



INSTITUT C.D. HOWE INSTITUTE

COMMENTARY

NO. 360

# The New Multilateralism: The Shift to Private Global Regulation

*The use of private-sector standards, codes, and best practices — a kind of contemporary version of the medieval *lex mercatoria* — is a major and increasing factor in international business. Neither Ottawa nor the provinces can afford to ignore the impact and the benefits.*

Lawrence L. Herman

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COMMENTARY No. 360  
AUGUST 2012  
TRADE AND INTERNATIONAL  
POLICY



*Finn Poschmann*  
Vice-President, Research

\$12.00  
ISBN 978-0-88806-880-4  
ISSN 0824-8001 (print);  
ISSN 1703-0765 (online)

## THE STUDY IN BRIEF

Non-state actors are increasingly engaged in authoritative decision-making over standards. As a result, frameworks for governing international economic transactions are increasingly being maintained by the private sector, both with and without government cooperation.

Typically, these privately set standards help underpin cross-border exchanges, and increasingly help facilitate global trade beyond what World Trade Organization (WTO) rules or other government-to-government agreements have been able to do.

This can help governments solve problems they cannot overcome unilaterally or collectively. And governments, which may not have the resources or expertise to keep abreast of fast-evolving needs and technologies, have in some cases already anticipated the growing role of private standard-setting, for example under the WTO Technical Barriers to Trade agreement.

These standards can have major effect on trans-border acceptance of products, to the point of often determining the ability of producers to access markets. As such, they have generally beneficial effects in smoothing trade, yet they can also have effects detrimental to competition.

There is no need for governments to attempt to direct their evolution through formal government-to-government treaty. Indeed, the task for government is to encourage and assist the formulation of these business-driven norms, through informal consultations and effective articulation of the underlying public interest, and instruments such as mutual recognition agreements.

This model of non-intrusive government vigilance could constitute a sort of “trusteeship,” promoting private regulation where it legitimately serves the public interest, while having governments act as guardians against abuse. Under this model, governments would ensure private standard-setting does not encourage anti-competitive behaviour or attempt to shield an industry from government oversight; promote transparency and even-handedness; ensure standard-setting bodies do not become private clubs; and try to address standards’ proliferation and fragmentation where these could degenerate into confusion for market participants. WTO requirements of non-discrimination and equality of competitive opportunities would be applied.

Canada should give this phenomenon a more explicit place in its global commerce and competitiveness strategies; for example, through the emerging efforts of the Canada-US Regulatory Cooperation Council.

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## The international community has seen the steady decline and eventual demise of the Doha Round of multilateral trade negotiations at the World Trade Organization (WTO) in Geneva.

The December 2011 Ministerial meeting effectively shut down the talks, recognizing the reality that on almost every key issue there was little chance of consensus. The unfortunate story is that, as 10 years of negotiations dragged on, political will in world capitals steadily dissipated.

The collapse of the Round raises many questions, including those pertinent to the business community. If the WTO is unable to negotiate improved disciplines for international trade, what then? Has the Doha Round collapse irretrievably impaired the credibility of the WTO as a negotiating forum? If the multilateral, intergovernmental process cannot advance open markets for goods, technology, and services, where does that leave us?

One response has been to intensify government efforts to cement preferential trade agreements (PTAs) at the bilateral level. Canada is belatedly but actively pursuing this approach, and is now in the final stages of trade negotiations with the European Union and beating on the doors of key emerging economies such as India, Brazil, China, and others. In parallel with these PTA exercises is another phenomenon that is the focus of this *Commentary*: the growth of private standard-setting

and rulemaking outside the formal domain of governments and international treaties but of major importance in international trade and business transactions.<sup>1</sup>

It would be a stretch to attribute the growth of private regulation entirely to the grinding down of the Doha Round and the lack of results in the multilateral process. Other factors are obviously involved in these industry-generated activities, including the rapid speed of technological innovation, the need for commercial norms to meet market demands, and the limitations on the capacity of governments to react to a fast-moving and dynamic global business environment.<sup>2</sup> Whatever the reasons, as multilateral treaty-making has languished, private rulemaking has matured and expanded over the past decade or so. Non-state actors increasingly are engaged in authoritative decision-making previously the prerogative of sovereign states, with the result that frameworks for governing international economic transactions are being created and maintained by the private sector, both with and without government cooperation (see Cutler, Haufler, and Porter 1999, 16; Vogel 2008).

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I am grateful for comments on previous drafts of this *Commentary* from John Curtis, Laura Dawson, Gary Hufbauer, Finn Poschmann, Daniel Schwanen, Debra Steger, Robert Wolfe and other anonymous reviewers. Their advice was helpful and illuminating. At the end of the day, however, responsibility for the analysis and recommendations herein rests on my shoulders.

- 1 Although there has been a fair degree of academic discourse on this phenomenon in the past decade or so, it has generated relatively little or only sporadic comment in business circles. Among the academics who have written extensively on the subject are David Vogel of the University of California—Berkeley, Virginia Haufler of the University of Maryland, and Tim Büthe of Duke University, whose works are cited below.
- 2 Scholars differ on whether this is indicative of a “retreat of the state” or simply a reconfiguration of the dynamic balance between the public and private sphere; see Büthe (2010, 6).

As a result, private regulation and its impact on international trade and business cannot be ignored. It shapes corporate behaviour on an increasingly larger scale and enhances cross-border trade in goods, services, and technology, arguably in some ways as significant as the market-opening benefits of the WTO Agreement. As but one simple illustration, the acceptance by a company such as Walmart or Home Depot of a given industry standard for the products on its shelves – perhaps even of its own formulation – could be as commercially significant as a tariff reduction on that particular product.

### THE SCOPE OF THIS STUDY

In the following analysis, I look at the market effect of a somewhat random yet illustrative selection of standard-developing organizations in five areas: (1) international banking and financial reporting; (2) Internet and electronic commerce; (3) product specifications; (4) corporate social responsibility; and (5) environmental or “green” endorsements and “fair trade” certifications. These areas offer illustrations of where private actors, instead of waiting for governments to act through international agreements, have taken independent standard-setting initiatives whose market-enhancing effects in some respects reach beyond intergovernmental treaties, including the WTO Agreement, in their commercial impact.<sup>3</sup> Private rulemaking, however, can entail negative features as well; for example, these activities can actually restrict competition and protect markets. Yet, without discarding that concern, on balance I see no need for governments to try to control or supplant these organizations or to bring them under

a formal treaty umbrella or intergovernmental agreement. Quite the opposite: experience with the Doha Round provides no encouragement for that approach, and both the historic record and recent developments show that industry rulemaking can function effectively without direct government involvement or formal treaty frameworks.

That said, carefully defined governmental involvement is needed in these efforts, first, to identify those organizations that are the most credible and that promote the highest-quality norms and standards; second, to encourage the development, harmonization, and implementation of these standards in an open, transparent, and accessible manner; and, third, to guard against monopolistic or anti-competitive rulemaking that is inconsistent with the broader public interest. Although discharging these tasks might result in informal protocols or arrangements for mutual standard recognition among governments, I am not suggesting that governments engage anew in a formal multilateral negotiating process in these fields. That game deserves a rest, at least for the time being.

Finally, in the latter part of this *Commentary*, I look at the Canadian government’s current activities in relation to industry self-regulation, including the work of the Canada-US Regulatory Cooperation Council. I conclude that Ottawa is not paying enough attention to this issue, and I offer several suggestions that it should consider for further action.

### THE DEMISE OF DOHA

Views differ about the reasons for the demise of the Doha Round. Clearly, however, no single factor was the cause; rather, it was a combination of many

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3 Although this *Commentary* focuses on private industry rulemaking, the product certification activities of civil society non-governmental organizations (NGOs) also has an important influence – in some cases, an overwhelming one – on corporate behaviour. The example of the forestry industry’s quest for environmental certifications and “green” endorsements by NGOs is testimony to this phenomenon.

things, including the intractable complexity of the issues; the emergence of new and influential WTO members – the so-called BRICS (Brazil, Russia, India, China, and South Africa) – which were not prepared to go along with the larger economic players (the United States and the European Union); and the slow-moving and cumbersome nature of multilateral negotiations at a time when international business is moving at breathtaking speed.<sup>4</sup> Indeed, with hindsight, one wonders if the Doha Round was really justified from the outset. With an overly optimistic feeling that the successes of the previous Uruguay Round (completed in 1994) could be repeated, and without much of an interval, governments launched renewed negotiations to deal with some unfinished business left over from the Uruguay Round, particularly in agriculture. Although this attempt had merit, events showed that the political will needed to sustain the negotiations was lacking, and the Round progressively degenerated into messy squabbles over innumerable complex issues. Entrenched national interests and the rise of new powers with protectionist tendencies added to the difficulties.

Given these factors, it is difficult to believe that the achievements of the Uruguay Round could have been replicated or that governments could have repeated the remarkable successes in multilateral treaty-making that characterized the first 50 years after the Second World War. Those achievements resulted from a confluence of international circumstances that no longer exist. This does not gainsay the signal achievements of the Group of 20 major industrial countries in grappling with the global financial crisis of 2008/09 that, by some

measures, is still continuing. But the G-20 functions through informal arrangements and consensus, not through formal treaty-making of the variety that produced the 1947 General Agreement on Tariffs and Trade (GATT), the 1979 Tokyo Round Codes, and the 1994 WTO Agreement.

## SOME LESSONS LEARNED

There are interesting parallels between global trade talks and the Law of the Sea negotiations in the 1970s and 1980s. The effort to codify international law and relieve the world of maritime anarchy produced the seminal 1958 UN Law of the Sea Conventions. After some stock-taking, a new set of negotiations was launched in the 1970s (UNCLOS III), eventually producing the omnibus 1982 United Nations Convention on the Law of the Sea. It took 10 years of hard bargaining to achieve consensus, but it is hard to believe that the UNCLOS III achievement could be repeated today. Indeed, with respect to the environment, both the UN Framework Convention on Climate Change and the Kyoto Protocol process also could be victims of the complexity of issues in combination with widely divergent national interests. Although there is some glimmer of possible agreement on a replacement regime for the first commitment period under the 1997 Kyoto Protocol, the prospects are uncertain at best given what transpired at the last Conference of Parties in Durban, South Africa, in late 2011.<sup>5</sup>

The lesson from these multilateral efforts in maritime affairs, the environment, and trade is that there are limits to how far governments can go in the quest for broad-based consensus on increasingly

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4 Whether the Doha Round is actually dead or only on life support is not the issue. The hoped-for achievements of the Round have not occurred, and even if some lower-level discussions are continuing on the fringes of the WTO in Geneva, the broad negotiating agenda agreed to in Qatar in 2001 and later in Singapore will never be realized.

5 See “Durban climate change conference: agreement reached on course for future accord, environment minister Peter Kent ‘cautiously optimistic,’” *Huffington Post*, December 11, 2011; “Kyoto Protocol will be on life support after Durban summit,” *Guardian*, November 29, 2011.

complex international issues. As with UNCLOS in 1982, the 1994 WTO Agreement probably represents the apex of state-inspired multilateralism in the post-Second World War period. With the decline in multilateral prospects and the uneven record of regional and bilateral trade and investment treaties, the question now is how much of the vacuum can be filled by the private sector.

Of course, multilateral agreement remains the ideal, and the existing WTO Agreement continues to provide the gold standard in international trade relations. For example, the WTO Agreement on Technical Barriers to Trade (TBT Agreement) requires WTO member governments to follow specific market-opening rules, including a non-discriminatory approach in passing national certification measures and to recognize harmonized product standards set by international standardizing bodies. The TBT Agreement was a signal achievement, and provided underpinnings for subsequent private-sector standard-setting.<sup>6</sup> The Doha Round aimed to improve on that agreement, but it was not to be.

Although the Doha Round bogged down, the business community did not wait. Private industry has continued to formulate standards to improve cross-border trade in goods, services, and technology, largely dictated by market incentives.

The task ahead is for governments to encourage and assist the formulation of these business-driven norms, not by renewed attempts at treaty-making but through informal consultations and effective articulation of the underlying public interest, including, where possible, through mutual recognition agreements (MRAs).<sup>7</sup>

### *Lex Mercatoria: THE RISE OF PRIVATE RULEMAKING*

The ascendancy of private rulemaking can be described as the modern version of “merchant’s law” or *lex mercatoria*, a medieval system of commercial understandings that emerged in the days of the Hanseatic League to aid the smooth flow of intra-European merchant trade. As López Rodríguez (2002, 46) explains,

The flourishing of international economic relations in Western Europe at the beginning of the eleventh century caused the formation of the law merchant, a cosmopolitan mercantile law based upon customs and applied to cross-border disputes by the market tribunals of the various European trade centers. This law resulted from the effort of the medieval trade community to overcome the fragmentary and obsolete rules of feudal and Roman law which could not respond to the needs of the new interlocal

6 The crux of the TBT Agreement is to apply common and non-discriminatory standards set by international standard-setting organizations, whether governmental or non-governmental in nature. The Agreement does not single out specific organizations but leaves these to be decided among governments outside the WTO. For example, the Agreement encourages acceptance of the standards set by the International Organization for Standardization (ISO) through its multiple committees and subcommittees, with the result that the number of ISO standards has grown from just under 10,000 in 2000 to more than 19,000 today. The WTO Committee on Technical Barriers to Trade continues to monitor application by members of the TBT Agreement; see WTO (2011).

7 Industry Canada (Canada 2011c) describes one type of MRA as follows:

The main purpose of MRAs is to facilitate trade by streamlining conformity assessment procedures for a wide range of telecommunications and telecommunications related products. Through MRAs, products that are tested and certified before exportation can enter the importing parties’ territories directly without having to undergo similar conformity assessment procedures once they arrive. This is done by providing for the mutual recognition by the importing parties of conformity assessment bodies and the acceptance of their test reports, of which the result shows that a product conforms to the requirements of the importing party.

and international commerce. Merchants created a superior law, which constituted a solid legal basis for the great expansion of commerce in the Middle Ages. For almost eight hundred years uniform rules of law, those of the law merchant, were applied throughout Western Europe among traders.

As nation-states gradually emerged and monarchs, princes, and parliaments took over, *lex mercatoria* subsided. But it did not disappear completely, and now, with the demise of modern-day treaty-making, these “merchant laws” are in resurgence.<sup>8</sup>

One of the best illustrations of modern-day *lex mercatoria* is Incoterms, a set of trade terms employed in international shipments of goods. Developed privately in 1936 by the Paris-based International Chamber of Commerce (ICC) and refined continually since,<sup>9</sup> they consist of usages for and interpretations of commercial terminology and definitions in international shipping contracts and bills of lading. Even though they have not been implemented by government regulation, Incoterms have become almost universally accepted by business, and it is impossible to imagine how international commerce could function without them.

Another example of *lex mercatoria* in operation, also developed by the ICC, is the Uniform Customs and Practices for Documentary Credits (UCP), which are used in banking and trade finance for handling international letters of credit in more than 175 countries. They originated in commercial practice and evolved into standardized methods that eventually were codified into consensus rules by the ICC in 1933 and subsequently have been updated by regular revisions – the current version was issued in 2007.<sup>10</sup> The result is arguably one of the most successful efforts at unifying international

business rules, with somewhere between 11 and 15 percent of international trade using the UCP for letters of credit covering more than a trillion dollars each year; without them, international trade finance would grind to a halt.

Büthe and Mattli (2011, 25), in one of the more cogent analyses of the resurgence of *lex mercatoria*, describe it as part of a growing trend in the de facto delegation of regulatory authority from governments to private-sector bodies:

International standard-setting by public bodies is an important part of global regulation. With the onset of economic globalization, however, international rule-making led by governments or public agencies has come under considerable pressure, particularly in product and financial markets. Globalization has laid bare serious procedural inadequacies and organizational limits of public international governance, notably the excruciatingly slow pace of standards production and, in some cases, lack of technical expertise and financial resources to deal with ever more complex and demanding standards issues. These limitations and failures have reinforced the rapid privatization of international standard-setting.

The following selects a number of examples, by no means exhaustive, where private-sector rule-making is flourishing as part of the global trend toward private regulation – *lex mercatoria* in contemporary garb.

### **International Banking and Financial Reporting**

Standards and practices in international banking are formulated outside formal state-to-state treaties by the Bank for International Settlements

8 A huge body of literature exists on *lex mercatoria* and its modern manifestations. Among the useful are Berman (1987); and De Ly (1992).

9 See the ICC website at: <http://www.iccwbo.org/about-icc/history/>.

10 For the most recent version of the UCP, see the ICC website at: <http://www.iccbooks.com/Product/ProductInfo>.



(BIS), an organization of central banks. Created by treaty in 1930 and continued under the post-World War Two Bretton Woods accords, today the BIS functions like a private, non-governmental corporation, with its shares owned by the central banks that make up its membership.<sup>11</sup> Although the BIS is underpinned by intergovernmental agreement, it operates not through formal treaty but through its pre-eminence and force of authority. It promotes discussion, facilitates collaboration, encourages measures to ensure financial stability, conducts research on policy issues, acts as a prime counterparty for central banks in their financial transactions, and serves as an agent or trustee in connection with international financial operations, all outside a legally binding treaty framework or a set of formalized international sanctions.

Under the BIS umbrella, the Basel Committee on Banking Supervision provides a forum for the regular cooperation of central bankers on all sorts of supervisory matters. The Committee's objective is to enhance understanding of key supervisory issues and to improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches, and techniques, with a view to promoting common understanding. The Committee develops guidelines and supervisory standards, and is best known for its international standards on capital adequacy enshrined in the Core Principles for Effective Banking Supervision and the Concordat on cross-border banking supervision. Much in the news as a result of the 2008 credit

and banking crisis is so-called Basel III, a set of guidance measures developed by the Committee to strengthen the regulation, supervision, and risk management of the banking sector.<sup>12</sup> The guidelines are accepted as the universal standard in banking operations, even though they have been formulated outside intergovernmental treaty. Although the BIS structure can be considered as quasi-governmental because of its central bank membership, the Bank and its Basel Committee show that many aspects of international finance are independent of formal government-to-government treaties and conventions.

Perhaps a more potent illustration of pure private-sector rule-making is the worldwide shift to the International Financial Reporting Standards produced by the International Accounting Standards Board (IASB), a London-based private-sector organization. The rule-setting role of the IASB resulted from more than a decade of fruitless negotiations on financial reporting standards among EU governments, which eventually prompted the EU Commission to delegate the task to the IASB (Büthe 2010, 5-6). The IASB's rules were subsequently approved by the US Securities and Exchange Commission in 1988, which cemented their international acceptance. As Haufler (2005, 5) states, "the shift of financial rule-making to the IASB is part of a striking and much wider – yet little understood – trend: ...the delegation of regulatory authority from governments to a single international private-sector body that, for its area of expertise, is viewed

11 Unlike the International Monetary Fund or multilateral bodies such as the World Bank or the European Central Bank, the BIS was not created as an intergovernmental organization. Rather, it is essentially a highly reputable, voluntary organization with a mission to promote monetary and financial stability in the global banking system through ensuring international cooperation among central banks. See the BIS website at: <http://www.bis.org/about/index.htm>.

12 As explained on the BIS website, these measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source; to improve risk management and governance; and to strengthen banks' transparency and disclosures. The reforms target bank-level, or micro-prudential, regulation; macro-prudential system-wide risks that can build up across the banking sector, and the pro-cyclical amplification of these risks over time.

by both public and private actors as the obvious forum for global regulation.” The switch to these new IASB standards was momentous, affecting financial reporting throughout all sectors of a country’s economy as well as the entire range of accounting practices, training, and methodology and the reporting of everything from accounting for research and development costs to reporting executive compensation. Yet this massive shift is the result of standards set by a private professional body operating outside governments and implemented worldwide in the absence of any international treaty or convention.<sup>13</sup>

### Cyberspace and Electronic Commerce

It seems totally obvious today, but the advent of the Internet as a business tool was the most profound development of the late twentieth century – in historic terms as significant as the Industrial Revolution and the later inventions of the light bulb and the internal combustion engine. Yet most of the Internet and electronic commerce is based on standards established without the involvement of governments. For example, the World Wide Web Consortium (W3C) sets the international rules for the World Wide Web (W3) totally outside of international treaty. Founded by Tim Berners-Lee at the Massachusetts Institute of Technology, the consortium is made up of 344 (as of 2012) member organizations that maintain full-time staff to work together to develop W3 standards. The W3C website describes its standard-setting process in this way:

W3C standards define an Open Web Platform for application development that has the unprecedented

potential to enable developers to build rich interactive experiences, powered by vast data stores, that are available on any device. Although the boundaries of the platform continue to evolve, industry leaders speak nearly in unison about how HTML5 will be the cornerstone for this platform. But the full strength of the platform relies on many more technologies that W3C and its partners are creating....W3C develops these technical specifications and guidelines through a process designed to maximize consensus about the content of a technical report, to ensure high technical and editorial quality, and to earn endorsement by W3C and the broader community.<sup>14</sup>

Thus, W3C standards have evolved to the point of almost universal acceptance without intergovernmental agreement, another illustration of contemporary *lex mercatoria* in action.

### Trade in Goods and Technology

*Lex mercatoria* abounds in consensus standards for thousands of industrial products and technologies, where no government or international treaty has ordained acceptance. The bodies responsible for much of this work are the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC), both of which are described as “centrally coordinated global networks” that operate outside government but jointly account for about 85 percent of all international product standards (Bütte and Mattli 2011, 5). As the ISO website explains,

ISO is a non-governmental organization that forms a bridge between the public and private sectors. On

13 See Bütte and Mattli (2011, 73–9), who describe the attributes of the IASB governance structure and consensus approach as characterized by transparency and openness, combined with extensive professional and stakeholder support at the country level.

14 For further information on the history, structure, mission, and non-governmental nature of W3C, see its website at: <http://www.w3.org>.

the one hand, many of its member institutes are part of the governmental structure of their countries, or are mandated by their government. On the other hand, other members have their roots uniquely in the private sector, having been set up by national partnerships of industry associations. Therefore, ISO enables a consensus to be reached on solutions that meet both the requirements of business and the broader needs of society.<sup>15</sup>

The bulk of the ISO's work is done by 2,700 technical committees, subcommittees, and working groups, which are responsible for issuing internationally accepted standards (close to 20,000 so far) that entitle the producer of products services and technology to be ISO-certified.

An example of ISO-related rulemaking is the work done by ASTM International, known until 2001 as the American Society for Testing and Materials. Despite its US roots, ASTM is now an internationally recognized body that develops voluntary consensus technical standards for a vast range of materials, products, systems, and services. The organization also supports thousands of volunteer technical committees around the globe that collectively develop and maintain more than 12,000 standards relating to iron and steel products, nonferrous metal products, metals testing, construction, petroleum, plastics, rubber, electronics, environmental technology, nuclear items, solar and geothermal energy, and medical devices and instrumentation, to name just a few. ASTM International is but one of hundreds of industry standard-setting and certification bodies operating under the ISO umbrella but outside formal treaty and governmental regulation.<sup>16</sup> As with the IASB

and W3 cases noted above, these standards have had a profound effect on international trade – indeed, global trade flows would be affected negatively in the absence of the harmonizing effect of ISO-sponsored certification.

Like the ISO, the IEC is a private-sector, voluntary NGO. Founded in 1906, it develops international standards and operates conformity assessment systems mainly in the field of electrotechnology. The IEC cooperates with the ISO and the International Telecommunication Union to ensure that international standards fit together seamlessly and complement each other, and joint committees ensure that standards combine all relevant knowledge of experts working in related areas.<sup>17</sup>

The critical point about the ISO and the IEC as private-sector standard-developing organizations is that they open markets in goods and technology in a real way. As Büthe and Mattli (2011, 30) note, “the stakes in ISO and IEC standardization are high: their product standards often determine market access, due to demands from purchasers or due to government regulations.” In other words, separate from tariff and non-tariff-barrier reductions negotiated through the WTO process or under regional or bilateral treaties, these private ISO and IEC rules and standards determine the ability of a given good or service to penetrate a foreign market.

### **Corporate Social Responsibility**

One of the more dramatic illustrations of twenty-first-century industry self-regulation is in the field of corporate social responsibility (CSR), which has

15 See the ISO website at: <http://www.iso.org/iso/about.htm>.

16 Among the many ISO-partnered, industry-based standard-setting organizations are the American National Standards Institute, the Deutsches Institut für Normung, the British Standards Institution, the Canadian Standards Association, the European Committee for Standardization, and the Commonwealth of Independent States set of standards.

17 See the IEC website at: <http://www.iec.ch/about/profile>.

had a profound influence on the way international business is conducted.<sup>18</sup> CSR overlaps with related concepts such as corporate sustainability, corporate sustainable development, corporate responsibility, and corporate citizenship. Regardless of shifting definitions, CSR can be summarized as the private sector's way of integrating economic, social, and environmental imperatives into a strategic business model. In addition to integration into corporate structures and processes, CSR frequently involves innovative and proactive solutions to societal and environmental challenges, as well as collaboration with internal and external stakeholders to improve CSR performance.

As stated in the Canadian government's own CSR strategy under the umbrella of the Department of Foreign Affairs and International Trade (DFAIT), "Corporate Social Responsibility (CSR) is defined as the way companies integrate social, environmental, and economic concerns into their values and operations in a transparent and accountable manner. It is integral to long-term business growth and success, and it also plays an important role in promoting Canadian values internationally and contributing to the sustainable development of communities."<sup>19</sup> The critical element for the purposes of this review is that, by and large, governments are not involved in articulating substantive CSR standards, leaving it up to industry to establish the appropriate norms, best practices, and benchmarks.

The motivation underlying CSR is largely, but not exclusively, corporate self-interest, aimed at ensuring positive branding and acceptance of products, services, or investment activities in foreign jurisdictions. There are, however, some challenges in this respect. One is for the enterprise to identify which of the plethora of ethical norms and best practices are the most credible, reliable, and responsive to social needs in any given country. Another is to implement those standards and report achievements measured against transparent benchmarks.

An important development in the CSR context has been the formulation of guidelines on the prevention of corruption in foreign markets and overseas investments. Of course, many countries have criminal laws that prohibit these kinds of activities;<sup>20</sup> what the private sector has done is to set out best-practice standards and guidelines on an ethical plane, providing a kind of interstitial set of norms to channel corporate behaviour that is not necessarily at the criminal level. Among the most prominent of these private-sector guidelines are those from Transparency International (TI), a global network that fights corruption by bringing together players from government, civil society, business, and the media to promote transparency in elections, public administration, procurement, and in business.<sup>21</sup> TI uses advocacy campaigns to lobby governments to implement anti-corruption reforms. Although the network includes government

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18 A vast body of commentary and analysis has been generated by the CSR phenomenon. See, for example, the review of the literature and references on CSR in Vogel (2008), who notes, "it is surprising how readily large, multinational corporations... have adopted CSR standards and reporting mechanisms, considering the lack of financial incentives or regulatory coercion" (268).

19 See Department of Foreign Affairs and International Trade and the Department's programs for promoting CSR as a strategy for Canadian companies operating abroad, notably in developing countries: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/ds/csr.aspx?view=d>. Industry Canada has developed a useful summary of the CSR phenomenon; see <http://www.ic.gc.ca/eic/site/csr-rse.nsf/eng/home>.

20 For example, *Canada has the Corruption of Foreign Public Officials Act*, while the United States has the *Foreign Corrupt Practices Act* of 1977.

21 See TI's website at: [http://www.transparency.org/about\\_us](http://www.transparency.org/about_us).

representatives, it is a private body that sets ethical standards that influence, rather than direct, the way international business is conducted.

Related to TI's efforts are the voluntary guidelines covering ethical behaviour and human rights in international mining investments produced by the Extractive Industries Transparency Initiative (EITI), a brain-child of former UK prime minister Tony Blair. EITI is not entirely private-sector driven, but a coalition of governments, companies, civil society groups, investors, and international organizations. It is not based on a state-to-state treaty or national laws or regulations, however, but formulates non-binding ethical standards for resource companies that operate at the international level.<sup>22</sup> Corporations agree voluntarily to follow these standards; where they do not, they can be subjected to public opprobrium and social pressure.<sup>23</sup> As with the other examples of industry self-regulation cited above, these non-legal standards and norms of behaviour have a cross-border effect by influencing the nature and acceptability of foreign direct investment in the oil and gas and mining sectors in many parts of the world.

### **“Fair Trade” and Environmentally Friendly Standards**

It is impossible to understate the effect that endorsements and certifications in the environmental and “fair trade” areas have on international commerce. Although these mostly involve NGOs and are beyond the scope of this *Commentary*, their significance in shaping

public and consumer attitudes and thus affecting international business standards is a growing phenomenon. So too is the ability of these NGO-driven standards to affect consumer acceptance of a given product and thus to affect its sales in foreign markets.

One of the most significant of these endorsements is the “fair trade” certification administered by Fairtrade International (FLO), a private standard-setting body, and its companion certification body, FLO-CERT. The FLO system involves independent auditing to ensure that agreed, though legally non-binding, ethical standards are met. Companies may apply for licences to use the Fairtrade Certification Mark (or, in North America, the applicable Fair Trade Certified Mark). Fairtrade certifications cover a wide range of agricultural products, and in 2009 FLO-certified sales amounted to about US\$4.9 billion worldwide, a 15 percent increase from 2008. Such sales are projected to reach US\$9 billion in 2012 and as much as US\$25 billion by 2020.<sup>23</sup> Although not a huge amount in dollar terms, this growth indicates the trade effect of one of many such private certification bodies.

Somewhat in the same category are the endorsements given by organizations that certify environmentally acceptable practices and processes. Among the earliest of these organizations is the Forest Stewardship Council (FSC), which originated through the efforts of forestry companies in the early 1990s to respond to concerns about global deforestation by assuring consumers that their products were ecologically sustainable. Today, FSC operates as an independent, non-

22 For more information, see EITI's website at: <http://eiti.org/eiti>.

23 The governments of Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom, and the United States are among those that provide political and technical support to the EITI, both internationally and at the country level. They also provide financial support through direct bilateral support to EITI-implementing countries or through a multi-donor trust fund managed by the World Bank. The EITI has also been endorsed by the United Nations, the G8, the G20, the African Union, La Francophonie, and the EU. See the FLO website at: [http://www.fairtrade.net/facts\\_and\\_figures.0.html](http://www.fairtrade.net/facts_and_figures.0.html).

government, not-for-profit organization promoting the responsible management of the world's forests.<sup>24</sup> As a result of media pressure and the efforts of lobbyists, FSC certification has become widely accepted, aided by the decision of companies such as Home Depot to require the FSC stamp of approval from their suppliers (Büthe and Mattli 2011, 28). This is clear example of the acceptance of NGO standards by private industry and their direct effect on international trade.

FSC endorsements are delegated to its affiliated certifying organizations in the private sphere. An illustration – and there are literally hundreds of these – is the Rainforest Alliance, which, as its website states,

developed the world's first global forestry certification program and the first to rely on market forces to conserve forests. We are one of the founders of the...FSC [and]...are now the largest FSC-accredited certifier and have certified the greatest number of community and indigenous operations to FSC standards. Today, Rainforest Alliance certification and auditing services are managed and implemented within our RA-Cert Division. All related staff and personnel responsible for audit design, evaluation, and certification/verification/validation decisions are under the purview of the RA-Cert Division.<sup>25</sup>

Compliance with these standards entitles companies to apply for certification and exclusive opportunity to use the Rainforest Alliance Certified seal on certified products and in promotional materials. Application of that seal can have a significant effect on the trans-border acceptance of the company's goods, possibly greater in real terms

than tariff reductions or other WTO-based market-opening obligations.

An interesting example of a different kind is in urban building design, exemplified by the standards of construction set by Leadership in Energy and Environmental Design (LEED). Developed by the US Green Building Council in 1998 as a purely private-sector set of standards for modern construction projects, LEED certification has grown internationally to encompass more than 7,000 projects in the United States and 30 countries covering more than 1.5 billion square feet (140 million square metres) of development area. Although no data exist on the value of these projects, LEED certification evidently is having a commercial and trade-related effect on cross-border flows of architectural design and urban construction services as architects and consulting engineers use LEED standards to gain approvals from public authorities.

## PRIVATE REGULATION AND THE ROLE OF GOVERNMENT

To the extent that the ascendancy of private regulation is the result, even in part, of the breakdown in intergovernmental cooperation and consensus-building, as exemplified by the Doha Round, that is regrettable. There is little quarrel that the WTO Agreement and other multilateral agreements establishing global disciplines for trade and investment remain the ideal. Only by such agreements can uniform, legally binding, market-opening rules based on the GATT-based pillars of non-discrimination and most-favoured-nation treatment be implemented on a comprehensive

24 The FSC is a pioneer forum where the global consensus on responsible forest management convenes and, through democratic processes, effects solutions to the pressures facing the world's forests and forest-dependent communities; see the FSC website at: <http://www.fsc.org/about-fsc.html>. See also Büthe and Mattli (2011, 28).

25 See <http://www.rainforest-alliance.org/forestry/certification>. For a thorough, if rather academic, treatment of the prominence of the FSC in private rule-making, see Pattberg (2005).

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scale. It follows that the business community should not fall into the false belief that private sector rule-making offers a complete substitute for multilateral treaty-making.

Governments have a role to play in all this. Without inserting themselves in the rulemaking process, governments can carve out a sort of “trusteeship,” promoting private regulation where it legitimately serves the public interest while acting as guardians against abuse. A number of issues point to the need for some kind of moderate, balanced, and non-intrusive governmental vigilance.

First, governments should ensure that private rulemaking does not encourage anti-competitive interests, by permitting market dominance, deflecting legitimate government regulation, or attempting to shield an industry from government oversight. It has been suggested, for example, that the UCP has had the result of safeguarding the interests of bankers, keeping them insulated from government supervision while leaving purchasers or suppliers little recourse in the event of problems or shortfalls.

Second, without inserting themselves into the nitty-gritty of industry rulemaking, governments should promote both transparency and even-handedness in the deliberations of standard-developing organizations. Although this might be difficult to achieve at arm’s length and would require careful balancing, governments should ensure that such deliberations are accessible – meaning that these bodies do not bar entry or operate akin to private clubs. Government trusteeship could ensure that these bodies are open to stakeholder comment and that rules are not developed or applied with a bias toward western industrialized countries to the detriment of emerging economies and industries in developing countries.

Third, intergovernmental cooperation should ensure uniformity, or at least a degree of coherence, in private rulemaking within a given sector or even across sectors. As evident in the many existing “green” certifications reviewed above, recent years have seen an inordinate amount of standards proliferation and their resulting fragmentation. Similar proliferations are found in the CSR field, with innumerable NGOs and industry organizations vying for recognition. Which ones are valid, or more valid than others? How do stakeholders choose among them? As in the case of the ISO certifications discussed earlier, this is an area where governments might agree to designate the appropriate agency or rulemaking body to ensure a degree of uniformity.

A related and little discussed issue is the interplay between private standards, which are set outside WTO disciplines and obligations, and the WTO Agreement. Because the WTO Agreement engages only states, private rulemaking escapes both legal obligations and the scrutiny that operates within the WTO sphere. Nothing ensures, for example, that a given industry standard or practice is subject to WTO requirements of non-discrimination and equality of competitive opportunities for the industry concerned. Some kind of intergovernmental agreement or understanding could help ensure that such requirements are met.<sup>26</sup>

These issues illustrate that governments and private-sector bodies have a mutuality of interest and shared concerns. Governments can aid in promoting high-quality, fair, and transparent industry standards. By the same token, to the extent that private regulation helps governments to solve or ameliorate problems they cannot overcome unilaterally or collectively, the rise of private

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26 For ground-breaking work on the trade implications of product labeling and the desirability of WTO conformity and consistency, see Wolfe, Baddeley, and Cheng (2012).

regulators need not diminish state power at all. In this respect, it might be more fruitful to think in terms of contestation and complementarity between public and private authority (see Büthe 2010, 22–3).

### Where Is Canada?

Canadian government policy supports the international harmonization of standards, both in the WTO at the multilateral level and at the regional and bilateral levels. A commendable initiative to weed out unnecessary inefficiency, duplication, and regulatory overlap in Canada-US trade is under way through the joint Regulatory Cooperation Council (RCC) as part of the bilateral “Beyond the Border” initiative. However, the RCC exercise focuses on cooperation in government regulation, not on private industry initiatives, and the RCC agenda does not include any effort to consider the impact of private rulemaking on Canada-US trade.<sup>27</sup>

Yet the Canadian government is not totally divorced from private-sector standard-setting. The Standards Council of Canada (SCC) is a Crown corporation that accredits the activities of four private-sector standard-setting organizations: the Canadian Standards Association (CSA), the Underwriters’ Laboratories of Canada (ULC), the Canadian General Standards Board, and the Bureau de normalisation du Québec.<sup>28</sup> The CSA and ULC are probably the best known of these private bodies, as anyone buying a consumer electronic product would likely be aware. Each has broad-

based industry membership and a transparent and consensus-based standard-setting program. Through the SCC, each is closely linked to the ISO and IEC as Canada’s agencies for certification of international consensus standards.

Notwithstanding the coordination role of the SCC, federal government monitoring and cooperation with other standard-setting bodies is spread through various departments and agencies. As examples, industry standard-setting in aviation and aeronautics is the responsibility of Transport Canada, food safety standards are under the jurisdiction of Agriculture Canada and the Canada Food Inspection Agency, banking and financial standards are the responsibility of the Department of Finance and the Bank of Canada, industry product standards are monitored by Health Canada, and industry-based standards in the “green” sector are the responsibility of Environment Canada.

Given the vast array of sectors in which industry plays a standard-setting role, centralizing federal government involvement and coordination in these many private-sector activities might be difficult. But the dispersal of responsibility for monitoring these activities is a shortcoming that warrants greater attention by Ottawa. Indeed, despite the huge impact that private industry norms have on international business activity, the federal government has undertaken no systematic evaluation of standard-setting organizations in terms of Canadian trade and investment. No general policy appears to exist to encourage and support key industry-based standard-setting bodies

27 No mention is made in the RCC *Joint Action Plan* (Canada 2011b) or in the Canadian government’s various reports on the matter of the effect of industry rulemaking or the activities of standard-setting organizations (see, for example, the reports issued by the RCC to date posted on the government’s website at <http://www.actionplan.gc.ca>).

28 These four bodies develop standards in a large spectrum of subjects and generally agree upon areas of specialty that reflect the expertise of their technical committees. Once a new standard has been developed, it may be sent to the SCC, where it will be evaluated to see if it meets the criteria of a National Standard of Canada. If it does, the standard is recognized and given the SCC’s endorsement. See the SCC’s website at: <http://www.scc.ca/en/programs-services/standards/directory-of-accredited-standards-development-organizations>.



within Canada's larger trade policy framework or to ensure overall consistency with Canadian public interest or with Canada's international trade and investment priorities. None of the policy reviews issued by DFAIT mentions of the role and impact of industry standard-setting bodies on Canada's foreign trade and investment performance (see, for example, Canada 2011a,e).

Given the private sector's growing role in the setting of international standards, Canada should determine how to benefit from this phenomenon by giving it a more central place in its global commerce and competitiveness strategies, particularly with respect to Canada's ability to benefit from global value chains. At the same time, a watchful eye needs to be kept on aspects of the phenomenon that might give rise to anti-competitive behaviour, or even to misinformation about the effect of certain products or activities that might disadvantage Canadian producers.

There is, however, a bright light in all of this. The Canadian government has a robust, if little-known, private rulemaking awareness program, launched in 2009 and aimed specifically at the Canadian mining and oil and gas sectors under the "CSR Strategy for the Extractive Sector" administered by DFAIT. The objective of the program is to promote and support Canadian companies in the extractive sector in implementing high-standard, industry-developed CSR performance guidelines abroad and improving their ability to manage social and environmental risks in foreign jurisdictions (see Canada 2009). A key part of the program is the role of the Extractive Sector Counsellor (see Canada 2011f). The program endorses a combination of intergovernmental and private industry CSR

standards, and uses the Canadian Institute of Mining, Metallurgy and Petroleum, the Mining Association of Canada, and the Prospectors and Developers Association of Canada as the industry vehicles for disseminating CSR norms and standards.<sup>29</sup>

A shortcoming is that the extractive sector CSR model is not applied to other sectors where Canadian business is active in foreign markets, either as suppliers of goods and technology or, importantly, as investors. Even data on the extent of credible private-sector standards and best practices, as we have seen, is dispersed widely across federal government departments and agencies.

## CONCLUSIONS

The use of private-sector standards, codes, and best practices – a kind of contemporary version of the medieval *lex mercatoria* – is a major and increasing factor in international business, illustrating that forces of economic self-interest can produce effective international standards, with market-opening effects outside state-to-state treaties or binding multilateral obligations. This phenomenon is happening even though recognition comes through the operation of markets, not through formalized dispute-settlement proceedings.

Although multilaterally agreed rules and disciplines under the WTO framework remain the ideal, the disappointing experience of the Doha Round provides little optimism that governments will put aside national politics and cherished positions for the sake of the global community at large. In such a world, private industry standard-setting has an essential role to play,

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29 Individual Canadian mining companies have been responsive to the need for applying high-quality CSR standards in their foreign operations. One of the best examples is Barrick Gold Corporation, which pays enormous attention to meeting these industry-developed social and environmental norms with a sophisticated and transparent set of company benchmarks; see the company's website at: <http://barrickbeyondborders.com>.

but governments, including Canada's, are paying insufficient attention to this increasingly important factor. Although I do not suggest that it interfere in the process of well-trusted and credible private standard-setting, the Canadian government could make a valuable contribution if it were to:

- identify *critical sectors* in which private standard-setting activities are having the greatest impact on Canada's trade and investment priorities; this should include assistance and advice to Canadian business – modelled after the CSR initiative for the extractive industries – to separate those standard-setting and certification bodies that are of merit from those that have less legitimacy;
- ensure that the *public interest* is properly identified and factored into the various efforts and activities of standard-setting bodies, not through diktat or regulation but through consultation and informal exchanges;
- promote *greater harmony and convergence* in private regulations through possible mutual-recognition arrangements and protocols at the international level and through other informal efforts at international cooperation;
- promote and encourage *openness and transparency* in standard-setting activities to aid in their broader legitimacy, both in Canada and abroad;
- discourage *anti-competitive standards* that permit less than full and open market forces to operate, and, where a concern is identified, consult with standard-setting bodies and in concert with like-minded governments to correct potential anti-competitive standard-setting;
- encourage the development of private standards that heed the *special needs of developing countries and emerging economies*, rather than those that respond only to corporate interests in western industrialized countries; and
- support acceptance by standard-setting organizations of the non-discrimination and other *core principles of the WTO Agreement*, including, where appropriate, the work of relevant WTO committees and other intergovernmental bodies engaged in keeping trade in goods, services, technology, and investments as barrier-free as possible.

All of this is in recognition of the impact of these private standard-setting bodies and the growing relevance of the new multilateralism – 21<sup>st</sup> century *lex mercatoria* – on Canada's trade and investment activities. Neither the federal government – nor the provinces – can afford to ignore the growing impact and the benefits of private regulation on Canada's international business and on global commerce generally.

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