

# THE ROLE OF THE LEGAL REGIMES IN NEW INDUSTRIAL ECONOMIC THEORY

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## I. INTRODUCTION

CLASSICAL TRADE THEORIES ASSUME perfect competition, full knowledge on the part of all parties, no technology advantage, and no barriers to entry into the market.<sup>1</sup> While these theories do seem to recognize that tariffs and quotas distort markets (tariffs can be so high as to preclude trade),<sup>2</sup> critics of traditional trade theory argue that these assumptions are problematic and that only by drawing upon the other branches of economics can trade theory even begin to explain international trade.<sup>3</sup>

Most traditional trade theory has specifically ignored the costs associated with transactions resulting from the production and consumption of tradable products,<sup>4</sup> including the costs associated with contract negotiation, formation, and enforcement in the event of a breach. Recently, some work has been done in the modeling of transaction costs;<sup>5</sup> however, transaction costs remain largely ignored by most trade theorists.

This article begins by outlining an example of classical trade theory, highlighting the inherent weaknesses in such theory with respect to the

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<sup>1</sup> See Adam Smith and David Ricardo, among others.

<sup>2</sup> Jagdish N. Bhagwati & T.N. Srinivasan, "Some Extensions of Ricardian Theory" in *Lectures on International Trade* (Cambridge, Mass: MIT Press, 1983) at 45-47.

<sup>3</sup> John. H. Dunning, "What's Wrong (Right) with Trade Theory?" in *Alliance Capitalism and Global Business* (London: Routledge, 1997).

<sup>4</sup> Dunning, *ibid.* at 123.

<sup>5</sup> John Wenli Cheng, Jeffrey Sachs, & Xiaokai Yang, "An extended Heckscher-Olin model with transaction costs and technological comparative advantage" (2004) 23 *Economic Theory* at 671-xxx; Wei-Ping Wu & W.L.Choi, "Transaction Cost, Social Capital and Firms Synergy Creation in Chinese Business Networks: An Integrative Approach" (2004) 21:3 *Asia Pacific Journal of Management* 325; Keith D. Brouthers, Lance Eliot Brouthers, & Steve Werner, "Transaction Cost-Enhanced Entry Mode Choices and Firm Performance" (2003) 24 *Strategic Management Journal* at 1239-49; Ernst Verwaal & Bas Donkers "Customs-related Transaction Costs, Firm Size and International Trade Intensity" (2003) 21 *Small Business Economics* 257.

classical omission of transaction costs; by way of contrast, the article then examines The New Institutional Economics, as developed by Oliver E. Williamson. This later, still-developing body of theory attempts to account for transaction costs in economic analysis through the development of institutions (though not specifically with reference to international trade). Finally, the article presents a review of the goals and outcomes of the Convention on Contracts for the International Sale of Goods (CISG). The CISG represents an effort to address the most significant transaction cost for international trade—uncertainty of contract—faced by the most significant players in international trade, the multi-national enterprises (MNEs). The article concludes with a discussion of the role of legal regimes, such as the CISG, in economic theory.

## II. STRATEGIC TRADE THEORY

STRATEGIC TRADE THEORY IS RELATED to another branch of economics: industrial organization or industrial economics. Traditional industrial economics has relied on a structure-conduct-performance paradigm.<sup>6</sup> A market structure produces certain conduct on the part of the firm that results in a set performance: structure is exogenous, and conduct and performance are predetermined by the structure of the market. Later industrial economic theory has increasingly drawn from the tools of microeconomic theory, including models of imperfect competition and game theory.<sup>7</sup> Game theory, in fact, served as the acknowledged basis for strategic trade theory.<sup>8</sup>

The traditional unit of analysis of industrial economic theory is the firm. A firm is generally defined as any non-governmental, economic entity other than an individual, which is still capable of agency. Since the firm is the traditional unit of analysis of industrial economics, and—as a matter of revision of the traditional view—it is the major contention of strategic trade theory that the nation achieves its greatest impact in trade by serving as an ally of the firm in the international arena.<sup>9</sup> Specifically, strategic trade theory suggests that a firm engaged in selling a product to

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<sup>6</sup> Alexis Jacquemin, *The New Industrial Organization: Market Forces and Strategic Behavior* trans. by Fatemeh Mehta (London: MIT Press, 1987) at 2-9.

<sup>7</sup> Jacquemin, *ibid.* at 5-9.

<sup>8</sup> James A. Brander & Barbara J. Spencer, "International R&D Rivalry and Industrial Strategy" (1983) 50 *Review of Economic Studies* 707; Paul R. Krugman, ed., *Strategic Trade Policy and the New International Economics* (Cambridge: MIT Press, 1986); J. David Richardson, "The Political Economy of Strategic Trade Policy" (1990) 44:107 *International Organization*.

<sup>9</sup> James A. Brander & Barbara J. Spencer, "Export Subsidies and International Market Share Rivalry" (1985) 18 *Journal of International Economics* 83.

more than one country may utilize several strategies:<sup>10</sup>

- (1) The firm may produce in the home market and export to the foreign market (export);
- (2) The firm may produce in the foreign market, for sale there, by opening a plant (foreign direct investment);  
or
- (3) The firm may arrange a license with a foreign firm to sell its product in a foreign market (cross-border contract).

While the firm may select from these strategies, a nation may also adopt certain strategic trade and industrial policies of its own, which can influence the three areas described above.<sup>11</sup> It is a major contention of strategic trade theory—as well as a matter of revising the traditional view—that the nation achieves its greatest impact in trade by serving as an ally. Nations can serve as allies through participation in regional trade groups such as the North American Agreement on Free Trade (NAFTA) or through alliances that serve their industrial policy. Through cooperative efforts of uniform trade policy, blocks of nations can achieve mutual goals, e.g. trade embargoes against rogue nations. This challenges the established mix of comparative advantage and free markets and concedes that perfect competition rarely exists in the international market. In other words, perfect competition is virtually non-existent in international markets because some nations' policy choices will prove more conducive to or advantageous over the other strategies available to the firms. As a practical matter, national policy choices present, at the very least, an additional variable for inclusion in any theoretical consideration of comparative advantage and free markets.

If strategic trade theory were expanded to take account of the importance of transaction costs in any explanation of international trade, the logical conclusion would be that governments could assist domestic firms in one of several ways. First, the government could grant export subsidies or provide tax incentives for foreign direct investment. These are predictable strategies under present strategic trade theory; however, with the addition of transaction costs to the analysis, it becomes evident that these are strictly negative initiatives designed to inhibit trade through the creation of transaction costs. If transaction costs were part of the theory, another strategy would present itself - the reduction of transaction costs

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<sup>10</sup> Stefan H. Robock & Kenneth Simmonds, "International Business: How Big Is It-The Missing Measurements" (1970) 5 *Columbia Journal of World Business* 6 at 7.

<sup>11</sup> Brander & Spencer, *supra* note 8 at 708.

through the harmonization of pertinent domestic laws with those of potential trade partners. This harmonization could greatly enhance trade opportunities by reducing transaction costs.

Strategic trade theory further asserts that government intervention can raise national welfare by shifting oligopoly rents from foreign to domestic firms.<sup>12</sup> In Brander's and Spencer's germinal analysis in this area,<sup>13</sup> they assume two firms, both located in a country that has no domestic demand for the firms' industry's products, and therefore, must export to a third country. For each country, their analysis holds: national welfare can be identified with the profits earned by its firm. Using Cournot competition, Brander and Spencer conclude that government policy acts much like investment in excess capacity in entry deterrence models, i.e. it serves to alter the "game" in a way that benefits domestic firms. In other words, these authors hold that a nation can provide its firms an advantage through strategic industrial trade policy, which works as a barrier to foreign firms. Once again, this analysis would benefit from a focus on the removal of barriers in the form of transaction costs, rather than merely positing the erection of new, governmentally imposed barriers to the free flow of trade.

Other ways in which strategic policy has been used to increase domestic welfare include the imposition of tariffs to protect a domestic industry while it establishes itself (infant industry argument), or while it learns to reduce its marginal cost to compete in the foreign market.<sup>14</sup> United States' law, for example, allows firms some protection through the imposition of subsidies while they are regrouping from unfair competition sustained at the hands of foreign firms, e.g. dumping.<sup>15</sup> It may prove helpful here to distinguish between countervailing duties and anti-dumping duties. The latter are imposed in cases where a specific industry is injured or threatened with injury, while the former can be imposed if a country determines that subsidies are harming its producers.<sup>16</sup> However, this too does not

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<sup>12</sup> James A. Brander & Barbara J. Spencer, "Strategic Competition with Research and Development: The Symmetric Case" (1983) 14 *Bell Journal of Economics* 225.

<sup>13</sup> *Ibid.* at 234.

<sup>14</sup> P. Krugman, "Industrial Organization and International Trade" in Richard Schmalensee & R. Willig, eds., *Handbook of Industrial Organization* (New York: Elsevier, 1989).

<sup>15</sup> Dumping is the act of selling goods at below world market price and it can result in injury to a domestic industry. Relief for that industry can be obtained through the Export Administration Act of 1977 as amended by the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C 1673 et seq. See also 19 U.S.C 1337 et seq. for remedies available in the event a firm is determined to be competing in an unfair manner. Goods of that firm may be stopped at the border.

<sup>16</sup> See section 301 of the Trade Act of 1974 and compare with the Subsidies and Countervailing Measures Agreement of GATT 1994, online: World Trade

explain trade so much as makes its practice all the more problematic.

Finally, a major weakness with strategic trade theories is their focus on the national firm, since the true players in the trade of cross-border goods are multinational enterprises (MNEs).<sup>17</sup> Markusen and Venables introduced MNEs into the standard oligopoly model of the new trade theory. They concluded that MNEs arise endogenously and become more important than national firms relative to trade as nations become more similar in relative endowments, i.e. as world income grows.<sup>18</sup> The increasing importance of MNEs serves to highlight the weaknesses of extant industrial theories like strategic trade theory because MNEs tend to be much less advantaged by the welfare strategies than that theory suggests. The success of MNEs flies in the face of strategic trade theory's implied outcomes.

Transaction cost economics, a developing area in economic theory, could provide the needed correction to existing notions such as strategic trade theory. The subject of transaction cost economics is examined in the next section.

### III. TRANSACTION COST ECONOMICS

**T**HE TRANSACTION COST APPROACH to the study of economic organization treats the transaction as the basic unit of analysis.<sup>19</sup> Oliver E. Williamson's work in the field is a direct extension of the Coase Theorem developed by Ronald H. Coase.<sup>20</sup> Posner paraphrased the theorem, "if transactions are costless, the initial assignment of a property right will not affect the ultimate use of the property...the property will be put to its most productive use regardless of the initial assignment of rights."<sup>21</sup> Therefore, the greatest efficiency in economic transactions is achieved when costs are the lowest. It is precisely for the purpose of reducing transaction costs to their lowest that Williamson says the firm has evolved at all.<sup>22</sup>

Transaction cost analysis can be applied to the evolution of the firm at three levels: the overall structure of the firm, the activities of the firm

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Organization <[http://www.wto.org/english/docs\\_e/legal\\_e/24-scm\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/24-scm_01_e.htm)>. WTO members may take unilateral action as well as pursue WTO remedies.

<sup>17</sup> James R. Markusen & Anthony J. Venables, "Multinational Firms and the New Trade Theory" (1998) 46 *Journal of International Economics* 183 at 184.

<sup>18</sup> Markusen & Venables, *ibid.* at 201.

<sup>19</sup> Oliver E. Williamson, "The Economics of Organization: The Transaction Cost Approach" (1981) 87 *American Journal of Sociology* 548 at 548.

<sup>20</sup> Ronald H. Coase, "The Problem of Social Cost" (1960) 3 *J.L. & Econ.* 1.

<sup>21</sup> Richard A. Posner, *Economic Analysis of Law* 5th ed. (New York: Aspen, 1998) at 8.

<sup>22</sup> Williamson, *supra* note 19 at 548.

(efficient boundaries), and the organization of human assets.<sup>23</sup> The transaction is the most common unit of economic analysis<sup>24</sup> and transactions occur when a good or service is transferred across a technologically separable interface. The economic friction experienced by this transfer is a transaction cost.<sup>25</sup>

By Williamson's standard, transaction cost analysis involves the comparison of costs under alternative structures, taking into consideration the costs of planning, adapting, and monitoring task completion.<sup>26</sup> Two behavioural assumptions underpin Williamson's analysis: (1) the bounded rationality of human agents and (2) the temptation to opportunism by these same agents.<sup>27</sup> These two transaction costs limit certainty of contract and thus, trade. Also, these same two transaction costs are not addressed by any legal regime that purports to foster certainty of contract.

Previously proposed typologies of economic transactions have focused on several key factors including uncertainty, frequency, and asset specificity.<sup>28</sup> If a transaction is unique, the transaction costs will be high; however, if it is a routine transaction, high transaction costs will abate as firms learn the routine.

The basic assumptions of transaction cost analysis hold that (1) markets and firms are different yet interchangeable mechanisms for completing transactions; (2) the cost to the firm will determine if it elects to use its own resources or the market for the transaction; and (3) transaction costs will vary across markets due to human and environmental factors.<sup>29</sup> The key environmental factors are uncertainty and the number of firms, while the human factors are bounded rationality and opportunism. Firms will utilize markets if there is less uncertainty, more competition, and an enforceable limitation on opportunism.<sup>30</sup>

Transaction costs have also been defined as the costs of running the

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<sup>23</sup> Williamson, *ibid.* at 549.

<sup>24</sup> Williamson, *ibid.* at 548.

<sup>25</sup> Williamson, *ibid.* at 552.

<sup>26</sup> Williamson, *ibid.* at 553.

<sup>27</sup> *Ibid.*

<sup>28</sup> Jean-Paul Bouttes & Pascal Hamamdjian, "Contractual Relationships within the Firm" chap. in *Transaction Cost Economics*, ed. by Claude Menard (Cheltenham, UK: Edward Elgar, 1997) 59 at 62-63.

<sup>29</sup> Erik G. Furubotn & Rudolf Richter, *Institutions and Economic Theory: The Contribution of the New Institutional Economics*. (Ann Arbor: University of Michigan Press, 1997) at 42.

<sup>30</sup> Williamson, *supra* note 19 at 548.

economic system,<sup>31</sup> market and managerial costs,<sup>32</sup> or measurement and enforcement costs.<sup>33</sup> Market costs are comprised of bargaining, negotiation, and information costs, such as the costs of preparing contracts, concluding contracts, and enforcing contracts. Managerial transaction costs include the management of labour contracts. Measurement costs are those involved in determining the value and price of a good, while enforcement costs are those attributed to the legal process that will enforce the bargain and the right to contract. The transaction costs of import here are the market and enforcement costs in the international arena.

John Dunning prepared a typology of the nature of the transactions possible in international trade.<sup>34</sup> Dunning described the transfer of assets and products as taking three organizational forms:

- (1) the spot market (which implies arm's length transactions);
- (2) the inter-firm alliance or network; and
- (3) the hierarchies of firms that internalize transaction costs.

Dunning argues that classic international trade transactions were of the spot market variety, however, since the Second World War, more trade is conducted on a hierarchical level, intra firm.<sup>35</sup> The MNE, in that context, becomes a more significant player than the national firm.<sup>36</sup>

Spot transactions carry more risk than those of a hierarchical nature. This is because spot transactions occur in the open marketplace among unrelated firms negotiating at arm's length, and are not routine business for the firms engaged in those transactions. Globalization and specialization increase transaction costs for all types of transactions, but especially for spot or arm's length transactions.<sup>37</sup>

The Convention on Contracts for the International Sale of Goods (CISG) addresses the reduction of these transaction costs, including those of contract negotiation, formation, and dispute resolution. Negotiation

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<sup>31</sup> Kenneth Arrow, "The Organization of Economic Activity: Issues Pertinent to the Choice of the Market versus Non-Market Allocation" in *The Analysis and Evaluation of Public Expenditures*, 91st. Congress, GPO.

<sup>32</sup> Furubotn & Richter, *supra* note 29 at 43.

<sup>33</sup> Chong Ju Choi, "A note on Countertrade: Contractual Uncertainty and Transaction Governance in Emerging Economies" (1999) 30 *Journal of International Business Studies* 189.

<sup>34</sup> John H. Dunning, *Alliance Capitalism and Global Business* (London: Routledge, 1997) at 122.

<sup>35</sup> Dunning, *ibid.* at 123.

<sup>36</sup> Markusen & Venables, *supra* note 17.

<sup>37</sup> Dunning, *supra* note 34 at 127.

costs are reduced by the existence of a shared law that deals with the formation and dispute resolution of the contract. Specifically, the reduction of transaction costs is addressed by the CISG in two significant ways. First, it establishes a single rule of law, which should reduce cross-border contract negotiation, and addresses the issue of rationality by making contracting more feasible and predictable. Second, through its applicability in all signatory courts, the CISG should reduce the transaction cost of contract enforcement by providing legal redress for overly aggressive opportunism.

The CISG sets forth rules governing transactions for the sale of goods between entities located in signatory states, and has been likened to an international Uniform Commercial Code (UCC). As a treaty, it is the law of the land in the U.S. and applies automatically to transactions that meet the jurisdictional requirements. Commercial parties, provided they are aware the CISG applies, may opt out of its application and select law and forum of their choice. The CISG is the law in over sixty countries, countries of which account for two thirds of global trade.<sup>38</sup> While the advent of the MNE is a method for minimizing transaction costs within the firm through horizontal and vertical integration aimed at cost reduction, firms engaged in spot transactions must seek cost reductions in other ways. The CISG, as a new institution of global economics, seeks to provide just such a reduction in cost.

#### IV. NEW INSTITUTIONAL ECONOMICS

**T**HE NEW INSTITUTIONAL ECONOMICS holds that institutions are significant economic structures.<sup>39</sup> The traditional neoclassical view that transaction costs do not exist in a perfectly competitive market is contrary to the thinking of the new institutionalists. The latter believe that imperfect foresight (what will the future bring?) and asymmetric information require institutions to play a pivotal role in the economy by managing transaction costs.<sup>40</sup>

According to this view, institutions are the sets of rules, formal or informal, that shape human interaction, provide structure to activity, and reduce uncertainty.<sup>41</sup> These new institutionalists argue that an institution or an institutional structure is generally introduced by some legiti-

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<sup>38</sup> See online: Pace Law School, "CISG Database" <<http://www.cisg.law.pace.edu/cisg/cisgintro.html>>.

<sup>39</sup> Oliver E. Williamson, "The New Institutional Economics: Taking Stock, Looking Ahead" (2000) 38 *Journal of Economic Literature* at 595-613.

<sup>40</sup> Furubotn & Richter, *supra* note 29 at 179.

<sup>41</sup> Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990) at 3.



mate authority, which Williamson terms as "intentional governance."<sup>42</sup> His main assertion is that institutions evolve to reduce transaction costs. The United Nations Commission on International Trade Law (UNCITRAL) and its work are examples of this.

The stated purpose of UNCITRAL is to harmonize international trade law to facilitate trade.<sup>43</sup> UNCITRAL is, as suggested by Williamson's theory, a legitimate authority of the combined sovereigns of its membership, and it introduced the CISG as the institutional structure designed to reduce uncertainty. Thus, the CISG fulfills Williamson's definition of intentional governance in all respects.<sup>44</sup>

The proposition that lack of such institutional infrastructure can serve as a barrier to trade is highlighted by the current research on Eastern Europe.<sup>45</sup> New republics that previously did not recognize private property interests and do not have established rules of law are finding it difficult to attract trade. Firms will not risk spot transactions; they must be able to rely on the enforcement of contracts or property rights to engage in any trade, particularly spot transactions. Trust must first be developed either through identity of parties (known trading partners with established relationships) or through the confidence of a law of contract.<sup>46</sup>

UNCITRAL and the CISG, as institutions of formal rules, can increase the level of trust between parties, but only to the extent the parties are willing. It is certain, however, that the CISG increases confidence somewhat by codifying international contract law.<sup>47</sup> This was the clear intention of its drafters, as evidenced by the text of the CISG:

(c) The draft Convention constitutes a significant achievement in the unification of international commercial law

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<sup>42</sup> Oliver E. Williamson, "Economic Institutions: Spontaneous and Intentional Governance" (1991) 7 J.L. Econ. & Org. 159 at 159.

<sup>43</sup> Established in 1966 by the General Assembly of the United Nations, UNCITRAL's mandate is "...to further the progressive harmonization and unification of the law of international trade." Resolution 2205(XXI) (Dec. 17, 1966).

<sup>44</sup> The preamble to the CISG states: "Being of the opinion that the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade." United Nations Convention on Contracts for the International Sale of Goods, April 11, 1980, U.N. Doc. A/Conf. 97/18 (1980).

<sup>45</sup> Choi, *supra* note 33 at 191.

<sup>46</sup> Choi, *ibid.* at 193.

<sup>47</sup> John O. Honnold, "Uniform Laws for International Trade: Early 'Care and Feeding' for Uniform Growth" (1995) 1 International Trade and Business Law Journal 1 and "The Sales Convention: From Idea to Practice" (1998) 17 J.L. & Com. 181.

(Portugal, Yugoslavia). As a result, it will serve to facilitate international trade and diminish the risk of conflict between the parties to a sales contract (Sweden).

- (d) The practical application of the draft Convention by practitioners will be made easy by the fact that it has been drafted in a flexible manner (Portugal) and the solutions chosen to a great extent comply with the need for simplification and clarity (Sweden).
- (e) The Convention will be of major international importance and have a great prestige, particularly in the developing countries, since they participated in its elaboration and since it can reasonably be expected to play a significant role in the modification of the existing rules of the international sale of goods, which do not protect sufficiently the interests of the weaker contracting party (Yugoslavia).

*United Nations Document A/CONF.97/9 [Original: English]  
[21 February 1980]*

Clearly, the drafting nations intended the CISG to address issues of contract specificity and uncertainty, as these factors have been identified as trade deterrents.<sup>48</sup> Even though the CISG allows firms to opt out, like the Uniform Commercial Code, it may still provide courts with a useful default.<sup>49</sup> In the end, by design or by default, the CISG itself stands as a testament to its drafters' belief that unmanaged transaction costs lead to economic inefficiencies.

International agreements create the larger international regulatory framework that MNEs and domestic firms must deal with in the ordinary course. On the international level, international agreements exist to manage trade, such as the General Agreement on Tariffs and Trade

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<sup>48</sup> Yadong Luo, "Transnational Characteristics, Institutional Environment and Joint Venture Contracts" (2005) 36 *Journal of International Business Studies* 209 at 220; Benoit Aubert, Suzanne Rivard & Michel Patry, "A Transaction Cost Model of IT Outsourcing" (2004) 41 *Information and Management* 921 at 926.

<sup>49</sup> Alan Schwartz & Robert E. Scott, "Contract Theory and the Limits of Contract Law" (2003) 113 *Yale L.J.* 541 at 595.

(GATT),<sup>50</sup> the World Trade Organization (GATT's successor), and various regional agreements like NAFTA, MERCOSUR and the E.U. However, as noted above, these agreements create limited individual rights, relying rather on the rights and obligations of nations.<sup>51</sup> Firms may petition their governments for assistance in the event a firm or industry is injured by unfair trade practices,<sup>52</sup> but it ultimately remains at the government's discretion to pursue the matter. Private parties can pursue remedies available under domestic law but are limited to local jurisdictional requirements and to defences of sovereign immunity.<sup>53</sup>

The CISG goes further. By harmonizing the rule of law on contracts for the international sale of goods, signatory nations seek to assist their domestic firms in competing in the global marketplace. They do this not by negative strategies that approach subsidy status, but by the more positive means of reducing the transaction costs of contract formation, negotiation, and enforcement. The value of the CISG is that it is an "institution" in the sense that term is used by new institutional theory. As a rule of contract law, the CISG addresses two fundamental problems of economic theory: bounded human rationality and unfettered opportunism.

A regime like the CISG reduces transaction costs not only practically in the day-to-day operations of firms, but by de-emphasizing the conflict of laws, it diminishes the importance of MNEs and state/taxpayer-sponsored welfare. As a result, it is hoped that more, and even smaller firms, can compete and become viable in international commerce. Further, if the CISG is an effective "institution" to facilitate trade, the production advantages, hypothesized by classical industrial economic theory, would likely increase. That is, if the trade field is levelled, production advantages among nations will become a more significant variable. In sum, greater economic efficiency will accrue to all actors.

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<sup>50</sup> The GATT was signed by participating nations on October 30, 1947, and became effective January 1, 1948, with the agreement of signatories that they would adopt it in their own countries. The United States passed most of the components of GATT as law; see 19 U.S.C. 1600 et seq. GATT was revised in 1994, thus creating the World Trade Organization, a stronger enforcement arm of the GATT agreements.

<sup>51</sup> International trade agreements rarely provide for a private cause of action for individual firms; however, NAFTA did include the controversial Chapter 11, which allows investors to maintain private actions.

<sup>52</sup> Tariff Act of 1930, 19 U.S.C. 1337 et seq.

<sup>53</sup> Foreign Sovereign Immunities Act of 1976, 28 U.S.C. sec. 1601-11. Note that sovereigns may not claim immunity in U.S. courts in certain cases, notably if the activity complained of is commercial in nature or if an expropriation under international law has occurred. Sections 1605(a)(1), 1605(a)(3).

## V. CONCLUSION

THE NEW INSTITUTIONAL ECONOMICS holds that the institutions that governance produces actually do matter: the "play of the game,"<sup>54</sup> in Williamson's words, is a necessary component to the allocation of property rights, and that the contract is as important as the property right it conveys.

Generally, contract rights are left to the parties and resolved through private ordering. When institutions develop to facilitate these contractual rights, the unit of analysis becomes the transaction. To the extent that such an institution can be designed to reduce costs, efficiency and opportunity will be maximized for the parties to the transactions.

The work of UNCITRAL, and specifically the CISG, meets this threshold. The CISG is an act of governance and an institution: sovereign nations came together to negotiate a uniform law of contract, thereby creating a system of laws shared amongst all signatories. The method in which this created institution is used by the signatory nations, however, may also be a tool of strategic trade theory. Regimes, such as the CISG, can become either an impediment to the free flow of commerce by creating an additional layer of bureaucracy or institutions that reduce transaction costs through the negotiation and harmonization of those regimes. If the view of strategic trade theory is government influence operating to benefit domestic producers, then the mere ratification of the CISG by a signatory is an exercise of strategic trade. By adopting the CISG, that nation has minimized transaction costs for some of its firms, hopefully allowing them to be more competitive than those nations who have not.

Still, it is one of the fundamental tenets of economic theory that actors reserve at least a modicum of free will. At the individual level, factors such as taste, personal preference, individual talent and capability all impact economic outcomes. In the international realm, the method in which a signatory nation interprets and enforces an agreement like the CISG allows for variance from the intended outcome, and is thus another potential area of strategic choice. For example, if a nation fails to honour the international spirit and obligations of the CISG through its court system, then it has chosen a strategy that may favour domestic firms over more cost-efficient foreign concerns. It is true that the literature is replete with witnessing references that the CISG remains underutilized,<sup>55</sup> and

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<sup>54</sup> Williamson, *supra* note 19 at 574.

<sup>55</sup> Monica Killian, "CISG and the Problem with Common Law Jurisdictions" (2001) *J. Transnat'l L. & Pol'y* at 217-242.

signatory courts continue to interpret it in self-serving ways.<sup>56</sup>

Legal regimes increase in importance as the marketplace expands across borders. These regimes can become impediments to the free flow of commerce. Nations that choose to assist domestic firms by reducing transaction costs can order contracts through the negotiation of harmonization of these regimes. Harmonization should operate to minimize some transaction costs of contracting by providing transparency of rules and self-enforcement through national courts. The paradox remains that nations reserve the right to engage in strategic trade, even at the level of enforcement. However, just like the vagaries of humans, individual differences and prejudices do not discount socio-economic theories in total, so too, tendencies to chauvinism and nationalistic impulse should not and cannot negate the importance of international legal regimes to trade theory.

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<sup>56</sup> Frank N. Fisanich, "Note and Comment: Application of the U.N. Sales Convention in Chinese International Commercial Arbitration: Implications for International Uniformity" (1999) *Am. Rev. Int'l Arb.* 101.