other, while global welfare gains are presumed as the logical result of the system's general discouragement or prohibition of national 'protectionism'.

As an approach to the global welfare effect of local rules, the international trade regime has some serious disadvantages. Many background rules affecting global economic life remain out of focus—part of the background to 'normal' prices.<sup>31</sup> The perspective from which foreign rules are evaluated is very narrow. A more comprehensive approach would require that we attempt to compare the economic effects of each legal rule against the costs and benefits of alternative legal arrangements on a global basis, rather than presuming that removing a local 'distortion' will always be welfare enhancing. More importantly, the trade-off framework for thinking about the legitimacy of local rules uses achievable inter-sovereign bargains as a proxy for global welfare. Coase helps us to see the limitations of treating sovereign interests, however modified by negotiation with one another, as a suitable measure of global welfare.<sup>32</sup>

Further, once we start assessing local rules based upon their effects on global economic welfare as a whole, it becomes possible to imagine circumstances where transnationalised local rules might be better global regulatory tools than international rules from the perspective of global economic welfare. Such circumstances might arise when achieving consensus on a global rule is politically unfeasible or would involve very high transaction costs, or when the compromises necessary to reach global consensus on a rule lead to less effective regulation than existing local regimes and thereby reduce global welfare, or when the complexities or specificities of particular markets, industry sectors or local economic conditions make universal international rules of general application more costly than more particularised and targeted local rules due to over- or under-inclusiveness.<sup>33</sup> Global banking and financial regulation might provide an example. It

<sup>30</sup> *Ibid*, 233.

<sup>31</sup> See eg Daniel K Tarullo, 'Beyond Normalcy in the Regulation of International Trade' (1987) 100 *Harvard Law Review* 546; David Kennedy, 'The International Style in Postwar Law and Policy: John Jackson and the Field of International Economic Law' (1994–5) 10 *American University Journal of International Law & Policy* 671; David Kennedy, 'Turning to Market Democracy: A Tale of Two Architectures' (1991) 32 *Harvard International Law Journal* 373.

<sup>32</sup> For a very interesting and useful analysis applying Coasean insights to prescriptive jurisdiction in international law built on the notion that states may be better aggregators of individual preferences than the market or private litigation and that state preferences expressed through adoption of mandatory legal rules should not be lightly eviscerated through jurisdictional doctrines, see Trachtman *The Economic Structure of International Law* (n 13) 26–71.

<sup>33</sup> See generally Braithwaite and Drahos *Global Business Regulation* (n 9) 511–12 (discussing examples of regulatory approaches based on national rules and harmonisation at the transnational level and identifying examples where national regimes have won out or national rules have become the basis for the global rule); Dan Danielsen, 'How Corporations Govern: Taking Corporate Power Seriously in Transnational Regulation and Governance' (2005) 46 *Harvard International Law Journal* 411, 417–20 (describing an example in which national rules transnationalised through private ordering led to higher standards than would have been achieved through a harmonised rule) (hereinafter Danielsen 'How Corporations Govern').

seems quite possible under current economic and political conditions that stricter local regulation in each of the G-8 or G-20 countries might produce a better (if imperfect) global architecture for financial regulation in a more timely way than the rules that might emerge from a multilateral negotiation attempting to establish a uniform global regime.<sup>34</sup>

Overall, the continued focus on national interests and sovereign rights in the disciplinary approaches of both public international law and international trade law makes it difficult to see beyond sovereignty, national territorial geography and state institutions to imagine what a global economic policy perspective of the type I am advocating might entail.

#### D. Global Power Asymmetries in a Global Policy Conversation

If, following Coase, we are to think about the local rules that have transnational effects from a new global perspective, beyond the sovereignty-focused frameworks embraced by public international law or the trade system, it is reasonable to ask what might be lost if we leave sovereignty behind. After all, organising the world's political process in nation-states has had a significant emancipatory dimension, not only for populations in colonial territories that achieved self-determination, but also for individuals in nation-states who gained the rights and benefits of national citizenship. Nation-states have been and remain among the most effective institutions ever devised for making the political choices and trade-offs necessary to manage economic life, to plan for development and to provide for the social welfare of their populations. Politics within the sovereign frame has been, in many ways, better politics than anything that came before.

The globalisation of economic life has placed these achievements under enormous pressure. Local politics is no longer effective politics when policy decisions taken and rules made in faraway places can swamp local policy initiatives. Beyond questions of effectiveness, moreover, the disciplinary focus on formal sovereign equality within public international law and international trade law renders real substantive differences among sovereigns as to bargaining power and the ability to influence economic activity with their local rules harder rather than easier to assess. Take the evaluation of extraterritorial exercises of jurisdiction as an example. Under the international rules of prescriptive jurisdiction, efforts to exercise jurisdiction outside one's territory are lawful if they are 'reasonable' and linked to one of five recognised legal bases for sovereign jurisdiction.<sup>35</sup> Their reasonableness is measured by balancing their importance against a range of factors

<sup>34</sup> Cf Braithwaite and Drahos, *Global Business Regulation* (n 9) 138–142 (noting that international co-operation in the context of monetary policy has been weak and that the most effective feasible alternative might be a tri-polar monetary regime based on the US dollar, the Euro and the Yen, in part because such a regime would rely on the co-operation of fewer parties than would be required for a global alternative like a world central bank).

<sup>35</sup> See nn 22 and 23 above (describing the legal requirements for the lawful exercise of jurisdiction under international law).

relating to the interests and prerogatives of other sovereigns.<sup>36</sup> We must recognise that there is an important equalising component here. As a formal matter, all sovereigns can exercise jurisdiction outside their territory on the same bases, and all have the same legitimate ‘interests’ and prerogatives when it comes to assessing the reasonableness of the extraterritorial assertions of other states.<sup>37</sup> The difficulty with this framework is the enormous gap between the formal world of equal sovereigns it imagines and our actual world. This framework has nothing to say about the radical disparities of power between the states that can actually exercise jurisdiction abroad or command that other states acquiesce in their extraterritorial assertions and those that cannot. Nor does it reflect the *de facto* regulatory importance of foreign rules that affect domestic economies even absent formal jurisdictional application.

Consistent with examples already given, in the real world, assertions of jurisdiction by the US or China or Japan will be much more significant in terms of economic or behavioural effects on others than similar assertions of jurisdiction by Cambodia or Uruguay or Sri Lanka. Yet these asymmetrical differences in regulatory or economic effects remain outside the frame of traditional analyses of jurisdictional legitimacy. Further, the jurisdictional rules have nothing to say about the fact that the local rules of some economically important jurisdictions may have not only significant effects on other states but also significant global economic effects even when they are aimed primarily or exclusively at achieving domestic regulatory goals and are not formally applied or enforced outside domestic borders of the sovereign making them. My suggestion is that an institutionally supported habit of assessing the impact of local rules based on their global welfare effects might foster conversations far better able to confront and contest the substantive power imbalances that a sovereign frame tends to obscure.

Another example of the way formal sovereign equality makes power more difficult to address comes from international trade law doctrines relating to the regulation of subsidies and dumping aimed at addressing so-called ‘unfair trade’. While the possibility of imposing dumping duties or countervailing duties against imports from offending nations or firms may be formally available to all, the economic effects and consequences of the use of such remedies will vary dramatically depending on whether the remedies are deployed by an economically powerful country or an economically weak one. Indeed, it has often been remarked that organising trade negotiations around national governments gives far more weight to large national economies and the economic interests they are most likely to represent.<sup>38</sup> The bargaining power of states representing large diverse

<sup>36</sup> See n 23 above.

<sup>37</sup> See n 23 above. See also Convention on the Rights and Duties of States, Art 4, 26 December 1933, 49 Stat 3097, TS 881, 165 LNTS 19, 3 Bevans 145 (‘Article 4: States are juridically equal, enjoy the same rights, and have equal capacity in their exercise. The rights of each one do not depend on the power which it possesses to assure its exercise, but upon the simple fact of its existence as a person under international law’).

<sup>38</sup> See eg Jackson *The World Trading System* (n 25) 273–4 (noting the advantage unfair trade laws give to large economies over smaller ones, with a concentration of power in the ‘big three’, the US, the EU and Japan).

economies and negotiating on behalf of 'their' economic actors is simply greater than smaller economies dependent upon trade access. The United States, the European Union and China can all use the WTO structure, which multilateralises bilateral bargains, far more effectively than Costa Rica or South Africa. At the same time, their capacity to strike separate favourable bilateral deals may also be stronger than smaller economies lacking the kind of economic power that might allow them to extract more of the gains from trade.<sup>39</sup> In such circumstances it seems likely that organising the creation and evaluation of local rules affecting global economic life on the basis of bargains among formally equal and substantively unequal sovereigns risks entrenching and accelerating the divide between the haves and have-nots and between leading and lagging economic sectors with no assurance that such a structure can be relied on to lead to improvements in overall global welfare. As a result, a trade regime which roots the assessment of local rules in interstate bargains without addressing substantive differences in bargaining power may do more to entrench than ameliorate power asymmetries.

While international trade lawyers are well aware of these power differences and their significance in the global economic order, the conceptual centrality of formal sovereign equality in their policy framework makes it difficult for these differences to be engaged directly. Of course, it seems possible to imagine that local regulators and policymakers might be encouraged to take the transnational economic effects of their rulemaking into account. But, we are much more accustomed to expecting if not requiring local regulators to act in ways that counter-pose interests 'here' with interests 'there'.<sup>40</sup> A shift to a more global economic policy perspective is unlikely to happen without the kind of institutional

<sup>39</sup> Cf Sornarajah *The International Law of Foreign Investment* (n 12) 1–3 (arguing that the trend toward bilateral investment treaties arose out of the collapse of Third World cohesion around the 'New International Economic Order' in favour of competition between developing states over foreign investment from the developed world).

<sup>40</sup> The notion of economic activity and competition as a 'zero-sum' game remains powerful, even if contested, across a range of regulatory fields. See eg Van Wezel Stone, 'Labor and the Global Economy' (n 6) 992–4 (noting that a country's labour protection laws can increase or decrease its global competitiveness resulting in a global race to the bottom in labour standards); Williams, 'Trade, Labor, Law and Development' (n 6) 370–5 (noting the competitive pressure on developing countries not to adopt high labour standards); Sanghan Wang, 'US Trade Laws Concerning Nonmarket Economies Revisited for Fairness and Consistency' (1996) 10 *Emory International Law Review* 593, 608–9 (noting the benefits for foreign producers and the harm to domestic producers of dumping); George J Borjas, *Heaven's Door: Immigration Policy and the American Economy* (Princeton University Press, 1999) 99 (arguing that the real costs of weak US policy vis-à-vis illegal immigration are born by low-skilled domestic workers); Mark B Baker, "'The Technology Dog Ate My Job': The Dog-Eat-Dog World of Offshore Labor Outsourcing' (2004) 16 *Florida Journal of International Law* 807, 810–14, 818–21, 833, 843–4 (arguing that outsourcing results in a reduction of available jobs for US workers). Compare Peter L Reich, 'Environmental Metaphor in the Alien Benefits Debate' (1995) 42 *UCLA Law Review* 1577 (arguing that immigrants do not reduce the net amount of available resources for citizens); Adam Mordecai, 'Anti-Offshoring Legislation: The New Wave of Protectionism and the Backlash Against Foreign Outsourcing of American Service Jobs' (2005) 5 *Richmond Journal of Global Law and Business* 85, 102–4 (arguing that outsourcing is win-win for both countries involved and refuting the notion that outsourcing produces zero-sum outcomes).

support and encouragement now enjoyed by the sovereignty framework. Only by rooting a focus on overall global welfare in the institutional structure of both public international law and international economic law regimes does it seem likely that a new global politics more attuned to global asymmetries in bargaining power could take hold.

In short, our most common international legal mechanisms for thinking about the politics of local rules are very often focused on defending local sovereignty or ameliorating conflicts among sovereigns rather than global welfare. What is needed is a new global politics up to the challenges of our global economy. One step in that direction may be the emergence of an improved global vernacular for discussing and contesting the link between local decisions and global welfare, de-linked from sovereignty. It is here that Coase may be helpful, at least as a first step, and it is to Coase that I now turn.

## 2. A COASEAN ECONOMIC POLICY FRAMEWORK, THE TRANSNATIONAL EFFECTS OF LOCAL RULES AND THE LIMITS OF TRADITIONAL INTERNATIONAL LEGAL APPROACHES: WHAT IS TO BE LEARNED?

In this part, I explore how Coase's approach to 'economic policy analysis', which attempts to assess the policy desirability of particular legal rules based on their relative economic effects on the value of production in an economy, provides a useful and revealing starting point for exploring the transnational economic effects of local rules from a new global vantage point. I introduce key elements of Coase's approach through a series of 'maxims' drawn from his work that help illuminate the regulatory and distributional significance of local rules in the global economic regulatory order as well as important aspects of the global economic regulatory order itself. In addition, I use Coase's work to explore more deeply the limits of the more traditional approaches to the analysis of local rules in an international context, including those introduced in Part 1, and to suggest why a new approach is needed.

For purposes of this analysis, I offer Coase's approach to economic policy analysis more as a useful perspective or orienting point of view than a functionally complete analytic methodology for making scientific or apolitical policy determinations regarding the correct legal rule in a particular situation. In doing so, I largely set aside, for purposes of this article, quite important questions and concerns about the viability of Coase's approach to economic policy as an analytic for directing policy decision-making at the transnational level. In fact, I am quite skeptical of such viability—both skeptical that a pure Coasean analysis of legal rules as he intended it to be done is either possible to accomplish or determinate in its outcomes, and skeptical that Coase's conception of social welfare is comprehensive enough to serve as an appropriate surrogate for global welfare when making global policy. Nevertheless, just as Coase's work shook up traditional

analyses of the role and effects of legal rules in national economic life,<sup>41</sup> I contend that his insights remain a powerful and useful corrective to some of the most common international legal approaches to issues arising from the impact of local rules in the global economy, and for that reason are worthy of study and attention. In fact, it may be that in order to move *beyond* Coase's significant insights to a richer and more robust understanding of the welfare consequences of local rules in the current global economic regulatory order and to more equitable, just and plural conceptions of global welfare and policymaking, we must work *through* Coase—as I now propose to do.

*Maxim 1: Undesired economic effects on others are ubiquitous and inevitable in any economy. Assessing whether 'harm' results from those effects becomes a relative question when the effects are considered in relation to their impact on the economic system as a whole*

In 'The Problem of Social Cost', Coase seeks, as he puts it, to examine 'those actions of business firms that have harmful effects on others'.<sup>42</sup> Through this somewhat humble formulation of the aim of his article, Coase suggests as a foundational premise that economic activity will inevitably cause 'harmful effects'. While the term 'harmful' certainly does not suggest that these effects are desirable, Coase does not seem to attribute moral or ethical significance to their occurrence either. Rather than using the language of directional causality—A causes harm to B with the moral implication of blame and restitution—Coase simply suggests that firms 'have harmful effects on others'. The use of the passive voice leaves open questions that are frequently the centre of attention in the context of legal notions of 'harm', such as whether the 'harmful effects' were intended or inadvertent, whether economic actors took the 'harmful effects' into account in the pursuit of their activities, and what, if any, legal or economic consequence should flow from the 'harmful effects'. As such, Coase's formulation seems to treat these effects as at once a mundane and 'to be expected' aspect of all economic activity and a central (if not *the* central) concern of economics as a discipline. In his introduction to *The Firm, The Market, and The Law*, he states:

It needs to be realized that, when economists study the working of the economic system, they are dealing with the effects of individuals' or organizations' actions on others operating within the system. That is our subject. If there were not such effects there would be no economic system to study. Individuals and organizations will, in furthering their own interests, take actions which facilitate or hinder what others want to do. They may supply labour services or withdraw them, provide capital equipment or decline to do so, emit smoke or prevent it, and so on. The aim of economic policy is to ensure that people, when deciding which course of action to take, choose that which brings about the best outcome for the system as a whole.<sup>43</sup>

41 For the significance of Coase's work to American legal thought, see n 4 above.

42 Coase 'The Problem of Social Cost' (n 3) 95.

43 Coase *The Firm, The Market, and The Law* (n 18) 27.

When Coase speaks of ‘harmful effects’ he has in mind situations in which the activities of one economic actor affect another in an undesired or adverse way. His examples mainly derive from the kinds of situations that arise in common law tort cases—smoke damage to homes from a nearby factory, crop damage from straying cattle, fire damage from sparks created by a passing railroad, disturbance from noise and vibration created by the operation of machinery in an adjacent building. But, in the passage quoted above, Coase makes clear that his notion of ‘harmful effects’ is not limited to traditional damage in tort. In fact, the passage suggests that quite ordinary economic choices, like selling or withholding one’s labour, or investing or withholding one’s capital, or allowing or prohibiting the use of one’s property by another, create effects that may be construed as beneficial or benign by some economic actors and ‘harmful’ by others.<sup>44</sup> Further, to the extent that limiting or eliminating the ‘harmful effects’ on some economic actors may often be impossible without constraining the choices or activities of others, any attempt to avoid ‘harmful effects’ may also create ‘harm’ from the perspective of those whose freedom of action has been constrained. In other words, ‘harm’ as between the economic actors themselves is a relative concept based upon their respective points of view.

It is perhaps this recognition that one’s economic well-being and choices can be affected by the activities of others far away that is at the root of much anxiety about economic globalisation. In the twenty-first century it seems hard to deny that consumer choices regarding spending in the United States can have a tremendous impact on the economic well-being of manufacturing workers abroad.<sup>45</sup> Or that wage rates paid by manufacturing employers in China can affect the wage rates and competitiveness of manufacturers in numerous other places in both the developed and the developing worlds.<sup>46</sup> Or that the construction of a transnational oil pipeline by a consortium of oil producers can have dramatic effects on the economic, social and environmental well-being of people living along the pipeline’s path.<sup>47</sup> Advocates of economic globalisation frequently assert that the integration of the global economy is ‘good for everyone’ based

44 The ‘push-me-pull-you’ quality of assertions of legal entitlements and their undesired but nevertheless ubiquitous effects on others has a long history in American legal scholarship. See eg Oliver Wendell Holmes, ‘The Path of the Law’ (1897) 10 *Harvard Law Review* 457; Wesley Hohfeld, ‘Some Fundamental Legal Conceptions as Applied in Judicial Reasoning’ (1913) 23 *Yale Law Journal* 16; Robert Hale, ‘Coercion and Distribution in a Supposedly Noncoercive State’ (1923) 38 *Political Science Quarterly* 470 (hereinafter Hale ‘Coercion and Distribution’); Morris Cohen, ‘Property and Sovereignty’ (1927–28) XIII *Cornell Law Quarterly* 8 (hereinafter Cohen ‘Property and Sovereignty’); Duncan Kennedy, ‘Form and Substance in Private Law Adjudication’ (1976) 88 *Harvard Law Review* 1685.

45 See eg Peter S Goodman, ‘Weighty Role on the World Stage’ *New York Times* (New York), 25 January 2008, C1 (contrary to pre-crisis expectations of many economists, the dramatic drop in US consumer spending has put enormous downward pressure on the global economy and demand for manufactured goods worldwide).

46 See eg Kaplinsky *Globalization, Poverty and Inequality* (n 6) 132–5, 217–18.

47 See eg Amnesty International, ‘Contracting Out of Human Rights: The Chad-Cameroon Oil Pipeline Project’ (2005).

on the theory of comparative advantage and its prediction of gains from trade.<sup>48</sup> Whatever one's views on the merits of the theory or the likelihood of gains from trade, experience and common sense tell us that with increased global economic integration comes an increased likelihood that economic choices made in one place will produce economic effects and relative winners and losers in others and that the gains and losses from any particular set of economic choices might be distributed across the globe in all sorts of unequal ways. At the simplest level, Coase's notion that economic activity will frequently result in effects that are perceived by one or another constituency as 'harmful' is useful to the extent that it helps to bring these diverse transnational effects of economic choices in one place on welfare in others to the surface for exploration and analysis.

Moreover, if we were to imagine that economic actors in one place routinely produce economic effects elsewhere in the global economy, then the production by economic actors of transnational economic effects would not, in and of itself, be exceptional or stigmatising.<sup>49</sup> The focus of analysis would shift from whether or not particular economic choices produce transnational effects to whether particular economic choices are better or worse from the perspective of their net effect on the global economy as a whole. As Coase puts this point more generally in the passage quoted above, 'The aim of economic policy [would be] to ensure that people, when deciding which course of action to take, choose that which brings about the best outcome for the system as a whole.'<sup>50</sup> Such an approach to economic policy could move states and their economic actors to at least consider the possibility that while they might sometimes experience 'harmful effects' from the economic activities of foreign others, they are also likely to produce 'harmful effects' on foreigners as well, thereby putting into context the posture of outrage and indignation that often accompanies the idea of foreign 'harmful effects' at home.<sup>51</sup> At the same time, perhaps situating those effects (both positive and negative) in the context of their impact on the greater global good might help to reduce fears of globalisation, while making states and economic actors more aware of the ways their actions shape the global situation as a whole.

<sup>48</sup> See eg Paul Anthony Samuelson and William Samuelson, *Economics* (McGraw Hill, 11th edn 1980) 651 ('[T]here is essentially only one argument for free trade or freer trade, but it is an exceedingly powerful one, namely: free trade promotes a mutually beneficial division of labor, greatly enhances the potential for real national product of all nations and makes possible higher standards of living all over the globe'). See also Peter Kenen, *The International Economy* (Cambridge University Press, 4th edn 2000) and Jagdish Bhagwati, *Protectionism* (MIT Press, paperback edn 1989).

<sup>49</sup> Cf Hale 'Coercion and Distribution' (n 44) (emphasising that coercion is inevitable in all economic relations and suggesting that the important issue is how coercive power is allocated in a society through law and economic policy); Duncan Kennedy, *Sexy Dressing Etc* (Harvard University Press, 1993) 145–7 (hereinafter Kennedy *Sexy Dressing*) (suggesting that shifting the line between toleration and prevention in the law of sexual abuse of women by men would not eliminate coercion in gender relations but would alter the bargaining power between men and women).

<sup>50</sup> Coase *The Firm, The Market, and The Law* (n 18) 27.

<sup>51</sup> Compare n 40 above (emphasising a zero-sum game approach).

As introduced in Part 1, the regime of public international law is not well situated to engage issues of undesired or harmful effects of economic actors on each other in this way. At the most basic level, the regime's focus and *raison d'être* is the regulation of state behaviour vis-à-vis other states (and more recently, in the context of human rights, persons within a state's jurisdiction or control).<sup>52</sup> In fact, public international law leaves sovereigns free to permit or pursue whatever economic activity they wish within their territorial borders so long as the transnational effects of the activity do not breach an international obligation to another state or persons within their borders.<sup>53</sup> For this reason, the transnational economic effects of behaviour by non-state economic actors becomes hard to cognise doctrinally, except to the very limited extent that such behaviour can be linked or attributed to a breach by an economic actor's home state of an international legal obligation to the state where the undesired or harmful effects on other economic actors occurs.<sup>54</sup>

When state responsibility is found to apply, the remedy is cessation of the breach by the breaching party and/or compensation to the state harmed by the breach.<sup>55</sup> To the extent that the economic effects created by non-state actors are considered under the doctrine, the concepts of 'injury', 'responsibility' and the appropriate remedy are generally conceived in relation to the consequences of economic activity on affected states rather than other actors in the economic system or the system as a whole. For example, while in the context of cross-border pollution there is some doctrinal support for the attribution of state responsibility for harms created by private actors in one territory to a foreign

52 See eg *The Case of the SS Lotus (France v Turkey)*, PCIJ Ser A No 10, 18 ('International law governs relations between states'). See also Damrosch *International Law* (n 22) xix ('Traditionally, international law has been seen as the law of the international community of states, principally governing relations among states, the basic units of the world political system for more than 300 years. For more than half a century, however, international law has increasingly dealt also with other entities, including, notably, the individual as bearer of human rights').

53 See ILC 'Draft Articles on Responsibility of States', 'Responsibility of States for International Wrongful Acts, General Commentary' para 4(c) (n 24) 31 ('The articles deal only with conduct which is internationally wrongful'). See also United Nations Conference on the Human Environment, 5–16 June 1972, 'Declaration of the United Nations Conference on the Human Environment', Principle 21, UN Publication E 73 II A.14 (1973) ('States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other states or areas beyond the limits of their national jurisdiction'); *The Case of the SS Lotus*, *ibid*, 18 ('Restrictions upon the independence of states cannot ... be presumed').

54 See ILC 'Draft Articles on Responsibility of States', 'Chapter II Attribution of Conduct to a State, Commentary' paras 2 and 3 (n 24) 38 ('[T]he general rule is that the only conduct attributed to the State at the international level is that of its organs of government, or of others who have acted under the direction, instigation or control of those organs, i.e. as agents of the State. ... As a corollary, the conduct of private persons is not as such attributable to the State').

55 See ILC 'Draft Articles on Responsibility of States' Arts 30, 31 (n 24) 88, 91.

sovereign,<sup>56</sup> the creation of undesired economic effects abroad by private economic actors at home is not generally understood to raise issues of state responsibility under international law.<sup>57</sup> Further, because the focus of doctrinal attention is on whether or not there has been a breach of a sovereign obligation, the scope and consequences of the effects of economic activity on other economic actors becomes an inquiry only incidentally relevant to the questions of breach and possible compensation, but of no significance in its own right. Finally, the application of the remedial framework of cessation of the breach and compensation for harm seem to be framed in moral or punitive rather than economic terms. If a breach is found, a cessation of the breach or compensation is required without regard to the economic impact of the mandated remedy on the general welfare of the states parties, let alone the effects of the remedy on economic actors or states beyond the states parties' borders.

Thus, as currently articulated, state responsibility doctrine is not well calibrated to recognise or analyse the prevalence or consequences of the vast majority of undesired or adverse transnational economic effects resulting from the activities of non-state economic actors. In fact, the situation may be even worse. State responsibility doctrine may well have the effect of directing our attention away from the role of economic actors themselves in creating 'harmful effects on others' by leading us both to expect that such effects are rare and to believe that they are only really significant when they involve state malfeasance. It might be better for global welfare if state responsibility doctrine were interpreted differently—perhaps a 'broader' interpretation of what gives rise to state responsibility with stricter penalties for damage caused by one state to another and/or a less restrictive approach to the attribution of damage caused by private actors to states.

<sup>56</sup> For the paradigm case articulating this doctrine, see *The Trail Smelter (US v Canada)* [1941] 3 Rep International Arb Awards 1911, 1965 (holding in a case of transboundary air pollution that 'under the principles of international law, as well as the law of the United States, no State has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another or the properties of persons therein, when the case is of serious consequence and the injury established is by clear and convincing evidence').

<sup>57</sup> See ILC Secretariat, 'Survey of State Practice Relevant to International Liability for Injurious Consequences Arising out of Acts Not Prohibited by International Law' UN Doc A/CN.4/384 (5 July 1985), para 413 (liability for injurious acts conducted by private actors rests with the private actor absent state involvement or complicity in the act). See also n 54 above. Cf *United States Diplomatic and Consular Staff in Tehran* (Judgment) [1980] ICJ 3 (finding that Iran was not responsible for the taking of the US embassy by private individuals, but that it was responsible for failing to take all reasonable steps to protect the embassy from seizure or to regain control of it in violation of an international obligation to do so); Oscar Schachter, 'International Environmental Law' (1991) 44 *Journal of International Affairs* 457, 488–9 ('[I]t would be difficult, and perhaps impossible, to apply liability in its normal sense to the vast number of environmental harms that result from routine economic and social life'). But see 'Report of the International Law Commission to the General Assembly' 53 UN GAOR Supp (No 10) 366–431, UN Doc A/56/10 (2001), reprinted in [2001] 2 Ybk ILC 148, UN Doc A/CN.4/SER.A/2001/Add.1 (Part 2) (hereinafter ILC 'Draft Articles on the Prevention of Transboundary Harms') (seeking to create a framework of obligations in respect of environmental transboundary harms created by activities not in violation of international law).

Yet, it is not clear that either change in general approach would get us closer to enhanced global welfare. From a global welfare perspective, eliminating cross-border harms may not always be the right way to go. Coase suggests that the problem with state responsibility doctrine may be that it focuses on the wrong issues: territorial boundaries and inter-sovereign harms rather than a collective responsibility to enhance general global welfare, which may require, in some circumstances, that inter-sovereign harms be tolerated in the interest of the broader global good.

*Maxim 2: If the ordinary pursuit of self-interested economic activities by economic actors will inevitably result in limitations on what other economic actors would like to do, then a general economic policy presumption in favour of correcting, through regulation or compensation, 'harmful effects on others' (or what is more generally referred to in welfare economics as 'externalities') whenever they occur is neither feasible nor desirable. Rather, if the production of such 'harms' is the joint result of productive economic activity, then the issue for economic policy should be avoiding the more serious harm vis-à-vis the system as a whole.*

Through his critique of two important concepts in mainstream welfare economics, externality and the distinction between the 'private' and 'social product' of economic activity, Coase advocates a change in perspective with regard to the proper role of law in relation to 'harmful effects' in an economy.

Like 'harmful effects on others,' Coase uses 'externalities' as unexceptional by-products of modern social and economic life.<sup>58</sup> He states:

The concept of 'externality' has come to play a central role in welfare economics, with results which have been wholly unfortunate. There are, without question, effects of their actions on others (and even on themselves) which people making decisions do not take into account. But, as employed today, the term carries with it the connotation that when 'externalities' are found, steps should be taken by the government to eliminate them. ... To prevent it being thought that I shared the common view, I never used the word 'externality' in 'The Problem of Social Cost' but spoke of 'harmful effects' without specifying whether decision-makers took them into account or not. Indeed, one of my aims in that article was to show that 'harmful effects' could be treated like any other factor of production, that it was sometimes desirable to eliminate

<sup>58</sup> For an argument that the problem of externalities is much more pervasive than economists generally suppose, in part because whether an 'externality' exists or not is a function of the background private law rules that are the implicit foundation of all economic relations, see Kennedy 'Law-and-Economics From the Perspective of Critical Legal Studies' (n 20) 466–8. See also Duncan Kennedy, 'Cost-Benefit Analysis of Entitlement Problems: A Critique' (1981) 33 *Stanford Law Review* 387, 389–400 (hereinafter Kennedy 'Cost-Benefit Analysis'). For an analysis of the 'externalities' resulting from the national regulatory choices with transnational effects and the role of jurisdictional rules in determining whether particular effects will be treated as an 'externality' or not, see Trachtman *The Economic Structure of International Law* (n 13) 11–13.

them and sometimes not, and that it was unnecessary to use a concept such as ‘externality’ in the analysis in order to obtain a correct result.<sup>59</sup>

Coase uses this idea of the ubiquity of ‘harmful effects’ in any economic system to critique the traditional Pigouvian notion that an ‘externality’ reflects an exceptional divergence between the private and social products of the economic activity at issue and that the state should intervene to require the economic actor causing the externality to internalise the costs of the harm by making the actor’s private costs equal to the social costs of the activity.<sup>60</sup> Instead, Coase suggests that ‘harmful effects’ are more accurately understood as reflecting the reciprocal or joint costs of the pursuit by different actors of economic activities producing inter-connected economic effects. Describing the paradigmatic case of smoke emitted from a factory having ‘harmful effects’ on neighbouring properties, Coase states:

The economic analysis of such a situation has usually proceeded in terms of a divergence between the private and the social product of the factory, in which economists have largely followed the treatment of Pigou in *The Economics of Welfare*. ...

...

The traditional approach has tended to obscure the nature of the choice that has to be made. The question is commonly thought of as one in which A inflicts harm on B and what has to be decided is, How should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would be to inflict harm on A. The real question that has to be decided is, Should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm.<sup>61</sup>

By re-conceptualising the ‘harm’ in the paradigmatic nuisance case from harm inflicted by the factory on the neighbouring properties, to the reciprocal costs of the pursuit of two (presumably) socially useful economic activities—in this case, factory manufacturing and residential or other non-industrial uses of property—all the costs become in some sense ‘social’, as does the decision as to how best to allocate those costs to maximise social welfare. As Coase puts it:

<sup>59</sup> Coase *The Firm, The Market, and The Law* (n 18) 26–27.

<sup>60</sup> As Coase suggests in the quotation linked to n 61 below, the British economist Arthur Cecil Pigou’s notion that ‘externalities’ reflected in the divergence of private and social costs of an economic activity could be corrected through a mixture of taxes and subsidies that would cause the externalised costs to be internalised was widely influential in the field of welfare economics and one that Coase sought to challenge in ‘The Problem of Social Cost’. For an argument that Coase unfairly mischaracterised Pigou as an advocate of government intervention in every case involving an externality, see AW Brian Simpson, ‘*Coase v Pigou* Reexamined’ (1996) 25 *Journal of Legal Studies* 53.

<sup>61</sup> Coase ‘The Problem of Social Cost’ (n 3) 95–96.

When an economist is comparing alternative social arrangements, the proper procedure is to compare the total social product yielded by these different arrangements. The comparison of private and social products is neither here nor there.<sup>62</sup>

While Coase devotes a significant portion of ‘The Problem of Social Cost’ to a critique of the Pigouvian tradition of welfare economics, for our purposes the most important element of Coase’s analysis in this regard is his conclusion. As he puts it:

What is needed is a change of approach. Analysis in terms of divergences between private and social products concentrates attention on particular deficiencies in the system and tends to nourish the belief that any measure which will remove the deficiency is necessarily desirable. It diverts attention from those other changes in the system which are inevitably associated with the corrective measure, changes which may well produce more harm than the original deficiency. ... Economists who study problems of the firm habitually use an opportunity-cost approach and compare the receipts obtained from a given combination of factors with alternative business arrangements. It would seem desirable to use a similar approach when dealing with questions of economic policy and to compare the total social product yielded by alternative social arrangements.<sup>63</sup>

The Pigouvian tradition in welfare economics against which Coase’s analytic is aimed—that economic activity by actors resulting in unwanted or harmful effects on other actors is exceptional and necessarily problematic and that harms once identified should be addressed by the state by forcing the actors causing the harm to internalise the full costs of their economic activity—remains prevalent in the analysis of ‘harmful effects’ at the transnational level. We explored one example in connection with state responsibility doctrine. As we saw, state responsibility doctrine focuses on determining which state is responsible for the transboundary harm and on mechanisms requiring that state to internalise the costs of the harm by causing the cessation of the offending activity and making reparations to the injured state for the harm.<sup>64</sup> The bilateralised conception implicit in this Pigouvian frame makes it terribly difficult to analyse these cross-border effects from the perspective of their impact on general welfare or what Coase calls ‘the system as a whole’, even the system formed by the interconnected economies of two states let alone a globalised understanding of the broader effects of the harm and/or its remedy. It seems possible that state responsibility doctrine—with its general approach of requiring compensation in those rare cases where the transboundary effects of private economic activity are deemed substantial enough to constitute a breach of an international legal norm while allowing the vast majority of transboundary effects of economic actors on one another to fall below the line of doctrinal scrutiny—will turn out to enhance global

<sup>62</sup> *Ibid*, 142.

<sup>63</sup> *Ibid*, 154.

<sup>64</sup> See generally ILC ‘Draft Articles on Responsibility of States’ (n 24).

welfare. Coase's analysis gives us good reasons to be skeptical, but current state responsibility doctrine neither mandates nor encourages us to find out.

The continuing prevalence of Pigouvian tendencies can also be seen quite clearly in the context of international environmental law in the so-called 'polluter pays principle', which seeks to require states to internalise the costs of their transboundary pollution and compensate those deemed injured by it.<sup>65</sup> While in some cases there may be good economic justifications for requiring firms (or states) to bear the cost of their productive activities (including any 'harmful effects on others'), Coase's notion that harmful effects or externalities are often the joint product of diverse economic activities rather than circumstances of unidirectional causation in which 'A inflicts harm on B' helps to remind us that when approaching questions such as 'Who caused "harm" to whom?' and 'Which "costs" are "production costs" and who should "internalise them"?' in the context of the global economy, we are engaged in more than a simple factual determination of causal attribution. Embedded in such attributions are policy choices with implications not only for the parties themselves but for the broader 'system as a whole', however that system may be construed.

Take, for example, the tremendous increase in emissions of greenhouse gases from China and India in recent years. Are the transnational effects of these emissions best understood as production costs attributable to China and India? As the costs of outsourcing and off-shoring production by Western firms for Western markets to Eastern locales? As the costs of low environmental standards in China and India? As the costs of high environmental standards in the US, Europe and Japan? As the cost of lower technological standards for manufacturing in China and India? As the cost of ever-increasing demands by customers in the West for Chinese and Indian manufacturers to produce the same goods at lower prices? In thinking about the complex and multi-directional transnational forces producing the current location of particular forms of production and pollution in China, India and other parts of the developed and developing worlds, it seems somewhat arbitrary (or at least insufficiently attentive to the actual dynamics of the global economy) to designate the transboundary pollution that emanates from Chinese and Indian plants as 'harm' inflicted by China and India on the rest of the world, the full costs of which China and India should internalise as part of *their* costs of

<sup>65</sup> See Philippe Sands, *Principles of International Environmental Law: Volume I Frameworks, Standards and Implementation* (Manchester University Press, 1996) 213 ('The polluter-pays principle is the requirement that the costs of pollution should be borne by the person responsible for causing the pollution and consequential costs'); Hakan Nordstrom and Scott Vaughan, *Trade and Environment* (Special Studies No 4, WTO 1999) 2 ('In the best of all worlds, governments would use proper environmental policies to "internalize" the full environmental costs of production and consumption—the "Polluter Pays Principle"') (emphasis in original); Candace Stevens, 'Interpreting the Polluter Pays Principle in the Trade and Environment Context' (1994) 27 *Cornell International Law Journal* 577 (proposing a framework for a new principle aimed at internalising costs to protect transboundary environments).

production.<sup>66</sup> A Coasean perspective would lead us to resist the temptation to avoid the complex welfare and policy choices implicit in notions of causation, blame and compensation embedded in the polluter pays principle by exploring the impact of the current allocation of costs and benefits of production, pollution, economic growth and low-cost products on global welfare as a whole. It might be the case that a global policy that resulted in allocating the costs of transboundary pollution emanating from China and India to those countries (or their economic producers) would be more likely to lead to a greater increase in global welfare. Or it might turn out that costs should be allocated based on consumption rather than production or that some division of costs among all affected constituencies may prove to be best if the relative impact of possible alternative policy arrangements on the global system as a whole were taken into account.

The point here is not to suggest that the application of the polluter pays principle is wrong in any particular case. Rather, Coase's analysis of externalities and policy responses challenges us to test the soundness of any general tendency toward a Pigouvian policy presumption in favour of correcting transnational externalities whenever they occur. Instead, he urges us to see the constructed nature of the concepts of 'externalities' and 'social' versus 'private' costs and the potential pitfalls of attempting to avoid hard questions of economic policy by treating economic effects as 'caused' by one party and 'inflicted' on another, when they often may be more accurately understood as resulting from the economic activities of all affected parties. It is important to recognise here that Coase is not suggesting that because 'harms' may be jointly caused, all actors are somehow equally culpable and policymakers should be neutral in their assessment of harms and appropriate responses. Rather, properly understood, Coase is arguing that there is no 'neutral' policy position vis-à-vis harms and responses because implicit in any doctrinal attribution of

<sup>66</sup> See eg Roger Harrabin, 'Britons Creating More Emissions' BBC News, 30 September 2009, <http://news.bbc.co.uk/1/hi/science/nature/8283909.stm> (citing studies that suggest that when the carbon footprint of consumption is added to the total, the UK's carbon footprint is significantly higher than China's). For a growing literature examining the combined effects of consumption and production as the proper measure of carbon emissions, see eg R Muradian *et al*, 'Embodied Pollution in Trade: Estimating the "Environmental Load Displacement" of Industrialized Countries' (2002) 41 *Ecological Economics* 51; Damien Friot and Gabrielle Antille Gaillard, 'Tracking Environmental Impacts of Consumption: An Economic-Ecological Model Linking OECD and Developing Countries' (Research Paper Geneva International Academic Network 2007), [www.ruig-gian.org/research/outputs/output.php?ID=335](http://www.ruig-gian.org/research/outputs/output.php?ID=335). Compare ILC 'Draft Articles on the Prevention of Transboundary Harm' (n 57) (approaching the allocation of responsibility for transboundary environmental harms based on the territory from which the pollution emanates). While it appears from the United Nations Framework Convention on Climate Change (UNFCCC) E-Newsletter that discussions regarding a new treaty on climate change will recognise separate and differentiated responsibility based on each country's level of development and current contribution to total greenhouse gas production, the focus is still on a territorial conception of responsibility as opposed to joint responsibility based on the structure of global production, consumption and pollution patterns. See, generally, UNFCCC E-Newsletters, October, July, May and March 2009, at [http://unfccc.int/press/news\\_room/newsletter/items/3642.php](http://unfccc.int/press/news_room/newsletter/items/3642.php) (last accessed 24 November 2009).

directional causality in circumstances where causes are multiple and complex, are policy choices with material and distributional consequences not only for the parties most directly involved but also for the broader system. As such, in Coase's view, the goal of economic policy is to endeavour to make the policy choice that seems most likely to lead to the greatest good (or the least harm) for the system as whole, which may, in some circumstances, mean leaving the losses where they lie. As will be discussed below, in any such calculus, conceptions of 'harm' and 'good' may (and often should) incorporate notions of social welfare a good deal broader than the limited notion that Coase employs in his work. Nevertheless, Coase's perspective seems a useful one for highlighting the responsibility of policymakers for the economic consequences of their choices when considering appropriate policy responses to a wide range of transnational harms, from terrorism to tax evasion.<sup>67</sup>

A similarly Pigouvian perspective can be found in the international trade regime, particularly in the trade law doctrines designed to address so-called 'unfair trade' introduced in Part 1. While generally extolling the global benefits of increased market integration through the reduction of tariffs and non-tariff barriers to trade, the WTO Agreements nevertheless permit nations under certain circumstances to impose compensatory tariffs or duties under the dumping and subsidies regimes when low-priced foreign products are deemed to cause the requisite level of 'injury' to import-competing domestic producers.<sup>68</sup> These remedial regimes, particularly the dumping regime and to a lesser extent the subsidies regime, are considered controversial and perhaps counter-indicated by many trade theorists because of the expectation that the practices giving rise to the low-priced goods will be temporary and often self-correcting through competitive market forces and that the benefits of the low-priced goods to local consumers often will be greater than the harm to local producers.<sup>69</sup> Only by presuming sovereigns to be

<sup>67</sup> One of the most interesting characteristics of law and economics scholarship has been the breadth of legal issues and rules to which economic approaches have been applied. See eg Posner *Economic Analysis of Law* (n 4) 23–24 (asserting that a significant characteristic of the 'new law and economics' is its tendency to apply economic analysis to areas of law that do not regulate economic relationships). See also Gary S Becker, *The Economic Approach to Human Behavior* (University of Chicago Press, 1976); Gary S Becker, *A Treatise on the Family* (Harvard University Press, enlarged edn 1991); Gary S Becker, *Accounting for Tastes* (Harvard University Press, 1996). A growing body of literature is emerging regarding the application of Coasean insights to diverse international legal issues. See sources listed in n 13 above. My hope is to inspire that literature to grow to include a broader array of issues of transnational regulation and governance.

<sup>68</sup> For the rules with respect to dumping, see General Agreement on Tariffs and Trade 1994 (15 April 1994) Art VI LT/UR/A-1A/1/GATT/1 (hereinafter GATT); Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (15 April 1994) LT/UR/A-1A/3 (hereinafter Anti-Dumping Agreement). For the rules regarding subsidies, see GATT, Art XVI, LT/UR/A-1A/1/GATT/1; Agreement on Subsidies and Countervailing Measures (15 April 1994) LT/UR/A-1A/9 (hereinafter Subsidies Agreement). All available at <http://docsonline.wto.org>.

<sup>69</sup> See eg Langille 'Fair Trade is Free Trade's Destiny' (n 28) 233–4 (noting controversy regarding the economic justification for 'unfair trade' regimes); Jackson *The World Trading System* (n 25) 248–55, 281–5 (discussing

adequate proxies for national welfare and inter-sovereign bargains as adequate proxies for global welfare can the international trade regime safely avoid confronting the issue of just who wins and who loses as a result of the 'unfair trade' rules in practice.

These remedial regimes in the WTO Agreements suggest the continued power and significance of Pigouvian notions of the need for compensating mechanisms to offset national harm from foreign activities. Without taking sides as to whether these regimes are justifiable on economic or other grounds, what is most significant about them for my purposes is their focus on balancing harms among domestic and foreign producers without requiring any specific analysis of the impact of either the disfavoured practices or the remedies on other affected national constituencies in the states directly involved or on global welfare as whole.<sup>70</sup> It seems possible that the particular balance of national interests and harms embedded in these regimes was determined or assumed by the Members of the WTO to lead to a general increase in global welfare when they decided to include the regimes in the WTO Agreements in the first place. On the other hand, in light of the fact that the regimes are most frequently invoked by developed nations with large economies and that the remedies of compensating tariffs and countervailing duties are of limited efficacy when used by nations with smaller economies to deter the disfavoured practices of more powerful nations with larger economies, the inclusion of the regimes in the WTO Agreements may more likely reflect the asymmetries in bargaining power among the Member States rather than an affirmative determination that the regimes would increase general global welfare as a whole.<sup>71</sup> In either event, Coase's analysis of the joint nature of economic harms reminds us to be wary of assuming that the general application of remedies in particular cases will necessarily enhance the general welfare when the impact of those remedies on the economic system as a whole is taken into account.

Coase's insights regarding the ubiquity of 'externalities' and his critique of the difference between 'private' and 'social product' provide us with a theoretical foundation and framework for a new approach to thinking about the transnational economic effects of local rules. To a certain extent, like economic actors engaged in the pursuit of their

controversy among economists as to whether dumping duties or countervailing duties can be justified on economic policy grounds and the potential welfare reducing effects of the remedies themselves); Alan O Sykes, 'Countervailing Duty Law: An Economic Critique' (1989) 89 *Columbia Law Review* 199 (arguing that the cases in which countervailing duty law might generate a net benefit to the economy were difficult to identify in practice).

<sup>70</sup> See GATT, Art VI:6(a) (n 68); Anti-Dumping Agreement, Art 3 (n 68); Subsidies Agreement, Art 15 (n 68) (articulating the standards for a determination of actionable 'injury' under the anti-dumping and subsidies regimes). See also John H Jackson *et al*, *Legal Problems of International Economic Relations, Cases, Materials and Text* (Thomson/West, 5th edn 2008) 813–14 (explaining that the injury tests in both regimes require positive evidence based on an objective examination of the volume of unfairly traded imports, the effect on prices in the domestic market for like products and the impact of the imports on domestic producers) (hereinafter Jackson *Legal Problems of International Economic Relations*).

<sup>71</sup> See n 38 above (regarding the way power asymmetries can be reflected in trade doctrines).

particular interests, local regulators, in pursuing their diverse parochial regulatory goals, 'will take actions which facilitate or hinder what others want to do'.<sup>72</sup> Some of the effects of these rulemaking or enforcing actions will be the intended result of the regulation (after all, the purpose of regulation is to shape behaviour), while others may be the by-products or unintended consequences of the local regulatory objectives as they ripple through the global economy.<sup>73</sup> If the transnational economic effects of local rules, like the 'harmful effects' of normal economic activity, are both ubiquitous, and to some extent inevitable, then, by analogy, Coase's approach would suggest that key aspects of economic policy analysis from a global point of view would be, first, identifying the economic effects (both harmful and helpful) of alternative legal rules and, second, weighing their relative impact 'on the system as a whole'. Such an approach would seem to require a shift in analytic focus to the impact of the rules both on relevant transnational economic governance systems or regimes and on the total value of global production with respect to which analysis of comparative welfare trade-offs and relative winners and losers takes place.

Of course, limiting the authority or activities of any government through alternative international legal or other means could be perceived from the perspective of that government as 'harm'.<sup>74</sup> For example, a decision by the US Department of Treasury to increase the capital reserve requirements of US banks could be perceived by banks and businesses in many developing countries as harmful to the extent that the increased reserve requirements resulted in diminished available capital for lending in the developing world.<sup>75</sup> At the same time, an attempt by some international body like the International Monetary Fund or consortium of countries like the Organization for Economic Co-operation and Development (OECD) or the G-20 countries to standardise rules for capital reserve requirements for banks at lower levels in order to alleviate the possibility of capital shortages in the developing world might be perceived as 'harmful' by the US to the extent that it believed such lower reserve requirements put the Treasury and consumers at risk by allowing too much leverage in US banks.<sup>76</sup>

<sup>72</sup> Coase *The Firm, The Market, and The Law* (n 18) 27.

<sup>73</sup> For a discussion of possible 'externalities' resulting from regulation in one state on others, see Trachtman *The Economic Structure of International Law* (n 13) 11–13.

<sup>74</sup> *Ibid.*

<sup>75</sup> See n 7 above.

<sup>76</sup> Cf Joel P Trachtman, 'Unilateralism, Bilateralism, Regionalism, Multilateralism and Functionalism: A Comparison with Reference to Securities Regulation' (1994) 4 *Transnational Law and Contemporary Problems* 69, 82–85 (hereinafter Trachtman 'Unilateralism, Bilateralism, Regionalism') (discussing a range of reasons why countries may differ substantially in their domestic goals for securities regulation, making universal securities rules difficult to achieve or inappropriate and leading to various levels of deference and co-operation); Stephen J Choi and Andrew T Guzman, 'National Laws, International Money: Regulation in a Global Capital Market' (1997) 65 *Fordham Law Review* 1855 (arguing that a global regime for regulation of capital markets characterised by greater territorial limits on national securities regulation would allow for the differentiation of national securities markets and greater global mobility of capital).

Seeking to assess these conflicting conceptions of ‘harm’ would require us to analyse the transnational effects of each rule in relation to the relative impact of alternative social arrangements. In the transnational context, such alternative social arrangements might include altering the original rule to reduce its ‘harmful effects’ on global economic welfare, adopting an international rule that could accomplish similar regulatory aims at lower global cost, undertaking ameliorative regulatory measures by individual affected constituencies to limit the ‘harmful effects’ with the goal of eliminating the global ‘harmful effects’, making adjustments to the ‘harmful effects’ of the initial rule through market transactions by affected economic actors, and many others—or, perhaps doing nothing to reduce the ‘harmful effects’ if the total global cost of all the possible alternative arrangements exceeds the cost resulting from the ‘harmful effects’ of the original or contemplated rule.

Such an analytic approach would shift our perspective from that of the traditional role of the Pigouvian welfare economist trying to discern what might be understood as the divergence between the ‘private’ (or ‘national’) and ‘social’ (or ‘global’) product of a particular legal rule, and devising the appropriate level and means of compensation for eliminating that divergence, to one of endeavouring to compare the relative economic effects of the status quo rule scheme and alternative rule schemes on total global welfare and choosing the rule that seemed most likely to produce the most positive effect on global welfare as a whole. Much like a businessperson would attempt to weigh the relative opportunity costs of alternative deployments of economic resources in a firm in light of his or her best assessment of the relevant facts and circumstances in order to decide upon the best deployment of resources for the firm as a whole, local and global policymakers informed by Coase’s insights and perspective would endeavour to articulate the relative opportunity costs of alternative legal and policy arrangements based on their best assessments of the relative impacts of such arrangements on global welfare, in order to make more informed decisions as to which legal arrangement might be most likely to enhance (or least likely to reduce) global welfare as a whole.

The point here is that a Coasean perspective helps us to see myriad possible global policy options for engaging the transnational ‘harmful effects’ of a local rule that fall outside the doctrinal and remedial scope of the traditional international legal frameworks we have explored, that may nevertheless be welfare-enhancing from the perspective of the globe as a whole. Many of these policy options might be politically unfeasible or lack the necessary institutional mechanisms to bring them about, but that does not detract from the possibility that they might nevertheless be a good idea. In fact, if the anticipated welfare gains of some of these possible policy options or approaches were large enough, the fact that available institutions could not bring them about might lead diverse global constituencies to focus on addressing the apparent deficiencies in the current global economic governance regime through institutional innovation and reform.

Of course, if the anticipated global welfare costs of addressing the regulatory ‘harmful effects’ were higher than the global benefits of eliminating them, the losses and gains of the status quo might well fall unevenly on some constituencies. In this way, Coase’s approach also helps us to remember that all regulatory policy choices produce relative winners and losers and to expose to scrutiny and contestation the often unstated premise of many international regulatory regimes, namely, that the regimes produce universal welfare gains without cost. By focusing attention on the real costs to some global constituencies implicit in even the most broadly welfare-enhancing regulatory regimes, Coase’s framework makes more transparent the political and normative choices embedded in these transnational regulatory choices. Such choices could include the choice of placing national sovereignty prerogatives ahead of global welfare concerns in respect of particular local rules or the decision that ‘harmful effects’ can be ‘resolved’ by compensation to the state deemed to be harmed without consideration of the impact of that determination on other affected constituencies or on global welfare as a whole.

*Maxim 3: Assessing the consequences of and appropriate policy responses to ‘harmful effects’ that are the joint product of independent economic activities requires the economic policy analyst to take a position on what constitutes the general welfare and how it could best be maximised.*

Perhaps the most significant consequence of Coase’s shift from analysing economic harms through a doctrinal lens focused on the attribution of causation and the determination of an appropriate regulatory response to a framework focused on assessing ‘harms’ and possible alternative remedial arrangements by comparing the relative effects of the original ‘harm’ and available alternative arrangements on the economic system as a whole is that it requires the policy analyst not only to articulate the policy but also to articulate (and defend) the criteria against which the applicable policy will be measured—in other words, to take a position on what ‘the best outcome for the system as a whole’<sup>77</sup> would be. For purposes of his economic policy framework, Coase assumes that ‘the best outcome for the system as a whole’ is ‘equivalent to maximizing the value of total production.’<sup>78</sup> While Coase uses the maximisation of the value of total production as a surrogate for social welfare as a whole, he does so conscious of the fact that his conception is a limited one. As he puts it,

In this article, the analysis has been confined, as is usual in this part of economics, to comparisons of the value of production, as measured by the market. But it is, of course, desirable that the choice among different social arrangements for the solution of economic

<sup>77</sup> Coase *The Firm, The Market, and The Law* (n 18) 27.

<sup>78</sup> *Ibid.*

problems should be carried out in broader terms than this and that the total effect of these arrangements in all spheres of life should be taken into account. As Frank K. Knight has so often emphasized, problems of welfare economics must ultimately dissolve into a study of aesthetics and morals.<sup>79</sup>

Recognising that any formulation of what might constitute ‘general social welfare’ would be both highly contested and contestable, the idea that policymakers should nevertheless orient themselves toward some conception of the general welfare when devising policy responses to particular economic or social problems or ‘harms’ seems a relatively uncontroversial one in the context of local or national policymaking despite the frequent interventions of ‘special interests’ in the policymaking process.<sup>80</sup> With varying degrees of legitimacy or persuasiveness, local and national political processes strive to articulate some conception of ‘the national interest’—or, with respect to sub-state political units, ‘the public interest’—as a rough rubric against which the soundness of policy initiatives can be measured and in the name of which policy choices can be justified.

From the examples we have considered thus far—from state responsibility doctrine in public international law to the polluter pays principle in international environmental law to the dumping and subsidies regimes in international trade law—it would seem that often the conception of general welfare at work in international legal analyses of transnational ‘harmful effects’ is focused on the prerogatives and balance of harms between sovereigns without any specific attention to the impact of the ‘harms’ or their legal resolution on non-state constituencies or global welfare more broadly in either the economic sense of the total social product or in the broader sense of what Coase calls ‘a study of aesthetics and morals’.

A particularly dramatic example of this tendency can be found in the International Court of Justice’s *Advisory Opinion on the Use and Legality of Nuclear Weapons*.<sup>81</sup> In that case, in the face of a number of passionate and diverse dissenting opinions, a majority of the Court determined that it could not rule out the possibility that when the very existence of a sovereign was at stake, the sovereign right to self-defence could include the use of nuclear weapons, even if such use would produce catastrophic effects and perhaps the annihilation of other non-belligerent sovereigns and their populations.<sup>82</sup> My point here

<sup>79</sup> Coase ‘The Problem of Social Cost’ (n 3) 154.

<sup>80</sup> See Paul B Stephan, ‘Accountability and International Lawmaking: Rules, Rents and Legitimacy’ (1996–7) 17 *Northwestern Journal of International Law & Business* 681 (hereinafter Stephan ‘Accountability and International Lawmaking’) (contrasting domestic lawmaking in democratic societies, where mechanisms for holding lawmakers accountable to their constituents generally exist, to international lawmaking processes where mechanisms for holding lawmakers accountable to broader public interests are significantly weaker with possible adverse consequences for global welfare).

<sup>81</sup> *Legality of the Threat or Use of Nuclear Weapons* (Advisory Opinion) [1996] ICJ 226.

<sup>82</sup> *Ibid*, 266.

is not to condemn the Court for its ruling, but rather to suggest the tremendous continuing power of a sovereigntist point of view in international legal thought. If sovereign prerogatives (admittedly under quite extreme and limited circumstances) can create a legal privilege for the creation of ‘harmful effects on others’ so large as to include total annihilation, it would seem safe to conclude that a national sovereignty perspective as a trump on a perspective based on global welfare as a whole is pervasive in the international legal mindset.

To be fair, one might reasonably assert that international legal doctrines that pragmatically attend to balancing sovereign interests and prerogatives or international trade doctrines that permit sovereigns to create economic defences to perceived ‘unfairness’ in the behaviour of trading partners, even if they will result in disproportionate benefits and burdens on diverse global constituencies in some cases, are animated by a belief that they will ultimately enhance global welfare as a whole by reducing sovereign conflict and preserving peace and security or contributing to the smooth functioning and stability of the global trading system. Such a belief might reflect a ‘global welfare perspective’ of sorts, although a perspective on the general welfare no less limited or partial than Coase’s use of ‘the value of total production’. But an important distinction between Coase’s economic policy approach to assessing ‘harmful effects on others’ and the international legal approaches we have explored so far is that in Coase’s framework, all ‘harms’ are assessed in relation to their relative effects on ‘the value of total production’. By contrast, to the extent that global welfare conceptions such as ‘global peace and security’ or ‘the stability and functioning of the global trading system’ are animating international legal analyses at all, they are operating only indirectly, at most as background presumptions, but not as central aspects of the analytic frameworks themselves. From this vantage point, Coase’s framework seems to invite critique, contestation and alternative conceptions of social welfare into being by placing a self-consciously partial conception of social welfare at its centre, while the common international approaches we have explored seem to create the opposite result—narrowing our view to the interests and concerns of the sovereigns directly involved in the matter at issue.

Moreover, at the transnational level, it is commonplace to assume that international regimes are good for the world as a whole—perhaps simply by virtue of the fact that they are transnational in scope or multilateral in form—even if we know that not every nation benefits (or benefits equally) from most international regulatory regimes and institutions.<sup>83</sup> To return to an earlier discussion of power and the limits of formal sovereign equality, it is no secret that different states are differently situated in terms of powers and opportunities to influence the UN system or to reap the benefits of its activities and that states with large economies and sophisticated administrative

<sup>83</sup> See David Kennedy, *The Dark Sides of Virtue: Reassessing International Humanitarianism* (Princeton University Press, 2004) 111–46.

bureaucracies are more able to use the remedial processes and to influence rulemaking in the WTO system than are states with small economies or more limited administrative capacity. Of course, general regulatory regimes cannot avoid creating at least some relative winner and losers, even if the scheme might from some standpoint improve 'general welfare'. Even human rights conventions will produce costs that will doubtless be borne by some constituencies, even if it is customary to speak about human rights in the language of their common benefits to all mankind.<sup>84</sup> Yet in the absence of some framework for engaging or challenging the effects of these regimes from 'a global point of view', it seems likely that general claims about the universal benefits of international regulatory regimes will remain expressions of ideology and conjecture and subject to critique in traditional international legal terms primarily from the perspective of preserving national sovereignty or, at most, enhancing the formal equality of states.

Perhaps the difficulty in formulating, articulating or defending a conception of 'global welfare' that might serve as a rough equivalent of 'the national interest' in a national context is not surprising. Global differences among states with respect to things like geographic size, income inequality, cultural values and preferences, economic power, political and institutional structure, population and diversity, level of economic development and many other factors may make it considerably more difficult to come to any even provisional consensus on what a 'global welfare perspective' might mean or entail in any particular context.<sup>85</sup> Further, global institutional structures for international

<sup>84</sup> See *ibid.*, 3–35 (challenging the presumption that human rights produce global benefits without cost and calling for better mechanisms for pragmatically assessing the downsides of human rights strategies along with their benefits).

<sup>85</sup> The practical and political difficulties of developing a satisfying 'global welfare perspective' in a world of diverse interests and perspectives is similar to that which faced the generation-long effort of Myres McDougal and his colleagues in the 'Yale policy school' of international law during the 1960s and 70s. Their advocacy of a 'world public order' perspective proved very useful as a critical analytic and heuristic for identifying and enumerating practical factors and ethical considerations that would need to be taken into account in developing a realistic and ethically compelling analysis of international legal issues. In doing so, they sharpened our awareness of the limits of more conventional 'formal' or 'positivist' analytics, on the one hand, and the then fashionable 'realism' of political science, on the other. My own effort to foster a 'global welfare perspective' from which local and international policymaking might be assessed and contested shares a certain commonality with the broad analytic objectives of the McDougal effort to place conceptions of 'world public order' openly at the centre of international legal analysis: despite the very real complexities and difficulties implicit in the analytic perspectives, each seeks to use the debate generated around the perspectives to guide a more purposive and pragmatic approach to global policymaking. For an articulation of the main tenants of the 'world public order perspective' see Myres S McDougal and Harold D Lasswell, 'The Identification and Appraisal of Diverse Systems of Public Order' (1959) 53 *American Journal of International Law* 1, reprinted in Myres S McDougal *et al.*, *Studies in World Public Order* 3 (Yale University Press, 1960). For a critical elaboration of these ideas, see Richard A Falk and Saul H Mendlovitz (eds), *The Strategy of World Order*, 4 vols (World Law Fund, 1966). For other examples of the complexities of mediating different national interests through international rules, see eg Trachtman 'Unilateralism, Bilateralism, Regionalism' (n 76) (differences in history, market structure and policy goals among states make universal rules for securities regulation difficult to achieve); Braithwaite and Drahos *Global Business Regulation* (n 9) 138–42 (noting that international co-operation in the context of monetary policy has been difficult due to different national policy needs and priorities).

rulemaking tend to be more attuned to achieving a balance of interests among the states or of the other interests they serve than a conception of the 'global good'.<sup>86</sup>

Without seeking to limit the numerous other elements that might be relevant to a satisfactory definition of 'global welfare' in some objective sense (such as distributional equity, participation, freedoms and opportunities, happiness, satisfaction and quality of life, health and well-being, levels of economic development, sustainability, peace and security etc), it seems reasonable to suggest along with Coase that one important element of 'global social welfare' would be the size of the total global social product and thus that one significant element of global economic policy analysis would be comparing alternative economic and social arrangements with a view to choosing one that would most likely result in a net increase in the value of total global production. Recognising its limitations, Coase's definition of global welfare is nevertheless suggestive of what a 'global welfare perspective'—however articulated—might add to our current analytic approaches to the impact of local rules in the global economy.

Moreover, it is important to recognise that Coase's self-conscious choice of 'the value of total production' as his measure of 'social welfare' is helpful in highlighting the fact that all such general conceptions of welfare will be necessarily partial, political and the result of contested value choices. At the same time, Coase's framework focuses our attention on the fact that under conditions of economic interdependence and the ubiquity of economic effects (both harmful and helpful) arising from the diverse ordinary activities of economic actors and local rulemakers on one another, it seems important to articulate *some* analytic perspective of the 'global good' that would facilitate, at least provisionally, the capacity both to recognise and to look beyond the interests of particular national governments, transnational regulators and economic constituencies in order to assess and debate the relative costs and benefits of particular economic activities or policy choices for the globe as a whole.<sup>87</sup> It is this general orientation that I have in mind as the animating sensibility for what I am calling 'a global economic policy perspective'. It is my contention that such a perspective will prove useful to regulators, scholars, activists and citizens committed to engage issues of regulatory policy, whether global or local, with a view to maximising 'global welfare' while helping us and them to remain cognisant of the fact that significant substantive differences will always persist as to what 'global welfare' should entail or where it might lead in respect of particular policy choices.

<sup>86</sup> See eg nn 11 (noting the persistence of power asymmetries in international agreements) and 80 (asserting that international lawmaking processes may be less accountable to democratic oversight than national ones) above. See also Teubner 'Global Bukowina' (n 10) 3–28 (arguing that under current global conditions emerging forms of 'private' global law are reflective of the diffuse social processes and specialised social and technical fields that produce them rather than the interests of national sovereigns or of global society as a whole).

<sup>87</sup> See n 14 above (noting a range of theoretical efforts to articulate a global economic policy perspective).

*Maxim 4: Under real world conditions, legal rules shape the formation of economic institutions, the behaviour of economic actors, the allocation of resources and ultimately general welfare in an economy. Thus, analytic attention to the relative economic effects of alternative legal arrangements on general welfare under real world conditions of positive transaction costs is the core function of economic policy analysis properly understood.*

So far, our analysis of Coase's approach to economic policy has focused on his assertion that regular economic activity will routinely if not inevitably produce economic effects that will be undesired or 'harmful' from the perspective of one or more constituencies in an economy and that attempts by regulatory institutions (whether local or international) to eliminate the 'harmful effects' with respect to some constituencies may be perceived as 'harmful' by others. In addition, we have explored Coase's notion that a key element of economic policy analysis is situating the 'harmful effects' (whether local or transnational) as well as policy efforts to eliminate them in the broader context of their net impact on general welfare measured as the value of total production with a view to choosing the policy path that leads to the lesser harm for the system as a whole.

We will now turn to that portion of Coase's work for which he is most famous in both legal and economic circles—his analytic model for assessing how and under what circumstances legal rules will shape the formation of economic institutions (such as firms and markets),<sup>88</sup> the behaviour of economic actors, and the allocation of the factors of production; when economic actors will address 'harmful effects' themselves through bargaining or market transactions and when they are unlikely to do so; and the significance of transaction costs in the structure of economic institutions, in the behaviour of economic actors and in the analysis of alternative legal rules from an economic policy perspective.

<sup>88</sup> See Ronald H Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386; RH Coase, 'The Firm, The Market, and The Law' in Coase *The Firm, The Market, and The Law* (n 18) 1–31 (introduction to his work generally and relating his theories of the firm and market institutions to 'The Problem of Social Cost'). This work on the nature of the firm generated a significant body of work in institutional economics. See eg Armen A Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 *American Economic Review* 777; David J Teece, 'Towards an Economic Theory of the Multiproduct Firm' (1982) 3 *Journal of Economic Behavior & Organization* 39; David J Teece, 'Economies of Scope and the Scope of the Enterprise' (1980) 1 *Journal of Economic Behavior & Organization* 223; Oliver E Williamson, 'Transaction Cost Economics: The Governance of Contractual Relations' (1979) 22 *Journal of Law & Economics* 233. For an essay expressing his approval of this trend in economic theory, see Ronald Coase, 'The New Institutional Economics' (1984) 140 *Journal of Institutional and Theoretical Economics* 229. For examples of institutional economics applied in the international context, see eg William J Aceves, 'The Economic Analysis of International Law: Transaction Cost Economics and the Concept of State Practice' (1996) 17 *University of Pennsylvania Journal of International Economic Law* 995; William J Aceves, 'Institutionalist Theory and International Legal Scholarship' (1997) 12 *American University Journal of International Law & Policy* 227; Joel P Trachtman, 'The Theory of the Firm and the Theory of the International Economic Organization: Toward a Comparative Institutional Analysis' (1997) 17 *Northwestern Journal of International Law & Business* 470.

What is perhaps most striking about Coase's analytic model for economic policy analysis is his emphasis on the centrality of law to the formation and structure of economic institutions, to the nature and content of economic decision-making and to economic policy as a disciplinary practice. As he puts it, 'Economic policy involves a choice among alternative social institutions, and these are created by the law or are dependent on it.'<sup>89</sup> In fact, according to Coase a fundamental problem with mainstream micro-economic policy analysis is its failure to give sufficient or proper attention to the causes and character of the firms and institutions whose choices comprise the central focus of economic study and the role of law and legal institutions in shaping those choices. As Coase puts this point in his introduction to *The Firm, The Market, and The Law*:

What differentiates the essays in this book is not that they reject existing economic theory, which, as I have said, embodies the logic of choice and is of wide applicability, but that they employ this economic theory to examine the role which the firm, the market, and the law play in the working of the economic system.<sup>90</sup>

One way to get a concrete sense of Coase's notion of precisely how law is relevant to economic behaviour and the allocation of resources in an economy (and hence the centrality of law to the economic policy analysis) is to focus on his reformulation of the concept of a 'factor of production'. According to Coase, while factors of production are most often thought of as physical things such as an acre of land or a ton of fertiliser, they are better understood as rights to perform or refrain from performing certain actions. Speaking of land, commonly understood as the quintessential example of a physical factor of production, Coase states:

We may speak of a person owning land and using it as a factor of production, but what the land-owner in fact possesses is the right to carry out a circumscribed list of actions. ... This does not come about simply because of governmental regulation. It would be equally true under the common law. In fact, it would be true under any system of law. ...

If factors of production are thought of as rights, it becomes easier to understand that the right to do something which has a harmful effect (such as the creation of smoke, noise, smells, etc.) is also a factor of production. ... The cost of exercising a right (using a factor of production) is always the loss which is suffered elsewhere in consequence of the exercise of that right—the inability to cross land, to park a car, to build a house, enjoy a view, to have peace and quiet, or to breathe clean air.<sup>91</sup>

By treating 'rights to perform certain actions' as indistinguishable analytically from other factors of production, Coase relies on price theory to suggest that their acquisition,

<sup>89</sup> Coase *The Firm, The Market, and The Law* (n 18) 28.

<sup>90</sup> *Ibid.*, 5.

<sup>91</sup> Coase 'The Problem of Social Cost' (n 3) 155.

subdivision or combination will be driven by maximising value, in part through minimising costs, including transaction costs. He states:

If rights to perform certain actions can be bought and sold, they will tend to be acquired by those for whom they are most valuable either for production or enjoyment. In this process, rights will be acquired, subdivided, and combined, so as to allow those actions to be carried out which bring about the outcome which has the greatest value to the market. Exercise of the rights acquired by one person inevitably denies opportunities for production or enjoyment by others, for whom the price of acquiring the rights would be too high. Of course, in the process of acquisition, subdivision, and combination, the increase in value of the outcome which a new constellation of rights allows has to be matched against the costs to achieve that new constellation, and such rearrangement of rights will only be undertaken if the cost of the transactions needed to achieve it is less than the increase in value which such an arrangement makes possible.

... How the rights will be used depends on who owns the rights and the contractual arrangements into which the owner has entered. If these arrangements are the result of market transactions, they will tend to lead to the rights being used in the way which is most valued, but only after deducting the costs involved in making these transactions. Transaction costs therefore play a crucial role in determining how rights will be used.<sup>92</sup>

In this passage, Coase asserts that if factors of production, whether land or the emission of smoke, are understood as ‘rights to perform certain actions’ then, in accordance with basic micro-economic price theory, the arrangement and rearrangement of factors of production as rights should be organised, to the extent possible, through the self-interested bargaining transactions of economic actors in the context of markets.<sup>93</sup> As Coase puts the point, ‘Markets are institutions that exist to facilitate exchange, that is, they exist in order to reduce the cost of carrying out exchange transactions.’<sup>94</sup>

In order to demonstrate how the effects of legal rules allocating factors of production like the right to emit smoke or the right to live free of smoke damage could be reallocated through market transactions among affected economic actors seeking to reduce costs and maximise the value of total production, Coase hypothesises a world in which such market transactions could occur without cost.<sup>95</sup>

<sup>92</sup> Coase *The Firm, The Market, and The Law* (n 18) 12–13.

<sup>93</sup> For a critique of the proposition that market allocations of resources are more efficient than rule allocations, see Kennedy ‘Law-and-Economics from the Perspective of Critical Legal Studies’ (n 20) 472–3. See also Guido Calabresi, ‘The Pointlessness of Pareto: Carrying Coase Further’ (1991) 100 *Yale Law Journal* 1211–16 (hereinafter Calabresi ‘The Pointlessness of Pareto’) (arguing that neither market nor non-market command systems are primary, but rather work in interactive symmetry in which each corrupts and alters the other in complex ways, making Pareto efficiency no guide to avoiding complex issues of distributional effects and policy, even in theory).

<sup>94</sup> Coase *The Firm, The Market, and The Law* (n 18) 7.

<sup>95</sup> See Coase ‘The Problem of Social Cost’ (n 3) 97–114.

Using the example of straying cattle that destroy crops on neighbouring farm land (which he analogises to the example of factory smoke on neighbouring houses), Coase analyses how ranchers and farmers might address this issue under different liability rules if bargaining between them were assumed to be without cost.<sup>96</sup> Underlying this analysis is the assumption that if the initial allocation of resources established by the legal rule is already optimal, then no bargaining will take place even in the absence of transaction costs and we would have a theoretical basis for concluding that the allocation of resources under the initial legal rule is already efficient. If, on the other hand, bargaining would take place in the absence of transaction costs, then the original rule (and its impact on resource allocation) would be suboptimal when compared to the bargained-for adjustment to resource allocations under conditions of zero-cost bargaining. From this perspective, if a reallocation of resources took place through a bargain struck between the parties, then the reallocation would necessarily result in an improvement on the allocation initially established by the rule in net social welfare measured as the value of total production. Based on this analysis, Coase concludes that, 'in the absence of transaction costs, it does not matter what the law is, since people can always negotiate without cost to acquire, subdivide and combine rights whenever this would increase the value of production.'<sup>97</sup> This is the conclusion that has come to be known as the 'Coase Theorem'.

Though it may come as a surprise to many readers, as Coase is perhaps best known in economic and legal circles for the so-called Coase Theorem, the purpose of Coase's work is not to demonstrate the irrelevance of legal rules under theoretical conditions of zero-transaction costs. In fact, as Coase suggests in following passage, such a purpose could not be further from his intention. As he puts it:

'The Problem of Social Cost,' in which these views were presented in a systematic way, has been widely cited and discussed in the economic literature. But its influence on economic analysis has been less beneficial than I'd hoped. The discussion has been largely devoted to sections III and IV of the article and even here has concentrated on the so-called 'Coase Theorem,' neglecting other aspects of the analysis. In sections III and IV, I examined what would happen in a world in which transaction costs were assumed to be zero. My aim in so doing was not to describe what life would be like in such a world but to provide a simple setting in which to develop the analysis and, what was even more important, to make clear the fundamental role which transaction costs do, and should, play in the fashioning of the institutions which make up the economic system.<sup>98</sup>

The crucial goal for Coase, then, is the development of a framework to analyse the impact of legal rules on economic activity and the allocation of economic resources under conditions of positive transaction costs. Again in his own words,

<sup>96</sup> *Ibid*, 97–104.

<sup>97</sup> Coase *The Firm, The Market, and The Law* (n 18) 14.

<sup>98</sup> *Ibid*, 13.

[W]hen dealing with the problem of the rearrangement of legal rights through the market, I argued that such a rearrangement would be made through the market whenever this would lead to an increase in the value of production. But this assumed costless market transactions. Once the costs of carrying out market transactions are taken into account, it is clear that such an arrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about. ... In these conditions, the initial delimitation of legal rights does have an effect on the efficiency with which the economic system operates. One arrangement of rights may bring about a greater value of production than any other. But unless this is the arrangement of rights established by the legal system, the costs of reaching the same result by altering and combining rights through the market may be so great that this optimal arrangement of rights, and the greater value of production which it would bring, would never be achieved.<sup>99</sup>

From this passage, we can discern the last step in Coase's analytic framework—under real world conditions legal rules will have a significant effect on the allocation of resources in an economy and transaction costs can significantly limit or preclude the adjustment of resource allocations by interested parties through market transactions. His proposed analytic solution is to use the basic insights from his largely counterfactual zero-cost model to suggest a research agenda whereby economists and legal policy analysts would study, on a case-by-case basis, the effects of legal rules on resource allocations, the relative efficiency of those allocations and, in circumstances where inefficiencies were indicated, the likelihood of adjustments through bargaining by all interested economic actors, taking into account the magnitude and extent of the effects of transaction costs—where transaction costs include both the costs (and hence, the likelihood) of market adjustments through bargaining and the costs of implementing alternative legal arrangements. In such circumstances, Coase suggests that the efficiency of a legal rule scheme could only be analysed in relative terms through comparison with possible alternative rules schemes using a common methodology of anticipated economic effects on the value of total production.

Recognising the inherent complexity of any such analysis, Coase does not imagine that his analytic framework will necessarily lead to efficient rules. In fact, he expresses some doubt that in the presence of transaction costs perfectly efficient rules can be generated in real world contexts.<sup>100</sup> Rather, the hope is that through empirical study using the assumptions regarding unavoidable joint costs of economic activity in an interdependent economy and a model that seeks to analyse the allocational effects of legal rules under conditions of transaction costs, economic and legal policymakers might better understand how particular legal rules could be designed to more closely approximate allocations of factors in the economy that would maximise the total value of

<sup>99</sup> Coase 'The Problem of Social Cost' (n 3) 115.

<sup>100</sup> Coase *The Firm, The Market, and The Law* (n 18) 178.

production.<sup>101</sup> What is called for is a theory that permits the comparison of alternative legal arrangements under conditions of positive transaction costs.<sup>102</sup> As Coase puts it,

Without some knowledge of what would be achieved with alternative institutional arrangements, it is impossible to choose sensibly among them. We therefore need a theoretical system capable of analyzing the effects of changes in those arrangements.<sup>103</sup>

<sup>101</sup> *Ibid.*, 30–31. Duncan Kennedy helpfully identifies three streams of law and economics literature based on differing definitions of ‘efficiency’—anti-Paretian, Paretian, and ‘liberal’, the latter being based on a notion that ‘[i]f a change in the legal regime helps those who gain by it more than it hurts those who lose, it is a good idea to put it into effect’. See Kennedy ‘Cost-Benefit Analysis’ (n 58) 388, 387–8. For the anti-Paretian stream, emphasising alternatives to Pareto optimal efficiency, see eg Posner *Economic Analysis of Law* (n 4) 10–15 (focused on ‘wealth maximisation’ as the measure, sometimes referred to as ‘Kaldor-Hicks efficiency’); Richard A Posner, ‘The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication’ (1980) 8 *Hofstra Law Review* 487. See also Amartya Sen, ‘The Impossibility of a Paretian Liberal’ (1970) 78 *Journal of Political Economy* 152 (suggesting an inherent conflict between Pareto optimal solutions and liberal values); Calabresi ‘The Pointlessness of Pareto’ (n 93) 1211–16. For examples of the Paretian stream based on the notion that an efficient equilibrium is achieved when no one can be made better off without someone being made worse off (which would include Coase), see Howard Beales *et al.*, ‘The Efficient Regulation of Consumer Information’ (1981) 24 *Journal of Law & Economics* 491; John Prather Brown, ‘Toward an Economic Theory of Liability’ (1973) 2 *Journal of Legal Studies* 323; A Mitchell Polinsky, ‘Controlling Externalities and Protecting Entitlements: Property Right, Liability Rule and Tax-Subsidy Approaches’ (1979) 8 *Journal of Legal Studies* 1; A Mitchell Polinsky, ‘Resolving Nuisance Disputes: The Simple Economics of Injunctive and Damage Remedies’ (1980) 32 *Stanford Law Review* 1075; Steven Shavell, *Foundations in the Economic Analysis of Law* (Harvard University Press, 2004). For examples of the ‘liberal’ stream, see Bruce Ackerman, *Reconstructing American Law* (Harvard University Press, 1984); Guido Calabresi and Jon T Hirschoff, ‘Toward a Test for Strict Liability in Torts’ (1972) 81 *Yale Law Journal* 1060; Guido Calabresi and A Douglas Malamed, ‘Property Rules, Liability Rules, and Inalienability: One View of the Cathedral’ (1972) 85 *Harvard Law Review* 1089; Richard S Markovits, ‘The Causes and Policy Significance of Pareto Resource Misallocation: A Checklist for Micro-Economic Policy Analysis’ (1975) 28 *Stanford Law Review* 1; Frank Michelman, ‘Pollution as a Tort: A Non-Accidental Perspective on Calabresi’s Costs’ (1971) 80 *Yale Law Journal* 647; Frank Michelman, ‘Property, Utility and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law’ (1967) 80 *Harvard Law Review* 1165; Mario Rizzo, ‘The Mirage of Efficiency’ (1980) 8 *Hofstra Law Review* 641.

<sup>102</sup> Coase’s model of analysing legal rules in light of transaction costs spawned a huge literature. Examples include George J Benston and Clifford W Smith, Jr, ‘A Transaction Cost Approach to Financial Intermediation’ (1976) 31 *Journal of Finance* 215; Guido Calabresi, ‘Some Thoughts on Risk Distribution and the Law of Torts’ (1961) 70 *Yale Law Journal* 499; Guido Calabresi, ‘The Decision for Accidents: An Approach to Nonfault Allocation of Costs’ (1965) 78 *Harvard Law Review* 713; Guido Calabresi, ‘Transaction Costs, Resource Allocation and Liability Rules—A Comment’ (1968) 11 *Journal of Law & Economics* 67; Steven NS Chung, ‘Transaction Costs, Risk Aversion and the Choice of Contractual Arrangements’ (1969) 12 *Journal of Law & Economics* 23; Harold Demsetz, ‘The Cost of Transacting’ (1968) 82 *Quarterly Journal of Economics* 33; Benjamin Klein *et al.*, ‘Vertical Integration, Appropriate Rents, and the Competitive Process’ (1978) 21 *Journal of Law & Economics* 297; Steven Shavell, ‘Suit Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs’ (1982) XI *Journal of Legal Studies* 55; Oliver E Williamson, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) 22 *Journal of Law & Economics* 233; Edward Zabel, ‘Consumer Choice, Portfolio Decisions and Transaction Costs’ (1973) 41 *Econometrica* 321.

<sup>103</sup> Coase *The Firm, The Market, and The Law* (n 18) 30.

In Coase's view, 'Economic policy consists of choosing those legal rules, procedures, and administrative structures which will maximize the total value of production.'<sup>104</sup>

With some understanding of Coase's ideas about the role of law and legal rules in the organisation of economic activity and the allocation of resources within an economy, we can now explore how Coase's analytic model helps to query some of our more traditional conceptions of the significance of local rules for the global economic regulatory order and global welfare.<sup>105</sup> At the most basic level, Coase's general analysis of the role of law in economic systems, particularly under conditions of positive transaction costs, suggests that law is likely to play as significant a role in the structure of firms and markets and the allocation of resources and economic decision-making at the transnational level as it does in national or local economies. This insight helps to illuminate the role of local rules in the global economy in several important ways.

First, it helps us to see how, even in the absence of a sovereign's express intention to produce extraterritorial effects or to create international rules through treaties or other international legal means, sovereign policy choices regarding ordinary domestic law rules—such as whether employment contracts are generally presumed to be 'at will' or 'terminable only for cause', whether to adopt or enforce a minimum wage, collective bargaining rights or a right to strike, whether and how to regulate the level of auto emissions or fuel efficiency for cars and trucks, whether and under what circumstances to enforce arbitration, choice of law or choice of forum provisions, or whether to require implied warranties, obligations of good faith or rights of rescission in commercial or consumer contracts, to name only a few—will shape the economic decision-making of transnational economic actors as they seek to reduce costs and increase returns in relation to the diverse range of local and international rules potentially applicable to their transactions. They might do so through the conduct of ordinary market transactions, or the creation of large, consolidated multinational firms, or the disaggregation of firms into networks of independent actors linked by complex contractual relationships, or the location, relocation or refusal to locate capital or other resources, facilities or operations in particular locales, or the attempt to influence the content of particular local rules directly or to contract around them, or through other strategies, institutions or

<sup>104</sup> *Ibid.*, 28.

<sup>105</sup> It seems worth reiterating at this point that I am not suggesting either that Coase's analytic model is an accurate description of the world or that it provides a determinate mechanism or methodology for making policy decisions regarding the relative efficiency of particular legal rules in a global context. Much ink has been spilled debating the validity of Coase's analytic and its predictive capacity under theoretical and 'real world' conditions. See nn 20 and 101 above. However, my argument here is not contingent on resolving these debates. Rather my claim is a more modest assertion that Coase provides a vocabulary, a perspective and a general welfare orientation that can help us to see the place of local rules in the global economic regulatory order in new and potentially productive ways. It won't tell us what to do, but it may help us to include variables in our analysis that might otherwise be missed and enable new political discourses and formations to engage these issues in ways more attuned to global welfare as a whole.

mechanisms. By helping to focus analytic attention on the diverse mechanisms of private ordering through which local rules ‘travel’ in the global economy, Coase’s analytic model provides a useful theoretical framework for examining the role of private economic actors in shaping the impact of local rules in the global economic regulatory order which can supplement more traditional international legal analyses focused on the legitimacy of express assertions of extraterritorial jurisdiction by states and on the creation and enforcement of international law rules by states and international institutions.<sup>106</sup>

Moreover, following in the tradition of American Legal Realism, Coase’s analytic attention to the fact that, in addition to so-called ‘public law’ regulatory regimes like antitrust, labour, tax, corporate, banking, securities or environmental law, basic ‘private law’ regimes such as contract, property and tort can be significant determinates of economic behaviour and the allocation of resources in an economy suggests that the range of local rules that might appropriately be the subject of global policy concern and analysis should be expanded beyond those traditionally understood to be regulatory or ‘market distorting’ rules to include the full range of public and private law rules that produce significant transnational economic effects.<sup>107</sup>

<sup>106</sup> For an analysis of the significance of corporations in the creation of local and global rules, see Danielsen ‘How Corporations Govern’ (n 33) 411–425; Dan Danielsen, ‘Corporate Power and Global Order’ in Anne Orford (ed), *International Law and its Others* (Cambridge University Press, 2006) 85–99; Braithwaite *Regulatory Capitalism* (n 9) 1–31; Braithwaite and Drahos *Global Business Regulation* (n 9) 3–36; Teubner ‘Global Bukowina’ (n 10) 4; Jean-Philippe Robé, ‘Multinational Enterprises: The Constitution of a Pluralistic Legal Order’ in Teubner *Global Law Without the State* (n 21) 45–77; Peter T Muchlinski, ‘“Global Bukowina” Examined: Viewing the Multinational Enterprise as a Transnational Law-making Community’ in Teubner *Global Law Without the State* (n 21) 79–108.

<sup>107</sup> A sub-strand of the Progressive critique of legal formalism that came to be known as Legal Realism included important work focused on the importance of private law rules in the distribution of economic resources and welfare. See eg Hale ‘Coercion and Distribution’ (n 44); Robert Hale, ‘Bargaining, Duress, and Economic Liberty’ (1943) 43 *Columbia Law Review* 603; Cohen ‘Property and Sovereignty’ (n 44). See also Barbara H Fried, *The Progressive Assault on Laissez Faire: Robert Hale and the First Law and Economics Movement* (Harvard University Press, 1998) (tracing Hale’s life and work, including his ideas regarding the economic significance of private law, as well as the critical legal scholarship that followed in his intellectual footsteps); William W Fisher III *et al*, ‘The Critique of the Public/Private Distinction’ in William W Fisher III *et al* (eds), *American Legal Realism* (Oxford University Press, 1993) 98–100 (describing the significance of the work of Hale, Cohen *et al* challenging the ‘private’ nature of ‘private’ law); Duncan Kennedy, ‘The Stakes of Law, or Hale and Foucault!’ in Kennedy *Sexy Dressing* (n 49) 83–125. While an enormous body of law and economics literature has been devoted to using economic analysis to improve the efficiency of private law rules, the significance of Legal Realist critique regarding the importance of private law background rules to the structure of markets and the distribution of wealth has had no significant effect on mainstream law and economic methods. See Kennedy ‘Law-and-Economics from the Perspective of Critical Legal Studies’ (n 20) 469–73. For an analysis of the significance of private law rules in shaping the behaviour of transnational economic actors, see Robert Wai, ‘Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization’ (2001–2) 40 *Columbia Journal of Transnational Law* 209, 233–8 (hereinafter Wai ‘Transnational Liftoff’). For an effort to analyse international law issues by analogy to private law rules of property and contract, see Dunoff and Trachtman ‘Economic Analysis of International Law’ (n 13) 22–36.

Such a shift in focus on the range and ubiquity of local rules with transnational effects would offer a powerful counter-narrative to the common conception that the global economy is or should be beyond the scope of national regulation—a space in which the allocation and distribution of resources are principally determined by the competitive market transactions of self-interested private economic actors. The very notion of ‘free trade’ seems to imply (or at least invoke) a conception of the global economy as a realm of transnational economic activity largely free from the distorting effects of idiosyncratic national rules.<sup>108</sup> In fact a principle aim of global market integration is the creation of ‘world prices’ that would function to allocate more efficiently global resources and move states and economic actors toward their natural comparative advantage.<sup>109</sup> Yet, Coase’s analytic focus on the role of legal rules in the formation and structuring of firms and markets and the choices economic actors make as they bargain in relation to the rules to reduce costs and optimise the allocation of resources to their most productive use, suggests that prices and prices signals are themselves, in part, a function of the legal order. In particular, if firms are the product of local rules, and markets the result of numerous interactions of firms and other economic actors of diverse legal origins bargaining in relation to diverse and perhaps conflicting local private law rules and regulatory regimes, then we have to rethink the notion that the global economy either is or could ever be a kind of ideal unregulated market of private choice because no global sovereign or institutional authority has sufficient jurisdiction to regulate it. In fact, Coase’s framework suggests a much more disquieting conclusion—that the global economy is indeed highly regulated by a vast array of national and transnational rules even as the precise mechanisms of that regulatory order remain largely a mystery and out of reach of our current capacities for meaningful policy analysis or substantive revision.

A second aspect of Coase’s analytic model that makes it particularly useful for assessing the effects of legal rules is its scalability on the one hand, and its apparent detachment from geographic, political and institutional forms on the other. Much like micro-economic theory from which it is derived, Coase’s analytic model is built on theoretical bargaining by two arm’s-length economic actors negotiating a commercial transaction from which general premises are extrapolated about the behaviour of similarly situated actors across the economic system as a whole. Whether talking about the impact of factory smoke on neighbouring homes or of straying cattle on neighbouring farms, Coase’s examples suggest close geographic proximity between economic actors

<sup>108</sup> See Jackson *The World Trading System* (n 25) 11 (‘The starting point for any discussion of policy in the international economic system of today is the notion of “liberal trade”, meaning the goal to minimize the amount of interference of governments in trade flows that cross national borders’).

<sup>109</sup> See eg the sources listed in n 48 above. See also Tom Hewitt *et al* (eds), *Industrialization and Development* (Oxford University Press in association with the Open University, 1992) 151–66 (describing neo-liberal market and trade theory regarding price distortions and the aim of ‘getting prices right’ through global market integration).

and rules that are (or at least seem to be) 'local' in scope. At the same time, Coase's analytic model, like price theory itself, seems to be infinitely scalable to the extent that under similar market conditions (including the presence or absence of transaction costs) and similar legal rules, it would predict economic actors to behave similarly. In this way, Coase's approach draws our attention away from the jurisdictional scope, geographic origin or regulatory intention of the rules as well as the characteristics of the particular bargainers, the size of the relevant market(s), the number of market actors at issue, or the scale of the economic activity under study. In addition, Coase seems to minimise attention to the causal scope of the applicable rule under examination through his choice of examples (farmers and ranchers or factory owners and homeowners in adjacent properties) in which the effects of 'local' liability rules are presumed on 'local' actors and at the same time generalisable to the extent that economic actors similarly situated are presumed to behave in similar ways in respect of similar rules.

From the perspective of a lawyer, Coase's apparent lack of attention to the relationship between the scale and location of the economic activity being analysed, the scope of jurisdictional authority for regulation of that economic activity, and the causal scope of the effects of the regulation(s) under analysis seem to be problematic if not crucial omissions. This seems particularly true if the economic activity is transnational in scope and multiple or even numerous legal authorities with diverse legal regimes might have (or claim to have) jurisdiction over some or all of the economic actors and/or some or all aspects of the economic activity under analysis.<sup>110</sup> Yet, Coase's shift away from the focus of traditional geographic and jurisdictional categories of legal analysis by measuring the impact of rules based on their economic effects helps to reveal potentially important disjunctures between the limits of political boundaries and economic ones. In fact, once we begin to imagine the class of constituencies economically affected by a local rule wherever they may be found as a potentially relevant sphere of global policy concern and analysis, it quickly becomes clear that there is no *a priori* reason to assume that the sphere of effect of any particular rule will always or even often coincide with the geographic boundaries or the jurisdictional authority of the state making the rule.

Take, for example, the corporate law of Delaware. As a legal matter, the rules establishing the governance and legal structure of Delaware corporations are state rules of Delaware, subject to the legislative, judicial and executive authority of the State of Delaware. At the same time, due to the number and the global scope and economic significance of the operations and activities of corporations subject to Delaware corporate law by virtue of being incorporated there, it seems hard to imagine that the economic

<sup>110</sup> For an analysis of conflicts of jurisdiction arising out of the effects of national rules in the transnational economy and mechanisms for addressing these conflicts, see Wai 'Transnational Liffoff' (n 107) 232–74; Trachtman *The Economic Structure of International Law* (n 13) 26–71.

effects of Delaware corporate rules do not extend beyond Delaware.<sup>111</sup> While it seems both possible and potentially useful for some purposes to attempt a Coasean economic policy analysis of the relative effects of particular Delaware corporate rules versus alternative rules on economic actors and the value of total production in Delaware, such an inquiry would hardly seem to tell us very much about the real world economic effects of either the Delaware rules or the possible alternatives given that so much of the economic activity of Delaware corporations takes place outside the geographic and express jurisdictional limits of Delaware. A national sovereign approach might focus on the effects of particular Delaware corporate rules versus possible alternative formulations on economic actors and the value of total production in the United States. Or, one might focus on the economic effects of Delaware corporate law wherever Delaware corporations have business operations or shareholders. Yet, taking seriously Coase's admonition that economic policy analysis requires the analyst to trace and measure all of the economic effects of alternative legal rules on the system as a whole, if the effects appeared or seemed likely to be global in scope, Coase's model would seem to call for an analysis based on the effects of the Delaware rules on economic actors in the global economy and the value of total global production.

Of course, there might be a number of reasons why an economic policy analyst assessing the relative efficiency of particular Delaware corporate rules as against proposed alternatives might rather focus on economic effects closer to home. One such reason might be that the rule is a state rule that presumably produces numerous benefits for Delaware as well as the United States and Delaware incorporated firms, and there is no transnational legal institution with the jurisdictional authority to impose an obligation on Delaware to change its corporate rules even if particular rules were determined to have an adverse effect on the value of total global production and hence on global welfare. However, the significance or usefulness of an inquiry into what the best rule scheme might be from the standpoint of global economic policy or welfare is not eliminated by the fact that the legal/jurisdictional scope of the Delaware corporate rules do not match their economic effects or that there are no extant political or institutional processes that could legally require Delaware to take account of or alter its rule scheme based on its global effects.

In circumstances like the ones described regarding Delaware corporate law, where the economic effects of particular local rules are likely to be significant and to extend well beyond the political boundaries of the jurisdiction making the rules, it seems quite arbitrary (or even possibly inappropriate) from the perspective of 'the system as a whole' to assume that those exclusively or even most interested in the content of the rule are

<sup>111</sup> According to the Division of Corporations of the State of Delaware, more than 850,000 companies are incorporated in Delaware, including more than 50% of US publicly traded companies and 63% of Fortune 500 companies. See [www.corp.delaware.gov/aboutagency.shtml](http://www.corp.delaware.gov/aboutagency.shtml) (last visited 26 November 2009).

those politically responsible for enacting it rather than those by whom the effects of the rule are most strongly felt. In this way, Coase's effects-based economic policy model sheds new light on important disjunctures between the transnational economic impacts of particular local rules and the political and institutional processes that create them that are difficult to see from a perspective focused exclusively on whether the particular rules are within the legitimate sovereign authority of the rulemaker. This new light, in turn, should reveal important information and knowledge about the actual structure and functioning of the global economic regulatory order, as well as help to lay a theoretical foundation for the contestation of certain particular local rules based on their adverse global effects in circumstances where the rules are neither illegitimate exercises of sovereign jurisdiction under applicable international law, nor trade distorting in ways that would make them suspect under applicable international trade law, nor clearly contrary to one of the limited number of specific international obligations that give rise to state responsibility for causing transboundary harm.

A third important insight from Coase's analytic model regarding the significance of local rules in the global economy can be gleaned from the implications of Coase's assumption regarding the impact on global welfare (in Coase's terms, the value of total production) of bargaining behaviour by economic actors in the absence of transaction costs. If, as Coase suggests, private and social costs of interrelated economic activity are best understood as joint costs and, in the absence of transaction costs, such costs would be most efficiently allocated through bargaining by all interested parties, then it would be incumbent on both lawyers and economic policy analysts assessing the economic effects of a legal rule and possible alternative rules to try to identify and include not only the most obvious constituencies affected by the rule, but the full range of interests and effects that might spread through an economy, and to base their policy recommendations on which legal arrangement seemed most likely to result in or steer economic behaviour toward an increase in the value of total production for the economy as a whole. In other words, Coase's model provides a theoretical framework for thinking about all of the possible economic effects (including what might more traditionally be described as 'externalities', as well as adjustments and resistances to those effects and the cost of alternative arrangements) that might result from a legal rule, as well as how the opportunity costs and economic benefits of related economic activity might be adjusted through bargaining, through a rule change, or through some combination of the two in order to achieve a result that was more likely to increase the total value of production.

Putting aside for the moment the question whether such an analysis of all the global economic effects of a particular legal rule could actually be accomplished, if the goal of Coase's theoretical framework is to make claims (or predictions) about the relative efficiency of particular legal arrangements in the real world context of transaction costs, then use of the framework at the transnational level would seem to require a serious attempt to take into account the impact of the legal rule being analysed on all of the

constituencies potentially affected by it, wherever they may be located. Moreover, exclusion of any possibly affected constituency would only be justifiable under the model if there was a very good empirical reason to conclude that the rule's effects with respect to that constituency either did not exist or were so insignificant that inclusion of the constituency's interests would likely result in a *de minimis* effect on the allocation of resources and the value of total global production. While one might expect that this would sometimes be the case, there would seem to be no *a priori* reason to assume that it always or even frequently would be. In this way, Coase's model challenges us to reject any policy in favour of presuming the territorial limits of local rules and, in circumstances where transnational effects may be present, to look broadly at the possible economic effects in an effort to identify all the constituencies sufficiently affected by the rules that, but for transaction costs, would bargain their interests in relation to the local rules that affect their welfare.

An example should help to demonstrate the usefulness of this perspective. Let us imagine that Brazil is considering a rule limiting the amount of land in the Brazilian rainforest that landowners may either deforest and convert to ranch land or rent or sell to ranchers for such deforestation and conversion. In a sense, Brazil's rule regarding forest preservation is similar to a zoning rule limiting the lawful uses of property, in that it reflects an effort by government to shape the use of available land in particular ways through a limit on certain types of market transactions in property. Let us imagine further that current market conditions are such that, but for the deforestation restriction, many more owners of forest land would convert their land to ranch land or rent or sell their land to ranchers because current returns on ranch land are considerably higher than returns on forest land.

In such circumstances, it is important to recognise that the rule limiting the amount of forest land that can be converted to ranch land does not preclude bargaining between foresters and ranchers. Rather, the rule would have the effect of limiting the amount of land potentially available for conversion to ranching with a consequent increase in the price for that portion of forest land that could be rented or sold for ranching, until the price was just below the additional returns derived from the use of the land for ranching (including the costs of burning and clearing). As a consequence, the rule would function as a limit on the cost and range of available bargains between ranchers and foresters in a manner quite similar to the way in which other factors of production such as the amount of available land suitable for ranching versus foresting or the labour costs per unit of output for ranching versus foresting would create constraints with respect to which bargaining would occur.

One possible conclusion at this point in the analysis might be that the rule is 'inefficient' in Coasean terms, to the extent that the 'public law' rule regarding forest preservation limits the reallocation of rights in respect to the 'private law' property rules regarding the use and disposition of land in ways that reduce otherwise desirable market

adjustments that might have been made by ranchers and foresters in the absence of the rule. Yet if, as the Coasean model would seem to require, we expand our economic scale and frame of reference beyond the interests of ranchers and foresters in Brazil to *all* the constituencies that might be economically interested in the Brazilian forest preservation rule, it becomes apparent that without more analysis there would be no basis to conclude that the Brazilian forest preservation rule is inefficient from either a Brazilian or a global perspective, even if ranchers and foresters might have arrived at a different allocation of factors through bargaining in the absence of the rule.

If we expand the universe of potential bargainers, it seems likely that, in the absence of transaction costs, a number of constituencies both inside of Brazil and around the globe might be willing to pay foresters not to convert, rent or sell their land or ranchers not to ranch in order to help reduce global warming or the air pollution associated with burning and clearing the forests or to preserve indigenous cultural habitats or valuable species or medicinal plants contained in the forests.<sup>112</sup> Whether such bargainers would be willing to pay more than the additional rents that would have been obtained by foresters from converting, selling or leasing their land or ranchers from additional ranching in the absence of the Brazilian forest preservation rule is an empirical one. In other words, when all affected interests are taken into account, it could be the case that the total value of Brazilian production or global production is more closely approximated by the Brazilian forest preservation rule than the equilibrium allocation of resources that ranchers and foresters might have reached on their own through bargaining in the absence of the rule.

Of course, when transaction costs and other institutional obstacles to bargaining are taken into account, it could well be the case that many global constituencies economically interested in the Brazilian forest preservation rule and the allocation of land resources between foresting and ranching in Brazil might be dissuaded or precluded from expressing those interests through bargaining or otherwise. But that doesn't mean it might not be better from the standpoint of global welfare if they did. In this way, Coase's assumption of zero-cost bargaining helps to remind us that beyond those national and economic interests most directly impacted by a particular local rule may be a whole vast array of additional global constituencies economically interested in the content of the rule. Moreover, in some circumstances, were their interests taken into account, we might reasonably conclude that the national gains of a particular rule were outweighed by the

<sup>112</sup> See eg Emilio F Moran, 'Deforestation and Land Use in the Brazilian Amazon' (1993) 21 *Human Ecology* 1 (arguing that, while global attention to the destruction of the richest biome on earth resulted in a slowing of deforestation, favourable credit policies for ranchers rather than population increases explain the continued deforestation of the Brazilian Amazon); Philip M Fearnside and William F Lawrence, 'Tropical Deforestation and Greenhouse Gas Emissions' (2004) 14 *Ecological Applications* 982 (asserting that for Brazilian Amazonia, the net impact of deforestation on global warming may be twice previous estimates). See also Christian Friis Bach and Søren Gram, 'The Tropical Timber Triangle' (1996) 25 *Ambio* 166 (arguing for a global tax and compensation scheme to create sufficient incentives for tropical forest states like Brazil to adopt sustainable forestry practices).

costs in terms of global welfare. Under such circumstances, the application of Coase's approach may provide a theoretical basis from which foreign constituencies that are significantly impacted by legal rules might assert a legitimate interest in the content of those rules even if there is currently no extant institutional mechanism to take those interests into account. In this way, Coase's model helps to provide a basis from which to challenge the current international legal balance in favour of sovereign rulemaking autonomy in the absence of sovereign waiver or express international legal limits with an alternative economic policy framework based on the impact of local rules on global welfare as a whole.

### 3. ENGAGING THE ISSUE OF POWER ASYMMETRIES IN THE TRANSNATIONAL EFFECTS OF LOCAL RULES: PROBLEMS AND POSSIBILITIES

So far we have explored the importance of local rules in the allocation of resources and the distribution of welfare in the global economy as well as the limitations in our current international legal approaches both for assessing local rules in terms of their economic effects and for challenging the legitimacy of local rules with transnational effects. In particular, we have seen that framing the issue of the global impact of local rules as a question of legitimate or illegitimate exercises of sovereign jurisdiction makes it quite difficult to engage with or assess the implications of the numerous local rules, such as US banking regulations or Chinese environmental regulations or German corporate regulations, that fall doctrinally within the scope of legitimate exercises of domestic jurisdiction designed to achieve a domestic policy purpose that is not in restraint of trade but that nevertheless produces significant transnational effects (maybe positive, maybe negative) on global economic welfare. Moreover, extrapolating from Coase's analysis of the significance of legal rules in the allocation of resources in an economy under real world conditions of positive transaction costs, we can surmise that a combination of high transaction costs and limited institutional capacity (at all levels of the transnational economic regulatory system) for taking account of the interests of foreign affected constituencies in local rulemaking processes will not infrequently preclude the amelioration of global welfare-reducing effects of local rules through market transactions or other institutional means such as changing the local rule.

In such circumstances, the economic significance of power takes centre stage—in particular, the power to make or influence the rules that shape economic activity both at home and abroad, and the power to defend against the welfare-reducing effects of rules made by others. This could be public power—the differential ability of various local or national jurisdictions to make rules with widespread consequences—or private power—the differential abilities of private actors to affect official rules or make private

arrangements to enhance their relative share of economic surplus in the global economy. To return to an earlier discussion, we need only look out at the world to realise that while sovereigns may be 'formally' equal in their jurisdictional authority and sovereign prerogatives and economic actors may be 'formally' equal in their obligation to abide by the promises they make, there are significant asymmetries in the ability of both sovereigns and non-state economic actors to shape their own destinies in the global economy.

Building on Coase, I have argued that we should think about the local rules that have transnational effects from a new global welfare perspective, looking beyond the sovereignty-focused frameworks made familiar by public international law or the trade system. Indeed, we are right to worry that both local and global regulatory capacity and political processes may be swamped in a global economy that does not also operate in accordance with a 'global economic policy perspective'. At the same time, disjunctures in the location and scale of regulatory politics and economic activity are putting enormous pressure on the current international legal order's ability to address issues from global warming to poverty alleviation. The radical asymmetries in power evidenced by the global effects of some networks of local rules suggest that before taking up the banner of a new global welfare approach, it seems important to explore what might be lost if we relaxed our vigilant attention to sovereignty at both the national and the international level. Sovereignty, after all, was supposed to address precisely these questions of power in a variety of ways.

In such circumstances it may seem both understandable and reasonable that we are often inclined to redouble our legal focus on a dual strategy of protecting or even bolstering national sovereignty while simultaneously pursuing co-ordination and harmonisation through generally applicable or even universal international rules rooted in sovereign negotiation and consent. After all, a strong notion of national sovereignty promises to secure and defend local policy autonomy while the system of international rules built on the consent of formally equal sovereigns promises to ameliorate the adverse effects of power asymmetries that lead to sovereign conflict. To the extent that the international legal focus on sovereignty is able to address these issues of economic and political power asymmetries, perhaps we ought to be reluctant to displace it with a more 'global point of view'.

Yet, the persistence of extreme inequality both between and within many states, and dramatic disparities in the vulnerability of diverse nations and economic constituencies to the turbulence and vicissitudes of global economic life, make it difficult to sustain a claim that the global economic regulatory order premised on national sovereignty tempered by international rules is capable currently or in the future of living up to its promises, either as an effective bulwark against foreign incursions on policy autonomy or a viable mechanism for securing a fair share of the gains from global economic integration. In fact, this (perhaps general) experience of intense vulnerability in the face of global integration may present one of the most significant challenges to the

'effectiveness' of the sovereignty-based strategies for dealing with global economic and political power imbalances. It may simply no longer be possible for the world's most powerful nations (let alone the world's weakest ones) to exercise effective regulatory control over economic welfare within their geographic territories, let alone shape the behaviour of economic actors in the global economy in their national interest.

Of course, scholarly attention to the limits of national sovereignty as a means for securing the welfare of global society is far from new in both international law and trade law.<sup>113</sup> In fact, it has been a recognition of the risks and realities of power asymmetries among states and the limits on national sovereignty to address them or secure the interests of global society that has provided much of the justification for the proliferation of universal internationalist regimes such as the UN system and its core human rights treaties, and for co-ordinating or harmonising international regimes such as the World Trade Organization system and the Kyoto Protocol and its possible progeny or successor. Nevertheless, sovereignty continues to play a persistent central role in the disciplinary approaches of both international law and trade law—as we have seen, it is through the bargaining and consent of formal sovereigns that international rules are made (and made legitimate) and sovereign consensus in international rules is often taken as proxy for enhanced global welfare.

But, when we focus on power asymmetries in the economic effects of local rules, it becomes apparent that the problem with our ongoing attachment to sovereignty is not only the practical reality that sovereignty is no longer an effective mechanism for the

<sup>113</sup> In public international law, critiques of sovereignty are ubiquitous and calls for new forms of global ordering abound. See eg Louis Henkin, *International Law: Politics and Values* (Martinus Nijhoff, 1995) 10 ('For legal purposes at least, we might do well to relegate the term sovereignty to the shelf of history as a relic from an earlier era'); Philip Allott, *Eunomia: New Order for a New World* (Oxford University Press, 1990) 418 ('In an international society which knows itself as a society, state-societies have no natural and inherent or unlimited powers. Like any other of the myriad societies in international society, they have only the legal relations, including powers and obligations, conferred by the international constitution and by international law'); Boutros Boutros-Ghali, 'Empowering the United Nations' (1992) 71(5) *Foreign Affairs* 89, 98–99 ('While respect for the fundamental sovereignty and integrity of the state remains central, it is undeniable that the centuries-old doctrine of absolute and exclusive sovereignty no longer stands ... Related to this is the widening recognition that states and their governments cannot face or solve today's problems alone'); Secretary-General Kofi Annan, 'Annual Speech to the General Assembly' UN Doc SG/SM/7136, GA/9596 (20 September 1999) ('State sovereignty, in its most basic sense, is being redefined by the forces of globalization and international cooperation. ... In short, it is not the deficiencies in the [UN] Charter which have brought us to this juncture, but our difficulties in applying its principles to a new era: an era when strictly traditional notions of sovereignty can no longer do justice to the aspirations of peoples everywhere to attain their fundamental freedoms'); Richard Falk, *Explorations at the Edge of Time: The Prospects for World Order* (Temple University Press, 1992) ('The state has demonstrated a remarkable degree of resilience over the several centuries of its existence, but whether it can significantly reorient its sense of sovereign prerogative from space (protecting territory) to time (contributing to a viable and desirable future) is uncertain in the extreme'). In the international trade literature, critiques of sovereignty take two common forms. The first involves an acknowledgment of the inability of sovereigns to effectively regulate in the face of a global economy. See eg *Legal Problems of International Economic Relations* (n 70) 1 ('Despite all the talk about

protection of national interests or the maximisation of global welfare. Perhaps more significantly from the standpoint of global economic or regulatory policy analysis, the persistent focus on national sovereignty (and upon international legal rules) may also lead to inaccuracies in our understanding of how the global economic regulatory order actually functions and to the perverse consequence of making it much more difficult to engage with the significant but very real differences in the economic impact of rules made by different players in the global economy.

For example, a defensive focus on national sovereignty can lead us to overemphasise the dangers posed by local rules when their effects extend beyond geographic or jurisdictional boundaries, and underestimate the potential of local rules as regulatory forms that might at times contribute positively to overall global welfare. At the same time, a too hopeful focus on the potential of universal international rules or international rules aimed at the co-ordination or harmonisation of local rules can lead us too often to equate apparent global consensus over international rules with improved global welfare when the international rules may be more accurately seen to formalise and reinforce the substantive power imbalances among sovereigns participating in rulemaking. If we are to develop a more satisfying global welfare perspective regarding local rules than the ones offered by public international law and trade law, the new perspective will need to address more directly the issues of power and welfare to which these sovereignty-focused approaches are addressed but for which they seem no longer adequate.

sovereignty and independence, these concepts can mislead when applied in today's world economy. How "sovereign" is a country with an economy so dependent on trade that its government cannot readily affect the real domestic interest rate, implement its preferred tax policy, or establish an effective program of incentives for business or talented individuals? Many governments face such constraints today including, increasingly and inevitably, the United States'; Langille 'Fair Trade is Free Trade's Destiny' (n 28) 252-3 (speaking in the context of labour standards, '[O]ur ability to establish our own domestic labor standards has been eroded. The standards will, to some extent, be established internationally. The issue is how, not whether, they will be established internationally'). The second line of critique, moving beyond critiques of ordinary trade protectionism, involves the assertion that national regulatory policy is often deployed in ways that benefit domestic firms over foreign firms to the detriment of global economic welfare. See eg Joel Trachtman, 'International Regulatory Competition, Externalization and Jurisdiction' (1993) 34 *Harvard International Law Journal* 47, reprinted in Trachtman *The Right to Regulate* (n 13) 224, 276 ('In an increasingly global and mobile economy marked by brutal competition in trade, states increasingly compete with one another to provide their firms with the advantage of reduced regulatory costs or increased regulatory subsidies. ... Regulatory arbitrage is acceptable [from a global welfare point of view] only when firms are required to bear the regulatory costs properly allocable to their activities and states are required to bear the social costs associated with their regulation or lack thereof'); Alan O Sykes, 'Regulatory Protectionism and the Law of International Trade' (1999) 66 *University of Chicago Law Review* 1, 6 ('[F]rom a political standpoint, regulatory protectionism is an inferior form of protectionism for nations that are unconstrained in their trade policies. But, after a nation enters a trade agreement, circumstances may arise that tempt political officials to employ regulatory protectionism due to constraints on their ability to use other preferred protectionist instruments').

I have argued that Coase, with his economic policy focus on the sociological effects of rules on economic behaviour and general welfare, can help in this regard. It is difficult to turn one's attention to the actual transnational effects of local rules without directly confronting issues of power. At the most basic level, the local rules of some jurisdictions will have a significantly larger impact on economic behaviour around the globe and on the value of total global production than the local rules of others. The differences in the global economic effects of local rules may arise from a variety of causes. The size of the jurisdiction or its populations (eg China, India, Brazil, Indonesia) or size of the jurisdiction's economy (eg the US, Germany, Japan, California) may give some local rules disproportionate global influence. The proportionate contribution of the jurisdiction's economic activity to total global production (eg the G-8 or the G-20 countries) or the presence of valuable resources in global demand (eg Saudi Arabia, Russia, Venezuela, South Africa) or the level of integration into the global economy (eg Singapore, Switzerland, Hong Kong), or the perceived prestige of the rules of particular jurisdictions (eg until recently, the US regimes for corporate governance, securities regulation and financial regulation) may also give some local rules an advantage on the global stage.

In light of these differences, our policy tools for assessing when and under what circumstances a jurisdiction might benefit from an asymmetrical power advantage in its ability to influence economic activity for itself or for others will need to take account of many factors in addition to the sovereign or institutional origin of the rule. Sometimes, for example, the advantage will relate to the subject matter of the rule. A German banking rule regarding reserve requirements for its chartered banks and a Venezuelan rule regarding the long term preservation of its oil and gas reserves might, by virtue of their respective roles in the global economy, each produce substantial transnational economic effects, although the relative size and global impact of their respective economies is quite different. Sometimes, the very same rule adopted in different jurisdictions may produce quite different economic effects. Returning to earlier examples, it seems obvious to expect that Chinese regulation of emissions from coal-fired power plants or Californian regulation of emissions from automobiles will have a larger effect on the behaviour of more economic actors and on global production than identical rules adopted by Costa Rica and Rhode Island. Similarly, it seems reasonable to expect that the corporate governance rules of Delaware would produce global economic effects through their impact on the behaviour of Delaware-incorporated multinationals, while the same corporate governance rules adopted in Gabon may have little economic impact outside (or potentially inside) Gabon. Further, sometimes, because of the size or global economic importance of some jurisdictions we might expect many or most of their local rules to produce significant global economic effects. For example, rules adopted in China or the US regarding such diverse subject matters as birth control, carbon emissions, labour standards and tariff rates might all be expected to produce large global economic effects, while similar rules adopted in numerous other jurisdictions might not.

These kinds of differences in the economic effects of local rules are what I mean by transnational regulatory asymmetries, and taking these asymmetries into account as a matter of global economic policy means, at a minimum, that local rules should be evaluated in the context of the many transnational economic forces that influence the size and scope of their economic effects on general welfare both locally and globally. This shift in perspective will facilitate the creation of new maps of the scope and limits of sovereign power in the global economy by charting the asymmetrical economic effects of local rules. These new maps will challenge and confound our conventional notions of sovereign power and the economic and legal significance of territorial boundaries in a range of ways while suggesting new possibilities for global politics and policymaking that might better serve the global public interest.

For example, to deepen a theme implicit in earlier examples, it would be a mistake to conclude that transnational regulatory asymmetries will always be reflective of a sovereign's apparent position in global hierarchies of sovereigns based on jurisdictional size or political power. To be sure, less economically significant jurisdictions may often find themselves under economic, political or cultural pressure to conform to the rule systems of more economically significant ones, especially when even local economic actors orient their business practices to the operative rules in their most significant export markets. Yet it is sometimes possible for small jurisdictions to reap substantial economic benefits from local rules while limiting the ability of more powerful neighbours to regulate their domestic economies. Banking havens such as the Cayman Islands, Luxembourg, Liechtenstein and Switzerland come to mind in this regard.<sup>114</sup> Other examples include the way in which a politically insignificant jurisdiction like Delaware has been able to use its local rulemaking power to place itself at the centre of national and global legal innovation in corporate law<sup>115</sup> or how the city-state of Singapore has used its political stability, limited corruption and local investor-friendly rules to position itself as a small economic

<sup>114</sup> See eg Robert T Kudrle and Lorraine Eden, 'The Campaign Against Tax Havens: Will it Last? Will it Work?' (2003) 9 *Stanford Journal of Law, Business and Finance* 37, 40–43, 50–54 (discussing how countries through the passage of domestic bank secrecy laws are able to become global tax havens and collect huge amounts of foreign bank deposits, and the impact of such laws on the global financial system).

<sup>115</sup> One way to gauge the importance of Delaware corporate law is the vast literature that has emerged using Delaware's dominance as a site of incorporation to explore questions of regulatory competition more broadly. For some representative examples of this literature, see Lucian A Bebchuk, 'Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law' (1992) 105 *Harvard Law Review* 1435; Alfred F Conard, 'The European Alternative to Uniformity in Corporate Law' (1991) 89 *Michigan Law Review* 2150; David Charny, 'Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities' (1991) 32 *Harvard International Law Journal* 423; David Schaffer, 'Delaware's Limit on Director Liability: How the Market for Incorporation Shapes Corporate Law' (1987) 10 *Harvard Journal of Law & Public Policy* 665; Roberta Romano, 'Law as Product: Some Pieces of the Incorporation Puzzle' (1985) 1 *Journal of Law, Economics & Organization* 225. Of course, another measure is the number and economic power of firms incorporated there. See n 111 above.

powerhouse and the corporate headquarters gateway for many multinationals seeking access to Asian markets.<sup>116</sup> From these few examples, we can see that the relative abilities of states to exploit regulatory asymmetries for national gain will be a function of many complex circumstances in addition to the conventional indicia of sovereign power such as size or economic, political or military strength.

Another example of how taking account of transnational regulatory asymmetries confounds our expectations regarding sovereignty is the way in which it forces us to consider the many situations in a globally integrated economy when foreign rules may prove more significant than domestic ones in terms of economic effects on the behaviour of *domestic* economic actors. For example, it is not hard to imagine that US antitrust laws or EU competition policy would have a more significant impact on the behaviour of many economic actors than the competition law of their home countries (if any).<sup>117</sup> But one need not look to local rules with explicit (or implicit) extraterritorial reach to encounter this phenomenon. Chinese rules regarding domestic wage rates may well have more impact on the wage rates of manufacturing workers in numerous jurisdictions from Vietnam and Cambodia to Mexico and Uganda than domestic regulations regarding wages in those countries simply by virtue of China's relative competitive significance in the global market for low wage manufacturing.<sup>118</sup> The recent global financial crisis provides another telling example of this phenomenon. Many countries with no significant domestic banking industry simply abandoned the regulatory field, relying for regulatory oversight on the laws of the home countries of the foreign banks doing business in their countries through subsidiaries, only to suffer enormously when the home country regulatory systems proved inadequate and bailout programs for home country banks were not extended to their foreign subsidiaries.<sup>119</sup> These situations challenge our standard presumption (if not assumption) that the most important rules in a jurisdiction will always be its own or that national sovereignty entails maintaining an effective monopoly on positive law-making within national territorial borders.

<sup>116</sup> See eg Sornarajah *The International Law of Foreign Investment* (n 12) 2, 24 (noting the success of small states like Hong Kong and Singapore in using liberal regulatory regimes to attract significant investment from foreign multinationals); James M Cypher and James L Dietz, *The Process of Economic Development* (Routledge, 3rd edn 2009) 461 (noting that unlike the developing world as a whole which derived less than 3% of total investment from foreign direct investment during the period 1980–92, Singapore received over 20%).

<sup>117</sup> See Eleanor M Fox *et al*, *Cases and Materials on United States Antitrust in Global Context* (Thomson/West, 2nd edn 2004) 168, 725–55 (describing the scope of extraterritorial reach of US and European competition laws).

<sup>118</sup> See Kaplinsky *Globalization, Poverty and Inequality* (n 6).

<sup>119</sup> See Floyd Norris, 'A Retreat From Global Banking' *New York Times* (New York), 24 July 2009, B1, B6. For a possible reason for such reliance, see Basel Committee on Banking Supervision, 'Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments' (July 1992) para 1 ('1. All international banking groups and international banks should be supervised by a home-country authority that capably performs consolidated supervision').

If we imagine, inspired by Coase, how economic actors might respond to a local rule in the absence of transaction costs, it becomes apparent why domestic economic actors might be more attuned to foreign rules than domestic ones in some circumstances. After all, from the perspective of the economic actors themselves, the local or foreign origin of a rule would be much less significant than the rule's effect on their relative share of resources and its impact on their desired economic activities. Affected constituents from weaker or less economically significant jurisdictions may more often find themselves interested in the economic effects of foreign rules than domestic ones while constituents from larger or more economically significant jurisdictions might find themselves more often focused on the economic effects of their own local rules rather than foreign ones. For example, economic actors in those jurisdictions without a significant domestic banking industry might not waste resources seeking to influence the nominal effects of even poorly conceived local banking rules if the operative rules for banking in terms of actual economic effects are the rules of the UK or the US or Japan,<sup>120</sup> while the lobbying efforts of financial services firms in respect of proposed regulatory reform in the financial services sector in the US suggests just how much those firms care about the rules governing their actions at home.<sup>121</sup>

In this way, Coase helps to remind us that as we think about the economic effects of local and global rules we ought to remain attentive to the fact that economic actors will respond to and seek to influence the effects of whatever rule is most significant for their economic activities, regardless of its source. Moreover, enhanced attention to the role of economic actors in rulemaking helps us to remain cognisant of the fact that while economic and other constituencies within a state will have diverse interests with regard to the economic impact of local and foreign rules, they will be differently situated in their ability to influence those rules and effects, no matter how democratically the particular state may be organised. At home, key industries, sectors or groups may hold inordinate sway over the rulemaking process. Or, collective action problems may assist well-organised, more consolidated or more sophisticated constituencies in outflanking less co-ordinated, more disbursed or less sophisticated constituencies, leading to local rules that enhance the welfare of the former, sometimes (or perhaps often) to the detriment of the welfare of the society as a whole.<sup>122</sup> As to foreign rules, it may be the case that

<sup>120</sup> See n 2 above.

<sup>121</sup> See eg Edmund L Andrews, 'Battles over Reform Plan Lie Ahead' *New York Times* (New York), 27 March 2009, B1.

<sup>122</sup> 'Public Choice' theory has inspired analogous claims in a range of regulatory contexts. See eg Anthony Downs, *An Economic Theory of Democracy* (Harper, 1957) and Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press, 1965) (arguing that concentrated producer interests would outweigh thinly spread consumer interests in political processes); Jonathan R Macey and Geoffrey Miller, 'Toward an Interest-Group Theory of Delaware Corporation Law' (1987) 65 *Texas Law Review* 469 (arguing that regulatory competition in corporate law reflects state interests in franchise tax revenues and the interests of local constituents that service locally incorporated companies); Gene M

economic actors engaged in global commerce are often in a better position to influence the content or effects of foreign rules than their home states.<sup>123</sup> In other circumstances, the home state may have more leverage with respect to foreign rules, but that would not necessarily mean the state would use that leverage to advance the general welfare of its constituents as a whole. How the state acts in its bargaining over the local effects of foreign rules, and for that matter, global rules, may well be reflective of power asymmetries among economic and other constituencies at home.

From this perspective, we can see that economic actors may be as significant in the content and effects of rules at the local and the global levels as states themselves and inter-sovereign bargaining.<sup>124</sup> Moreover, while it seems possible that a global economic regulatory order based on formal sovereign policy autonomy and global rulemaking based on inter-sovereign bargains may turn out to be optimal from the standpoint of both local and global welfare, it is hard to find a reason for confidence that this would actually be the case.

In the absence of a global state, our current inter-sovereign legal and institutional order seems to offer two limited policy responses to the issue of local rules with global effects. First, it relies on sovereigns to defend their prerogatives vis-à-vis one another—a strategy that we have seen is substantially challenged by the realities of radical power asymmetries. In fact, exploring the great divergence in the significance and effects of local rules among states on local and global economic activity suggests that there is little basis on which to presume that a state's sovereign authority to make rules will translate as a general matter into an effective sword or shield against the economic or regulatory power of other sovereigns, or that it would use that authority to enhance the general welfare of its own (national) constituents.

Second, it urges sovereign participation in global rulemaking. But, the promulgation of global rules to constrain the transnational effects of the local ones or the harmonisation of local rules through international co-operation or a treaty regime seem likely to be equally caught up in asymmetric power dynamics. International inter-sovereign bargains on global rules may simply repeat the power asymmetries of local rules at a new level.

Grossman and Elhanan Helpman, 'Protection for Sale' (1994) 84 *American Economic Review* 833 (arguing that in a small country with insufficient market power to effect its terms of trade political officials would set trade policy based on a combination of concern for national welfare and placating organised interests to retain political power, resulting in a mix of policies that would frequently deviate from national welfare maximisation).

<sup>123</sup> See eg Braithwaite *Regulatory Capitalism* (n 9) 25 ('For 90% of the world's states there are large numbers of corporations with annual sales that exceed the state's GDP. The chief executives of the largest corporations typically are better networked into other fonts of power than the presidents of medium-sized states. Consequently, large corporations do a lot of regulating of states'); Braithwaite and Drahos *Global Business Regulation* (n 9) 27 ('The most recurrently effective actors in enrolling the power of states and the power of the most potent international organizations (eg the WTO and the IMF) are large US corporations').

<sup>124</sup> See nn 33 and 106 above.

There may also be reason to expect that some states—or perhaps powerful constituencies or ideological forces within states—will have an interest in the failure of global rulemaking efforts in order to continue to benefit from the *de facto* transnational effects of their own or someone else's local rulemaking.

Even if an economic policy perspective building from some of Coase's key insights regarding the significance of legal rules for general welfare in an economy does not offer definitive solutions to these complex issues and problems, it does help to suggest some additional possibilities for policymaking in the interest of global welfare as a whole at both the national and transnational levels. While a sovereignty approach would place considerable significance on whether the rule producing domestic economic effects was 'local' or 'foreign', a Coasean policy perspective would lead us to remain agnostic as to the rule's origin (whether local, foreign or international) and to focus instead on whether the net economic effects of the rule were likely to enhance or reduce global welfare relative to alternative policy options. From such a vantage point, it seems possible to imagine that in some circumstances local rules with transnational effects may indeed provide a global welfare-enhancing alternative to inter-sovereign efforts either to harmonise or co-ordinate local rules on a jurisdiction by jurisdiction basis or to adopt a universal international rule. For example, it seems at least possible to imagine that it might prove more beneficial from the perspective of global economic welfare to regulate some aspects of multinational corporate activity by changing corporate law rules in a few key jurisdictions like Delaware, the UK, Germany and Japan (when the cost savings of the transnationalisation of those changes through private ordering by the multinational corporations themselves are taken into account) than by attempting to impose 'best practice' corporate law regimes in every jurisdiction or by negotiating transnational regulatory regimes administered by international institutions like the OECD or the WTO.<sup>125</sup>

More importantly, under conditions of economic globalisation, territorial autonomy from the regulatory or economic 'harmful effects of others' may simply not be possible. These realities may suggest, as difficult as this may be to accept, that we should strive to remain agnostic with respect to these sorts of regulatory 'harmful effects', at least until we can better understand whether their relative benefits outweigh their costs as compared with the impact alternative social arrangements on global welfare as a whole. Of course, there is no question that in many cases, the asymmetric impact of local rules from economically significant jurisdictions may bring to those jurisdictions all sorts of economic benefits or impose all sorts of global costs that reduce rather than increase global welfare. But, as we have seen, it is also possible that in some circumstances asymmetrical rulemaking or private ordering might *increase* rather than reduce the total social product. Thus, a Coasean economic policy perspective might lead us to pause before rejecting these types of policy solutions out of hand.

<sup>125</sup> Cf nn 33 and 76 above.

Although the transnational impact of local rules on economic welfare in the modern global economy may be as unavoidable as it is undeniable, there remains something disconcerting about proposing the adoption of a 'global economic policy perspective' that may encourage us even occasionally to advocate the use of particular local rules over internationally adopted ones to achieve global regulatory goals, even if the local rules could be shown to produce 'better' results in terms of total global welfare. After all, so long as local rules remain the product of local politics and local interests, they would seem to be a strange and problematic tool for affirmative policymaking in the global economic regulatory order. Concerns might arise about political or economic hegemony to the extent that the local rules producing global effects too often seemed to derive from the same or a few economically significant jurisdictions. Or concerns might focus on democratic legitimacy to the extent that local rules function as *de facto* global rules while participation in their making and accountability regarding their effects is limited to the political constituents of the jurisdictions making the local rules. In the face of these very real and legitimate concerns about power inequality and democratic legitimacy in the global economic regulatory order, an economic policy perspective focused on territorial integrity, sovereign prerogative and national interest may seem the most relevant and compelling response. Yet, as we have seen through our exploration of the asymmetric effects of local rules, these same risks of hegemony by powerful states and a lack of democratic legitimacy of the rules that actually govern global economic life plague our existing model of inter-sovereign global economic governance. It may be that sovereigns are often better aggregators of powerful interests than promoters of general welfare at the national and the global level.

It is precisely because of the important questions of power and democratic legitimacy posed by the transnational effects of local rules for the global economic regulatory order that we need to find a new approach to assessing and coming to terms with them. If the local rules of some states will often, *de facto*, govern global economic activity and the consequent allocation of resources in the global economy, it may sometimes be better from a global welfare perspective (as well as the perspective of weak states) to acknowledge that reality—while also seeking to create political and institutional processes to 'responsibilise' those states to the global welfare effects of their rulemaking—than to persist with the fiction that all rulemaking is formally equal under the international rules of jurisdiction.

Further, if the local rules of some states are of little effect in protecting their economies from foreign 'harmful effects', in some circumstances it may be a better use of national resources for those states to follow the lead of their economic actors by seeking to influence the foreign rules that shape their welfare than adopting 'local' but ineffective rules at home. In this respect, Coase's suggestion that the maximisation of global economic welfare will best be achieved by approximating the policy solution that might have been reached if *all* of the constituencies affected by the rule had bargained their

economic interests in the absence of transaction costs may well prove useful not only in helping to identify the range of global constituencies that might have an interest in the content of a global/local rule but also in suggesting new potential global political alliances that might congeal in relation to ameliorating the global 'harmful effects' of the local rule.

By now it will have become obvious to the reader that our new global perspective calls out for a new global politics—one that is better able to aggregate interests across sovereign boundaries than our current sovereign-oriented order.<sup>126</sup> Of course, it may turn out that these new processes and political formations will continue to rely upon states acting as both determiners and proxies for both national and global welfare. In some circumstances, that might be the best outcome from a global point of view.<sup>127</sup> Yet, there are reasons to think that this need not always be the case when the 'state' is not the best aggregator of economic interests or protector of welfare as a whole. For example, with respect to the expansion of US intellectual property rules across the globe through adoption at the WTO of the TRIPS Agreement and the inclusion of TRIPS 'plus' intellectual property rules in bilateral and multilateral trade agreements, the economic interests of US drug-consuming seniors may be more in line with people infected with HIV/AIDS in Africa than with US pharmaceutical companies. The rules that are best for the US or UK financial services industries may not be best for US or UK citizens or for the people of the world as a whole. An increased awareness that the same power asymmetries that result in the capture by economic actors of legislative processes for local rulemaking at the national level may, by virtue of transnational regulatory asymmetries, create winners and losers not only at home but abroad should open up more possibilities for imagining the potential of new political constituencies based on an alignment of economic interests across national boundaries to increase global welfare.

This has certainly proved to be the case with powerful multinational firms which regularly attempt both individually and collectively to influence rulemaking wherever

<sup>126</sup> I have much in common here with other literatures calling for new political forms and institutions for the global political order. See eg Daniele Archibugi, *The Global Commonwealth of Citizens: Toward Cosmopolitan Democracy* (Princeton University Press, 2008); John Burnheim, *Is Democracy Possible?* (Polity, 1985); James Crawford, *Democracy in International Law* (Cambridge University Press, 1994); Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton University Press, 1995); Richard A Falk, *On Humane Governance: Toward a New Global Politics* (Polity, 1995); David Held, *Democracy and Global Order* (Stanford University Press, 1995); David Held and Anthony McGrew, *Globalization/Anti-Globalization: Beyond the Great Divide* (Polity, 2nd edn 2007); Daniele Archibugi and David Held (eds), *Cosmopolitan Democracy: An Agenda for a New World Order* (Polity, 1995); Christian Joerges et al (eds), *Transnational Governance and Constitutionalism* (International Studies in the Theory of Private Law, Hart Publishing, 2004); Robert O Keohane, 'The World Political Economy and the Crisis of Embedded Liberalism' in John H Goldthorpe (ed), *Order and Conflict in Contemporary Capitalism* (Clarendon, 1985) 15; Robert O Keohane and Joseph S Nye, *Power & Independence* (Little, Brown, 3rd edn 2000); John G Ruggie, 'International Regimes, Transactions and Change: Embedded Liberalism in the Post-War Economic Order' (1982) 36 *International Organization* 379; RBJ Walker and Saul H Mendlovitz (eds), *Contending Sovereignties: Redefining Political Community* (Lynne Reigner, 1990).

<sup>127</sup> See n 32 above.

their economic interests might be adversely affected.<sup>128</sup> But Coase would tell us that such firms only form or join forces to influence rules if the economic benefits of doing so outweigh the costs. If the economic benefits of creating such new political institutions or formations outside the 'state' to support the collective action of new economic constituencies exceeded the costs, they should already exist. On the other hand, it might just be that our political cultures remain conceptually locked in the territorial state even as our economies have kicked free of territorial constraints and that our attachments to certain conceptions of sovereignty are limiting our ability to imagine, let alone bring into being, new political forms. As the global political and economic order is now constituted, there is no one whose job it is to look after global welfare from a global perspective.

So what to do? We might begin by trying to see more clearly. I am convinced that our current international legal approaches to the role of local rules in the governance of the global economy, rooted as they are in sovereign interests, are simply insufficient to capture the complexity of the transnational economic regulatory order as it actually functions or the effects of local rules in shaping global welfare. Coase's focus on the role of law in the organisation and efficiency of economic activity brings into view the possibility (if not the likelihood) that myriad legal arrangements at various levels of the transnational economic system are having a significant impact on the allocation of resources among economic actors across the globe as well as on the value of total global production. Moreover, these insights suggest that our traditional notion that local rules are by and large matters of national concern and sovereign prerogative, needs to be questioned. Rather, we might more reasonably expect the number of local rules, both public and private, that might appropriately bear scrutiny from a global economic policy perspective based on their transnational economic effects, to be large and their cumulative effects on global welfare to be significant and pervasive. If this is true, it would seem of some importance to develop better conceptual tools for assessing the impact of these legal rules as well as institutional mechanisms and political processes for taking these realities into account in the global economic regulatory order.

Further, Coase's theoretical assumption that, but for transaction costs, all economic actors affected by a legal arrangement would bargain for adjustments to the initial allocation of resources under the applicable rule that would maximise the total value of production, while perhaps insufficient to provide definitive answers to the relative costs and benefits of local rules, might nevertheless orient us toward analysing alternative rules in relation to their potential impact on global welfare. The zero-cost assumption, with its focus on the economic effects of legal arrangements, is particularly useful in this regard because it helps us to look beyond possible territorial, jurisdictional, institutional and transaction cost-based obstacles to bargaining even as we strive to identify all of the constituencies around the globe that might be impacted by a local legal rule and its alternatives.

<sup>128</sup> See eg n 123 above.

Attempting to identify all these constituencies should put us in a better position to imagine or hypothesise potential adjustments to existing legal arrangements that might be arrived at through bargaining among these myriad constituencies in the absence of transaction costs. Such a thought experiment should significantly enhance the visibility not only of the range of global constituencies that have an economic interest in the content of a local rule by virtue of its economic effects on them, but also the range of possible legal arrangements that might enhance global economic welfare if territorial, jurisdictional, institutional and transaction cost-based objections and obstacles could be put aside or transcended. Such an exercise should also help focus attention and analysis beyond transaction costs to the many other real world obstacles that can affect the relative global economic impact of existing and imagined alternative legal arrangements, including disparities in economic starting point, information asymmetries, limitation in available institutions to facilitate bargaining or participation among affected global constituencies, and asymmetries in the ability of different constituencies to influence economic behaviour on a global level as well as many others.

Moreover, such a thought experiment could also potentially help in defining a 'global welfare perspective' by providing a range of factors from which the transnational economic effects of particular local rule choices could be measured and perhaps contested. Whether a regulatory approach—involving a global rule, transnational harmonisation of local rules, the asymmetrical application of one or more local rules, private ordering, some combination or a 'do nothing' approach—would prove to be more beneficial from the perspective of global welfare would need to be evaluated in light of the particular facts on a case by case basis. Of course, an evaluative conclusion in this regard is likely to be the subject of considerable political disagreement and debate.

Yet, from such global conversations or controversies we might imagine new global constituencies forming to support the adoption or continuance or urge the alteration of local rules depending on their global economic effects, or to strategise more broadly about both local and global rules.<sup>129</sup> From this perspective, it seems possible that the attempt to articulate 'a global economic policy perspective' for analysing local rules might lead to new and more complex notions of global economic participation, political pluralism and distributional justice rather than a hegemonic vision of the 'global good'. Even if such a perspective were to prove incapable of providing determinate policy conclusions regarding whether a particular rule was or was not desirable as a matter of global economic policy, striving for such a perspective may nevertheless help to orient political debate regarding local rules towards a focus on their global economic effects and toward the range of political choices they bring in their wake. The result may be a deeper sense of our transnational economic and political interdependence as well as our collective responsibility for global welfare.

<sup>129</sup> See eg Braithwaite and Drahos *Global Business Regulation* (n 9) 602–29 (proposing a political program to enhance the sovereignty of global citizens over global regulation). See also n 126 above.