

The role of regional agreements in trade and investment rule-making

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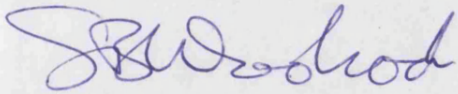
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Declaration

I declare that the work presented in this thesis is my own.

A handwritten signature in blue ink, appearing to read 'S Woolcock', written in a cursive style.

Stephen Woolcock

Abstract

The role of regional agreements in trade and investment rule-making

This thesis investigates the role of regional and bilateral trade and investment agreements in rule-making. Rule-making at the regional and bilateral levels has become more important, but there are at present no general criteria for assessing its impact. The thesis discusses the existing literature on preferential trade agreements and argues that there is a gap in terms of how rule-making in RTAs and FTAs might be assessed. An analytical framework is then developed that provides the basis for a qualitative assessment of the role of RTAs and FTAs. This framework is then applied to four horizontal case studies; technical barriers to trade, public procurement, investment and competition policy. These, together with secondary literature describing other case studies, show that rule-making is and has always been a multi-level process. The issue to be addressed in terms of the rule-making aspects of preferential agreements should therefore be what role RTAs and FTAs play in rule-making rather than whether preferential agreements undermine multilateral rules or not. The thesis argues that RTAs had a broadly positive effect during the period from the early 1980s to the mid 1990s, but that subsequent developments give rise to a more nuanced assessment. The thesis also makes a comparison of two dominant European Union and US approaches to regional and bilateral agreements. This shows the US approach to be more uniform and more assertive compared to the EU approach to negotiating FTAs. The thesis concludes with a discussion of how criteria developed from the analytical framework could be used as the basis for qualitative assessments of the role and impact of the rule-making aspects of regional and bilateral trade and investment agreements.

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Chapter One Introduction

1.1 The role of regional trade agreements (RTAs) in rule-making

This thesis investigates the role of RTAs¹ in rule-making² in trade and investment. Both RTAs and rule-making have become more important for the international system of trade and investment.³ It is therefore important to understand how rule-making at the regional and bilateral level relates to multilateral and plurilateral rules.

Whilst there can be little doubt that RTAs are now playing a more important role in trade and investment, the importance of rule-making is not universally accepted. Some trade analysts continue to argue that discussing ‘non-trade’ issues, by which they mean many but not all issues in rule-making, is at best a distraction from tackling the ‘real’ protection that remains in terms of tariffs and other market access issues, or at worse a cynical device to muddy the waters of WTO negotiations and thus retain more blatant protection. But with some important exceptions tariff liberalisation is now well advanced and tariff preferences have been progressively eroded. Tariffs remain more important for developing countries, but here the trend is also towards further reductions. The fact that some tariff and other forms of protection remain should not therefore be used as grounds for leaving aside rule-making.

Non-tariff barriers have assumed increased importance as tariffs have fallen. The more immediate trade-related non-tariff measures, such as safeguards, voluntary export restraints and anti-dumping duties, have been addressed by trade rules with only partial success. But experience suggests that governments (or regional entities) will insist that trade and investment liberalisation is accompanied by some form of safeguard, whether in the form of GATT Article XIX, anti-dumping or a ‘regulatory

safeguard.’⁴ The expectation must therefore be that the use of such safeguards or ‘contingent protection’ will continue and that these form part and parcel of trade policy. The existence of contingent protection is therefore also no reason for neglecting rule-making and its potential impact on the trade and investment regime.

In addition to recognised non-tariff trade barriers, a number of issues have emerged in which rule-making can have an impact as great if not greater than any remaining tariff barriers. These include rules of origin (RoO), technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures, public procurement, regulatory policies in a range of service sectors, investment, intellectual property, competition etc. As tariffs and conventional market access issues become less important these rule-making issues will assume a progressively more important role in shaping the trade/investment regime in the 2000s and beyond.⁵

Regional and other preferential agreements are assuming a greater importance in rule-making. There is less rule-making taking place at the multilateral and plurilateral levels of trade/investment negotiation. The World Trade Organisation (WTO), with now 150 members has not been able to agree on the inclusion of significant new rule-making in the current Doha Development Agenda (DDA). This, combined with the generally low level of ambition in the round, means that there will be less rule-making done in the WTO over the coming years than during the period between the early 1980s and the end of the Uruguay Round.⁶

At a plurilateral level the OECD has long played an important role in developing framework rules that have then been implemented in multilateral, regional and bilateral agreements. The OECD has been a forum that has facilitated the kind of policy-related research work needed for countries to assess the merits of various approaches to rule-making. But its strength in bringing together (relatively) like-minded states is also a

weakness in the current more global trade and investment environment in which all countries, including in particular the developing countries, desire a say in shaping rules.

This thesis will show that this relative lack of work on rule-making at the multilateral and plurilateral levels, does not mean that rule-making is not taking place. The focus of rule-making has simply shifted to the regional/bilateral level.

The nature of rule-making is such that precedents set - or rules shaped - now are likely to have long term implications. Tariff and other preferences are subject to erosion as multilateral liberalisation catches up. Although some writers emphasise the danger that tariff preferences create vested interests for the preservation of the preference and thus create inertia against multilateral tariff liberalisation, there has been a progressive decline in tariff preferences. Preferences in rules are likely to be more enduring than tariff preferences. Rule-making generally involves a larger number of domestic actors in negotiations. In a predominantly liberal trading environment, rule-making entails complex negotiations on the balance between liberalisation and other legitimate policy objectives. This makes rule-making rather more resistant to policy reform, especially when rules are anchored into regional agreements.

The potential impact of rule-making can be illustrated by a negative example. Assume that the approach to rule-making across important trade and investment issues diverges between the two major 'hubs', namely the EU and US. This 'regulatory regionalism' (van Scherpenberg, 1998) would result in increased costs for suppliers who would have to comply with different sets of rules in order to be able to operate in both markets. From a systemic point of view, divergence between the major regional groupings would make any reconciliation between the divergent rules problematic and weaken the prospects for future multilateral level rule-making. No progress on multilateral rule-making then means that regional preferences in rules-making would be

less subject to erosion. This is not to say that rules are *per se* barriers to trade. Some rules facilitate trade so that the issue of a regional preference does not arise or does not create difficulties. The question is which rules at the regional level facilitate trade and which risk creating 'regulatory regionalism'?

The existing literature on regional agreements assumes that deep integration, which includes large parts of the rule-making agenda, will be less discriminatory than market access provisions such as tariff preferences. (e.g. Winters, 1996) But this view is based on assumptions that have not been tested by much empirical work. Indeed, as set out in the literature survey in chapter two, most empirical work to date on both the welfare and systemic effects of preferential agreements has tended to concentrate on the trade creation and diversion effects of tariff preferences, or the impact of the more quantifiable trade provisions such as contingent protection and sector coverage of services. There has been work on the growth effects of deep integration at the regional level using imperfect competition models. This work suggests that such growth effects can significantly outweigh the relatively small trade diversionary effects of regional preferences (Hufbauer, 1995). But there has been little empirical work on the impact of rule-making in enhancing competition and growth, apart from the work on EU deeper integration in the form of the Single European Market. Much of the mainstream trade policy literature on regional integration has disregarded rule-making on the grounds that it is non-trade and should therefore be subject to policy competition. (Bhagwati, 1996) Even the 'political economic' models (e.g. Grossman and Helpman, 1994) are built on the rational choice type approaches in which sectors compete for tariff protection.

There are however the beginnings of a research effort to assess the broader impact of regional/bilateral agreements driven by the growth of these agreements and the evident fact that these are likely to become a permanent feature of the trading

system. The products of this research effort that are relevant to the thesis are discussed in the case study chapters four to seven.

1.2 The research questions

The aim of this thesis is therefore to fill a gap in the literature concerning the impact of RTAs on rule-making. The central question is what role does the regional/bilateral level of rule-making play? This involves addressing the impact of RTAs on the trade/investment system, as well as the signatories to agreements and third parties. But the focus of the thesis is on the systemic impact of RTA rule-making. This is close to what the existing literature has called the building versus stumbling bloc issue. (Lawrence, 1991)⁷ In other words are regional agreements building blocs for a wider multilateral system or do they stand in the way of such wider multilateralism.⁸ This means in turn establishing whether -and if so how - regional rule-making goes beyond existing agreed international rules, such as those in the WTO or other bodies and assessing the interaction between the regional and multilateral or other levels of rule-making?

In terms of the impact on signatories do RTAs facilitate trade and investment by, for example, providing a more predictable stable environment, or do they restrict trade by imposing inappropriate rules on weaker signatories. In terms of third countries, the question is whether RTAs result in higher regulatory standards that have restrictive effects equivalent to trade diversion, or in more transparent, less discretionary regulation at the national level that facilitates trade and investment?

The thesis also considers the role of RTAs over time and compares, in particular, the 'second phase of regionalism' (Bhagwati, 1991a) between the mid-1980s and mid-1990s, with the post Uruguay Round period.⁹ The thesis also compares the

approaches of the dominant 'hubs', namely the US and EU and assesses whether they are convergent or divergent. This has a bearing on the systemic impact of RTAs since divergent US (North American) and EU (European) approaches will create potential difficulties for the trading system by making it harder to make progress on future multilateral rules. Finally, the policy implications of the findings are discussed.

1.3 A summary of the findings

The case studies discussed in chapters four to seven all show that rule-making is a multi-level process. Rules tend to evolve over time as a result of a complex interaction between the different levels of negotiation and rule-making. This is not a new finding, but it is of importance to the discussion of RTAs/FTAs. If rule-making is a multi-level process then one must assess how the various levels interact, what are the respective roles of the different levels and how one can ensure they are complementary? This is a rather different approach to the regionalism versus multilateralism approach that has characterised much of the recent debate in that this assumes the two to be mutually exclusive.

The case studies compare the more recent developments in rule-making with earlier decades and show that rule-making has always been multi-level in nature. We are not therefore faced with an entirely new phenomenon in which regionalism is suddenly challenging multilateralism. Indeed, when it comes to rule-making, much of the post GATT 1947 rule-making has been initiated on levels other than the multilateral level. Whilst one can say that there was a multilateral tariff regime in the shape of MFN reductions under the GATT, the picture in terms of rule-making is much less clear cut. GATT embodied general principles of non-discrimination, but rule-making took the form of qualified MFN codes in the Tokyo Round. Much international rule-making also went on outside of the GATT, in the OECD and in regional or bilateral negotiations. So what is new about the recent developments is an increased role for the regional/bilateral level of rule-making, not the fact that rule-making is multi-level in nature.

A core finding of the thesis is that the interaction between RTAs and wider multilateral rule-making in the GATT/WTO during the second phase of regionalism

was, on balance, positive. Positive in this sense means that regional rule-making helped promote a more transparent, consistent and predictable environment for trade and investment that benefited signatories and third parties alike and was consistent with the continued evolution of multilateral rules for trade and investment. This positive balance was due to a number of factors. First, the regional initiatives were taken at a time when a liberal paradigm dominated the policy agenda. Thus regional and any bilateral initiatives were also, on balance, liberal. Second, there was a close synergy between the regional initiatives and multilateral negotiations during the Uruguay Round. The existence of an ongoing, comprehensive round of negotiations helped ensure that regional rule-making was consistent with the emerging multilateral rules. The point here is that it is not essential for the multilateral negotiations to always succeed, but there must be a credible multilateral route to rule-making if such negotiations are to discipline those negotiating at the regional and bilateral level. During the Uruguay Round the fact that serious efforts were being made to negotiate multilateral rules, led those negotiating RTAs at the time to ensure that the regional rules were consistent with multilateral rules. Third, the multilateral and main regional initiatives were based on common approaches to rule-making developed over the previous decade at a plurilateral level within the OECD. The dominant regional models, such as the US and EU-centred RTAs/FTAs, therefore drew on common origins. This, together with close transatlantic co-operation during the period between the main proponents of more extensive rule-making, namely the US and EU, helped minimise divergence between the main regional models and between them and multilateral agreements. Forth, the regional and bilateral agreements of the US and EU during the period did not go much beyond existing agreed multilateral rules, so there was less scope for 'selfish regional hegemons' (Bhagwati,

1991) using such agreements to force others to adopt rules that diverged from multilateral rules.

Analogous to trade creation, regional agreements during the period therefore tended to facilitate trade and investment by, for example, enhancing transparency, promoting improved regulatory practices or replacing multiple national rules with a single set of regional rules. The common regional rules generally did not set norms or standards at significantly higher levels than the former national norms and standards.¹⁰

The position after the end of the Uruguay Round is less clear cut. Since the late 1990s the liberal paradigm has been less dominant with opposition to further liberalisation contributing to the failure to advance rule-making at the plurilateral and multilateral levels. This is illustrated, for example, by the failure of the Multilateral Agreement on Investment in 1998 and the absence of significant rule-making on the Doha Development Agenda of the WTO.

Since the early 1990s there have been far more bilateral than regional agreements and more agreements have gone beyond existing multilateral rules. There are also more north-south agreements, hence greater scope for asymmetric power bargaining and for selfish regional hegemonies to use RTAs/FTAs as a means of pushing their own mercantilist interests. Agreements that extend rules beyond existing multilateral rules are not necessarily to the disadvantage of the weaker partner. It depends very much on the kind of rule-making that southern partners are adopting as a result of FTAs/RTAs with northern, more powerful trading partners. The case studies also show how bilateral or regional negotiations are being used strategically, either as alternatives to multilateral negotiations or as a means of setting precedents for wider multilateral rules.

The danger of regulatory regionalism has also grown since the end of the Uruguay Round. There are a number of general differences between the North American (US) approach to bilateral agreements and that of the EU. The US could be said to pursue an ‘enforced non-discrimination’ approach. This provides considerable policy autonomy on paper, because there is little emphasis on policy approximation or harmonisation, although the US seeks harmonisation on a more selective basis, where it is in its interests to do so. But the US approach includes tough and detailed enforcement provisions that facilitate private actions in cases of non-compliance. Coverage of agreements tends to be based on negative listing. Finally the US approach is uniform. The NAFTA model is effectively the starting point for all US FTAs although some recent agreements have gone beyond NAFTA.

In contrast, the EU approach tends to seek agreed, comprehensive rules even if these are to come only after a long transition period. The EU uses state-state dispute settlement in its bilaterals with third countries, although there is of course direct effect within the EU. This means that the private right to challenge decisions of other governments does not feature much in the EU FTAs. Finally, EU policy is not uniform. There are different generations of agreement with different types of partners. The internal *acquis communautaire* shapes EU policies just as domestic policies shape all trade agreements, but because it is not suitable for most FTAs with third parties it does not serve as a firm model.

Finally, the thesis discusses the relevance of the findings for policy. In the WTO there remains no agreement on criteria for assessing the compatibility of RTAs/FTAs with the Article XXIV of GATT 1994 or Art V GATS. Despite negotiations during the Doha Development Agenda (DDA) there has been no agreement to date on the definition of substantially all trade, let alone any agreement on what

criteria to use for assessing rule-making in RTAs and FTAs. The application of the analytical framework developed in chapter three provides the basis for a practical set of criteria for qualitative assessment of rule-making provisions in bilateral and regional agreements. This could, for example, be the basis for a simple ‘traffic light system’ (green, amber and red) similar to that used in the GATT rules on national subsidies.¹¹ This framework consists of core elements of rule-making including coverage, transparency/due process provisions, substantive rules/norms, cooperation provisions and enforcement.

Coverage of rules is an important element in any agreement. Where an RTA covers more sectors, regulatory entities or types of regulation than is the case for equivalent international agreements, a preference is established analogous to a tariff preference. But this preference will be subject to erosion as the coverage of rules at the international/multilateral level is extended. For example, an RTA may extend the binding application of rules to more sectors or to more sub-national regulatory agencies than is the case for WTO rules. The subsequent extension of coverage of WTO rules to cover these additional areas of regulation will erode the preference, so any negative effects should only be short lived. But as for tariffs it is possible that regional preferences on coverage create vested interests that will resist an erosion of the preference. So RTAs that extend coverage beyond that of multilateral rules should perhaps be given an amber light.

Provisions in bilateral or regional agreements that promote transparency in rule-making or otherwise open up the regulatory processes to greater scrutiny, will tend to have the effect of promoting better regulation. Such better regulation is likely to mean the use of clearer, more objective criteria as the basis for regulatory decisions and thus reduced scope for the abuse of regulatory discretion to limit competition or close

markets. Improved regulatory practice may also come about as a result of cooperation between governments or between regulatory agencies in different countries. This cooperation can pass on best practice and overcome difficulties of territorially constrained regulators dealing with global markets. So provisions on transparency, open decision-making/due process in regulation, and regulatory cooperation would get a green light.

Substantive rules that extend beyond agreed international norms or standards pose more of a potential threat for third parties and for the system. Substantive rules can take the form of standards (safety, food, intellectual property or environmental) or binding obligations that have a direct and immediate effect of limiting policy autonomy. For example, the use of specific contract award procedures in public procurement. Some substantive provisions will have a liberalising effect, by for example, pre-establishment national treatment for investment. The benefits of these for developing countries is a topic of considerable debate. These broad questions of the benefits of liberalisation are beyond the scope of this thesis.

The adoption of specific standards or regulatory norms in bilateral or regional agreements can be benign in that these facilitate trade by creating a predictable environment in which producers that comply with such standards or norms can expect to have uninterrupted access to markets. When anchored in formal agreements such rule-making removes or reduces the scope for the abuse of regulatory discretion to disrupt or close markets. The codification of regulatory norms and standards in formal agreements can also ensure that legitimate social or environmental policy objectives are pursued according to clear, objective criteria. Such positive, trade facilitating effects can result when a dominant party shapes the rules or through genuine common agreement between parties to an agreement.

On the other hand, regional and in particular bilateral agreements between a 'selfish hegemon' and weaker parties can result in the use of asymmetric power to impose standards or regulatory norms that simply serve the interests of the dominant party and are inappropriate for the weaker parties.

The adoption of regional standards or regulatory norms can also clearly have effects on third parties. The adoption of common standards or the use of mutual recognition or equivalence within a region offer economies of scale as producers can supply all national markets with products or services that conform to the same standards or norms. Clearly the level of the standard or stringency of the regulatory norm will affect the costs and benefits for each signatory. In the absence of strong regulatory competition (Woolcock, 1994) common standards or norms will be higher for some signatories. Thus the costs of adapting to the higher level standard or norm must be set against the benefit from increased economies of scale and predictability for suppliers from such countries.

The impact on third parties will also depend on whether benefits from the economies of scale reaped from the ability to export to a whole region using one standard or norm outweigh the costs of retooling or modifying the good or service in order to comply with the new regional/bilateral norm or standard.¹² As a general rule regional or bilateral norms or standards that are in line with agreed international standards will minimise the costs of adapting to new standards and maximise the scale economies, because one approximates to a position in which all markets can be supplied using the same standard or norm.

The adoption of divergent norms or standards in regional and bilateral agreements will also make it harder to establish agreed multilateral rules in the future. Rules that require the adoption of national or regional norms or standards that are not

consistent with established international standards should therefore be shown the red light. On the other hand, bilateral or regional agreements that require the adoption of existing international norms or standards and thus promote the use of such standards or norms should be given a green light.

This leaves the question of what constitute agreed international regulatory norms or standards. Many international regulatory norms or standards are plurilateral, such as is the case for public procurement rules, or have been drawn up by bodies in which most work is done by a minority of countries even though they are nominally international in nature (for example the International Standards Organisation (ISO) or the Codex Alimentarius of the World Health Organisation (WHO)). (Chen, Otsuki and Wilson, 2004) Some norms or standards may have been agreed as voluntary codes at the multilateral level. How should RTA provisions that require the application of such norms or standards be assessed? This thesis argues that binding regional rules based on recognised international norms and standards should generally be seen as compatible with multilateralism, even if the norms or standards are plurilateral or voluntary in nature. To argue that agreed standards can only be used if all countries (i.e. all 150 WTO members or all ISO members) have approved them, is to argue against agreed standards and is in any case contrary to the practice in international organisations.

The use of agreed international standards can be clearly distinguished from the case in which bilateral or regional agreements enforce the norm or standard of the dominant hub, which should be shown a red light.

Finally, there is the issue of implementation and enforcement. All rule-making in trade and investment leaves some ambiguity and is likely to include 'regulatory safeguards' that will need to be interpreted on a case by case basis. How the rules are interpreted and applied will shape their impact on signatories and third parties.

Divergent bilateral or regional interpretations of rules that are applied at both levels can also pose problems for the evolution of the international trade and investment regimes. Therefore regional of bilateral enforcement and implementation measures should also be shown an amber light, which implies scope for multilateral review of 'lower level' interpretations that diverge from interpretations in the WTO.

By applying the analytical framework developed in chapter three to the case studies, this thesis shows how such practical criteria can be developed to provide the basis for a qualitative assessment of the impact of regional and bilateral rule-making.

1.4 The contribution to research

As noted above and elaborated in the literature survey in chapter two, there is already a considerable literature on the impact of preferential agreements on the multilateral system.¹³ A good deal of this literature has focused on efforts to measure the static trade creation and trade diversionary effects of tariff preferences. This has been important work and there still remains an important role for such studies, especially when regional agreements have tariff reduction or elimination as a major aim.¹⁴ Generally speaking the results of much of this work on tariff preferences has been ambiguous. Although there are some cases in which regional agreements are clearly net trade creating or net trade diverting, (see chapter two for details), most studies have come to ambiguous results. For example, the work on the trade creation and trade diversionary effects of European integration in the 1970s found very small positive gains. This led many to conclude that political or other policy objectives were more important than economic objectives. It was not until imperfect competition models were developed and the growth effects of regional integration were measured in

the 1980s, that the economic analysis began to find significant economic benefits in European regional integration. (Baldwin and Venables, 1996; and Baldwin, 1989)

Recognizing the limits of static analysis, a number of economic models have sought to simulate the dynamic effects of regional agreements. In elegant economic models this work has sought to answer the question of the dynamics of increased preferences. The models are based on the assumption that tariffs are the only form of preference and that a regional preference leads to progressive bloc building. The models then look at the effect of such regional block building on the multilateral system. (Krugman, 1993) After stimulating a number of articles and modifications of the original model, this work is generally considered to offer little by way of further value added. (Winters, 1996)

There have also been 'political economic' models of RTAs in which governments are seen as utility maximising in retaining power and responding to given set of sometimes competing sector preferences. These rational choice models are equally based on tariff protection and the rather simplistic assumption that government utility maximisation is framed by the financial contributions of vested interests to party funds. Such models are of limited practical value because, in the search for a parsimonious theory, institutional and systemic factors are widely disregarded. (Grossman and Helpman, 1994a)

The international relations/political economy literature has addressed the question of motivations behind preferential agreements. (Higgot, 1997; Mansfield and Milner 1997) Generally speaking work in this field has come to the view that there are multiple motivations behind RTAs such as security, foreign policy, domestic reform, 'locking in' existing reform initiatives, commercial as well as economic aims. (Sampson and Woolcock, 2003; Schott, 2004; Aggarwal and Foggerty, 2004; Pelkmans

and Brenton 1999) This general finding is no doubt correct. Whilst the motivation to negotiate preferential agreements may often be political or strategic, there remains the question of what should go into any agreement? Here sector interests and institutional factors come to play a greater role.

As the case studies in this thesis will show, institutions and precedent are important factors in shaping rule-making and must be considered alongside sector interests. The starting point for any international rule-making will invariably be the domestic regulatory regimes in the major trading entities and in particular the US and EU,¹⁵ the 'hubs' in the regional and bilateral initiatives that have covered rule-making. Those negotiating international agreements will seek to ensure that the international rules are compatible with existing domestic rules. Domestic rule-making is the product of the interaction between a range of domestic stakeholders and regulators over an extended period of time. In the case of the EU, this means all the various national and EU interests and institutions. Established norms and institutional contexts will shape such domestic regulation/rules. Furthermore, precedent, or existing international norms or codes are used as a starting point for international rule-making. The case studies will again show how plurilateral OECD codes formed the basis of both multilateral and regional rule-making in the policy areas concerned. In other words rational choice explanations of the 'new regionalism' are in need of considerable qualification and elaboration as a means of explaining regional and other preferential initiatives. In terms of providing guidance for policy prescription on how to shape preferential agreements so that these are compatible with one another and with multilateral rules, political economy approaches appear to offer little as they try to explain RTA policies rather than suggest how regional rule-making interacts with international/multilateral rule-making.¹⁶

In the international relations literature regional or other preferential agreements tend to be seen as instruments of foreign policy, for example as a means of promoting economic and thus political stability in a partner country. Realist schools of international relations have seen bilateral or regional agreements as a tool of strategic competition or as a means of enhancing the relative gains for a country by imposing its norms and standards on 'partner' countries. This has been termed 'imperial harmonisation,' because the norms and standards that are imposed penetrate deep into domestic preference structures and policies. (Baldwin, 2000) But the international relations literature eschews discussion of the substance of RTAs, especially the detail of agreements and in trade as well as regulatory policy the detail is fundamental. As a result general theoretical propositions tend to be supported by selective case studies or anecdotes rather than systematic study. It is only through detailed analysis of the substance of agreements that one can assess whether such agreements serve a wider public good or purely the interests of a narrow vested interest.

Another important area of research work has been that dedicated to assessing the legal compatibility of RTAs with the WTO rules. This, along with the other approaches, will be discussed in detail in chapter two. Again there is a voluminous literature on this aspect of preferential agreements, but one that has made little progress because of the lack of agreement on how to interpret the legal provisions in article XXIV of the General Agreement on Tariffs and Trade (GATT) 1994 and Article V of the General Agreement on Trade in Services (GATS). Even this literature has been focused on tariffs in the sense that it has set about to clarify the interpretation of GATT Article XXIV provisions on 'substantially all trade' with regard to tariffs or, in the case of services, sector coverage. Some more recent work has begun to address the possible application of Art XXIV and GATS Article V to regulatory policy issues. (Trachtmann,

2002) But this has shown that the lack of any operational criteria for assessing the compliance of RTAs in the field of rule-making make things very difficult. Without some criteria to guide interpretation, there is no scope for Art XXIV to be more effective in disciplining regional and bilateral preferential agreements.

The approach adopted in this thesis therefore provides an elaboration of the rational choice approaches. It uses an approach similar to that initiated in the OECD in the early 1990s (Woolcock, 1996). More recent OECD work has looked at the linkages between the 'trade policy' of regional agreements and domestic regulatory reform. Within the OECD this formed part of a wider aim of studying how trade and regulatory practice interact, with a view to providing guidelines for what should be done to promote regulatory best practice. (OECD 1993a; OECD, 2000a; OECD 2002c) But the OECD work has, for political reasons, tended to eschew any detailed evaluation of differences between the predominant models of regional trade agreement, such as those emanating from the US and EU. Detailed work on a comparison, let alone an evaluation of the impact of these respective approaches, has been blocked by the US and EU.¹⁷ There have been similar constraints on work within the WTO, with the result that there was only very limited progress in the work on the systemic effects of regional agreements within the WTO Committee on Regional Trade Agreements (CRTA) after it was established in 1995. The WTO has, however, developed a valuable inventory of regional agreements, including all aspects of rule-making that are included in such agreements. (WTO, 2005) This thesis includes a comparison of the dominant approaches to preferential agreements and therefore provides an additional dimension to such work.

This brief summary of the existing work shows that there has been relatively little work on the impact of RTAs in the field of rule-making. There has also been

surprisingly little work that considers the detail of RTAs. Many authors have opted to avoid looking at the agreements article-by-article and schedule-by-schedule in preference for developing generalised models based on first principles. Here then is the gap in the existing literature that this work begins to fill.

1.5 Assumptions and normative questions

There are a number of assumptions on which this thesis is based that should be made explicit from the outset. The first assumption is that rule-making is- and will remain - an enduring feature of 'trade' negotiations and that there can be no clear distinction between rule-making and trade/market access issues. In research and policy making there has been a tendency to maintain or indeed create a clear distinction between trade and non-trade issues. In terms of research, trade economics has concentrated on tariffs and other border measures, such as anti-dumping, that have been defined as trade issues. Because much of rule-making is seen to be non-trade, it has tended to be neglected by trade economists, who argue that such issues should be left to policy competition between national regulatory jurisdictions.¹⁸ In terms of policy, negotiators have sought to draw a line between trade and non-trade issues. This line should then determine what is subject to international negotiation (the trade issues) and what should be left to national policy autonomy (the non-trade issues). In the policy debate this may be a simple expediency to facilitate negotiations, especially when there is no consensus on what areas of domestic regulatory policy should be subject to the discipline of international rules.

In reality, however, what is and is not a trade issue has varied over time and is likely to continue to do so. At the time of the GATT 1947 the scope of rule-making was essentially limited to non-discrimination, although the Art III national treatment

provisions of the GATT 1947 could have had quite far-reaching implications for national regulatory autonomy had they been effectively enforced. By the time of the Kennedy Round, the definition of trade extended to include a number of the more immediate non-trade barriers such as anti-dumping rules. By the 1970s the definition of a trade issue extended to include technical barriers to trade and public procurement, two of the case studies included in this thesis, as well as national subsidy/industrial policies, an issue touched upon in the competition case study. By the 1980s 'trade' included national investment policies, regulatory policies on a wide range of services, intellectual property rights and food safety standards etc. So what constitutes a trade issue and therefore subject to negotiation within the GATT has clearly evolved over time.

As the case studies in this thesis will clearly show, rule-making will continue to be included in agreements, if not in the World Trade Organisation then in regional, bilateral or plurilateral agreements. To argue that rule-making should be left out of the WTO is to argue for it to occur on other levels, not that it will somehow disappear.

Similar arguments can be made against simplistic distinctions between market access and rule-making issues. In the current DDA as in other negotiations, such a distinction may be expedient, but it cannot and should not be the basis for research or longer term policy analysis. Rules shape market access just as profoundly as tariffs have in the past. For example, there can be little doubt that national or regional sanitary and phytosanitary regulations can determine whether a particular market is open or closed. (Isaac and Kerr, 2004; Isaac, 2006) The nature of rules governing public procurement will determine whether these markets, which account for 8% of GDP in the industrialised countries, are open or closed. (Hoekman and Mavroides, 1997) Investment rules will determine whether market access can be achieved through establishment. The nature of the investment regime in a country will therefore have a

profound effect on market access. One could continue to name areas of rule-making, such as most service sectors, technical regulations and standards, competition that all affect and have been recognised as affecting market access.

If rule-making affects market access simply leaving rules on one side is not a practicable option. Domestic rules serve to balance liberal, competitive markets with other legitimate policy objectives and so cannot be removed lightly. International rules seek to ensure that domestic rules do not constitute unnecessary impediments to trade or investment. Indeed, international rules serve to facilitate trade by, for example, promoting transparency and predictability.

The danger is that divergent regional rules can develop. So there is a clear need to ensure that rules at different levels are compatible. This means in particular that regional rules and wider international or multilateral rules need to be compatible.

1.6 Definitions

There is a need to clarify a number of definitions. The traditional classification of regional market integration includes a progression from *free trade agreements*, (in which tariffs and border measures are removed among the participants, but each country retains its own tariff policy), through customs unions (with common external tariff), to single or common markets (with free movements of goods, services, capital and labour) and monetary or economic unions (which involve significant policy harmonisation or convergence i.e. of economic policies, single currencies etc.). Whilst useful in terms of defining different degrees of integration in general terms, this progression has a number of limitations.

One objection is that the use of the term *free trade agreement* (FTA) that is widely used in the public debate, implies that the agreements concerned are promoting liberal

or free trade. Many authors would challenge this view or at least argue that it is not proven that 'free trade agreements' in general are more trade creating than trade diverting and can therefore be classified as promoting liberal trade. For this reason many authors prefer to use *preferential trade agreements* (PTAs) to describe agreements between a limited number of countries. This more accurately reflects reality in the sense that these agreements include preferential tariffs for signatories over other parties. The word preference also has a negative connotation that suits opponents of such agreements.

Regional trade agreements (RTAs) is a term that has been widely used in the literature and is often used as synonymous with FTAs. The main distinction between the two, of course, is that an RTA implies that the signatories to the preferential agreement are contiguous countries or within the same region.¹⁹ This may affect how one might assess such agreements, because there is an argument that 'regional trade agreements' distort trade less than agreements between non-contiguous countries. This is because RTAs reflect traditional or natural markets with relatively low transport costs, so that one might assume that agreements between such parties will generally be less likely to lead to trade diversion. (Frankel, Stein and Wei, 1995)

This raises the problem of determining what is a region? Anderson and Nordheim (1993) suggest a pragmatic definition based on the 'major continents and subdividing them according to a combination of language, religion and state of development criteria'. But common identities and values may also be important factors, especially when considering the rule-making aspects of trade and investment agreements. Common values and norms can provide the basis for deeper integration agreements and may not be limited to geographic location. (Katzenstein, 1997)

Not all agreements concluded are however between countries within the same region, indeed many of the agreements concluded in the late 1990s and 2000s are *bilateral trade agreements* rather than regional agreements. The term RTA is however, still used in this thesis as a generic term to describe preferential agreements that may be between countries in the same region or between countries that are not.

At a somewhat different level there are *plurilateral trade agreements*, such as those concluded within the OECD between like-minded countries or countries that have similar approaches and expectations in terms of rules, norms or standards. The term plurilateral implies a level between the regional and multilateral level. Plurilateral agreements also tend to be deeper or more binding than multilateral agreements. But again the distinction in practice is less clear cut. There are for example, plurilateral agreements concluded within the WTO.

Another problem with the terms preferential, free or regional 'trade' agreement is that they imply agreements that are limited to trade i.e. measures at the border such as tariffs or quantitative restrictions. Many agreements concluded today go further than this to address a range of regulatory or non-tariff barriers. This is the case even though such agreements do not (with a few exceptions, i.e. the EU, Mercosur, South African Customs Union (SACU) and EU-Turkey) create a customs union or what might be seen as a single or common market. For example, the North American Free Trade Agreement (NAFTA) goes beyond tariff and border measures to include investment and services as do all the US-centred 'free trade agreements.'

Regional integration agreement is a term that has been used to encompass this deeper coverage. Indeed the term deeper integration agreement is sometimes used when a degree of positive integration is involved.²⁰ But again there is the difficulty that not all deeper integration agreements are regionally limited. Up to the 1990s deeper

integration was generally limited to contiguous countries with similar levels of development and similar domestic regulatory policies. But in recent years agreements between countries at different levels of development have increasingly included elements of deeper integration, such as investment.

Terms such as *regionalism and regionalisation* are also widely used in the literature. It has been suggested that regionalisation should be used to describe increased trade and investment flows due to the proximity of markets (Fishlow and Haggard, 1992; Tovias, 2000) while regionalism should be reserved for the political processes (Kupchan, 1997). The point here is that a 'regionalisation' of the world economy may occur independently of any political action such as the conclusion of a preferential agreements. Intra-regional trade and investment flows between countries that have not concluded regional agreements can be higher than those between countries that have. Regional trade agreements have also *followed* increased regionalisation rather than *created* closer economic relations. The south-east Asian economies in the early 1990s exhibited intra-regional trade flows of nearly 40% despite the absence of significant regional trade and investment agreements. Indeed, intra-regional trade within the formal ASEAN area was much lower than the overall level of intra-regional trade with the wider Asian region.

This study is concerned with the role of regional and bilateral agreements in the multilateral system, and one of the questions it addresses concerns the impact of regional rule-making on multilateral rules. This poses the question of what is meant by multilateralism. *Multilateralism* can be understood as a system that ensures non-discrimination and facilitates progressive liberalisation. (Bhagwati and Panagariya, 1999) ²¹ In the context of tariffs and other border measures this is fairly straightforward. Non-discrimination means the extension of any tariff reduction

between countries to all others under the most favoured nation (MFN) principle. It also means treating like-products from other countries the same as nationally produced goods (national treatment). Limiting a definition of multilateralism to non-discrimination would mean that the strict application of MFN and national treatment would suffice.

The definition of multilateralism in the field of rule-making is rather less clear cut. First of all national treatment and MFN does not guarantee liberalisation. Each country can retain its own rules on investment, technical barriers to trade, procurement and competition to take the case studies discussed in this thesis, and be consistent with non-discrimination. But these rules might set such high standards that markets remained effectively closed. For example, countries could retain public monopolies, as many did until recently in telecommunications or other utilities, and be consistent with non-discrimination. Both foreign and national competitors are excluded from such markets and therefore treated equally. In other words the progressive liberalisation element of multilateralism is not satisfied in this case.

To turn the discussion on its head does multilateralism mean that the rules should be adopted by all countries. In the telecommunications case discussed above, this might mean that all countries should adopt measures that facilitate a progressive liberalisation of telecommunications markets, whilst ensuring effective regulation. Such common rules are set out in the so called Reference Paper for Basic Telecommunications adopted under the auspices of the GATS in 1997. But this agreement is in fact a plurilateral agreement. Not all WTO members have (yet) agreed to implement the measures.²² Therefore is the adoption of such common policies within the WTO multilateralism? Many liberal economists would argue that policy harmonisation is illiberal because it removes or reduces policy competition between

national governments and locks all into potentially unsuitable rules. But if national governments can devise different rules that constitute effective barriers to competition can one call this multilateralism?²³

This can be illustrated by the case studies. For example, national technical regulations or voluntary standards have been recognised as being an important barrier to trade. The WTO rules on TBTs require national treatment and MFN. But they have done so since the 1970s without having any appreciable liberalising effect. Indeed, one could argue that the progressive introduction of new national regulations and standards consistent with the rules on non-discrimination had in fact resulted in market closure.

This thesis uses the various terms discussed above to describe as accurately as possible the type of agreement being discussed. For example, if the agreement is a bilateral free trade agreement it will be referred to as such. If the agreement includes only contiguous countries it will be referred to as a regional agreement. But in line with much of the existing literature in general discussion the generic term 'regional trade agreement' (RTA) will be used.

The case studies in this thesis are concerned with rule-making behind the border as distinct from border measures, such as anti-dumping and safeguards. But there are close links between different areas of rule-making. As pointed out above, rule-making is also distinct from tariffs. But a clear distinction is not made between rule-making and market access issues, since rules often determine market access. Chapter three provides an analytical framework that breaks down rule-making into its component parts.

1.7 Methodology

There is no general theory covering the role of RTAs or other preferential agreements in rule-making. But it is possible to use some analogies with existing

customs union theory, such as the degree of preference, trade creation and diversion and optimal tariffs. These are discussed in chapter three on the analytical framework. Chapter three also develops the analytical framework that breaks down trade and investment agreements into a number of key elements.

The analytical framework is then applied to a series of horizontal case studies. Each horizontal case study addresses the core research questions. The agreements included in each case study are all those that included rule-making in the respective policy area during the period of study. Thus the case study on TBTs looks at all agreements, whether bilateral, regional, plurilateral or multilateral that address TBTs. The degree of coverage is determined by how important the provisions are so that little time is spent on agreements that simply contain broad policy aims of ensuring compatibility of standards, whereas more space is given over to agreements that cover all aspects of TBTs.

The horizontal case studies enable a detailed comparison of the provisions of the RTAs with the existing multilateral provisions or principles within the WTO. Through this detailed analysis it is then possible to identify the areas in which agreements go beyond the WTO, where the various regional agreements diverge from WTO principles and where there are differences between the respective preferential or regional approaches. In this way the coherence between the approaches adopted by the regional agreements and the multilateral system can be assessed. It is also possible to identify similarities and differences in the dominant models of regional or free trade agreements.

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In order to assess the evolution of rule-making over time, each case considers rule-making in the period up to the 1980s, developments in a period from the mid 1980s up to the mid 1990s, and then the post 1994 period. The period from the mid 1980s to

the middle of the 1990s was also chosen as the main period of study because this was the time when the so-called “second phase of regionalism” occurred. Due to limitations of space the period up to about 1985 and after 1995 are treated somewhat less fully.

This methodology inevitably has a number of limitations. It is focused on the texts of the agreements, albeit with some assessment of the preference patterns that went to shape them. It is therefore still a relatively static approach. In some cases and especially for the more recent agreements, there remains a question of whether - and if so how - the rules will be implemented. There is also a limited discussion of how the rules impact upon market actors. Each case study draws on the relevant existing quantitative assessments of the effects of rule-making, but the thesis contains no new quantitative assessment.

1.8 The case studies

Chapters four to seven contain the four case studies. These have been chosen to cover different types of policy. There is one policy area in which multilateral rules have been in existence for some considerable period of time (technical barriers to trade/SPS), one in which there are plurilateral rules but no multilateral rules (public procurement), one in which there are only a few elements of multilateral rules (competition) and one in which an international regime exists in the form of a patchwork of different rules at different levels (investment).

Technical barriers to trade (TBTs) have long been recognised as a significant issue in trade relations and rule-making on TBTs has been incorporated in a range of different agreements. Indeed, TBTs are generally one of the first topics after tariffs to be addressed in any negotiations. Forty percent of cases brought in WTO dispute settlement involve TBTs, which indicates their importance in trade. Rules on TBTs

cover three types of rule-making: mandatory technical regulations introduced by national governments or regulatory bodies to ensure specific health or safety standards; voluntary standards developed by standards making bodies, which may be public or private; and conformance assessment, such as certification and testing of products. The adoption of common regulations, standards and conformance assessment can be seen as facilitating trade by enabling compatibility between products produced in different countries or enabling producers outside a market to easily match consumer preferences in a market. But harmonisation is often difficult and other methods have been used such as equivalence, mutual recognition of test results or full scale mutual recognition.

A short section on SPS is provided in order to contrast the development in this policy areas with that of TBT. SPS rules emerged out of TBT rule-making because of a desire to establish more stringent rules for food safety. The WTO SPS rules which integrate agreed international standards on food safety in the form of the Codex Alimentarius, provide a more controversial example of rule-making in the field of standards.

Public procurement accounts for about 8% of GDP in developed economies and is of considerable importance in the larger developing economies. This topic was discussed at the Havana negotiations on the International Trade Organisation (ITO) in 1948, but explicitly excluded from the multilateral rules drafted at that time. This exclusion of public procurement was extended to the GATT. Ever since 1947 there have been attempts to introduce rules on public procurement into the multilateral system of rules. Despite work at a plurilateral level in the OECD and various regional initiatives, there has to date been no success introducing rules that apply to all WTO Members, although two Government Purchasing Agreements (GPAs) have been negotiated within the context of the Tokyo and Uruguay rounds of the GATT. The

negotiations leading up to the adoption of the July 2004 Framework Agreement on the Doha Development Agenda effectively dropped public procurement from the multilateral negotiations (along with the other rule-making issues of investment and competition). Procurement therefore provides a case in which there has been debate of rule-making at various levels for some time and one in which plurilateral and regional agreements have prevailed.

Investment is of central importance to the international economy and a policy area in which regulation and rules determine the degree of market access. Investment, another of the so called Singapore issues, is included in bilateral, regional, plurilateral and multilateral agreements. Although there is no single comprehensive set of rules for investment, one could say that an international regime exists in the shape of this patchwork of rules on different levels. Investment, like government procurement and competition, has also been subject to much recent debate on the merits of its inclusion in multilateral negotiations. The investment case therefore enables one to observe how interaction between different levels of rule-making shapes policy outcomes.

Finally, the case of competition policy provides another example of a key horizontal policy area in which domestic rules can have a profound effect on markets. As markets have become more and more global the tension between the territorial limits of national competition policies and global markets has increased. This has led to a range of different responses, at different levels of rule-making. Provisions on rule-making have been debated and introduced at the bilateral, regional and, in a weaker or softer form, at the multilateral level. Competition is a case in which the debate on international rule-making has been relatively recent. Compared to the cases of TBT and procurement, where rule-making goes back to the 1960s and 1970s or to investment where precedents in investment rules go back to the 1950s if not the 1880s,

international agreements on competition have been influenced more by developments in the 1980s and 1990s. It therefore provides insights into how thinking on rule-making may have changed over time, for example, towards the use of soft law at the international level, such as in the 'UNCTAD Set' but harder laws in bilateral and regional rule-making.

The approach adopted in this thesis is equally applicable to other cases. Indeed, Isaac has used it in a more comprehensive study of SPS measures in RTAs, in which he shows how regulatory regionalism can emerge when different approaches to the regulation of risk find expression in FTAs/RTAs. (Isaac, 2006) In services the approach has also been used and has shown what appears to be a synergistic relationship between regional and multilateral rule-making. (Ullrich, 2006) The application of the approach to rules of origin (De Lombaerde and Garay, 2006) illustrates how the vacuum left by the absence of active multilateral rule-making is likely to be filled by divergent regional rules. But it also shows that careful detailed study of the substance of rules can pick out patterns in the otherwise diffuse 'spaghetti bowl' of different rules of origin. Garay and De Lombaerde illustrate, for example, how two dominant models of rules of origin are emerging in the form of the NAFTA and the Pan-Euro systems. Application of the approach to the case of intellectual property rights has illustrated that the interaction between levels of rule-making is not mono-causal. For example, stringent multilateral rules were adopted in the shape of the Trade Related intellectual Property (TRIPs) rights agreement in the Uruguay Round. But the subsequent interpretation of these rules, such as the Doha Declaration of 2001, have toned down the stringency of obligations, a fact that has arguably led to a renewed interest in using RTAs and bilateral agreements to firm up the rules. (Pugatch, 2006)

These other applications of the analytical framework show the general applicability of the model, and provide further empirical material on the interaction between levels of rule-making, which this thesis has been able to draw upon.

Endnotes

¹ As discussed in more detail in section 1.6 the term regional trade agreements (RTAs) is used here as a generic term to describe a range of preferential agreements. One of the central aims of the thesis is to illustrate how rule-making emerges from actions on a number of different levels of agreement. Therefore it looks at rule-making wherever it occurs; in bilateral, regional, plurilateral and multilateral agreements.

² Rule-making is the framework of specific rules that define the scope of government and/or regulatory intervention with a view to establishing a predictable environment for trade and investment. Such frameworks can be liberal or illiberal, but when used in the pursuit of liberalisation objectives they define the limits of national regulatory autonomy. In concrete terms rule-making applies certain general principles, such as non-discrimination, with regard to a range of non-border measures, by for example, requiring the use of national treatment or MFN in the application of national policy. Rule-making can also set out specific obligations on governments or regulators (and occasionally private actors) with regard to; (i) the transparency of national regulatory measures (statutes, secondary instruments, standards etc); (ii) the procedural practices to be used applying such measures; (iii) the use of standards (both those embodied in the text of any rule and existing international standards); and (iv) the implementation and enforcement of the rules. This definition of rule-making is extensively expanded upon in chapter 3. In the practice of trade negotiations rule-making can be distinguished from market access (i.e. tariff concessions or commitments on sector coverage of agreements) that constitutes the reciprocal nature of trade negotiations. In practice there is, however, no clear dividing line between rule-making and market access. In terms of the existing literature rule-making is a somewhat broader term than 'deeper integration measures' in that rule-making could also include rules on topics such as rules of origin which are not deep integration. In terms of the international relations and IPE literature the use of the term rule-making has much in common with a 'regime' in the classic Krasner definition, but in this thesis we are only concerned with the explicit, concrete provisions in regional or bilateral trade and investment agreements. The generally accepted definition of a regime also includes more informal arrangements and expectations.

³ It should be stressed at the outset that not all RTAs include extensive rule-making, although those between developed countries and an increasing number of agreements between developed and developing countries do. Many RTAs still focus on tariffs, especially those between developing countries.

⁴ Chapter three covers the topic of regulatory safeguards, arguing that these form part of rule-making, just as Art XIX-type safeguards or the use of anti-dumping actions as *de facto* safeguards have been used for market access in goods.

⁵ Tariffs will only become more important if there is a general regression towards increased tariff protection, which appears unlikely. A more likely scenario is a return to the 'new protectionism' of the 1970s and 1980s when various forms of quantitative restrictions and anti-dumping duties were used to protect industries.

⁶ This is not to underestimate the work that does go on in the various working groups of the WTO on rule-making. Even in the contentious fields of the 'Singapore' issues the WTO Working Groups did a considerable amount of work. But this technical work appears unlikely to result in any significant WTO agreements on rule-making.

⁷ Hufbauer (1995) attributes the concept of 'building versus stumbling blocks' to a lecture by Bhagwati at the Trade Policy Research Centre in London in 1991, although Lawrence appears to be the first person to use the term in a published work.

⁸ The 'building versus stumbling blocs' question generally entails a normative preference for multilateral rule-making. The premise of this thesis is that regional rule-making must be compatible with multilateral

rules, but that rule-making is multi-level and that the interaction between the levels should be understood as being a two way process.

⁹ This is the author's definition of the 'second phase of regionalism. Bhagwati (1991a) sees the second phase as beginning in the early 1980s, but does not give a cut-off date. I define the end of the Uruguay Round as the end of a second phase because the scope and nature of RTAs/FTAs changed significantly after that.

¹⁰ There was still upward pressure on standards resulting from a desire on the part of consumers for higher safety, food or environmental standards. But this increase was not related to RTAs, with perhaps the exception of the EU where moves towards common food standards resulted in higher standards among some EU Member States that had previously lower standards.

¹¹ Hufbauer (1995, pg 2) proposes this type of approach to regional agreements arguing that 'sophisticated analysis of the relative costs and benefits of regional versus WTO liberalisation will make little difference to the development of institutions' and that 'regional groupings will increase their role [but] the WTO will continue as an institution of substance'. Hufbauer argues for 'understandings as to what subjects are best addressed multilaterally and what regionally'. This kind of once and for all assignation of levels for any given policy does not chime with the reality of multi-level rule-making described in the case study chapters 4 to 7 in which different levels appear to have different functions within any given policy area.

¹² See Chen and Mattoo (2006) for a discussion of these issues with regard to standards. For a discussion on these issues see case study four on technical barriers to trade and in particular endnote 7.

¹³ For useful summaries of this literature see Bhagwati, Krishna and Panagariya (1999) and Krueger (1999).

¹⁴ The current interpretation of Article XXIV of the GATT 1994 that governs preferential agreements is that free trade agreements and customs unions must eliminate tariffs on 'significantly all' trade within a period of 10 years.

¹⁵ The EU pressed for the inclusion of the Singapore issues (investment, competition, government procurement and trade facilitation) in the WTO even though sector interests in the EU were not always very supportive. The institutional structure of EU trade policy making, with the European Commission and Member State officials largely shaping policy and collective decisions of the 25 (27) EU member states, does not leave much very much scope for electoral calculations and specific sector lobbies, except in exceptional circumstances. (See Woolcock, 2005)

¹⁶ Work on modelling the strategic use of preferences in multilateral negotiations and vice versa is however an exception here.

¹⁷ Work in the OECD on regional agreements is subject to some control by the committees and working parties responsible. These have tended to hold back work on regional agreements for political reasons, for example, when most OECD countries favour giving multilateral negotiations priority in the work of the OECD.

¹⁸ See for example Bhagwati 1996 for a comprehensive statement of this argument and contributions on the debate as to whether there is a case for policy harmonisation.

¹⁹ It is also necessary to distinguish between the EU, which has gone significantly deeper in integration and other regions. In the thesis internal EU developments are considered because they impinge upon international rule-making, but it is the FTAs the EU has negotiated with other countries that are more analogous to FTAs negotiated by other WTO members.

²⁰ Positive integration occurs when agreements go beyond the removal of barriers to trade (negative integration) and encompass a degree of policy approximation or harmonisation.

²¹ In discussion of international trade there is a tendency to equate multilateralism with the WTO and other international institutions. In international relations a narrower definition is used, which sees multilateralism as being agreements between two or more countries.

²² Plurilateral agreements are those concluded between like-minded countries or countries at broadly the same level of development that are not necessarily within the same region.

²³ For a general discussion of the debate on regulatory competition versus harmonisation of policies see Woolcock, 1994

²⁴ There is a qualitative difference between the degree of integration achieved within the EU and that achieved in other agreements. For this reason the EU *acquis* is unlikely to provide a model that will be adopted in its entirety by other countries or by the EU's trading partners, unless they are seeking EU accession. For this reason the EU *acquis* is treated more as a set of 'domestic' regulatory norms than a model for wider RTAs.

Chapter Two Literature survey

2.1 Introduction

This chapter discusses the existing literature on regional trade agreements. It first looks at the literature on the history of preferential and regional agreements during the interwar period. The negative impact of preferential tariff agreements during this period has had a significant impact on perceptions of RTAs and therefore needs to be understood. The historical section then moves on to discuss the post 1945 literature, which has identified two phases of regionalism, one in the 1960s and one starting in the early to mid 1980s. The chapter considers the recent literature on regionalism and asks whether the world has not entered a third phase of regionalism characterised, among other things, by a more explicit use of multilevel rule-making by the major trading partners.

There is a good volume of literature on the motivations behind regional and bilateral agreements. This is summarised in section three, which is then followed in section four by a discussion of the economic, political economy and legal/institutional literature on the impact of regional agreements and their compatibility with the multilateral system. This is followed by a discussion of the building bloc versus stumbling bloc argument that touches directly on the topic of the thesis.

The argument made in this chapter is that there is a gap in the literature with regard to detailed empirical work on the impact of regional and bilateral agreements in the field of rule-making, which this thesis addresses. The literature on the motivations behind RTAs/FTAs looks at the driving forces shaping these initiatives, but does not look at their impact on the trading system. Economic literature on the static and even the dynamic effects of preferential agreements is predominantly tariff based and where it considers the impact of rule-making or deeper integration it fails to look at the detail

of regional/bilateral rules and how these interact with other levels of rule-making. The building versus stumbling blocs debate poses the right sort of question, but the empirical work in this field is rather thin, with much of the debate based on very broad generalisations.

2.2 The historical context of the current debate

2.2.1 The pre-1914 and interwar periods

Historical studies of the international trading system illustrate that trade policy has always been a mixture of unilateral, bilateral, regional, plurilateral and multilateral policies and initiatives. The 19th century liberal system was built up by bilateral trade agreements with MFN clauses that extended liberalisation to third parties. Many of these bilateral agreements contained MFN exemptions for customs unions in order to accommodate the network of customs unions that existed in the 19th century. The German Zollverein (initiated in 1815) was the most important ‘hub’ of these customs unions, but there were also clusters of customs unions involving Austria and South Africa as well as a number of customs unions involving small states. (Viner, 1950 pp 141 *et seq* for a list)

The 19th century practice was to provide exemptions from MFN in commercial agreements for customs unions provided the latter were complete. In other words, the precedent of customs unions covering ‘substantially all trade’ (to use GATT terminology) was already established during this period. Historical studies drawing on the pre-1914 period have, for the most part, concluded that customs unions and other preferential agreements can be good or bad depending on the case in point and the wider circumstances. (Viner, 1950; Irwin, 1993)¹

The assessment of preferential agreements in the interwar period is rather more complex. Preferential and bilateral agreements have been linked to the collapse of international trade during the 1930s, but a number of studies have suggested that restrictive FTAs simply reflected the economic nationalism of the period. The pernicious bilateralism of Schacht's foreign economic policies in Germany during the 1930s was based on blatant restrictions such as quotas and above all currency controls rather than trade preferences with southern and eastern European countries. (Irwin, 1993, pg 106) Some quantitative work using gravity models shows that the regionalisation of world trade that occurred in the 1930s was noticeable before the conclusion of the preferential trade agreements (PTAs), suggesting the regionalisation of trade was due to historical trade patterns as well as PTAs. (Eichengreen and Irwin, 1995)

Regional and plurilateral initiatives were taken to try and break the cycle of protectionism and declining trade flows during the 1930s. For example, Belgium, Luxembourg and the Netherlands proposed 50% tariff reductions using a formula approach in the treaty of Ouchy in 1932. This was blocked by Britain, which was not willing to waive its MFN rights with these countries, even though a year later it introduced (higher) imperial preferences in the Ottawa agreement. (Condliffe, 1940) In 1937 the Benelux countries tried again to initiate regional trade liberalisation, this time including all the Nordic countries, only to be blocked again by Britain. (Irwin, 1993)

Plurilateral or 'collective' initiatives were also considered in the League of Nations and were discussed at the 1933 London Monetary and Economic Conference. At this meeting Cordell Hull, the US Secretary of State, who led the US delegation, produced proposals for criteria to determine whether such plurilateral agreements would be compatible with the maintenance of an open trading system. These criteria reflected

discussions in the League on preferential agreements and provided the basis for the provisions of the 1948 Havana Charter on customs unions and free trade areas.² The US went on to use the same criteria in its proposals for a Pan American Union in 1939. (Viner, 1950)

The literature on the history of customs unions and other preferential agreements therefore shows that these contributed to liberalisation during the 19th century thanks to the widespread use of MFN clauses in preferential tariff agreements. In terms of the interwar period the literature allows for varying interpretations of the impact of RTAs. In addition to the interpretation that they contributed to the general economic malaise of the period, the predominant interpretation, one could argue that preferential agreements and RTAs were protectionist because of the general drift of national policies during the period. (Oye, 1992) It was the restrictive regional and bilateral agreements that were adopted. The liberal initiatives, such as those proposed by the Benelux countries, were not successful. In the current era one might similarly argue that the second phase of regionalism went hand in hand with a general liberal trend in trade and investment policies, whereas the post Uruguay Round period has seen a questioning of this liberal paradigm. A reading of the history therefore suggests a more nuanced and complex picture of the interaction between the different levels of trade negotiation and policy in which bilateral, plurilateral and regional agreements could be good or bad depending on the agreement itself and the wider economic and political context. This view is consistent with Viner's interpretation of the historical record. (Viner, 1950)

Another interesting finding from this brief summary of the historical literature is that the current GATT criteria for determining the compatibility of preferential agreements with the wider multilateral system are the product of an approach developed in the League of Nations in the 1930s. The criteria that tariff preferences could be

considered compatible with multilateralism if they covered ‘substantially all trade,’ appears to date from work carried out in the League of Nations in the 1930s. These criteria were promoted by Cordell Hull in the 1930s, were inserted into the Havana Charter and thus found their way into Art XXIV of the GATT 1947.³

2.2.2 Two phases of regionalism in the post 1945 period

The post war trade regime provided for free trade agreements and customs unions in article XXIV of the GATT. This applied the rule that RTAs would be considered compatible if they covered ‘substantially all trade.’ But the US emphasis on multilateralism in the late 1940s ensured that this was not used as a means of undermining multilateralism. Article XXIV was more a means of providing exemptions for a number of small customs unions. (Krueger, 1999) Seven customs unions survived the war and the Benelux customs union had been just about negotiated, though not implemented, in the summer of 1947.⁴ Subsequently a considerable body of literature has been produced on the question of the legal compatibility of preferential agreements with Art XXIV of the GATT (and the equivalent Art V of the General Agreement on Trade in Services (GATS)). See section 2.4.5 below.

Bhagwati identifies two phases of post WWII regionalism. (Bhagwati, 1991a). The first began with the negotiations in Messina on the establishment of the European Economic Community and the Treaty of Rome in 1957. The success of the EEC and the dynamic growth in trade it generated led to emulation of the European approach in a range of African and Latin American RTAs. The developing country RTAs were seen as a means of reaping economies of scale for indigenous industries in the developing countries and thus strengthening their competitiveness and ability to export to world markets. (Cooper and Massell, 1965; Bhagwati, Cooper and Johnson et al, 1965). But

the regional agreements in Africa and Latin America failed in the pursuit of these objectives because they were not internally liberal. Rather than promoting competition within the regions they were used as an extension of infant industry strategies, with each national government seeking to ensure that its industries benefited from the larger regional market. Poor performance hollowed out the credibility of the regional integration aims and initiatives outside of Europe (EEC and EFTA) generally failed. The EEC also lost momentum in the 1970s due to political differences over the nature of market integration in Europe and the continued use of defensive national policies and thus ceased to pose a major challenge to multilateralism. Thus the first phase of regionalism lost momentum.

The second phase of regionalism began in the early to mid 1980s and was driven by a shift in US commercial policy towards greater use of RTAs, the rejuvenation of European integration and the end of the Cold War. (Bhagwati, 1990) The shift in US commercial diplomacy occurred in the early 1980s.⁵ Schott (1989) points to the fact that the USTR was already considering bilateral negotiations with Canada as early as 1981 to build on the 1965 US-Canada Auto Pact. Indeed, US trade legislation (Section 612 of the 1974 Trade Act) included authorization for the administration to negotiate with Canada. When, in 1982, opposition from the EU and developing countries prevented the launch of a new GATT round, the US Trade Representative, William Brock, offered to negotiate preferential agreements with Israel, Egypt and ASEAN, of which only the US-Israel agreement was realised. In 1986 the US began negotiations with Canada on the Canada-US Free Trade Agreement (CUSFTA) that was concluded in 1988.

US trade legislation, in the form of the 1988 Omnibus Trade and Competitiveness Act, continued to authorize regional as well as multilateral

negotiations. The Reagan administration offered to negotiate a preferential trade agreement with the Caribbean countries under the Caribbean Basin Initiative (CBI) and in June 1990 the Bush administration offered to negotiate a wider preferential agreement covering the western hemisphere. (Bhagwati, 1990) These initiatives led nowhere at the time, but ultimately took the form of the Central American Free Trade Agreement (CAFTA), concluded in February 2005, and negotiations on the Free Trade Agreement for the Americas (FTAA). The most important product of this shift in US policy, however, was the North American Free Trade Agreement (NAFTA) on which negotiations began in 1990 and were concluded in 1992/3.

The use of multi-level commercial diplomacy by the US has been presented as a means of breathing life into moribund multilateral negotiations. But these initiatives in the 1980s came at a time of deep scepticism in the United States about the benefits of multilateralism for the US. The US Congress repeatedly threatened to introduce 'fair trade' legislation in the early 1980s and the legislation adopted in 1988 provided the US with the tools to pursue a policy of unilateralism as well as liberalisation at the regional or multilateral levels. (Woolcock, 1990a) Compared to the defensive unilateralism of the 1970s that included rules to defend US interests against subsidies and anti-dumping, the unilateralism of the 1980s was more aggressive in that it sought to oblige other countries to adopt rules, in such policy areas as investment and intellectual property rights, which were considered to be 'fair' by the US. This attempt to export US trade rules unilaterally took, for example, the form of the Super 301 provisions of the 1988 Trade and Competitiveness Act. (Bhagwati and Patrick, 1991; Low 1993)

Here one sees the linkages between the various levels of trade and investment policy already at work. On the one hand, US regional initiatives in the shape of the CUSFTA and NAFTA have been seen as facilitating wider multilateral negotiations in

the Uruguay Round by showing the US's recalcitrant trading partners how to do it. On the other hand, Canada's support for CUSFTA owed much to its desire to contain US 'contingent protection'.⁶ The EU's support for a more rules-based multilateral trading system in the 1980s was also in no small part motivated by a desire to contain US unilateralism. (Woolcock, 1996b) The multi-level nature of US commercial diplomacy therefore did not emerge in the 1980s or for that matter with the active use of 'competitive liberalisation' in the mid to late 1990s. (Bergsten, 1997) The US has always been ready to engage in unilateral, bilateral, plurilateral and regional as well as multilateral trade policy. (Baldwin, 1997) What changed during the 1980s was a shift towards greater reliance on the regional and bilateral levels. Whether this strategic use of different levels of agreement reflects a 'selfishness' in US hegemony or is 'benign' can only be assessed by considering the substance of the policies. The case studies considered in chapters four to seven, as well as other equivalent studies, suggest US hegemony was, on balance, benign with regard to rule-making until the Uruguay Round, since which the US has pursued rather more selfish approaches to the strategic use of different levels of negotiation.

The second impulse for regionalism came from Europe and the revival of European integration following the adoption of the Cockfield White Paper of 1985 and the Single European Act of 1986, which together provided the impetus for the European Internal Market (EC 1992) initiative. This in turn imparted new dynamism into European integration and provoked a debate on the impact of this deepening of European integration on the rest of the world and the trading system. This rejuvenation of European integration led to claims that the EEC carried most responsibility for undermining multilateralism (Wolf, 1994) and that the internal market programme was creating a 'fortress Europe'. (Hufbauer, 1990).

The deepening of EU integration involved, in effect, developing an approach to rule-making for integrating economies that was distinct from the predominant approach in North America. (Woolcock; 1998) In contrast to the US, which has used NAFTA as a model for its FTAs, the EU has not been able to use this *acquis communautaire* as the model for its FTAs, except in the case of accession states. But the *acquis* has still had a profound effect on the EU's approach to rule-making in trade and investment.

As in the 1960s, the success of the internal market programme had wider implications. The EFTA countries were first to press for an agreement with the EU in the shape of the European Economic Area (EEA) agreement, that effectively extended the *acquis communautaire* to the EFTA states. Baldwin argues that this came about because the economic costs of not being part of the EU outweighed the political costs of lost sovereignty, although Switzerland and Norway opted out of EU membership. (Baldwin, 1993) The Central and East European Countries (CEECs) and others then followed. Regions in Africa, (e.g. COMESA, ECOWAS), Latin America (Andean Pact and Mercosur, 1990), Asia (Asian Free Trade Area for ASEAN, 1992), Australasia (Australian New Zealand Closer Economic Relations Agreement, ANZCERTA, 1990) and Asia Pacific (Asian Pacific Economic Cooperation, APEC, 1988) again emulated the EU (and NAFTA) and sought deeper integration.

The EU motivations for concluding bilateral or regional agreements with third countries are, like those of the US, numerous and include political as well as economic and commercial rationales. The substance of EU agreements has also varied according to when the agreements were negotiated and the nature of the EU's relationship with the country concerned. Generally speaking the EU's FTAs with its neighbours are based on important political motivations. The Europe Agreements with the CEECs at the end of the Cold War were to promote economic and political stability on the EU's eastern

borders. The Euro-Med agreements with North African and Middle Eastern countries were to promote stability on the EU's southern borders. The substance of these agreements varied, with the *acquis* being applied more or less flexibly as a model for the FTAs. Thus foreign policy objectives, economic rationales and the partial application of the *acquis* all shaped EU RTA policy during the early 1990s and often resulted in inconsistencies. (Sapir, 2000; Rollo, 1993; Wonnacott and Enders 1996)

From the mid 1990s the EU sought to articulate a more coherent policy on RTAs. This involved the concept of region-to-region negotiations as a means of promoting regional integration in other regions of the world, (European Commission, 1995a; Maur, 2005), proactive efforts to promote a new comprehensive round of multilateral negotiations and a moratorium on new RTA negotiations. (Lamy, 2002)

A third force driving the second phase of regionalism was the end of the Cold War and the need to restructure the commercial relations of the CEECs and former Soviet republics. The EU was at the centre of this process and played an active role in reintegrating the CEECs into the trading system by negotiating a string of Association (Europe) Agreements with the transition economies. There were also a series of more partial bilateral trade agreements negotiated between the CEECs. Taken together these bilateral and regional trade agreements represented a significant share in the increase in preferential agreements negotiated in the 1990 – 1995 period. (WTO, 2005)

During this second phase of regionalism preferential agreements were still mostly concluded between countries within the same region, even if many agreements were bilateral. For example, the Europe Agreements between the EU and the CEECs and the Euro-Med RTAs negotiated under the 1995 Barcelona Process were within the same region, but took the form of a 'hub and spokes.' APEC was perhaps the biggest exception, but it did not really represent a preferential agreement in the sense that all

liberalisation was extended on an MFN basis to other countries under the concept of 'open regionalism'. (Bergsten, 1997)

2.2.3 A third phase of preferential agreements?

During the 1990s it is possible to identify a change in the nature of preferential agreements. First of all there was a quite dramatic growth in the number of agreements. (WTO, 2005) There was also a more explicit articulation of the multi-level nature of trade and investment policy by a wider number of countries (Bergsten, 1997), an increase in the number of north-south agreements between developed and developing countries (UNCTAD, 2004a), a growth in trans-continental and region-to-region agreements, deeper integration (OECD, 2002c; UNCTAD, 2004a) and finally a move by Asia to join the preferential bandwagon after the Asian financial crisis of 1997/98 (Hettne, 1998; Dent 2003; Sally 2004; Lloyd 2002).⁷ Taken together these could be said to have ushered in a third phase of regionalism.

2.2.3.1 An exponential increase in the number of FTAs

The number of RTAs in force rose from about 50 in 1990 to 250 by 2000 and to nearly 300 by the end of 2004.⁸ This dramatic increase in the number of preferential agreements has provoked a renewed debate on the impact of such a 'new dimension' or 'new wave of regionalism'. (World Bank, 2005, De Melo 1993, Hettne 1998) Most of these recent FTAs have been bilateral agreements. The growth in RTAs and FTAs has resulted in nearly all countries being now engaged, to a greater or lesser degree, in preferential trade agreements, even if these vary in their depth and the likelihood of them being fully implemented. Indeed, many of the agreements will have little impact on trade and investment, at least for some time, and most cover such a small share of

trade that they do not constitute a 'challenge to multilateralism', although the cumulative effect of so many FTAs may do so.

In the mid 1990s it could be argued that only regional agreements involving the North Atlantic, i.e. the US or the EU, threatened the multilateral trading system (Wolf, 1994). This view is harder to defend today given the growth in the number of RTAs/FTAs and the increased number of countries participating. But in the area of rule-making the statement may still be valid, since the US and the EU remain the main protagonists in trade and investment rule-making.

2.2.3.2 *More explicit multi-level commercial diplomacy*

The US appears to have adopted an explicit multi-level commercial diplomacy in the shape of 'competitive liberalisation'. The explicit enunciation of 'competitive liberalisation' or the use of bilateral, regional as well as multilateral levels of commercial diplomacy to promote liberalisation dates from at least 1995. (Bergsten, 1996) But the *de facto* practice using different levels is much older as noted above. Competitive liberalisation found limited application during the Clinton Administration, but the absence of Trade Promotion Authority (TPA) was a constraint. (Congressional Research Service, 2003) Since the Bush Administration of 2000, however, there has been a more proactive application of the policy with the US pursuing FTA negotiations with a wide range of trading partners. (Schott, 2004: Feinberg, 2003)

In Latin America, Mexico and Chile have followed a similar strategy and not only negotiated preferential agreements with the US, but also pursued very active bilateral trade diplomacy with countries both within the region and with countries outside, in order to establish themselves as 'mini-hubs.' (Reiter, 2006)

The EU has not really articulated a clear strategy on FTAs with third countries. It has stressed the importance of multilateralism and maintained a moratorium on new FTAs after 1999, but the fact that it had so many FTA negotiations in the pipeline means it has continued to be a very active player in the FTA stakes. Beyond this it has, since the mid 1990s, espoused region-to-region agreements such as the EU-Mercosur, EU – Gulf Cooperation Council and Economic Partnership Agreement (EPA) negotiations. Region-to-region agreements are seen as a means of promoting regional integration and thus economic prosperity and political stability in other regions similar to the EU experience since 1950. But region-to-region agreements also come with the expectation that the EU’s negotiating partners will make progress towards market integration before the conclusion of a region-to-region FTAs. Slow progress on the part of the EU’s partners towards integration has, as a result, acted as a break on negotiations. Thus the EU – Mercosur negotiations got bogged down due (among other things) to a lack of progress in intra-Mercosur negotiations as much as disagreement between the EU and the Mercosur countries. Straight bilateral FTAs would be easier and quicker to negotiate, as the case of the EU-Chile agreement illustrates. The EU began negotiations with Chile at the same time as Mercosur, because of Chile’s association with the latter, but the bilateral was concluded much quicker. (Aggrawal and Foggerty, 2005: interviews with EU officials June 2005) The Economic Partnership Agreements (EPAs) negotiations between the EU and the African Caribbean and Pacific (ACP) states seem likely to be equally encumbered by the slow intra-regional integration in the ACP regions. Despite this region-to-region rhetoric the EU has negotiated agreements with Mexico (to head off trade diversion from NAFTA) and South Africa (to re-establish trade ties with the post Apartheid government). It remains

to be seen how the EU will respond to the more aggressive US FTA strategy in Asia that since February 2006 includes negotiating an FTA with (South) Korea.⁹

2.2.3.3 North-South RTAs assume greater importance

Starting with NAFTA there has been a steady growth in the number of north-south RTAs negotiated by the US; with Jordan (2000), Morocco (2004), Oman (2006) Chile (2003), Peru (2005) Central American countries in the Central American Free Trade Agreement (2005), Singapore (2003) and the US begun negotiations with the South African Customs Union (SACU), Panama, Colombia, Ecuador, Thailand and Korea and failed to make much progress in the broader FTAA. The EU has its Euro-Med agreements with North African and Middle Eastern developing economies and has concluded agreements with Mexico, South Africa, and Chile and entered into Economic Partnership Agreement negotiations with the ACP states (African, Caribbean and Pacific). These agreements, like all north-south FTAs, raise questions about the impact of agreements in which there is a very pronounced asymmetry in the economic weight and power of the parties. Wonnacott (1995) has pointed to the danger of hub-and-spoke agreements in which a dominant economic power negotiates a series of preferential agreements with smaller countries. In such hub-and-spoke agreements the hub will tend to benefit because suppliers based in the hub have access to all the spokes, whereas the spokes only have access to the hub. This problem is accentuated when the traditional trade flows are between the small developing countries and the developed hub, such as is the case with the EU's Mediterranean or ACP partners or the US's trading partners in Central and South America. On the other hand, Ethier (1998) has argued that the southern partners in such agreements use them to join the established liberal multilateral trade and investment system by attracting foreign direct investment. Concluding

bilateral agreements with northern partners represents a commitment to liberal policies, helps to anchor domestic reform in the developing countries and thus attract foreign direct investment.

2.2.3.4 Inter-continental FTAs

Another important change has been the increased tendency for trade agreements to be concluded by countries in different regions and continents. Whilst the US agreements with Latin American countries might be argued to be within the western hemisphere, the same could not be said for other US agreements with Jordan, Morocco, Singapore or Australia. Likewise the EU has negotiated agreements across regions. Singapore, Korea and Chile have also signed agreements with one another. These inter-continental agreements are a phenomenon that really only emerged in the late 1990s. During the 1980s most RTAs were between contiguous countries.

2.2.3.5 Deeper integration

Until the post Uruguay Round period only the EU (and EEA), NAFTA and ANZCERTA really involved significant deeper integration. But agreements between developed and developing countries now include, to a greater or lesser degree, deeper integration commitments, such as provisions on services, investment, intellectual property, government procurement and TBT/SPS type rules. As will be discussed below in section three and in the following chapter, deeper integration requires a reassessment of the impact of preferential agreements. (Lawrence, 1995) There are also some leading developing countries that include deeper integration provisions in south-south agreements, such as those negotiated by Singapore and Chile with other developing or Newly Industrialising Countries (NICs).

2.2.3.6 The growth of Asian RTAs

The greater use of preferential agreements in Asia is another important new feature of the current phase of regionalism. Until the late 1990s the major preferential agreements in the region were an ineffective and incomplete ASEAN, APEC, which was not really a preferential agreement and some growing links with ANZCERTA. From the Asian financial crises of 1997 onwards, however, there has been a burgeoning growth in Asian FTAs so that most countries in the region, including Japan, China and India, are now involved in preferential negotiations. Many of the agreements within Asia are fairly recent and it is too early to say what impact they will really have. It has been argued that many of the agreements are more political statements than anything of real substance.

Taking the above factors together, there would appear to be good grounds for arguing that the trading system is experiencing a third phase of regionalism that can be distinguished from the earlier 'second phase' between the mid-1980s and the mid-1990s. Whilst interesting from an analytical point of view, from the point of view of this thesis, the issue of whether or not there is a new phase is not really very important. What is important is the fact that the regional/bilateral level has, without question, become more important and that the agreements being concluded and negotiated include deeper integration and thus more rule-making. Before discussing the literature on the effects of RTAs/FTAs, the next section summarizes the literature on the motivations behind such agreements.

2.3 Motivations behind regional and bilateral agreements

There has been a considerable interest in the motivations behind RTAs. In this discussion it is probably useful to differentiate between the motivations of developed and developing countries. Developed countries appear to be motivated by a complex set of factors including foreign/security interests, commercial diplomacy and a desire to 'lock in' reform or promote development in southern partners. (World Bank, 2005; Schott, 2004; Mansfield 1992). 'Free Trade Agreements are now understood as advancing a wide variety of commercial and diplomatic interests both tactical and strategic, that include bolstering local democratic institutions and processes of economic reform, strengthening US security ties, establishing new precedents to use as benchmarks in future trade negotiations and accelerating region-wide commercial liberalisation by allying with a regional leader.' (Feinberg, 2003, pg 1038)

Foreign policy or security interests tend to play some role in all agreements and may indeed be the original reason for initiating negotiations. This can be seen in the case of the Europe Agreements in the immediate post Cold War period as well as in the Euro-med agreements negotiated by the EU. Security and foreign policy issues have clearly also shaped US policy, such as in its agreements with Israel, the NAFTA and more recently proposals for a Middle East Free Trade Area as well as the US FTAs negotiated with a number of middle eastern states. The US has negotiated FTAs with countries in part as a reward for their support for US foreign policy initiatives. The US-Australian FTA following Australian support for the US in Iraq is such a case.

Commercial policy objectives are clearly central to all preferential agreements, even if the initial move has been made for foreign policy reasons. Commercial objectives may be uppermost in some agreements, such as the EU- Mexico agreement, where the EU was motivated by a desire to limit trade diversion as a result of NAFTA. In the 2000s EU preferential agreements were expected to offer better than WTO

market access if the EU was to proceed with negotiations. Market access or more rapid progress towards liberalisation than is possible in the multilateral forums is also a driving force in US preferential trade and investment policy.

Locking in domestic reform played a role in NAFTA and in the Europe Agreements, where reforms in the developing and transition economies concerned were anchored by binding commitments in FTAs. Northern countries' motivations also combine benign aims to *promote development* in southern partners by promoting sustainable development, with more malign aims to use north - south preferential agreements as a means of *pushing the WTO-plus objectives of the northern partner* on issues such as investment or intellectual property rights where multilateral progress is blocked or so politicised as to make balanced negotiations difficult. Finally, preferential agreements can be motivated by a desire to shape the wider international agenda on trade and investment. If the EU or US can negotiate a string of preferential agreements that suit their wider aims on trade and investment these may help shape future multilateral agreements. (Zoelick, 2002)

Another way of looking at this is to see RTAs as a means of *furthering the 'domestic' approaches to rule-making*. If globalisation is resulting in greater market integration, rules that balance liberalisation and other regulatory policy objectives become of central importance to national governments and a range of domestic interests. For governments, there is a desire to ensure that the established 'domestic approach' is reflected in international rules. Otherwise governments are likely to have difficulties reconciling the emerging international rules with domestic rules and will either have difficulty ratify international agreements, or face unpicking embedded domestic rules and practices. Governments will therefore seek to ensure that RTAs reflect the established 'domestic' rules as closely as possible. Governments (or the EU)

may not initiate RTA negotiations out of a desire to extend domestic rules, but once negotiations begin the detailed substance of the agreement may be influenced by this aim.

For developing country partners in RTAs, guaranteed market access is clearly an important motivation especially if there is a lack of confidence that multilateral rules can provide this. A number of developing countries have also opted for preferential agreements in order to gain first mover advantages in terms of access to large northern markets and attract the foreign investment inflows that result. There is evidence that Mexico has benefited from NAFTA in this sense and that other smaller developing countries with FTAs are also likely to benefit considerably from FTAs with the US or EU. But the benefits may be only short-lived if other developing countries follow suit. Simulations by World Bank economists suggest that developing countries as a whole will ultimately be worse off from north-south FTAs. (World Bank 2005)

Some developing countries are also motivated by a desire to lock in domestic reform, attract foreign investment and bring themselves into the liberal multilateral economy. In this sense the asymmetric negotiating power of the parties may not be to the disadvantage of the developing partner, since the more concessions made the more credible the developing country's reform becomes and thus the easier it becomes to attract the foreign direct investment required for development. (Ethier, 1998) Another reason why developing countries might be willing to sign up to rule-making in bilateral FTAs that they have resisted in the WTO is that preferential agreements with developed economies may be more effectively linked to financial and technical assistance. Thus the African, Caribbean and Pacific (ACP) states may be more willing to sign up to Economic Partnership Agreements (EPAs) with the EU, if the latter provides financial compensation for any additional compliance costs or lost tariff revenues.¹⁰

South-south agreements continue to be motivated by a desire to *strengthen the competitive position* of the countries concerned vis-à-vis the rest of the world. Perhaps in the 2000s this will be accompanied by general liberalisation vis-à-vis the preferential partners in a fashion that was not achieved in the early phase of regionalism. South-south cooperation may also be motivated by a desire to *strengthen the collective bargaining position*. Mercosur appears to be in part motivated by such an objective. Some developing countries or advanced developing countries, such as Chile, Mexico and Singapore have used preferential agreements as part of strategy aimed at becoming regional hubs. This appears to have motivated Singapore to negotiate RTAs with many countries, both developed and developing. Other countries, such as Chile have sought to follow suit.

Developing countries may feel that bilateral agreements are easier to negotiate than complex multilateral rounds. Not only is it easier for the developing country governments to assess the impact of bilateral agreements, but they are also easier to explain to domestic constituencies.

This discussion of the motivations behind RTAs illustrates the multiplicity of motivations in almost all cases. Inevitably therefore vertical studies of specific RTA initiatives or country policies have come to ambiguous results on the question of what forces are driving RTAs. This thesis adopts a horizontal approach to RTAs by considering the role of RTAs in shaping rule-making in trade and investment and thus enables a more concrete assessment of the motivations behind FTAs.

2.4 The impact of preferential agreements

Much of the economic literature on RTAs or preferential agreements has focused on the effects these have on trade and the trading system. This work covers the

static effects, essentially assessments of trade creation and trade diversion based on vinerian customs union theory. There is also some work on the dynamic/growth effects of regional agreements, based on the effects of RTAs on increased competition, increased economies of scale and total factor productivity (TFP). Finally, there are economic models of the systemic effects of RTAs that focus on the effects of sequential tariff reductions. A lot of the empirical work done on preferential trade agreements has focused on the static welfare effects, even though 'most economists' view the long term impact of preferential agreements on the trading system as more important. (Krueger, 1999, pg 114)

2.4.1 The static effects of customs unions and free trade areas

The static effect models are based on the vinerian trade creation and trade diversion model. The characterisation of preferential agreements in these models is often very simple 'with most focusing on the removal of tariffs but ignoring (other) issues' even those directly related to border measures, such as rules of origin. (World Bank, 2005 Chapter 3 pg 6) The 'standard discussion of RTAs proceeds as if tariffs were the only barrier' to trade. (Winters, 1996) Generally speaking the results from such studies are either ambiguous or show small net trade creation effects. This has been a fairly consistent conclusion throughout the past decade. (Krueger, 1999, pg 120; World Bank, 2005)¹¹ On the other hand, such static assessments based on general equilibrium models do not really come up with compelling evidence in favour of RTAs.

There are a number of difficulties with these conventional approaches. First of all there is the problem of determining the counterfactual, or what would have happened to trade and investment in the absence of the RTA. What, for example, would the levels of European tariffs have looked like in the absence of the EU? There is no way of

knowing whether protection would have been higher or lower. Another limitation that has already been noted and is relevant for this thesis is that the studies concerned do not account for anything but tariff preferences. This may have been a reasonable approximation for the impact of RTAs up to the 1970s for developed countries (although not for the EU even then). Tariffs are also still important among developing countries today. But the classic trade creation – trade diversion analysis fails to address the impact of deep integration in RTAs and thus the impact of rule-making on trade and investment.

The use of gravity models to assess the impact of preferential agreements includes the effects of tariff and other measures including rules, because these seek to measure outcomes against what would be expected in terms of market size, proximity and a range of other variables such as common language. But the results of gravity models have often proved contradictory, depending on the varying starting assumptions used. In an effort to overcome this problem the World Bank produced a meta-analysis that took the individual observation point estimates of the relevant parameter from different studies. This set of observations was then used to test whether the various coefficients are statistically different from zero. The results of this work are not encouraging as the ‘overall impact is uncertain’ (World Bank 2005 Chapter 3 pg 5)

Economists see the gains from deep integration (which would normally occur within regions) as emanating from the reductions in costs, such as through the creation of a common regulatory norm or standard. In most cases of deep integration both producers and service providers in the region as well as those outside will benefit, but the degree to which each benefit will vary. For example, where common rules/norms replace different national standards, any regional supplier can cover the wider regional market without incurring the costs of complying with a series of separate national rules.

Non-regional suppliers will also benefit because they can supply the whole market using one rather than numerous national standards and thus benefit from scale economies.

If the regulatory barriers addressed by deep integration entail expenditure of real resources (i.e. in compliance with different regulatory norms or standards) rather than the creation of rents, then reducing the barriers saves resources and can be beneficial even if there is some trade distortion. Although views inevitably differ, the consensus, based on first principles, is that 'discriminatory deep integration seems unlikely to be harmful except in the opportunity cost sense of foregoing the greater gains from non-discriminatory integration'. (Winters, 1996, pg 7) This would be the case provided the level of regulatory harmonisation in the regional is not excessive or unreasonable. If regional norms or standards were set exceptionally high the distorting effects would outweigh the benefits from having a single set of norms. The question then arises as to what is a reasonable level for any standard.¹² The assumption is still that regional rules are a second best option to non-discriminatory removal of regulatory barriers.

Another argument made in the discussion of the impact of RTAs on trade and investment is whether RTAs can provide secure market access and if so to what degree. Regional rules may for example, remove or reduce regulatory discretion in the hands of national regulators or governments that might otherwise be used to discriminate against foreign suppliers. Deeper integration can thus provide greater security of market access. In some cases it may also remove the scope for the use of instruments of commercial defence, such as anti-dumping and countervailing duties, such as in the EEA (European Economic Area), CER (Australia –New Zealand) and CCFTA (Canada-Chile Free Trade Agreement).

By analogy to trade creation and trade diversion it is possible to argue that if common regional rules are significantly more stringent than the rules of the signatories before the preferential agreement was signed, then one might argue that regional rule-making is restrictive of trade. But if regional rules are broadly on a par with the previous national rules, then the RTA will tend to facilitate trade and investment, by virtue of the greater ease of access to the whole regional market. The impact of regional rule-making in such instances cannot be easily determined except on a case by case basis. The impact of the regional 'preference' will, for example, depend, among other things, on the extent to which the regional rules diverge from any agreed international rules.

To sum up on the literature on the static effects of RTAs, tariff based models and gravity models are ambiguous in their results. There is a broad assumption, working from first principles that deeper integration covering rule-making will tend to be beneficial, even if still second best to multilateral rules. But, with the exception of a few studies of specific policy areas (the relevant ones of which are discussed in each of the case study chapters in this thesis) there has been no real attempt to assess through detailed studies the impact of rule-making/deep integration in RTAs, probably because of the difficulty applying quantitative methods to measure the effect of rules.

2.4.2 Dynamic effects

In the 1990s a number of approaches were developed that incorporated assessments of the dynamic effects of preferential agreements. Baldwin, for example, showed that medium term bonuses could be gained from regional integration. By removing barriers to investment, trade and competition, deeper integration in RTAs could result in increasing returns on investment, increased investment and thus an

increase in the stock of investment leading to a higher growth trajectory. (Baldwin 1989 and 1996a and Baldwin and Venables, 1996)

Generally speaking those who have employed elements of 'new trade theory that account of imperfect competition, increasing returns to scale, externalities and other dynamic gains, have concluded that regional agreements can generate big welfare gains compared to models that are based on neoclassical production structures.' (Krueger, 1999, pg 120) In terms of north - south agreements, Berthelon (2004) found that preferential agreements that increase the size of markets can have not insignificant growth effects for smaller 'southern' partners in north-south preferential agreements. North-south agreements that lead to more integrated production and thus the application of more advanced production methods in the southern partner or partners can also increase total factor productivity (TFP) through technology transfer. This was found to be the case in NAFTA, which was associated with an advance of between 5 and 7% in TFP in Mexico. (Schiff and Wang 2003, and 2004).

The inclusion of investment in any assessment raises the question of whether preferential agreements result in investment creation or diversion. For example, if a RTA includes rules of origin it may result in the diversion of investment from more competitive suppliers outside the region, or create investment by replacing higher cost, less efficient investors from an RTA partner. From the motivations of smaller southern partners of the US or EU, it would seem that attracting increased flows of FDI is one of the major reasons for negotiating FTAs.

There is therefore, a need to consider whether preferential agreements contribute to a more predictable environment for investors, which many investors especially in smaller markets see as important. As the investment climate is largely determined by domestic rules and how they are implemented and enforced, it is important to include

investment rules and a range of associated rules and regulations in any assessment of the impact of preferential agreements. Ethier (1998) argues that vinerian customs union theory based on trade creation and trade diversion has exceeded its usefulness. Rather than focus on trade (or investment) creation and diversion, assessment of the impact of RTAs should take account of the realities of the current liberal international order created by the OECD countries since 1958. In his model Ethier sees the regional or preferential agreements as having adapted to this predominantly liberal multilateral environment. Smaller countries conclude RTAs with larger markets in order to benefit from a number of externalities such as locking in domestic reforms and attracting FDI. This type of approach explains the otherwise paradoxical position in which developing countries reject the 'Singapore' issues of investment, public procurement and competition in the multilateral Doha Development Agenda, but accept the inclusion of these issues in FTAs under very adverse asymmetric power relationships with the US or EU.

2.4.3 Systemic effects of RTAs: the economic models

There has also been work done on the potential systemic effects of regional trade agreements. Once again economic studies of such effects have tended to be based on tariffs by modelling the impact of the progressive extension of customs unions and free trade agreements on optimal tariffs. Krugman (1991b), whose initial work provoked a series of other papers, argued that increasing size of RTAs results in an increase in optimal tariffs. In other words, the ever growing blocs would use their market power to enhance their terms of trade through higher tariffs. Krugman's model suggested that if regional integration advanced to the extent that there were three regional blocs, this would be the worst case for world welfare.¹³ Other writers have

sought to develop the Krugman approach with somewhat differing results.¹⁴ Whilst the model may be elegant, in reality tariffs continue to fall internationally and as with all applications of optimal tariff arguments, tariff bindings within the WTO and potential retaliation to any increase in tariff levels more or less preclude the actual application of an optimal tariff strategy. From the point of view of this thesis, the question is whether larger, more dominant trading blocs are able to shape the nature of rule-making. Intuitively this seems a more likely threat to the multilateral system than the pursuit of optimal tariffs by large trading blocs. In other words a selfish hegemon could, through sequential negotiations with a string of weaker trading partners, shape the rules for trade and investment in its own interest rather than create public goods. This theme will be picked up again later. But for the time being it is only necessary to state that the tariff based models are of rather doubtful value.

The more elaborate models of 'bloc formation' developed on the basis of the original Krugman approach included assessments of the effects of asymmetric bloc size. According to these models a regional bloc gains when it attracts members from other continents, because the terms of trade benefits of boosting demand for the bloc's comparative advantage goods outweigh trade diversion, even if the enlarged bloc does not increase its tariff vis-à-vis the other countries. Frankel, for example, argues that a continent can increase its welfare by integrating when other continents retain MFN. (Frankel, Stein and Wei 1995) Other continents then follow the regional option with the result that all are worse off in the end. Nordstrom (1993) produces a similar model in which a customs union grows as smaller countries sign up as an 'insurance premium' (i.e. to ensure market access), but they pay a price for this insurance. Once such countries join regional blocs they will be less concerned about multilateralism. As multilateralism is the best option such a process has negative systemic effects.

This raises the question of at what point a regional (tariff) preference becomes a disincentive to negotiate multilaterally. In search of an answer to this question negotiated tariff models have been developed that seek to find the 'discount rate' at which blocs are indifferent between defecting (from MFN and the multilateral system) and cooperation. If this point could be found it might be possible to determine at which point regional integration results in a reduced willingness to cooperate multilaterally. Bond and Syropoulos (1996) argue that the benefits of defection are greater, the greater the size of the blocs, but so is the welfare loss from retaliation. This model also suggests that the outcomes may vary depending on the speed with which a bloc's trading partners retaliate. If retaliation occurs rapidly there are few gains from defection, but the longer the period the RTA partners can 'get away' with discrimination, the greater the likelihood of defection. If the sanctions against preferential agreements are weak or ambiguous, as can be said to be the case for WTO sanctions against FTAs there is, according to this model, a greater likelihood of defection.

These models of the systemic effects of RTAs are also based on a number of limiting assumptions. For a start, they assume unitary rational actors (in national governments) that are able to assess the costs and benefits of any policy choices, such as the costs of trade diversion against the gains from regional preferences. As noted above, even if there were a unitary actor none of the economic models developed to date have been able to come to more than ambiguous answers to such questions. Second, the models are again invariably based on tariffs only and say little if anything about the systemic impact of RTAs or other preferential agreements in the field of rule-making. Third, the models largely discount the role of institutions and do not therefore take account of any harmonization or emulation of rules, which as the case studies in

this thesis and other work (Woolcock, 2006) show is clearly happening. Finally, the models are, understandably based on the impact on economic welfare. Rule-making involves a broader range of criteria including other legitimate policy objectives, such as consumer protection, environmental sustainability or prudential security. The existing work on the systemic effects of RTAs does not consider these wider governance issues.

There have been some studies of the impact of rule-making in one or two policy areas, such as services. These suggest that the inclusion of regulatory issues in RTAs is likely to be less distorting, because preferences are less evident and may indeed be impossible in some cases. But the work tends to be based on first principles rather than any detailed study of the substance of RTAs. (Mattoo and Fink, 2002)

2.4.4 Political economy models

It is possible to differentiate between a number of 'political economic' models that use rational choice approaches to model the interaction between protectionist and liberal sectors of the economy (Grossman and Helpman, 1994b) and wider 'political economy' approaches that consider the interplay between broader political and commercial interests at the systemic and domestic levels. (Mansfield and Milner, 1999)

In the political economic models trade policy and in particular decisions on whether to negotiate preferential or multilateral trade agreements are assumed to be determined endogenously by the interplay between different domestic sector interests. Grossman and Helpman (1994b) provided the basis for a number of studies using such an approach. They argued that RTAs are negotiated when producers believe they will gain from trade diversion. Utility maximizing governments (i.e. governments seeking reelection) will then support regional agreements if the benefits of the preferential agreement outweigh the general welfare effects of multilateral trade liberalization. The

subsequent use of this model has often assumed that it is 'good politics' to negotiate preferential agreements because producer interests in trade diversion are easier to identify than the consumer loses. (Mattoo and Fink, 2002)

Krishna then takes this line of argument still further by suggesting that RTAs are more likely to be supported the greater the trade diversion, because protectionist interests will be more effective in their efforts. (Krishna, 1999) Some studies then go as far as to argue that bilateral agreements can never increase political support for multilateralism, because the benefits of bilateral agreements for protectionist interests are such that the 'reservation utility' of the protectionist sector interests are raised above the multilateral free trade level with the result that such groups will always block multilateral free trade. (Levy, 1997)

While there is clearly a case that interests benefiting from preferences will resist the erosion of such preferences by multilateral liberalization, the explanatory value of these political economic models is undermined by some of the assumptions on which they are based. For example, many models are based on unrealistic assumptions that the median voter has perfect foresight concerning the impact of the choice between RTAs and multilateral trade. To facilitate the model building they are also still based on tariff protection. Perhaps the most striking thing about these political economic models is that, like most of the tariff based models discussed above, they are developed from first principles with only very generalized references to the nature of regional agreements (and the multilateral trading system). As Winters in his summary of the models suggests, the difficulties with the existing models means there is a need to consider actual cases. (Winters, 1996) But whilst the models are approached with methodological rigor, the debate on actual cases rapidly resorts to generalizations, such as speculation that the Seattle Summit of APEC in 1993 was instrumental in persuading

the EU to conclude the Uruguay Round. (Winters, 1996) There are also repeated references in the literature to the danger, sometimes it is presented as a fact, that regional and bilateral agreements detract from multilateral negotiations, there have been precious few empirical studies of the interaction between the two levels. As the empirical work that has been done is based on tariffs this also fails to address the question of the interaction between the regional and multilateral levels in shaping trade and investment rules. Finally, the political economic approaches fail to take adequate account of path dependency or policy emulation. (Bhagwati, 1999) Therefore they offer little policy relevant guidance on whether rule-making at the regional/bilateral level can be seen as a building or stumbling bloc for the wider multilateral trade and investment regime.

These shortcomings are addressed in the broader political economy studies of regionalism. Baldwin's domino model of regional enlargement, which draws on European experience, argues that endogenous trade policy models (such as those based on competing domestic sector interests) cannot fully explain why governments move to conclude RTAs and in particular why policies change over time. He suggests that closer regional integration leads producers in non-member countries to press for accession because they will otherwise find it harder to compete with producers inside the integrating market. As the bloc enlarges the costs of non-participation become greater as more and more markets are included, enlargement then stops when the remaining non-members have high enough (political) objections to accession. (Baldwin, 1996) Baldwin's approach therefore takes account of wider systemic factors exogenous to the nation state and explicitly links regional and other levels of trade policy.

The wider political economy approaches to the analysis of RTAs also bring in a range of factors including domestic societal (i.e. interest groups), institutional factors as well as international political factors. (Mansfield and Milner, 1999). The domestic societal factors are essentially the same as the sector interests included in the political economic models, but inclusion of institutional factors enables such factors as the relationship between economic (and political reform) and regional (integration) agreements to be addressed. In most cases the debate on the interaction between levels is still of a rather general nature. For example, the suggestion that regional agreements can promote democratic reform (such as in the case of EU enlargement) and economic liberalism (such as NAFTA locking in Mexican economic reform). The political economy literature also does not generally address the detail of rule-making in investment, competition etc.¹⁵

The political economy literature does, however, consider the wider international political context within which the interaction between the regional and multilateral levels of policy occurs. The role of power, security and international institutions find a more prominent role. For example, the rise of RTAs has been seen to be related to the relative decline in US hegemony (i.e. Baldwin, 1993; Bhagwati, 1993; Pomfret, 1998). Gilpin (1987) argues, on the basis of observation of the US, that hegemons become more aggressive as they go into relative decline.¹⁶ He therefore explains the growth in regionalism as a defence against such aggressive US policies. But he questions whether the US is really in relative decline and whether regionalism represents a competing force for the US.¹⁷ This touches on the role of regional agreements in shaping the international regimes for trade and investment, which the empirical case studies in chapters four to seven address.

Other political economy approaches, such as comparative regionalism, provide valuable insights into the political and institutional factors behind various regional initiatives, but do not address the detailed substantive issues. (Higgot, 1996)

Constructivist approaches to the study of regional integration posit that views and policies towards integration evolve over time as a result of political interaction and discourse. It will be argued here that the evolution of norms and precedents play a significant role in rule-making and in the interaction between levels of rule-making. Therefore the approach used in this thesis draws on constructivist view as it does on rationalist and more institutionalist approaches. Some political economy approaches address directly the relationship between regionalisation and globalization and the compatibility of regionalism and multilateralism, but do so without discussion detail of the regional agreements. (Coleman and Underhill, 1998)

2.4.5 Legal compatibility with GATT/WTO rules

Strengthening the WTO rules on RTAs and in particular improving their application is a very common theme in policy prescription. (e.g. Sapir, 2000) Existing WTO provisions on RTAs are ineffective and there is little prospect of improving their effectiveness unless more operational criteria can be developed for assessing the impact of RTAs. This section explains the limitations of the existing WTO rules and argues that developing criteria for assessing the impact of RTAs on rule-making as well as tariff preferences is an essential step if the WTO provisions are to have relevance in the future.

The existing WTO provisions concerned are Arts XXIV of the GATT, the Understanding on the Interpretation of Art XXIV agreed in the Uruguay Round, the 'enabling clause' provisions that include exceptions for developing countries from the

MFN obligations of the GATT for preferential agreements, and Art V of the GATS. Monitoring the RTAs in terms of their compliance with GATT Art XXIV has been an important aspect of WTO work. (WTO, 1995) The Committee of Regional Trade Agreements (CRTA) of the WTO has been tasked with providing a legal analysis of regional agreements and seeking ways of improving the application of WTO rules.¹⁸ (Sampson, 1996)

There are a number of well-known ambiguities in the wording of the GATT rules, which have made any definitive view on the application of the MFN exemption for preferential agreements elusive. First, there is the problem of defining what is *substantially all trade* under Art XXIV. For example, should this be interpreted in a qualitative fashion or a quantitative fashion? Discussions in the WTO were, in Spring 2006, still deadlocked on what should be defined as substantially all trade, 80%, 90% or 100% of trade and what sort of special treatment there should be for developing countries, both in south-south but also north-south agreements.¹⁹ The level set would have an important bearing on multilateral discipline of RTAs in that a low threshold might enable key sectors i.e. agriculture to be excluded from a preferential agreement without infringing GATT rules.

Similar questions arise with the interpretation of GATS Art V. For example, should 'substantially all trade' mean that an FTA in services could exclude a whole sector? The schedules in the GATS agreement already provide only selective coverage of services sectors. How should these exemptions be treated in any assessment of substantially all trade in RTAs? How should one define a quantitative measure of 'substantially all trade' given that many RTAs that include services/investment have schedules (negative lists), which effectively exclude many activities within services sectors that are nominally covered by the agreements?

More generally, should 'substantially all trade' include regulatory barriers to trade and if so which types of regulatory barriers? Article XXIV 8 (a) (i) (the 'substantially all trade') provision, refers to duties and 'other regulatory restrictions to commerce'. Should 'other regulatory restrictions to commerce' include regulatory barriers to trade and if so which? (Mathis, 2006) ²⁰

A second area of ambiguity in the GATT rules concerns the treatment of regulatory barriers to trade within the requirement that the *general incidence of protection* in the form of duties or 'other regulation of commerce' should not be greater in an RTA than was the case for the constituent countries before the agreement was concluded. Whilst there has been some clarification of the treatment of duties, (i.e. tariffs) under this provision in the 1994 Understanding on the Interpretation of Article XXIV, the treatment of 'other regulation of commerce' remains very unclear.

For example, if country 'B' has lower food or safety standards than its RTA partner 'A' and an RTA agreement results in common regional standards at the level of country 'A,' does this mean that third country suppliers will face a higher incidence of 'protection' in country 'B', or does the existence of a single standard for the whole RTA facilitate trade, reduce the costs of compliance for third country suppliers and thus result in a lower 'general incidence of protection.' How should one go about measuring these compensatory effects within the WTO context? Some WTO members view new common rules or standards within a regional agreement, for example, as an increase in the incidence of protection, whilst compliance with a single set of rules is seen by others as reducing the costs for third country suppliers. (Trachtmann, 2002) ²¹

Article V of the GATS provides for a similar, but not identical, set of criteria for assessing whether RTA provisions on services are compatible with WTO rules. Article V states that: 'any agreement....shall not in respect of any Member outside the (RTA)

raise the overall level of barriers to trade in services within the respective sectors or sub-sectors compared to the level applicable prior to such an agreement'. This has been interpreted as being better for non-members of RTAs than the GATT Art XXIV provision, because it requires no rise in the overall level of barriers on a sector by sector basis rather than the GATT requirement that there should be no increase in the incidence of protection 'on the whole'. The 'on the whole' wording in GATT Article XXIV has been the origin of the debate on whether reductions in protection in one sector can be balanced against increases in others. The GATS also requires that service suppliers with 'substantive business operations' in signatories to an RTA prior to the conclusion of an RTA, should be treated equivalent to suppliers of services from the signatories of the RTA.²² But there still remains ambiguity concerning the interpretation of Art V of the GATS. For example, in the debate following the European Commission's proposal for an FTA in services between the US and EU in 1998, it was unclear whether such an agreement would satisfy Art V if it excluded the audio visual sector. The issue was not resolved because the idea was a transatlantic free trade agreement in services did not have sufficient support.²³

With no clear criteria on the interpretation of Arts XXIV (GATT) and Art V (GATS), the WTO has not been able to make much progress assessing the impact of RTAs, despite the work of the CRTA. There is a debate on how the provisions of the WTO might be revised in order to make them more effective and operational in their coverage of RTAs.²⁴ This debate is now continuing as part of the Doha Development Agenda, which contains the mandate to '..clarify and improve disciplines and procedures under the existing WTO provisions applying to regional trade agreements' while taking 'into account the developmental aspects of regional trade agreements.' To date progress in the negotiations has been slow. The US has maintained that

substantially all trade should be near to 100%, whilst the EU has argued for 90% of trade. This issue has assumed importance for developing countries because of the growth of north-south RTAs. Under the enabling clause south-south RTAs are not under the same obligation to cover 'substantially all trade'. But in north-south agreements the northern parties must comply with this rule. Therefore in negotiations such as the EPA negotiations between the EU and ACP developing countries the developing parties have argued for greater flexibility to enable them to retain some protection for key industries. (Onguglo and Ito, 2003)

With regard to the treatment of other regulatory measures the EU argues that common rules established within a region facilitate trade, while India argues that any new rule constitutes a new barrier to trade. This issue is clearly of relevance to the debate in this thesis on the impact of rule-making in RTAs. The WTO negotiations have made more progress on transparency provisions relating to RTAs. The issue here has been whether an RTA need only be notified to the WTO when it is formed or whether there should be a regular reporting of RTA activities and implementation and if so what should be the frequency of such reporting?²⁵

Up to now progress has been blocked because signatories to RTAs have not been keen to have their policy options constrained by WTO rules. But as more and more countries sign up for more and more RTAs, the costs of having no clear rules may well begin to outweigh the benefit of greater policy autonomy for the existing signatories of RTAs. Indeed, by 2006 there were signs of some progress towards improving the transparency rules governing RTAs in the WTO, even though progress on the substantive issues remained elusive. (WTO,2006) Despite this progress it remains 'uncertain' that tougher WTO rules will help, because there is no consensus on what conditions should be met to ensure that RTAs are building rather than stumbling blocs.

(Krueger, 1999, pg 122) One of the aims of this thesis is to contribute to a clarification of these conditions with regard to the rule-making aspects of RTAs.

2.5 Building versus stumbling blocks

This brings us to issue of building versus stumbling blocs that has figured prominently in the literature for the past decade or so. If the question of the impact of RTAs on trade and investment is ambiguous or depends on each specific case, what about the wider effects of RTAs/FTAs on the trading system? In particular do RTAs create trade, help break barriers to market access and facilitate wider liberalisation (Summers, 1991) or do they divert trade, entrench preferences and thus detract from multilateral liberalisation? As noted in the introduction, this thesis challenges the premise in the building versus stumbling bloc question that causality flows solely from regional to the multilateral. It argues that trade and investment policy is, and always has been, multi-level and that the interaction can be a two-way process. Rule-making in particular is the product of a complex interaction between various levels. Ethier (1998) argues along similar lines and provides a formal economic model to illustrate how this process works for all aspects of regional agreements. Bergsten also discusses the building and stumbling bloc issue and comes to the view that 'the only irrefutable conclusion is that the interrelationship between regionalism and globalism depends on the management of the process by the countries involved. (Bergsten, 1997)

Chart 2.1 provides a summary of the arguments. The building versus stumbling bloc debate as applied to rule-making, relates closely to the interaction between the regional and multilateral levels of rule-making. What this thesis does is to ask which parts of regional agreements represent building and which stumbling blocs.

Bhagwati identified the need to address what he called the dynamic time path question. But he posed a rather different question, namely whether preferential agreements would grow larger as a result of increased membership of tariff preferences until they became, in effect, a multilateral system. (Bhagwati and Panagariya, 1996) A key issue in this debate is whether there is more pressure to extend the preferential area, as in the Domino theory of bloc building, or more pressure to keep preferences for the local market. In other words the model envisaged by Bhagwati is again tariff based.

Of more value for rule-making is Baghwati's discussion of sequential negotiations in which a selfish hegemon negotiates first with smaller and weaker neighbours in order to provide an incentive for others to negotiate and/or to set a precedent for wider trade regimes. (Bhagwati, 1994) ²⁶ This theme has been picked up in recent work on RTAs that seeks to differentiate between benevolent and selfish hegemons in their pursuit of RTAs and FTAs. (Maur, 2005)

Looking at the issues listed in Chart 2.1, issue (1) has been discussed extensively above and there is only an ambiguous answer to this. (Krueger, 1999 and World Bank, 2005). Issue (2) concerns the coverage of agreements. If difficult policy areas are excluded, this may create vested interests opposed to wider multilateral rule-making. The OECD has done work on this and shown that RTAs agreements have failed to address a number of 'hard nuts' such as agriculture and protection of a number of other sensitive sectors. (OECD, 2002). For example, Tsai (2006) building on previous OECD work, surveys 18 major preferential agreements and finds that although there is significant coverage of agricultural tariffs, sensitive agricultural sectors are excluded from the preferential liberalisation. Japan for example, excludes most tariff lines (1657 in the HS 1-24 range in its FTA with Singapore). The EU also excludes sensitive sectors in its RTAs, for example 282 tariff lines in its agreement with South

Africa. NAFTA excludes no tariff lines, but faced with tougher competition in agriculture the US excluded 83 specific products in the US-Australia FTA. Rules issues in agricultural trade are primarily concerned with competition, in other words what kind of national subsidies are considered compatible with the FTA. The obvious but important point here is that domestic subsidies cannot be reduced preferentially.²⁷ This is why neither the EU nor the US has made any commitment on agricultural subsidies in an RTA. On the other hand, liberal agricultural traders have been willing to include some rules on agriculture, see for example the Canada-Costa Rica agreement or Australia and New Zealand in the ANZCERTA. Some RTAs prohibit export subsidies on agricultural products and the China-ASEAN negotiating framework envisages rules on domestic agricultural subsidies.²⁸

Chart 2.2 The issues in the building versus stumbling bloc debate²⁹

	Building Bloc Argument	Stumbling Bloc Argument
1	RTAs have gone hand-in-hand with globalisation and evidence suggests that they have been mostly trade creating. (Krueger, 1999)	PTAs may promote costly trade diversion rather than efficient trade creation, especially when sizable MFN tariffs remain. (World Bank, 2005)
2	Expanding the number of RTAs creates stronger exporting interests and shifts the balance in favour of liberalisation in trade policy.	PTAs divert some trade and create vested interests that seek to retain preferences by resisting multilateral liberalisation. The alternative of PTAs with exceptions removes the incentive to negotiate multilaterally.
3	For issues such as regulatory policy or rule-making, RTAs offer a way to make progress in contrast to the WTO where the lowest common denominator tends to result in weak rules.	Asymmetric bargaining power can mean that sequential negotiations (bilateral followed by multilateral) may be used to force countries to adopt policies that they have opposed in the WTO.
4	RTAs 'lock in' domestic reform and countries use RTAs and FTAs to 'accede' to the prevailing multilateral liberalisation of the OECD countries.	Competing PTAs (especially different north-south combinations) may lock in incompatible regulatory structures or standards and may result in inappropriate norms for developing country partners.
5	RTAs promote the creation of negotiating and institutional capacity that can facilitate trade and investment in general, including multilateral trade.	Proliferating PTAs absorb scarce negotiating resources (especially among poorer WTO members) and 'crowd out' policymakers' attention on multilateral solutions.
6	Stronger RTA rules ensure more effective implementation and enforcement of principles agreed within the multilateral setting.	By creating alternative legal frameworks and dispute settlement mechanisms, RTAs may weaken the discipline and efficiency associated with broadly-recognised multilateral framework of rules.

Agriculture is *the* 'hard nut' excluded from any level of liberalisation whether bilateral, regional or multilateral, but there are some others such as textiles and clothing and other relatively labour intensive sectors. In this respect there is also a link between tariff protection and the use of rule-making to provide protection. For example, there is a clear correlation between the use of restrictive rules of origin and former tariff protection in a number of preferential agreements. (De Lombaerde and Garay, 2006) In this way rules can be used to preserve protection for sensitive sectors after tariffs are removed. The same is likely to apply for the use of safeguard measures or special safeguard measures. (OECD, 2002c).

In terms of the issue 2 in Chart 2.1, as noted above, there have also been some papers written on the likelihood of preferential agreements in tariffs reducing the motivation for multilateral liberalisation. Some models work on the assumption that multilateral tariff reductions are less likely when there is the option of preferential agreements. But this appears to have been developed from first principles rather than based on any empirical findings. It is argued for example, that multilateral tariff reductions are lower for products that have been excluded from preferential tariff liberalisation. This tends to support the view that the 'hard nut protectionist sectors', such as agriculture and textiles and clothing are protected at all levels. But it does not yet make a convincing case that preferential agreements remove the motivation for multilateral liberalisation. For developed countries tariff protection is generally of minimal significance, so it is difficult to argue that preferential tariff agreements would reduce their motivation for multilateral negotiations. For example, it has been argued, rather unconvincingly, that developed countries may hold back multilateral tariff liberalisation in order to have negotiating coinage with developing countries. As the developed countries wish to negotiate WTO-plus provisions on investment and other

rules, they will need to be able to offer tariff preferences to get these. This is not very convincing, or at least simplistic, because the main protagonist of a rules agenda, the EU has both offered tariff free access for the least developed countries in the Everything but Arms (EBA) initiative and dropped all but one of the Singapore issues so that the reciprocity negotiation is essentially one between the EU and G20 with tariffs and agricultural market access. The counter argument is that an increased number of RTAs will tip the balance of interests towards liberalisation.

The arguments 3-5 tend to be more important for rule-making, although one could equally use 1 and 2 with regard to rule-making. Do regional or preferential agreements in general result in countries being 'locked in' to incompatible regulatory structures? Or do regional approaches to rule-making facilitate wider multilateral rule-making? In order to address this question it is important to know in what respects and to what extent RTAs go-beyond the existing, agreed international rules, such as in the WTO.

There is a growing body of work on the WTO-plus question (OECD 2002c; Sampson and Woolcock, 2003). This has looked in some detail at the content of the RTAs and the extent to which they go beyond the WTO. The OECD work also builds on studies of the interaction between trade and regulatory policies. (OECD, 2000a) This work has explored the impact of trade policy, including in particular RTAs, on the evolution of domestic regulatory policy and has produced some broad prescription on how to ensure domestic regulation is compatible with open and competitive markets. (Feketekuty, 1996) Some of this prescription has a bearing on the impact of RTAs on multilateral rules, for example, it recommends the use of performance standards in voluntary technical standards (as opposed to proprietary or specific requirements),

independence for regulators (to facilitate transparency and non-discriminate regulation) etc.

Issue (4) in the chart 2.1 relates directly to rule-making. If the rules adopted as a result of an RTA are such that they contribute to better regulatory policies or practices in all signatories then the 'lock-in' effect of RTAs will be positive. If, on the other hand, FTAs result in a selfish hegemon imposing inappropriate rules or standards on its RTA partners, then they would have negative effects. This question can only be addressed by looking at the specifics of each RTA, although with the aid of the analytical framework developed in the following chapter it is possible to make some generalisations about how to make positive contributions from RTAs/FTAs more likely.

The OECD work has included rule-making as well as tariffs, but one shortcoming has been the lack of any direct or explicit comparison between the dominant approaches to rule-making in regional agreements. Given that it is the EU and US that have (to date) been the dominant driving forces behind trade and investment rules, it is important to know if their respective approaches to regional or preferential rule-making are compatible or divergent.

Work in the WTO has been carried out in the Committee on Regional Trade Agreements (CRTA). This has produced detailed inventories of the various RTAs. But much of the work was limited to more obvious quantitative restrictions. (World Trade Organization, 1998a) The systemic issues were defined in terms of the interpretation of the existing GATT rules, in other words whether RTAs were compatible with Art XXIV of the GATT or Art V of the GATS. (World Trade Organization, 2000)

There is also very little in the way of empirical findings on the question of whether regional negotiations detract from multilateralism by drawing off scarce resources or 'crowding out' policy makers attention. The resource issues are likely to

be real, especially for poorer developing. Even developed countries face resource constraints when it comes to negotiating on various levels at the same time.³⁰ The crowding out issue is often referred to, but there has been no empirical research conducted on the issue. It is also not clear to what extent resource or capacity constraints are a short or long term problem. This thesis will show that rule-making is significantly influenced by precedent. Rules developed at one level or in one RTA are frequently emulated on other levels or by other RTAs. Very rarely are negotiators working with a blank sheet. This use of precedent, which extends to adopting more or less the same rules at different levels of agreement, clearly touches on capacity issues. Existing rules may be used because there is no capacity to negotiate new rules, but in most cases existing rules will be used because they offer network efficiencies. Use of existing rules also makes the process of reconciling the proposed rules with domestic interests less burdensome, because the domestic constituencies will have already accepted them once before. If this is the case then the capacity issues may not be so serious.

There is also the question of whether there is any synergy between negotiations at different levels. For example, does the negotiation of regional agreements result in capacity building in terms of trade analysis, consultation procedures and negotiating expertise that can then be employed in multilateral negotiations, or vice versa? This is also likely to depend on the topics discussed. Rule-making tends to be relatively resource intensive because it involves domestic regulators. But if rule-making on one level results in enhanced regulatory capacity, such as in certification and testing or transparency, this can facilitate negotiations on the other levels. To date there does not seem to have been any empirical work on this topic.

2.6 Conclusion: the need for more empirical work on the role of RTAs in rule-making

This chapter has shown there is a gap in the literature on the role of RTAs in rule-making. The work on the impact of preferential tariffs is extensive and, although this has been able to indicate when a specific RTA is more trade creating than diverting, it has not been able to come to any general conclusion on the impact of RTAs. In this sense there has not been much change since Viner concluded that RTAs can be either trade creating or trade diverting, depending on the circumstances in each case. The work on the growth effects of deep integration tends to come to the general conclusion that these have a positive impact on welfare and trade that outweighs any small trade diversionary effect of RTAs. But the empirical work on the growth effects of deeper integration has been mostly limited to the EU.

The tariff based models of the systemic effects of RTAs do not appear to offer a very clear picture and are in any case modelling something of diminishing importance.

There is a general presumption, based on first principles, that deeper integration will not constitute significant 'preferences', but this has not been tested empirically.

The building versus stumbling bloc literature asks the right sort of questions, but there has, to date, been very little empirical work on the rule-making aspect of this debate. Research work on whether RTAs go 'beyond the WTO' address the substance of the regional and bilateral level agreements and are therefore closest to the work in this thesis. The OECD has done the most systematic work in this field, but has to date not compared the dominant regional models.

This thesis therefore fills a gap in the literature by addressing the role of RTAs in the multi-level process of rule-making in trade and investment. It also compares the

dominant models of rule-making, namely the EU and US, which have been the main promoters of trade and investment rules over the past 30 years.

Endnotes

¹ There seems to be little doubt that Viner was of the opinion that multilateral trade liberalisation was still the better policy choice.

² The proposed conditions were that plurilateral agreements should, (i) be of substantial size; (ii) reduce all tariffs; (iii) be open to all countries; (iv) benefit all countries that make concessions (i.e. rights and benefits only to those that sign up); and (v) represent no material increase in trade barriers for countries outside the agreement. (Viner, 1950)

³ The Havana Charter provisions were very close to what was finally included in the GATT Article XXIV. Article 44 of the Havana Charter recognised the desirability of increasing trade freedom through closer integration and that the purpose of customs unions and free trade areas should be to facilitate trade. Art 44 (2) (a) set out the conditions for customs unions that required, for example, that duties and other regulation of commerce should not on the whole be higher or more restrictive than the general incidence of measures employed by the individual members before the union was formed. Art 44 (2) (b) set out somewhat tougher rules for 'free trade areas' (a term first introduced in the Havana text) that required duties and other regulation of commerce to be no higher or more restrictive than was the case for each of the members. This is tougher because the wording 'on the whole' in Art 44 (2) (a) meant that some common external tariffs of a customs union could be higher as long as these were on the whole lower than those of the individual countries before hand. An earlier draft of the Havana text discussed in the 1946 meeting in London had in fact used the wording 'average level' in place of 'general incidence' of protection. Interestingly, had the ITO been ratified there might well have been more effective control of RTAs, because Art 44 (3) of the Havana Charter required the ITO to make recommendations to the parties involved in an RTA when it felt that there was little prospect of the customs union or free trade area being completed within a 'reasonable period.'

⁴ An alternative interpretation of the insertion of Art XXIV exception is that it also owes something to a US desire to retain scope for a preferential tariff agreement with Canada that it was discussing. A draft US-Canada protocol liberalising tariffs was produced in March 1948. (Wonnacott, 1987)

⁵ Although the US supported non-discrimination in the GATT, the negotiating process was of course not multilateral, but very much shaped by US hegemony. From the 1980s it was clear that the trading system was shaped by the US together with the EU and possibly the other members of the Quad (Japan and Canada).

⁶ The underlying reasons for the US shift away from a clear pursuit of multilateralism in trade towards a more nuanced position in which unilateral, bilateral and regional approaches to trade policy became more prominent are not the subject of this thesis. Clearly they have to do with the decline in US balance of trade and the impact of this on the domestic political coalitions favouring and opposing multilateralism. They also have to do with the relative decline in the ability of the US to shape multilateral trade rules. (Woolcock, 1990a) More widely it has been argued that the relative decline in US (hegemonic) power has stimulated the rise of preferential trade agreements and the number of states entering into them. (McKeown 1991, Oye 1992, Yarborough and Yarborough 1992, Mansfield and Milner 1999)

⁷ The rule-making elements in Asian FTAs are not as extensive as those centred on the US or EU. Rule-making is included in some of the intra-Asian agreements, especially those involving Japan and the more advanced developing countries, such as Singapore. India's Comprehensive Trade and

Cooperation Agreement with Singapore also includes important elements of rule-making, but this, like most of the Asian FTAs is still to be fully implemented. There must therefore be some doubt as to whether the Asian FTAs will contain significant rule-making and if they do whether these provisions will be implemented fully. On the other hand FTAs between Asian countries and the US contain extensive rule-making.

⁸ Despite the increase in FTAs the World Bank has estimated that only some 15% of trade is affected by tariff preferences. (World Bank, 2005, pg 5) This figure is lower than that often quoted for the volume of trade under preferential agreements, because the World Bank did not count the trade at zero tariffs or tariffs below 3% in the share of trade covered by preferences. These figures are based on tariffs so would tend to underestimate the potential scope of preferential agreements in the sense that rule-making issues may well also constitute a degree of preference.

⁹ In the summer of 2006 it appeared likely that the EU would initiate negotiations with ASEAN and the Republic of Korea.

¹⁰ This is an issue in the current EPA negotiations between the EU and ACP with the ACP regions keen to link the trade and other provisions of the EPAs with the financial dimension of the EPAs and the EU resisting this linkage until the end of the negotiations.

¹¹ See for example the findings of the World Bank in its Global Economic Prospects 2005 that are based on comprehensive work by Burfisher et al (2003) and Harrison et al (2004). World Bank 2005 Chapter 3 pg 3

¹² Other recent studies of the effects of RTAs in services make the same arguments, see Mattoo and Fink (2002)

¹³ See Paul Krugman (1991a) and (1991b)

¹⁴ For a summary of the various approaches see Winters (1996)

¹⁵ The OECD has however, looked at this issue by including an assessment of the impact of regional trade agreements on regulatory reform in a range of countries. See OECD (2000a)

¹⁶ This is compatible with the view that Canada saw regionalism in the shape of the CUSFTA as a means of containing US unilateralist tendencies, but equally evidence that the EU saw more rules-based multilateralism as the appropriate response.

¹⁷ The wider political economy approaches therefore address the role of relative power in the negotiation of regional trade agreements. They also addresses the potential security considerations in the formation of regional blocs. Gowa (1994) argues that security externalities shape country's trade policies including their approaches to RTAs. Gilpin (1975) also introduces the idea of benign or malign regionalism. Benign regionalism can be seen as that which promotes stability, multilateral liberalization and peace, while malign regionalism would be mercantilist, damage economic welfare and foster interstate conflict.

¹⁸ In fact the CRTA has three tasks; (i) to provide legal analysis of the RTAs (and their compatibility with the rules); (ii) to make horizontal comparisons (inventories of RTA rules have been produced including for example, safeguards, anti-dumping, intellectual property rights provisions, provisions on technical barriers to trade, investment rules, competition rules in RTAs ect.) and (iii) to debate the context and economic aspects of RTAs.

¹⁹ For a discussion on this issue with reference to the EU's enlargement to include the central and east European accession states, see Twesten (1999).

²⁰ See for example a discussion of whether TBT and SPS measures should be included in substantially all trade provisions in Trachmann (2002)

²¹ There is an argument that 'internal measures' taken within an RTA that are non-discriminatory do not fall under 'other regulatory restrictions on commerce'. On the other hand agreements between WTO members that adopt higher standards than existing international standards can be seen to be at odds with the MFN obligations in the GATT and specific agreements such as Art 2.1 of the TBT Agreement. (Mathias, 2006)

²² On the other hand the Committee on Trade in Services (CTS), to which notifications of RTAs covering services have to be made, has discretion to waive an examination of the compliance with Article V (an option that does not exist with Art XXIV), which could mean less effective scrutiny of services provisions in RTAs.

²³ This is an illustration of the limits to formal bilateral transatlantic agreements, which have been proposed on a number of occasions but always rejected on the grounds that anything formal would undermine the multilateral rules in the WTO. In the particular case of the free trade agreement in services, there was also opposition from France and other EU Member States to the substance of the proposed agreement.

²⁴ See for example, J Trachtmann (2002)

²⁵ In the prescription discussed in the concluding chapter of this thesis the idea of an enhanced notification procedure to help ensure rule-making in RTAs is compatible with multilateral rules is introduced. This builds on the work in the WTO on better transparency for RTAs. In June 2006 the CRTA of the WTO agreed on improved transparency for FTAs. (WTO, 2006)

²⁶ Bhagwati's approach views US unilateralism and regional or bilateral agreements in the same context. He discusses whether these policies are 'malign' or 'benign'. Malign policies are seen to be those that use power to extract greater gains from trade than the other party. Benign policies are when trade agreements are concluded voluntarily. (Bhagwati, 1990)

²⁷ At least not very simply. It is possible to envisage an approach in which domestic subsidies for products that are of relative importance to preferential partners might be reduced. In practice this kind of a policy would be complicated, not least because some of these schemes benefit the preferential partners. The EU sugar regime is a case in point. Here the high EU price support scheme also provided a preferential subsidy to ACP sugar producers.

²⁸ Whilst not challenging domestic agricultural support schemes, regional agreements have introduced a number of interesting innovations that could have a bearing on future multilateral agreements. For example, the EU has introduced a form of reverse tariff escalation in its agreement with the Euro-Med partners in which processed agricultural products benefit from a lower tariff than the agricultural commodities themselves, which the EU wishes to protect as sensitive.

²⁹ See Krueger (1999) and World Bank (2005) Chapter 6 pg 8, for similar presentations of the issue.

³⁰ Interview evidence from discussions with trade officials in the DTI and European Commission.

Chapter Three An analytical framework

3.1 Introduction

This chapter develops an analytical framework with which to make qualitative assessments of the role of regional trade agreements in rule-making. It consists essentially of a topology of rule-making, derived from an analysis of a range of regional, bilateral, plurilateral and multilateral agreements that identifies the main elements of all rule-making. The framework enables a differentiation between those elements of regional rule-making that will constitute a clear preference, such as greater coverage or national treatment limited to signatories, those elements that will generally have a positive impact, such as transparency, and those elements that may have positive or negative effects, such as substantive rules. The framework facilitates a qualitative assessment of the impact of regional and bilateral agreements in rule-making that goes beyond the existing generalisations that deep integration is by its nature non-discriminatory (Winters, 1996; Hufbauer, 1995), that RTAs constitute building blocks for wider multilateral liberalisation (Schott, 2001) or that RTAs will result in a spaghetti bowl of conflicting costly rules or rules that are inappropriate for developing countries. (Bhagwati 1996)

Baghwati based his spaghetti bowl analogy on rules of origin, where divergent rules clearly constitute a costly complication for trade and investment, even if recent work suggests there is something of a trend towards a limited number of dominant rules of origin centred on the Pan-European and NAFTA models. (Estevadeordal and Suominen, 2003). But the spaghetti bowl analogy has been applied to RTAs in general, without any real assessment of other areas of rule-making. The case studies discussed here and elsewhere (Woolcock, 2006) suggest that not all rule-making is divergent.

Equally, generalisations on the benefits of deep integration require closer study. There is a case for developing countries (DCs) to resist the imposition of unsuitable standards or regulatory norms through bilateral or regional agreements, just as they have within the WTO. (World Bank, 2005) But what rules are inappropriate? The inclusion of rules in north-south FTAs can make for a more predictable investment and trading environment in DCs and thus attract investment and improve development prospects. Clearly north-south FTAs can be both good and bad for development, so practical criteria to enable such a judgement are needed. The analytical framework developed here provides the basis for developing such practical criteria.

The analytical framework also provides a means of comparing the various approaches to rule-making in RTAs. As the following chapters will show, the European and American approaches to RTAs appear, at first glance, to be very similar. Both seek to establish clear predictable frameworks within which trade and investment can take place. But as the conclusions in chapter nine show, there are some general underlying differences between the US FTAs and the EU approach to FTAs with third countries that emerge when one compares the detailed substance of agreements. There are also vital differences in detail or in the application of common principles (such as precaution in food safety and environmental rules) that can make all the difference between harmonious trade relations and costly conflict.

Finally, breaking down rule-making in trade and investment into its component elements offers a means of developing operational criteria for WTO disciplines on RTAs. As section 2.4.5 (in chapter two) showed, the existing GATT criteria for assessing RTAs cannot be applied to the rule-making issues. All that GATT Article XXIV can offer is some as yet ill-defined concept of 'other regulatory restrictions on commerce'. The framework proposed here offers a practical means of differentiating

between elements of rule-making in order to provide the basis for more operational criteria for the application of Art XXIV and GATS Art V. The concluding chapter illustrates how these can form the basis for policy prescription.

3.2 The framework

The analytical framework presented here is derived from a careful analysis of a range of regional, bilateral, plurilateral and multilateral agreements. Although the detail of rule-making varies from agreement to agreement, the seven core elements identified in this typology form the basis of all rule-making. The elements are not mutually exclusive. For example, regulatory safeguards can take various forms. The framework is derived from earlier work under the auspices of the OECD.¹ Work by the OECD on the 'WTO plus' nature of RTAs has also broken down each policy area into its component parts, but not applied a common framework. (OECD, 2002c) Other OECD work on the interaction between domestic regulatory reform and rule-making provisions in trade agreements includes elements of rule-making such as transparency. The analytical framework developed here takes this work further by integrating other elements in rule-making.²

A summary of the analytical framework is set out in chart 3.1. This is intended to have general applicability to all levels (regional, bilateral, plurilateral or multilateral) of rule-making. The main elements of rule-making are listed in column one and discussed in detail below. The second column of the chart provides examples of typical provisions for each of the elements. The list is not comprehensive because of space limitations in the chart, but it includes many of the provisions found in the case studies discussed in the following chapters. Column three shows the likely impact of such provisions and column four lists the typical multilateral (i.e. WTO) provisions. WTO

provisions differ from case to case, but some generalisations are possible, such as the fact that the WTO rules tend to be limited to central government and do not provide for investor-state dispute settlement. Finally, column five provides an indication of the kind of “preference” potentially associated with each element.

3.3 Illustration of the elements of the analytical framework

The following sections illustrate the analytical framework with reference to the case studies discussed in the following chapters.

3.3.1 Coverage

Schedules of sectors and activities covered by agreements are the most common way of defining coverage. In the case of tariffs schedules specify those tariff lines that will go to zero immediately, those more sensitive products that will only be subject to partial tariff reductions or go to zero only after a transition period, and those sectors that will be excluded from liberalisation. Coverage of rule-making is determined in a similar fashion. For example, investment agreements list sectors covered and excluded from rules using either positive or negative listing. Negative listing enhances transparency by identifying the sectors in which rules will not apply. Negative listing is also likely to be more liberal in the sense that anything that is not listed is liberalised. It therefore requires no positive act to liberalise as with positive listing. Combinations of positive and negative listing may also be used, as in the GATS, so detailed analysis of the schedules is needed. At a regional level NAFTA has generally adopted a negative list approach to coverage of investment, for example, while others use positive listing or a combination of positive and negative listing. In this sense NAFTA goes beyond the WTO and plurilateral agreements in its coverage.

Chart 3.1 An analytical framework for assessing RTAs

Element of rule-making	Typical provisions	Likely impact	Typical WTO provision	Degree of preference
Coverage	<ul style="list-style-type: none"> sector schedules type of entity (e.g. central, state, local, independent regulator or private entities) regulatory instruments (e.g. codes, directives, decisions of agencies) 	<p>more extensive coverage means wider application of the (framework) rules</p>	<p>positive list approach</p> <p>generally central government and statutory measures only</p>	<p>third parties do not benefit from the WTO-plus coverage</p> <p>analogous to tariff preference</p>
Principles	<ul style="list-style-type: none"> national treatment most favoured nation status 	<p>precludes discrimination against foreign suppliers</p> <p>no discrimination between third party suppliers</p>	<p>WTO embodies national treatment and MFN principles but with exceptions, specifically for customs unions and free trade agreements</p>	<p><i>De jure</i> preference</p>
transparency	<ul style="list-style-type: none"> notification of legislation, secondary provisions and decisions opportunity for parties to comment obligation on regulator to explain decisions 	<p>promotes regulatory best practice</p> <p>facilitates compliance and guards against capture</p>	<p>general transparency provisions in all areas</p> <p>some agreements also require regulator to explain decisions</p>	<p>generally no significant preference</p>
substantive measures	<ul style="list-style-type: none"> prohibitions (e.g. of state subsidies) harmonisation partial harmonisation approximation as a general aim equivalence mutual recognition of regulations or test results 	<p>eliminates or reduces 'frictional' costs</p> <p>reduces costs but retains regulatory autonomy</p>	<p>selective harmonisation</p> <p>encourages but does not require mutual recognition or equivalence</p>	<p>if standards are higher than international</p> <p>preference for partners in mutual recognition</p>
co-operation	<ul style="list-style-type: none"> common decision-making institutions inter-governmental committee to oversee agreement specialist bodies for specific policy areas technical co-op. and capacity building 	<p>promotes convergence and helps identify regulatory barriers</p> <p>help for developing country regulators</p>	<p>co-operation difficult with large membership</p> <p>mostly general provisions and technical assistance thinly spread</p>	<p>third parties excluded from more intensive co-operation</p> <p>third parties excluded from assistance</p>
regulatory 'safeguard'	<ul style="list-style-type: none"> exemptions 'right to regulate' proportionality required use of least or less trade distorting measures 	<p>tight discipline promotes predictability</p> <p>loose limits allows discretion</p>	<p>generally broad exceptions that offer considerable scope for regulatory discretion, but some tightening e.g. SPS agreement</p>	<p>potential for greater discretion vis-à-vis third parties</p>

Enforcement and implementation	<ul style="list-style-type: none"> • requirement to have an independent agency • investor-state or state-state dispute settlement • independent reviews of decisions • remedies (e.g. financial penalties) 	effective implementation promotes confidence and thus trade and investment flows	state-to-state dispute settlement only, focuses on national legislation (rather than secondary legislation)	third parties no recourse to more immediate remedies and reviews
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Schedules are used to satisfy the demand for reciprocity. For example, like the GATS, the 1994 Government Procurement Agreement (GPA) consists of a framework agreement setting out the principles, transparency, substantive provisions, enforcement mechanism etc. and schedules to establish reciprocity in coverage. It is therefore a fairly straightforward - although time consuming exercise - to compare the coverage of RTAs with each other or with the respective multilateral or plurilateral agreement. Greater coverage means the RTA goes beyond the WTO. The nature of preferences is fairly clear-cut and is analogous to tariff preferences.

In the case of rules, coverage may also relate to the entities or instruments bounded by the rules. For example, the 1979 GPA covered only national government agencies engaged in purchasing, but initiatives at the regional level led to state and provincial level purchasing entities being included in the 1994 GPA. In the case of technical barriers to trade, WTO rules requiring national treatment for technical regulations and conformance assessment only apply to central government, with weaker 'best endeavours' discipline for sub-central government and only a Code of Conduct for private standards making bodies. Similarly investment rules may cover central government only or may also extend to state and provincial governments. Greater entity coverage means greater reach of non-discriminatory rules, greater predictability, more transparency and probably more open markets. But greater entity coverage also means higher compliance costs and a need to accept change and reduced regulatory autonomy

on the part of regulatory agencies. Consequently the more intrusive nature of rule-making is likely to be resisted.

Generally speaking WTO rules go no deeper than central government. A regional preference in entity coverage could therefore take the form of a larger number of entities bound by rules. For example, state-level agencies may be bound by national treatment obligations vis-à-vis suppliers from preferential countries, but able to discriminate against suppliers from third countries. In practice the preference in such a case is unlikely to be clear-cut. In a (very) few cases there may be a formal regional preference, such as the price preference for regional suppliers in public procurement. In many cases entities will find it easier to use the same procedures for all suppliers so there is no *de facto* preference. But at critical junctures, such as when a large contested procurement contract is to be awarded, an entity could use the greater residual discretion it has vis-à-vis non-preferential suppliers to exercise a preference.

Regulatory policy also uses a range of different instruments, which may also be involved in defining coverage. Legislation will generally set out the broad policy aims, such as the balance between liberalisation and other legitimate policy objectives, but day-to-day implementation will be through decisions in specific cases, guidelines, standards or directives. For example, in the TBT field, technical regulations are generally adopted by legislation subject to WTO obligations on national treatment. Compliance with these regulations is, however, likely to be by reference to voluntary standards developed and promulgated by private standards bodies.

WTO rules are generally restricted to legislative instruments, so coverage of secondary instruments by regional level rules might constitute a preference, but as with the entity coverage, the degree of preference will depend very much on how any scope for discrimination vis-à-vis third country suppliers is used. If regional rules require

decisions based on objective, non-discriminatory criteria the relevant body may opt to use the same criteria for all so there would be no preference.

3.3.2 Principles

Provisions in trade agreements on rule-making are, as with border measures, covered by the non-discrimination principles of national treatment and most favoured nation treatment. National treatment means that foreign products or suppliers are treated the same as national suppliers. This is simply stated but becomes more complex in its implementation, because there are always questions of interpretation. Most favoured nation status means that regulators cannot discriminate between foreign products or suppliers. The conclusion of a regional or bilateral agreement that offers preferential treatment to signatories is, of course, in breach of the MFN principle, but one that is provided for in Article XXIV of the GATT and Article V of the GATS.

In terms of their impact, rules that require non-discrimination may not result in any *de facto* change. Framework agreements such as the GATS and GPA require non-discrimination. Coverage of these framework agreements is then determined by negotiations on sector coverage. But even then coverage of non-discrimination rules does not necessarily mean liberalisation if there are *de facto* barriers. For example, in services, if there is a national monopoly provider of a specific service, national treatment simply means that foreign competitors will be excluded along with other domestic competitors. Equally, RTAs and WTO agreements also required national treatment in the TBT field for many years without this resulting in open markets. Indeed, new national regulations and standards were introduced that conformed to national treatment obligations, but still resulted in progressive market closure. Such *de facto* barriers grew despite multilateral and regional obligations (e.g. Article 28 (formerly Art 30) of the

European Communities) on central government to comply with non-discrimination obligations. In public procurement national treatment rules prohibiting *de jure* preferences (set out in legislation) did not prevent these markets from being distorted by anti-competitive preferences for favoured suppliers.

If an RTA or bilateral agreement only extends national treatment to preferential partners there is a clear preference. With regard to MFN any provision, which discriminates between different foreign products or suppliers, represents a preference.

3.3.3 Transparency

Enhancing the transparency of national policy making and regulation has long been recognised as an important first step towards facilitating trade and investment so that virtually all agreements include transparency rules. In assessing their scope however, it is useful to distinguish between different provisions that require information on statutory and secondary measures as well as, prior and post implementation notification and transparency in decision-making. Transparency on *statutory measures* provides the basic minimum of information required for suppliers seeking to operate in a market. Although there are some costs involved, these are generally not very great and there are a range of inventories of rules already in existence for trade agreements. In the WTO it is standard to include a requirement on notification of national statutory measures in all policy areas.

For effective transparency in regulatory policies it is often necessary to have information on *secondary instruments* including guidelines, decisions etc. Often a precedent set by a decision of a regulatory agency or a ruling of a court or review body, will shape future regulatory policy and thus market access. For example, the conditions for interconnection to telecommunications networks are laid down by the relevant

regulatory agencies. The GATS agreement on basic telecommunications therefore requires notification of such conditions. In public procurement, statutory measures set out procedures to be followed in placing public contracts, but the key information for potential suppliers comes in the form of calls for tender issued by a (large number) of public bodies that set out the qualifying conditions for prospective tenders and contracts. Regulatory agencies specify modifications to technical regulations or food safety standards. Decisions in specific competition cases can set precedents for future policy and thus shape the competitive framework for markets. For foreign suppliers to compel, transparency with respect to these subsidiary instruments may therefore be essential.

Some agreements require *prior notification* of any legislation or change in norms or regulatory standards. This gives foreign suppliers an opportunity to both make submissions on the revised rules and adjust their product to comply. The absence of prior notification can favour national producers who are likely to have been consulted on changes in the rules. Foreign suppliers, especially smaller companies or those in developing countries are unlikely to have the capacity to monitor regulatory policy decisions. *Ex anti* notification clearly precludes any input into regulatory decisions.

Agreements may also provide for *open decision-making* (due-process) or provisions equivalent to national treatment in regulatory practice and procedures. The WTO generally requires that central governments have the right to comment on new rule-making by WTO members, but notification does not always occur before a decision is taken. With deeper integration the right to comment may be extended to all those potentially affected by regulation, including legal persons (i.e. companies, consumers or other civil society NGOs) in other countries. For example, under US administrative procedures, private entities generally have extensive rights to make submissions and have regulators respond to their comments. This US model has been applied in NAFTA,

which extends the same rights to private entities in other signatory states. Such *due process* rules promote confidence that national regulation is implemented in a non-discriminatory fashion. When combined with recourse to legal remedies in cases of non-compliance, they can help to ensure that national treatment or non-discrimination is effectively implemented. The US 'policed non-discrimination model' model uses this approach. Such process transparency facilitates foreign supplier's compliance with changing regulatory standards and practices, can help ensure national regulation is non-discriminatory and promote competition, because new suppliers will have greater confidence to sell and invest in the market concerned. But notifying the many thousands of implementing decisions in regulatory policy can result in significant compliance costs. The use of information technology may mitigate such costs, but they are an important factor in resistance to the intrusiveness of rules, as is illustrated in all the cases discussed in the following chapters.

WTO provisions on transparency typically include obligations to publish and notify statutory changes. In some policy areas there is also a requirement to notify subsidiary regulatory instruments, but here coverage is not extensive. The WTO agreements on TBT and SPS measures require prior notification of statutory measures. A number of WTO agreements provide for comments by national governments on regulatory measures notified to the WTO. But these provisions are not very strong and have not always been implemented effectively.

Generally speaking the *degree of preference* embodied in transparency rules is low because most information is available to third parties. Only when information is provided more speedily or effectively to suppliers within a regional or bilateral grouping can there be any real preference. This may result from more effective exchanges of information within preferential agreements thanks to closer cooperation. A regional

preference may exist, however, if participation in regulatory decision-making is limited parties from preferred partners. On the other hand, involvement of parties from within the region may help to guard against regulatory capture by national producers and promote best practice in regulation. If this is the case there would be no effective preference.

3.3.4 Substantive measures

The ineffectiveness of principles of non-discrimination in dealing with regulatory policy issues has led to the inclusion of other substantive measures in trade agreements. As set out in chart 3.1 these can take the form of more negative integration measures, such as prohibition of investment controls as in OECD agreements, or of performance requirements as in the GATT and various FTAs. In the competition field there are bans on certain restrictive practices and state subsidies. Substantive rules may also take the form of specific obligations, such as the NAFTA obligation to establish an anti-trust/competition policy (NAFTA) (without specifying what this should do) and various agreements that require the establishment of independent agencies to implement regulatory policy.

Rule-making also contains more and more elements of 'positive integration.' For example, the EU approach to deeper integration, at least within the European region, if not in FTAs with countries outside the region, has been characterized by a significant degree of harmonisation. This comes at a cost in terms of lost policy autonomy, which is important if countries have significantly different policy preferences, such as agreements that include developed as well as developing countries. Economists also argue that welfare losses could result from harmonisation and that less rigid approaches, such as institutional or policy competition, are preferable.

Some agreements have therefore opted for *partial harmonisation* focused on the sectors in which there is most to gain from deep integration, such as in the targeted harmonisation of transport and telecommunications in NAFTA. Agreements may also have *approximation* as a general aim, without any detailed commitments on implementation. Such provisions are included in many FTAs. Alternatively, they may provide for harmonisation as a long-term aim, such as in the case of the Euro-Med agreements, but leave the implementation of this aim up to later decisions of the joint committees or ministerial councils governing the FTA.

Another alternative to harmonisation is *equivalence*. This is included in NAFTA and constitutes a lighter touch than detailed harmonisation. Equivalence encourages the parties to treat foreign products or suppliers of services the same as they treat national products or services, but in the case of NAFTA the provisions on equivalence are not accompanied by detailed implementing rules. The attraction of this approach is that it dispenses with all the detailed substantive rules and institutions involved with harmonisation, does not entail a loss of regulatory autonomy and limits compliance costs. But there is as yet little evidence that equivalence has been effective in opening markets, as national regulators retain considerable discretion to open markets, but equally to protect national suppliers. Another difficulty is that with no policy cooperation in setting norms or standards, equivalence may, in practice, simply mean that the standards of the dominant party are adopted. Whilst this may enhance access for the smaller parties, they also have to carry all the costs of adjustment.

Mutual recognition agreements (MRAs) are another kind of substantive rule that has found its way into rule-making at all levels. In the vast majority of cases mutual recognition refers to *mutual recognition of conformance assessment or test results*, not full mutual recognition of regulatory policy. Mutual recognition of conformance

assessment means that the costs of compliance are reduced. It does not overcome potential barriers to market access resulting from different national regulations or standards and often leaves regulators in the importing country with discretionary powers to reject recognition if they are not satisfied with the testing and certification procedures in the exporting country. This can mean that conformance assessment norms or accreditation procedures of the dominant party have to be adopted to ensure that an MRA functions. For example, the EU effectively requires the use of EU standards of conformance assessment in its MRAs, which has made negotiation of such agreements very cumbersome.

At a deeper level of integration one may find *full mutual recognition or home country control*. Here the importing country accepts that if a product or service can be safely sold in country 'A' it can be sold in the market of county 'B' that is a signatory to a mutual recognition agreement. In other words regulation in the exporting country is considered equivalent to that in the importing country, so that no further testing or certification is required. Such full mutual recognition generally requires *de facto* approximation or convergence of regulation and has only been applied in agreements between countries at broadly the same level of development, such as in the EU and the ANZCERTA (Australia and New Zealand).

The *WTO* includes a good deal of hortatory language on the use of common international standards, such as in the TBT and procurement fields. There is also partial harmonisation within the WTO in the shape of, for example, the sector agreements on telecommunications and financial services adopted under the GATS in 1997, the requirement in the TRIPs agreement to comply with WIPO standards and in the SPS Agreement to comply with standards of the Codex Alimentarius. The WTO also encourages mutual recognition without requiring its use for both TBTs and services.

What constitutes a preference in this area of harmonisation and mutual recognition? A regional preference can be said to exist if regional standards or regulatory norms are developed that are different from existing international standards. If regional standards are adopted when there are no agreed international standards, these may still have beneficial effects on third parties. The adoption on one regional norm or standard may mean lower (friction) costs in trading with the region and increase economies of scale, because exporters need only comply with one standard rather than a range of different national standards. The systemic impact of such regional norms may, however, be less benign, since the evolution of conflicting regional norms or standards may prevent or slow the adoption of genuine international standards. Whether this is indeed happening is one of the central research questions in this research.

Partial or selective harmonisation may represent a form of preference in the sense that harmonisation may be focused on those sectors in which the regional producers feel they stand to gain. Such partial harmonisation might result in trade diversion. An MRA could be said to constitute a preference, because it discriminates against third countries, but one subject to 'erosion' if all parties that satisfy its requirements are allowed to negotiate accession. Experience to date suggests that these are likely to be tough and not easily satisfied without *de facto* approximation of regulatory norms and conformance assessment.

3.3.5 *Co-operation/Institutional provisions*

Trade agreements generally include institutional provisions ranging from common decision-making machinery at one end of the spectrum, through to technical assistance at the other. *Common decision-making machinery* is generally only found where there is a high degree of policy integration, such as in the EU. This is for example,

the case in EU competition policy. In most policy areas however, national legislation implements the aims set out in EU Directives and competent authorities in the EU Member States deal with day to day regulatory issues.

The norm for most agreements is *intergovernmental institutions* responsible for implementation, such as in the case of the WTO General Council, or the committees or councils that are created in all trade agreements. The EU, for example, creates Association Councils for each Association Agreement and NAFTA has a Free Trade Commission. These are high-level bodies, which meet relatively infrequently and have responsibility for the overall functioning of the trade agreement.

Agreements also set up *specialist committees* to monitor implementation in specific policy areas, negotiate extensions, exchange information and provide a forum for initial consultations on disputes. Such specialist committees exist at all levels of rule-making including the regional or bilateral levels. In the case of WTO committees there are of course far more participants, even if not all WTO members are active. Specialist committees in regional agreements provide a more intimate setting with fewer interests, so there is likely to be more scope for dialogue.

Similarly, regional or bilateral agreements tend to enable more intensive and effective (and better resourced) *technical co-operation and capacity building*. Multilateral technical assistance and capacity building is thinly spread compared to that provided at the regional or bilateral levels and linking it with regional trade objectives increases the willingness of the richer 'hubs' to devote resources to assistance in the 'spokes.' The closer links in RTAs also facilitates twinning arrangements between regulatory agencies.

Technical assistance and funds for capacity building may help create the *institutional capacity* needed to implement rules. If preferential agreements contribute

to such institutional infrastructure they could be said to be going beyond the WTO, but the enhanced capacity may facilitate more effective implementation of multilateral rules.

What is the *impact* of such co-operation/institutional provisions? For common decision-making machinery one issue is whether co-operation dilutes protectionist preferences or results in their concentration? Preference dilution occurs when the more liberal states succeed in pressing for common policies that are more liberal than those of other partners in the agreement. Preference concentration occurs when the parties to a regional arrangement opt for trade diversion by liberalising among themselves and maintaining or perhaps even raising barriers vis-à-vis third countries. The question of preference dilution or concentration has been most pertinent for the EU because of the scope of its common decision-making machinery. But the same question can also be posed with respect to each preferential agreement.

Co-operation can promote regulatory best practice and thus contribute more generally to the evolution of an open trading system. On the other hand, co-operation may be used as a means of promoting the detailed specific standards of a dominant partner and can thus result in *de facto* regional preference and detrimental to wider multilateral trade and investment. More generally third parties are clearly excluded from the co-operation procedures and do not benefit from the enhanced technical assistance or funding in regional or bilateral co-operation.

3.3.6 *Regulatory safeguards*

All trade and investment agreements contain safeguards. Governments have been reluctant to make open-ended commitments to liberalisation, so that the GATT has general safeguard provisions under Art XIX, not to mention a range of potential *de facto* safeguard options under various exceptions or contingent protection measures. RTAs

also have safeguards for border measures and generally have special safeguard measures to cover unforeseen events during phased preferential liberalisation.

There are also safeguard provisions covering regulatory issues. Within the GATT/WTO system there is, for example, the general exception to national treatment and MFN under Art XX of the GATT. The scope of this GATT safeguard for regulatory policies was drawn very wide and in recent years there have been efforts to limit its scope such as in the TBT agreement, and in particular the conclusion of the SPS agreement in the Uruguay Round. The latter limits the discretion available to national regulators to control or prohibit imports of food and agricultural products on the grounds of protecting human, animal and plant health.

Inevitably there are also safeguards on regulatory measures in RTAs. For example, even the tight EU rules (Art 28 TEU), which have come to be interpreted as prohibiting any national regulatory measure that has an effect equivalent to a tariff, provide for an exception (under Article 30 TEU) that enables national governments to discriminate when pursuing other legitimate policy objectives. As is generally the case this safeguard is conditional on the use of, for example, 'least trade restrictive' or 'less trade restrictive' measures in such cases.

The issue with RTA regulatory safeguards is therefore, how tightly the conditions are drawn and how they are interpreted. Tight rules will mean limited discretion for regulators to pursue a range of social, environmental or other policy objectives. Loose rules will provide discretion for regulators, which could be abused to keep out competition from other countries and have a chilling effect on trade and investment within the regional market. Interpretations of 'regulatory safeguards' may also be seen as setting precedents that could influence the interpretation of equivalent multilateral provisions.

3.3.7 *Implementation and Enforcement*

It is not only the substance of rules that is important, but also crucially how these rules are applied. Generally all rules are open to interpretation and provide greater or lesser scope for discretion on the part of regulators. Abuse of such regulatory discretion can represent an important barrier to market access. As noted above, the scope for the abuse of regulatory discretion may be checked by the use of transparency in decision-making procedures. But it is also possible to limit the scope for discretion by providing for administrative or judicial reviews of regulatory decisions and backing these up with penalties in cases of non-compliance. RTAs that include their own *dispute settlement provisions* may exercise such discipline. Some of these are highly developed. The EU for example, has the European Court of Justice to interpret European law, which prevails over national law on issues relating to the European single market. Chapter 10 of NAFTA offers a comprehensive tripartite dispute settlement mechanism including conciliation as well as quasi-judicial panels analogous to those of the WTO. Other regional agreements may rely more on informal conciliation and consultation to resolve disputes through bilateral or regional councils or committees, such as the EU's Association Councils. Specific regional dispute settlement is likely to facilitate more rapid processing of disputes than in the WTO and thus contribute to better implementation of trade commitments at the regional level than the multilateral level.

Agreements may also offer *reviews and remedies* in cases where regulatory decisions are seen to be discriminatory. For example, the GATS agreement on basic telecommunications provides that suppliers, both domestic and foreign, should have recourse to a review of decisions concerning interconnection to the network, a key area affecting market access. In government procurement the plurilateral GPA provides

aggrieved parties that believe they have been unfairly treated in the granting of a public contract with the option of mounting a 'bid challenge'. If reviews are independent they can help ensure regulatory policy is non-discriminatory. If remedies are available they can ensure swift enforcement and prevent delay and prevarication when it comes to complying with trade rules. In measuring the regional or bilateral agreements against the WTO standard of provision, it will therefore be necessary to assess whether the former offer more effective or more immediate remedies.

There is also the question of who has the *right to bring a case* under the dispute settlement provisions of a trade agreement. In the WTO only states can bring cases. Some economic interests feel that this leads to a politicisation of dispute settlement in the sense that governments sometimes wish to avoid upsetting their trading partners for political or foreign policy reasons. Deeper integration agreements may include rights for legal persons (i.e. companies, trade associations, NGOs etc.) to bring cases. This is the case within the EU, where actions can be initiated against national regulators under 'direct effect'. It is also the case in NAFTA and a number of other US centred bilateral agreements that provide for investor - state dispute settlement in some key policy areas. Such rights for legal persons, combined with regional level dispute settlement to rule on areas of ambiguity, can represent as great a challenge to national regulatory autonomy and sovereignty as harmonisation.

If regional enforcement mechanisms provide a channel for 'legal activism' that carries the interpretation of trade rules beyond those widely accepted in the WTO, then one could say they are WTO-plus. Given that the provisions in regional and multilateral trade agreements can be very similar, and regional concepts and legal doctrine are likely to influence the interpretation of multilateral rules. Doctrines developed in preferential agreements can shape wider multilateral interpretations of key provisions or principles.

This process can already be observed in NAFTA, where the investor-state dispute settlement provisions have been used to press home such a broad definition of the *de facto* expropriation rules in NAFTA that it is seen as threatening regulatory autonomy.

On the other hand more extensive dispute settlement provisions at the regional level should ensure more effective implementation. When the regional agreements mirror multilateral provisions, as the case studies below will show is frequently the case, this means that RTAs implement principles contained in the WTO more effectively. More effective implementation is also likely to promote greater confidence and thus result in a growth of regional trade and investment.

Following the Uruguay Round the *WTO provides a fairly strong dispute settlement system* with the establishment WTO panels and the adoption of panel reports now more or less automatic and the Appellate Body to rule on questions of WTO law. The WTO also offers scope for consultation and conciliation. Given the strength of the WTO system countries participating in regional trade agreements are likely to wish to retain their right to bring cases in the WTO. What the WTO does not offer, however, is rapid review and remedies or investor-state dispute settlement. WTO dispute settlement cases can still take 18 months to complete and if one adds the time taken by governments to comply with decisions, it is likely to be years before a company can get any redress for discriminatory application of regulatory policies under the WTO. *Preference* in the area of dispute settlement therefore takes the form of more immediate and rapid remedies for states and particularly companies compared to third parties. Regional 'case law' may also lead to interpretations of common trade provisions that go beyond agreed international interpretations. In this sense regional enforcement mechanisms can pose a challenge to 'multilateralism'.

3.4 Facilitating or limiting trade and investment

When discussing how to assess the impact of RTAs on rule-making it helps to consider analogies with customs union and other tariff based trade theory. Chen and Mattoo (2006) make a similar analogy in their study on the impact of provisions on 'standards' harmonisation in preferential agreements.³ There are perhaps three analogies; preferences, trade creation/diversion and an analogy with optimal tariff theory.

The potential for rule-making to constitute a preference has been discussed in each of the items above, so need not be repeated here.

When does rule-making in RTAs create and when does it divert trade? Efforts to measure the quantitative trade creation and diversionary effects of rule-making in RTAs have only recently begun and there are only a few studies. These were discussed in chapter two and are covered in more detail in each of the case studies. Generally speaking such quantitative studies of the impact of RTAs on rule-making are more difficult than those of tariff preferences.

In the absence of quantitative measures the analytical framework discussed above provides the basis for a qualitative assessment. The analogy with trade creation and diversion is as follows: rule-making in RTAs can be said to facilitate (create) trade and investment through enhanced transparency and greater predictability thanks to the codification of rules in formal agreements. In other words national governments and regulators are locked into a framework of rules so that frequent and costly changes in the overall framework of rules are reduced.

Trade and investment will also be facilitated (created) when, for example, the benefits of economies of scale of supplying the larger market created by the replacement of divergent national rules with common regulatory norms and standards exceed the costs of adapting to the new common standards or norms.⁴ In practice there is very little

formal harmonisation of standards in bilateral and regional agreements. Even the EU, the most ambitious when it comes to seeking harmonisation, has moved away from harmonisation in favour of the new approach (see chapter four). FTAs between the EU and third countries seldom go beyond the general aspiration of progressive approximation to EU standards. This does not, of course, preclude the *de facto* convergence of standards towards to dominant European or US standard (in the case of US FTAs). But it should be stressed that this *de facto* convergence towards the dominant standard may have occurred without any RTA.

Mutual recognition can also facilitate trade without harmonisation. In the case of full mutual recognition, products approved for sale in one market can be sold without any further testing or controls in the other signator(ies) to the mutual recognition agreement. But full mutual recognition only exists between EU Member States and within the CER (Australia – New Zealand Closer Economic Relations) thanks to the Trans-Tasman mutual recognition agreement. In all other cases mutual recognition is limited to mutual recognition of conformance assessment. In other words products tested in an exporting party - that are found to be in conformance with the standards or norms of the importing party in a mutual recognition agreement – can be sold without further testing in the importing country's markets. In practice mutual recognition has only really been effective when the regulatory norms and expectations of the signatory parties are equivalent. As a result there have been fewer MRAs than some thought with the result that they do not appear to be creating the two tier system that was once feared. (Baldwin, 2000).

Trade restrictive effects (diversion) could be said to result when the level of regulatory norms or standards embodied in the common regional rules are such that the costs of meeting these for third country suppliers exceeds any economies of scale gained

from exporting to all signatories to an agreement. Measuring these effects is not an easy matter (see chapter four). A more straight forward criteria for assessing standards is therefore whether the common standards applied in any bilateral or regional agreement are consistent with agreed international standards. This offers a more concrete criteria than the relevant GATT provision that the 'incidence of protection' due to 'other restrictions on commerce' (GATT 1994 Art XXIV) should not increase due to the preferential agreement. Neither the 'incidence of protection' nor 'other restriction on commerce' have been defined to include standards or regulatory norms.

The potential trade facilitating and restricting effects of other common policy measures discussed in the case studies can also be illustrated. For example, the introduction of common contract award procedures for public contracts within a region to replace diverse national procedures could be said to facilitate trade and investment because third country suppliers, as well as regional suppliers, only need to conform with one unified set of rules. These benefits for suppliers to public procurement markets need to be set against the costs for purchasers in terms of adaptation to the new and possibly more complicated common contract award criteria. But detailed analysis of each case is necessary to measure the real effects. For example, in the case of public purchasing, evidence on the impact of more effective transparency in procurement practices as a result of common rules, suggests that the main impact is increased competition and thus benefits in each national economy, rather than increased cross border trade.

The third analogy is with optimal tariffs. Just as optimal tariff theory envisages the use of asymmetric bargaining relationships to shift the terms of trade and obtain welfare gains from tariffs, so the introduction of rules in RTAs can be seen as a means by which a large state or region can shape international rule-making through the use of its asymmetric power. Changes in the balance of power and influence at a multilateral

level have meant that dominant states, such as the US and EU, can no longer assume an ability to shape the 'rules of the game' at this level, so the use of FTAs may well be a means of maximising the asymmetric power of such dominant rule-makers. Developments after 2000 suggest that the 'competitive liberalisation' approach of the US entails the use of sequential negotiation of FTAs with a view to shaping international rules and regulatory norms. In the case of the EU this tendency is less pronounced and the EU has tended to adopt less aggressive approaches to FTA negotiations. But there are aspects of EU FTA policy that clearly seek to export the European approach to rule-making, such as the insistence on inclusion of competition policy in all FTAs. The optimal tariff analogy can therefore find ready application. Indeed it may be more fitting for rules than for tariffs. In terms of rule-making the EU and US remain the main proponents. This is no longer the case for tariffs policy where other major WTO members have assumed considerable influence. Given the relative weakness of multilateral discipline with regard to rule-making there is also very little threat of retaliation against the EU or US should either use their asymmetric economic power to shape rules in their favour. Optimal tariff theory does not bear much relation to current tariff policy because the most powerful states have bound their tariffs in the WTO. In rule-making there are few WTO disciplines, so there is more scope for the exercise of asymmetric power. There are clearly potential benefits for a 'hub' in using bilateral or regional agreements to promote its own domestic approach to rule-making to enhance market access or shift the costs of modifying or adjusting rules onto the trading partner.

But rules, like hegemony, can be both benign and malign. Benign rules would be those that promote regulatory practices that benefit the development prospects and policy aims of both parties. The US or EU might be seen as benign regional hegemony promoting rules that will enhance sustainable development in other economies.

Alternatively 'selfish hegemons' might use asymmetric power to promote rules that predominantly serve their own narrow vested national or even sector interests.

3.5 Conclusions

The analytical framework described above, as the following case studies will show, can be applied to a wide range of policy areas and at any level of regulation. It enables a qualitative assessment of the various regional agreements and how they relate to the WTO system, a comparison of the various RTAs and FTAs and a basis for developing practical criteria for determining which elements of RTAs/FTAs are compatible and which incompatible with multilateralism.

Endnotes

¹ A draft of this analytical framework was in fact included in the Sampson and Woolcock publication of 2003. The version of the framework given here is a somewhat improved version.

² The OECD framework draws on work carried out by the author in the early 1990s. In fact the origins of the research date from work conducted by the author at this time. See OECD 1993 and Woolcock 1995a, 1995b and 1995c.

³ Chen and Mattoo (2006) make the analogy between free trade agreements and mutual recognition and customs unions and harmonisation of standards.

⁴ As discussed in the case study on technical barriers to trade, Chen and Mattoo (2006) find that producers within signatories to agreements that include common policies tend to benefit. According to their model developing country third parties face greater costs adapting to the higher standard in the region and benefit less from economies of scale.

Chapter Four Technical barriers to trade (TBT) (with Sanitary and phytosanitary (SPS) measures)

4.1 Introduction

This first case study discusses the role of regional and other preferential agreements in the field of technical barriers to trade (TBTs) with some comparative material on SPS measures. It illustrates how the analytical framework developed in the previous chapter can be used to provide a qualitative assessment of the role of RTAs.

History shows the vacuum left by weak multilateral rules and insufficiently resourced international standards making was filled by costly, divergent technical regulations, standards and conformance assessment techniques. But widespread international harmonisation has been seen as neither desirable nor feasible. Efforts have been made to find a practicable middle ground between harmonisation and policy autonomy and regional rulemaking in TBTs has played a major role in these efforts.

In general terms there has been synergy between regional and wider multilateral initiatives in the TBT field. Regional agreements had, in particular, a positive effect during the second phase of regionalism when they raised awareness of TBTs and resulted in more resources being channelled into international policy-making. TBT provisions in RTAs also facilitated trade to the benefit of third countries as well as signatories by improving transparency and reducing the impact of costly multiple national TBTs. In terms of their systemic impact, RTAs provided models for reducing TBTs, such as mutual recognition. Regional initiatives were also consistent with international standards in that they did not result in the systematic development of exclusive regional standards at the expense of international standards, although in the

field of voluntary standards, European standards making was predominant.

In the post 1992 period TBT provisions in regional and bilateral agreements have not posed a significant systemic challenge to international rules or standards in the sense that RTA provisions have not been significantly WTO-plus. The dominant rule-makers in the TBT field have not pushed beyond the WTO. The EU, which has been very active in tackling TBTs within the EU has been much more modest in its FTA provisions on TBTs with third countries. Unlike in some other policy areas, the US has not sought to establish binding rules in the TBT field that go beyond the WTO.

There are clear distinctions between the North American and European approaches. Europe has a comprehensive approach to rules on technical regulations, voluntary standards and conformance assessment and one that links regional rule-making directly to international norms. The US has a much lighter touch, with more skeletal rules and relies far more on market forces and “policed non-discrimination.” These two dominant models have shaped and shape international rule-making in TBTs and although the underlying differences have been accommodated within the multilateral rules, there remains a danger that competition between the two dominant players may yet led to regulatory regionalism. This danger has become a reality in the field of SPS measures, which are discussed briefly in section eight to provide a comparison to the TBT case.

Developing countries are generally obliged to follow the norms and standards emanating from the developed economies, and divergent approaches in the EU and US will add to the DC exporter’s costs. Thus, the fact that RTAs have not led to regulatory regionalism is positive. But the signs of regulatory regionalism in SPS rule-making are troubling from a developing country point of view.

Section two provides a brief breakdown of TBTs and their importance before discussing what ‘liberalisation’ or ‘preference’ means in the context of such regulation. Section three applies the general analytical framework to the TBT case. There is then a discussion of the interaction between RTAs and the WTO in the second phase of regionalism and the post Uruguay Round era, before a comparison is made with developments in the SPS field. Section nine concludes the chapter.

4.2 How important are technical barriers to trade?

Work at both the multilateral and regional level in recent years has clarified the nature of TBTs and differentiates between three major forms of trade barrier: technical regulations (TRs), voluntary standards (VS) and conformance assessment (CA) including accreditation.¹ Technical regulations are mandatory rules laid down by regulatory authorities and can apply to *products* (e.g. safety of electrical equipment, chemicals or emission standards for diesel engines etc.) *processes* (e.g. air, water or noise pollution from production process) that may relate to the product characteristics or *labelling*. Whilst the GATT (and RTAs) prohibits discrimination between ‘like products’ in the use of TRs, the introduction of new products and pressure for higher standards from consumers contains the potential for new TBTs.²

New TRs provide scope for *de facto* discrimination, because they can be tailored to fit the interests of domestic suppliers while burdening foreign suppliers. (Nunnenkamp, 1983) Since the 1979 (qualified MFN) ‘Standards Code’ the GATT has required that regulations adopt *the least trade distorting* means available to satisfy legitimate regulatory policy objectives. But no real effort was made to interpret what ‘least trade distorting’ meant and there was a general lack of resources devoted to

implementing the 'Standards Code'. (Nusbaumer, 1984)

Producers forced to comply with divergent national TRs pressed for *harmonised* regulations. But harmonisation posed other problems. National regulatory agencies resisted change. Even where there was an attempt to harmonise, consensus based decision-making provided protectionist vested interests with a means of blocking progress. These limits to harmonisation, even at the regional level, led to the development of intermediate options such as *mutual recognition* (in the EU) and *equivalence* (in North America). Efforts to tackle *de facto* discrimination therefore resulted in rules with a greater or lesser degree of intrusiveness into national decision making autonomy.

*Voluntary standards*³ (VS) are voluntary documents produced by private standards-making institutions. These may be quasi public, national standards bodies, such as DIN (Germany), AFNOR (France) or ANSI (USA), or more sector-based and industry-led as is in the case of the 200 or so major US standards bodies. As standards are drafted in technical committees made up predominantly of (national) producers there is a potential for them to be used defensively.⁴ Standards are voluntary, meaning that products can be sold that do not conform, but they can constitute a *de facto* pre-requisite for effective market access when customers insist on them, or when they are used as a means of proving conformance with mandatory regulations.

The 1979 GATT 'Standards' Code only covered VS promulgated by central government. Pressure, primarily from the US, to discipline the national (and regional) standards bodies in Europe led to the inclusion of a voluntary Code of Conduct for standards making bodies in the GATT 1994 Agreement on Technical Barriers to Trade.

There have been efforts to develop agreed international standards since 1905 in the International Electrotechnical Commission (IEC) and 1947 in the International Standards Organisation (ISO). But these bodies have been dominated by European national standards bodies, in large part because of American antipathy to standards-making in public bodies. The US system is based on market-based industrial standards.⁵

Conformance assessment (CA) involves 'any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.'⁶ The effectiveness and credibility of technical regulations and standards depends on products conforming and being seen to conform to rules. The accreditation of the integrity and professionalism of the body doing the testing is therefore also a factor.

GATT rules require non-discrimination for CA, but again national treatment only touches the tip of the iceberg of potential discrimination. *De facto* discrimination in conformance assessment can occur unless test conditions are harmonised. For example, emission tests for cars are based on typical loading conditions that seek to simulate town and motorway driving, but unless there are similar loading conditions a car may comply in one country but not another. As with TRs and standards, asymmetry in the provision of information on conformance testing can also easily constitute an important barrier if foreign suppliers do not have information on testing methods.

The costs of conformance assessment have led to efforts to avoid duplication through the *recognition* of product testing carried out in the country of origin. But importing country authorities will generally only accept test results from the country of

origin when the test laboratory is accredited as meeting international standards.

There has been little systematic work on the impact of TBTs on trade in general and even less on the impact of regional or bilateral rules on TBTs. (Baldwin, 2000; World Bank, 2000) A world Bank survey of quantitative studies found only two, which both suggested a positive correlation between 'standards' and increased trade. (Swann et al 1996; Moenius, 1999). This is probably due to the fact that TBTs pose 'an almost insurmountable analytical challenge' for quantitative measurement. (Deardorf and Stern, 1998, pg 45). A World Bank programme involving survey data is underway to try and measure the impact of TBTs (on development). (Markus and Wilson, 2001) This is beginning to produce some results. Developing countries are likely to find difficulties due to the costs of testing and delays resulting from conformance assessment. Diverse regulatory norms and standards are likely to also cause difficulties. The issue is therefore whether regional or bilateral FTAs help third countries in general - and developing countries in particular - by reducing the number of norms or standards that exporters must comply with, or hinder them by raising the level of norms or standards. Clearly, much will depend on the capacity of the exporting country to satisfy the levels of standards and indigenous certification and testing capacity.

Chen and Mattoo (2006) have sought to assess the impact of RTA 'standards,' including mutual recognition agreements using data from 28 countries (both developed and developing). They produce theoretical and empirical evidence that regional (and bilateral) 'standards' increase trade between participating countries, but not necessarily with the rest of the world. Developing country exports might also be reduced, due to the stringency of TBT provisions in the developed markets. Chen and Mattoo found

mutual recognition agreements to be more uniformly trade promoting provided these did not contain restrictive rules of origin.

The work by Chen and Mattoo breaks new ground in that it is the first real attempt to measure the trade effects of 'preferential agreements' in the TBT field. The work develops a model that envisages a number of possible implications of TBT measures at a regional level including harmonisation (in which it is assumed 'standards' are harmonised at the level of the more stringent national 'standards' and mutual recognition. The model developed suggests that third country suppliers of products subject to regional harmonisation stand to benefit along with suppliers from the signatories, because the economies of scale in supplying the larger market with one standardised product outweigh the costs of retooling to the different (higher) standard, but suppliers from developing country will not benefit as much because the costs of retooling are higher, because these producers tend to have lower fixed costs than developed country producers and because the benefits of economies of scale are lower as developed country suppliers gain more of the market. The model suggests that mutual recognition is however, more beneficial, provided there are no restrictive rules of origin.

There are a number of weaknesses in the Chen and Mattoo approach. (i) At a conceptual level the work does not appear to make a distinction between mandatory technical regulations and voluntary standards, but follows the (North American) practice of calling all 'standards'. This is important because with voluntary standards third country suppliers can still sell into the market even if its products do not conform to the prevailing standard. In terms of voluntary standards the model does not compare the effects of regional standards harmonised in public standards institutions to the

effects of a market based dominant standard. It is not clear whether the study covers technical regulations or voluntary standards or both. (ii) There is also some lack of clarity on the use of mutual recognition, possibly resulting from the analogy between mutual recognition and FTAs.⁷ Contrary to the case for tariffs in an FTA, mutual recognition does not mean automatic right of access to the whole market, except in the case of the EU or the CER. The model seems to assume that mutual recognition does imply automatic right of access. This is important when it comes to one of the central conclusions of the model, which is that the benefits of mutual recognition are undermined by the application of rules of origin to agreements on TBTs in preferential agreements. The application of rules of origin will have a significant impact when full mutual recognition applies, as a product coming from a third country (say Indonesia) will not have originating status in the preferred country (say Australia) and thus not benefit from the *automatic* right to be freely sold within the preferential area (e.g. the EU under a mutual recognition agreement between the EU and Australia). In case of mutual recognition of test results, products originating in a preferred country (Australia) must still conform to the technical regulations or standards of the importing country (the EU). Third country (Indonesian) products sold in Australia must equally be tested as in conformance with EU regulations or standards before they can be sold within the EU, in the same way as products sold directly from Indonesia. In the model Chen and Mattoo appear to assume full mutual recognition (page 13), but in practice most MRAs only provide for mutual recognition of conformance assessment/test results. Existing GATT disciplines prohibit discrimination in conformance assessment, so that developing country (Indonesian) products must be treated the same as those from a preferred supplier (Australia) or for that matter domestic (EU) products

when it comes to conformance testing. (iii) In terms of the model itself, the findings rely heavily on the assumption that developing country suppliers will have lower fixed costs associated with compliance than developed country suppliers. One might question whether this is always the case for the more advanced developing countries, where production functions may not be very different from those in developed economies. The least developed countries are more sensitive to SPS measures, where meeting developed country standards could well mean higher fixed costs. (iv) The model assumes common 'standards' within an FTA will always be at or near the level of stringency of the most developed. This may well be the case in practice, but there is no discussion of how this 'standard' relates to the relevant international standard. If the common regional standard is the same as the agreed common ISO, IEC or other standard this will affect the costs and scale economies. For example, conformance with an agreed international standard will mean global economies of scale. (v) Finally, the model focuses on 'standards' or what have been termed substantive measures in the analytical framework in chapter 3. These may be important, but so are other aspects of rule-making in TBTs. Improved transparency can reduce the costs for third countries. Low levels of stringency of norms with a lack of transparency can be as problematic for exporters as high levels of stringency. Experience suggests that conformance assessment can be as much a problem as the level of the 'standard'. The Chen and Mattoo model does not account for different forms of conformance assessment such as self-declaration by exporters (with technical dossiers), type approval or item-by-item conformance assessment. Self-declaration with even some stringent standards may be less onerous than item by item testing with less stringent standards. There is also the issue of the use of exemptions from rules (regulatory safeguards) and what sort of

remedies exporters have against abuse of such regulatory safeguards.

In addition to these issues related to measuring the trade effects there is also the wider question of how to measure trade and economic welfare effects against welfare gains from regulation in terms safer or more environmentally sustainable products.⁸

The expectation must be that if it has not been possible to find unambiguous quantitative results in studies of the much more transparent effects of tariff preferences, it will prove even more difficult to produce anything clearer on the effects of TBTs.

There is anecdotal evidence that TBTs constitute an important barrier to trade. (Economists Advisory Group, 1987) A 1996 European Union study has suggested that 76% of intra-EU trade is affected by technical regulations that added in the order of 2% to the costs of production for manufactures. (OECD, 1999) OECD estimates for all countries put the costs of TBTs at between 2-10% of production costs. (OECD, 1996). Other partial data (usually originating from producers with an interest in stressing the costs of rules and conformance assessment) suggest that 65% of US exports of manufactures were subject to some form of TBT. The costs of 'duplication' of product testing of telecommunications equipment have been put at \$1.1 bn in US – EU trade alone. (David and Steinmuller, 1996) The APEC has produced a similar figure of \$1.8bn. (Wilson, 1998)⁹ It is also argued that the costs of conformance assessment are reflected in the revenue figures for US test laboratories, which were \$10bn a year in 1993 and growing at 13% a year. (Markus, Wilson and Otsuki, 2000)

Survey data has consistently shown TBTs to be a priority area for business. This was the case in the EU's Single Market programme, (European Commission, 1986d), with the Transatlantic Business Dialogue (TABD) and the APEC business forum. (Asia Pacific Foundation of Canada, 1998) Finally, TBTs have been one of the

first policy areas addressed in trade agreements after tariffs. TBTs were a priority for the Tokyo Round Codes on non-tariff barriers in the 1970s, accounted for more than 50% of the EU's Single Market Directives in the 1980s and rules to address TBTs have been included as a first step towards deeper integration in RTAs. Governments and the private sector have also invested considerable time and resources in negotiating some 30 bilateral mutual recognition agreements, of which MRAs between the EU and third parties account for 12. (World Bank, 2000 pg 15)¹⁰

4.3 Application of the analytical framework

This section illustrates how the framework can be applied to the TBT case and provides the basis for the comparison of RTA provisions with one another and with multilateral rules for a range of RTAs that are summarized in Charts 4.2 and 4.3. It offers a framework for qualitative assessments of the impact of RTAs in the field of TBT given the difficulties with quantitative measures.

Chart 4.1 Application of the analytical framework to the TBT case

Coverage:

TBT rules at the regional and multilateral levels typically cover all sectors with regard to principles such as non-discrimination or the application of transparency rules. But sector specific measures are often found when it comes to substantive rule-making such as harmonisation or mutual recognition. For example, there are sector specific harmonisation provisions in NAFTA and the EU and mutual recognition agreements are nearly all limited to specific sectors (with the exception of internal EU mutual recognition).

GATT rules apply only to central government with 'best endeavours' provisions for sub-central government. RTAs that reach down beyond the level of central government to require binding rules at the sub-central government level will therefore go beyond the WTO.

The GATT 1994 Agreement on Technical Barriers to Trade includes only a voluntary code of conduct for standards making bodies. RTAs therefore go beyond the WTO if they include binding rules for standards making bodies and/or more comprehensive rules for conformance assessment.

Principles

Rules requiring non-discrimination in the application of technical regulations or conformance assessment have existed in the GATT for many years and feature in all RTAs. RTAs that require *national treatment* in TRs and CA are therefore unlikely to go beyond the WTO rules. But facially non-discriminatory TRs can still constitute a *de facto* barrier to market access. Rule-making may attempt to address this problem by requiring the use of other principles such as the use of the '*least (or less) trade distorting provisions.*' Some rules may offer a definition of least trade distorting, for example the TBT Agreement in the

Uruguay Round defines 'least trade distorting' as equivalent to measures that satisfy 'legitimate objectives' (which tends to shift the debate onto what is a legitimate objective).

Transparency:

TBT provisions typically require *notification* of technical regulations, conformance assessment procedures and/or standards. One test of the stringency of transparency rules is whether they require *prior notification* and whether potential suppliers have an opportunity to make *submissions or comment on the rules*. Some agreements may also contain obligations on the regulator or standards making body to give a *reasoned response* to such submissions. For example, a regulator may be required to explain why it has not made use of existing international standards when it specified a national standard. Rules may give foreign suppliers *equal right of access* to regulatory procedures. Finally, notification of proposed rules may provide for cessation of work on national rules until regional or international initiatives have been explored, such as in the EU and the Trans-Tasman Mutual Recognition Agreement (TTMRA).

Substantive provisions:

Most OECD countries have adopted the view that *national treatment* is insufficient in addressing TBTs, because of the scope for *de facto* discrimination in TR, VS and CA. (OECD, 1997, Chapter 6). TBT rules involving developed economies therefore tend to include substantive rules such as *approximation* of TRs, CA or VSs as a *general aim*, *selective harmonisation* (for key sectors), *harmonisation of essential requirements* (as in the EU) or *full harmonisation*. Because of the difficulties and potential costs of harmonisation there has been a move to include *recognition* or *equivalence* as a means of facilitating market access whilst leaving national regulatory entities with some regulatory autonomy. Recognition generally takes the form of mutual recognition of test results. Only in exceptional cases do rules provide for full mutual recognition, which means that the countries concerned effectively recognise each other's regulatory regimes as equivalent.

The use of *equivalence* in TBT rules is rather different. Equivalence, for example in the context of NAFTA, is a generalised aspiration. In the NAFTA application there are no implementing provisions, so national regulatory bodies effectively retain regulatory autonomy. The principle is the same as for mutual recognition, but implementation is entirely up to the political will of the parties, subject to any reviews or remedies available under the relevant dispute settlement provisions.

Co-operation:

Agreements on TBTs typically include provisions on co-operation, such as *committees on TBTs* to promote the development of common technical regulations, standards and conformance assessment and may provide for *financial and technical co-operation*. For example the WTO has established the Standards and Trade Development Facility for this purpose. Agreements may also provide for *exchanges* or *twinning* of regulators, standards bodies or conformance assessment agencies, to promote common norms or mutual recognition.

'Regulatory Safeguards':

In the area of TBTs the regulatory safeguard takes the form of exceptions to protect *human, animal or plant life*. At the multilateral level Article XX (b) of the GATT 1994 provides for such an exception and equivalent provisions exist in all regional agreements. The danger with such exceptions is that they may be abused to provide covert protectionism. Rules are therefore also likely to include some form of *proportionality principle* to ensure this discretion is not abused. As for all 'regulatory safeguard' measures, how these provisions are interpreted will be important.

TBT rules may also provide a right to maintain *higher standards* (than the internationally or regionally agreed standard). This is the case in both the EU and in NAFTA and can be considered to be a regulatory safeguard. An important issue here is whether the rules leave the *burden of proof* of the need for higher standards with the exporter or the importing regulator.

Interpretation and enforcement

The interpretation will shape the scope of rules. The GATT rules are loose and there have as a result been few cases brought under dispute settlement. At the other extreme, the European Court of Justice's (Dassonville, ECR) interpretation of Article 28 (TEU formerly Art 30 EEC) goes well beyond the

GATT in arguing that *all* national regulatory measures may be potential barriers to trade.

Access to dispute settlement, reviews and remedies is crucial, because new regulations and standards are being generated all the time. Agreements may therefore provide for *review* of the regulatory decisions and *remedies* in cases of non-compliance. To enhance implementation and enforcement, agreements may include *specific dispute settlement*, *central enforcement* through official bodies or facilitate the use of private actions through the courts through *product liability laws*

What is the impact of a preferential agreement on TBTs? Unlike tariffs, which by definition discriminate against foreign products, TRs, VS and CA are *de jure* non-discriminatory and are applied to all (like) products. But the *de facto* position varies for different elements of rule-making?

Reference to the analytical framework suggests that regional TBTs may constitute a preference if they are more extensive in coverage than the WTO by including sub-national regulators or private standards bodies. There may also be procedural preferences in the transparency field in the sense that non-regional parties may not have a 'seat at the table'.¹¹ Closer co-operation between regional standards making bodies or regulators, such as promoted by many FTAs may also be seen as a form of preference. Mutual recognition agreements constitute a clear preference in that it is only the signatories benefit. (Trachtman, 2002; Baldwin, 1990)

Equally one could argue that regional harmonisation constitutes a form of preference because third parties are excluded from the decision making process for setting regional standards and that this is likely to result in *de facto* discrimination against non-signatories. Such a preference would be more important if the regional standard or regulation goes beyond any relevant international standard.

A regional preference in conformance assessment would exist if suppliers from non-preferential countries were subject to tougher compliance testing, but such blatant discrimination is prohibited by the national treatment rules of the WTO. More rapid

remedies in case of non-compliance may be seen as a preference. This is especially important in the TBT field because WTO dispute settlement and other remedies are seen to be too slow to be of much practical value.

Finally, a regional preference might result if there are tighter definitions of proportionality or necessity tests than in the WTO. In other words exports from third countries may face greater discretion in the application of such rules and thus be disadvantaged. The application of the GATT in this area is unclear, although Trachtman (2002) argues that recent Appellate Body decisions imply that RTAs are obliged to extend such tighter controls of discretion on an MFN basis.

On the other hand, common rules and standards can facilitate trade. Indeed, much of the effort in addressing technical barriers to trade has gone into developing common standards or recognition agreements that can get around TBTs. The evidence from the EU, which has gone furthest in this area, suggests there are significant gains from the introduction of common rules (European Commission, 1986a) and initial findings for other agreements suggest a positive correlation between common 'standards' and increased trade.

The analogy with trade creation and trade diversion introduced in chapter three is however, useful here. It can be argued that RTA provisions on TBTs facilitate trade in the sense that they replace a set of diverse national rules. If compliance with one set of rules ensures access to the whole regional market, then one can say that the rules have facilitated trade. The frictional costs of compliance with TRs, VSs or CA will be less than when a supplier has to comply with a set of different rules.

If, on the other hand, an RTA results in common regional TRs, VSs or CAs set above the level of the national regulations one could say that the RTA is trade

restrictive. The experience with regulation among developed economies is that harmonisation (even if only partial) tends to be towards the higher end of the spectrum of national regulations rather than the lower end. (Vogel, 1995)

At present there is no agreed view on what might constitute a preference in the field of TBTs. As mentioned in chapter two, the trade literature either neglects the topic, argues that regulatory harmonisation is *per se* a bad thing or concludes that deeper integration will tend to be non-discriminatory. Nor is there any agreed legal interpretation of GATT Article XXIV with regard to TBTs. (Trachtman, 2002)¹² This chapter therefore begins to fill the gap in the literature by providing a qualitative assessment of the impact of TBT rules in RTAs.

4.4 A history of interaction?

When the GATT was adopted there was recognition that a range of non-tariffs barriers to trade would persist, even as tariff barriers were removed. The Article III (GATT 1947) national treatment provisions were arguable applicable (but not applied) to discriminatory (mandatory) domestic regulation. But even GATT 1947 provided for exceptions, a regulatory safeguard, in the form of Article XX (b) when discrimination was 'necessary to protect human, animal and plant life or health', provided these were not abused to form 'disguised restriction(s) on trade'.

There were important limitations to these early multilateral rules. They only applied to technical regulations, not to voluntary standards promulgated by non-government bodies or to conformance assessment.¹³ There were no transparency rules requiring notification of TRs, let alone VS and therefore no check on national rulemaking, nor was there an effective dispute settlement procedure. With weak rules

and the interests of governments and industry focused on tariffs and the GATT non-discrimination principles were not applied to TBTs.

It soon became apparent, however, that technical regulations constituted a potential barrier to trade. There was particular attention paid to TBTs in Europe, where those drafting the Treaty of Rome were aware of the risk that non-tariff barriers could emerge. Article 28 (TEU) *et seq* therefore prohibited measures having the equivalent effect of tariffs. But in the EEC as in the GATT, it took years and a number of European Court of Justice (ECJ) cases before the European provisions began to bite.¹⁴

The EEC sought to promote harmonization of technical regulations and standards during the 1960s and 1970s in order to reduce the scope as TBTs, but work was slow. At an international level, work on the trade impact of TBTs was carried out in the OECD. This was fostered by the growing awareness of TBTs and helped frame the negotiations on TBTs in the Tokyo Round of multilateral trade negotiations from 1973-79.

4.4.1 The Tokyo Round 'Standards' Code

The Tokyo Round Code confirmed national treatment for (mandatory) technical regulations and sought to enhance transparency by requiring notification of new regulations to the GATT Secretariat. The GATT was also to provide a clearing house to enable other GATT contracting parties (CPs) an opportunity of commenting on proposed TRs. Information clearing houses were also to be established in each country that could provide information on technical regulations. But the GATT Contracting Parties were only required to notify regulations that 'had a significant

effect on trade of other parties.' Inevitably few notifications were made, because to notify was tantamount to confessing that the measure would adversely affect other countries' trade. The Code did however, go a little beyond national treatment by requiring that the 'least restrictive means' be employed in the pursuit of any national policy objective.

The Code urged governments to use *performance standards* 'whenever appropriate' and *international standards* where they existed, except where 'inappropriate'. But this weak wording meant that there remained ample opportunities to use national design standards.¹⁵ Combined with the neglect of work on international standards during the 1970s (and subsequently), this resulted in national standards becoming more numerous and influential than the limited number of agreed international standards.

One important innovation with the Code was the introduction of a dispute settlement procedure based on a three phase procedure of consultation, technical committee work and a final panel report. But the weak wording of the Code, the broad scope for exceptions under Art XX of the GATT, the difficulties in reaching a balanced view on scope for national discretion and the need for consensus to adopt panel reports, all meant that the rules were not effectively applied. The fact that the Code was only signed by OECD countries along with just 12 developing countries and that it did not cover sub-central government or private standards-making bodies were further weaknesses. These shortcomings might have been at least partially overcome, had it not been for the general lack of any sustained and well resourced effort on the part of the parties concerned to make the agreement work, or to develop the international standards that would have been needed to provide alternatives to national

design standards.

4.5 The active period of interaction between 1985 and 1995

Regional initiatives during the 'second phase' of regionalism had a significant impact on rulemaking in the TBT field. In particular the redoubling of efforts to address TBTs within the EU provided a model that was partially emulated in the CER, NAFTA, APEC and Mercosur. The EU initiatives during the 1980s also provided an incentive to strengthen multilateral rules in the WTO and international standards making. There was pressure from both within and outside the EU to ensure that stronger European standards did not diverge from international standards. These regional initiatives both influenced and were influenced by multilateral rules. So that one can say they constituted building blocs for more effective multilateral rules.

4.5.1 The European approach including EU bilaterals

European efforts to remove TBTs are long-standing and provide the most comprehensive model for rule-making in this field. It is not the purpose here to provide a comprehensive treatment of EU rules, but to summarize the EU approach so that it can be compared with the multilateral rules in the WTO and other regional rules. As noted above Art 28 *et seq* (TEC) was interpreted to prohibit national regulations that had an equivalent effect to tariffs in restricting intra-European trade. Article 30 (TEC) provided the regulatory safeguard or exception equivalent to Art XX of the GATT. Even with the expansive interpretation of Art 28 by the ECJ, however, these provisions proved inadequate.

Once the customs union had been created at the end of the 1960s the EC

embarked on a major programme of harmonization based on Art 94 (TEC) to create a genuine common market. Foremost among the non-tariff barriers addressed were the national TBTs. On the basis of proposals by the European Commission efforts were made to harmonise technical regulations for a number of industries including, in particular food and automobiles. But harmonisation proved laborious due to the need for consensus and provoked opposition from those seeking to retain national policy autonomy or averse to changing established rules.

There was a similar picture in standards making, in which national standards institutions were producing standards far quicker than the European standards bodies. By the early 1980s there were twenty three thousand DIN (Deutsche Industrie Normen) standards and between six and eighteen thousand standards in Britain (BSI), France (AFNOR) and Italy (UNI), compared to only about 2,000 European standards. In the early 1980s pressure from business to end the *de facto* fragmentation of the European market and disputes between EU Member State governments provided the impetus for the adoption of a new approach.

The new approach was adopted as part of the Single European Market initiative in the second half of the 1980s, but its origins can be traced back to a 1973 EC Directive on low voltage electrical equipment (LVD). This introduced the idea of using agreed European standards developed by CENELEC, as a means of indicating conformance with agreed minimum essential requirements. The Directive itself was modelled on a German law on safety of equipment the *Geraets sicherheitsgesetz*. (Schreiber, 1991) The LVD was successful in removing virtually all TBTs in the consumer electrical equipment sector by the mid 1980s. (European Commission, 1986a) The principle of mutual recognition based on minimum essential requirements

was then taken up by the ECJ in the famous 1979 *Cassis de Dijon* case. In this the ECJ ruled that a product sold as safe in one country could be sold in other countries, provided it satisfied certain minimum essential requirements.

The new approach involved the application of this idea to the entire field of TBT rules within the EU.¹⁶ Its aims were (i) to check the growth of national regulations and standards, (ii) to harmonise only the minimum essential health and safety requirements, (iii) to provide for mutual recognition of regulatory norms, (iv) to promote the development of European voluntary standards to facilitate assessment of compliance with the minimum essential requirements; and (v) to establish flexible but effective certification and conformance testing procedures. (European Commission, 1985)¹⁷

The EU approach to TBTs is *comprehensive* in the sense that it has detailed provisions covering technical regulations, voluntary standards and conformance assessment. There are even detailed provisions on the accreditation of the testing laboratories that conduct conformance assessment.

The EU rules require *national treatment* and MFN within the EU, but these general principles were not considered sufficient. Non-discrimination principles had applied from the beginning of the EEC and had little impact. Indeed, TBTs were seen to be growing as more and more national TRs and VSs were introduced.

In order to check the growth of national TBTs the EU introduced *enhanced transparency* rules that required the prior notification of first all new national technical regulations and later standards.¹⁸ On notification, work on national regulations or standards had to stop for a period to facilitate consultations. If during these consultations, the European Commission or a Member State believed that the new TR

created a barrier to trade, the Commission could be asked to propose a common TR at the European level. The national TR must then be withdrawn. In the case of VS a EU Standing Committee could decide whether to refer the issue to CEN/CENELEC (the European standards institutions) with a view to adopting a European standard. If this happened the national standard must then be withdrawn. This procedure has functioned reasonably effectively and helped ensure European TRs and VSs have kept pace with national rulemaking.

These new rules improved transparency considerably and as information was in the public domain and thus accessible for third parties. These EU provisions went well beyond the GATT rules, which contained, for example, no freezing of national measures. It is difficult to see these provisions as a form of preference. If anything they were making a better job of transparency than the existing weak GATT rules. In terms of the decision-making process, however, there was and remains no provision for third parties to comment or make submissions on the EU regulatory or standards making process. This contrasted in particular with the *de jure* position in the US, where the US Administrative Procedures Act provides for the participation of all interested parties in work on TRs.

The new approach limited harmonisation to minimum essential requirements (MERs) and used agreed European/international standards as a means of indicating conformity with these MERs. (Pelkmans, 1987; Egan 1991) The EU then introduced *full mutual recognition*. Reference to European or national standards could be used as one means of proving conformance with the MERs. The conclusion of the European Economic Area (EEA) agreement in 1992 extended the whole procedure to EEA members.

This approach has implications for third country suppliers. Any non-EC (or EEA) origin product, which is found by a certified national body to be in conformance with the EC minimum essential requirements can be sold throughout the entire European Union (inclusive of EEA countries). The third country supplier therefore still faces the hurdle of meeting the EU TR, but effectively faces only one test for the whole EU rather than individual national tests.

Mutual recognition is perhaps the most important model the EU has provided for addressing TBTs. It offers a means of removing the scope for TBTs to restrict market access without requiring extensive harmonisation. But experience has shown that mutual recognition only really works if there is broad equivalence in national regulatory policy objectives and conformance assessment standards. This has, in effect, meant that rather than lead to a 'race to the bottom,' the application of mutual recognition has constituted a form of re-regulation at the European level. (Majone, 1990; Nicolaidis 1996)

For mutual recognition to work there was a need for *common European standards* that could be used to show conformance with the minimum essential requirements. Standards making in Europe is the responsibility of the private national standards institutions working together (or not) in European standards bodies, such as the European Committee on Standardisation (CEN), the European Committee for Electro-technical Standardisation (CENELEC), the European Telecommunications Standardisation Institute (ETSI) and other functional committees. As part of the drive to complete the SEM, the European Commission moved to mandate the work of CEN and CENELEC in return for funding work on standards needed for the new approach directives.

In October 1990 the European Commission produced a 'Green Paper on Standardisation', which proposed the introduction of qualified majority voting in a new European Standards Body to steer work on standards and liaise with international standards bodies, such as the ISO.¹⁹ This bid for stronger 'regionalisation' of standards-making was blocked following opposition from industry, which was unhappy about being asked to pay more for standards while having less say in the way they were drafted. The national standards bodies also opposed the proposals because they felt they were at odds with the consensus based system of standards making and because they wished to defend their turf. (Jorges et al 1998) Third countries feared the development of a European preference in standards. Rather than a centralisation of decision making in the EU, what happened was a consolidation of co-operation between the CEN and the ISO in the so called Vienna agreement of 1990. This provided for the exchange of information, for transferring work on specific standards from CEN to ISO and for the adoption of ISO standards as European standards.²⁰ Similar procedures were agreed between CENELEC and IEC in a Lugano agreement.²¹ This episode is of interest because it showed how an initiative at the regional level stimulated efforts to strengthen international standards making. It also showed how regional actors, backed by pressure from third country suppliers, opted for cooperation between the regional and international levels rather than opting for a regional preference.

For full mutual recognition to function it was also necessary to have a common approach to certification and testing. Without such a common approach it was believed, with justification, that national regulators would not recognise products from other Member States as equivalent. The EU therefore adopted the Global Approach to

Certification and Testing in December 1989.²² This provided for flexibility in conformance assessment that could use manufacturer's self declarations, type approval, verification unit by unit or full quality assurance, depending on the risk. The EU also introduced harmonised standards for conformance assessment bodies (EN 45000 series). Mutual recognition applies throughout the EU.

With regard to third country suppliers, the EU provides national treatment in the sense that where, for example, a manufacturer's declaration accompanied by the maintenance of a technical dossier is sufficient within the EU, the same will be true for a non-EU origin product. Where a product must be submitted for type approval to a 'notified body' in the EU the same procedure applies for EU as non-EU products. In this sense the EU complies with what has been called 'open recognition' (Trachtman, 2002, pg 491).²³ But the EU only recognizes third country test results if; (i) the competence of the non-EU testing and certification bodies is on a par with those in the EU, (ii) mutual recognition arrangements are drawn up and issued directly by the bodies designated in the agreement; and (iii) there is a balance of advantages, i.e. reciprocity.²⁴ (The EC Council Resolution of 21 December 1989). In effect this means that the EU will grant mutual recognition only when other countries EU conformance testing and accreditation (by a central authority) and offer a 'once-tested-approved-everywhere' access to the domestic market. The EU has negotiated bilateral mutual recognition agreements with the USA, Australia, New Zealand, Canada, Japan and Switzerland. But the EU's high expectations on conformance assessment have meant that the aim of extending the EU's mutual recognition more widely has not (yet) been achieved. The wider applicability of the EU's global approach to conformance testing is therefore limited, but the use of quality assurance standards, such as ISO 9000 (or

EN 29000) and quality assurance standards for conformance assessment laboratories could be used as a means of helping to promote mutual recognition.

Under EU rules, national regulators can establish higher standards and regulations through the exemption to non-discrimination provided in the treaty. The burden of proof that stricter standards are required rests with the regulator imposing the higher standards. The criteria for assessing whether such exceptions are justified have evolved at the EU level through ECJ decisions, subsequently codified in EU Directives. According to these (a) the restrictive effects should not be 'out of proportion' to their contribution to fulfilling legitimate policy objectives and (b) exceptions should only be accepted if the legitimate 'objectives cannot be attained by other means that are less trade restrictive'. The ECJ has also repeated found that labelling offers a less trade distorting measure than more stringent standards, such as in the *Cassis de Dijon* case.

This discussion of the EU approach to TBTs illustrates clearly how the analytical framework can be applied. The framework captures the key elements of the European rules on TBTs as indicated in Chart 4.2.

The EU 'domestic' provisions on TBTs had a significant effect on TBT rulemaking in the wider international system. First of all, the EU rules contributed to clarifying the nature of rule-making relating to TBTs. Developments in the EU were carried over into the Uruguay Round Agreement on TBTs. For example, the clear differentiation between TRs, VSs and CA is carried over into the WTO rules, as are concepts such as the use of mutual recognition. There was a positive synergy between the evolution of rule-making in the EU and in the WTO. The EU approach was also partially emulated in other regional agreements, such as the ANZCERTA, which

applied full mutual recognition, and in a much weaker form in other regional agreements such as the NAFTA, see below.

Second, the resources put into TBT rules in the EU led to other countries doing more to match the EU effort in order to ensure that EU rules and standards did not dominate. In other words here was a case of a regional initiative stimulating international and multilateral work on rules.

In concrete terms the comprehensive EU domestic regime went well beyond the WTO by incorporating detailed rules for TRs, VSs and CA. The transparency provisions required prior notification and facilitated trade and investment, but decision making on TBT related issues in the EU remained relatively opaque.²⁵ In terms of the non-discrimination principles the EU was GATT/WTO conform, with all new rules applying to third country 'like products' in the EU. Thus third parties benefited from enhanced access to the EU market. This, together with mutual recognition within the EU, considerably facilitated trade for third countries. EU TRs were on the other hand set at a higher level than was the case in some of the Member States. For those Member States with well established TRs and VSs the level of rulemaking remained largely unchanged.

The degree of preference in EU rules on TBTs has not been particularly marked. Mutual recognition agreements with third countries that were envisaged as a means of extending the EU model internationally have been painfully slow and difficult to negotiate. In the standards field, the other area where the EU might have used its dominance to push European standards at the expense of international standards, opposition to such a selfish hegemon approach led to an explicit undertaking by the EU that European standards work would be channelled through the

international standards-making bodies.

4.5.2 *The Americas*

The US approach to rules on TBTs in trade agreements is, like the EU, shaped by its domestic regime. The US federal structure means that TBTs can impede interstate commerce when the states use their considerable powers to introduce safety and environmental regulations.²⁶ The US approach to these issues has been a rather inconsistent application of the 'least trade restrictive' principle to interstate trade by the US courts.²⁷ ²⁸ If anything, the US Supreme Court has been more cautious (in restraining the regulatory autonomy of the states) than the ECJ, has been in restraining EU Member States, which has been driven by a desire to create a genuine common market in the EEC/EC. (Sykes 1995).

Standards making is 'industry-led', in other words individual firms or fluid coalitions of companies and other stake holders, determine US standards rather than the quasi public American National Standards Institute (ANSI). This is illustrated by the Internet Engineering Task Force (IETF) that developed internet protocols, where membership was open and the only requirement of delegates at IETF meetings was that they 'wear shirts or blouses'. (OECD1999a) This contrasts with the standards making by technical committees in quasi-public standards bodies in Europe. The US system eschews any centralisation with the result that there are some 175 standards making bodies in the US recognised by ANSI. Both ANSI and NIST (National Institute of Standards and Technology a part of the Department of Commerce) have much less central control over the 'pluralist' US system than even the CEN/CENELEC and European Commission at the European level. Conformance

assessment and accreditation are also market based with private test laboratories doing the testing as in Europe. But there is no central, federal, accreditation of testing laboratories for conformance assessment, which has been a major stumbling block in the EU - US negotiations on mutual recognition agreements.

4.5.2.1 *The CUSFTA and NAFTA*

As in other policy areas these domestic arrangements shaped the US approach to TBT rules in FTAs. This means, among other things, a relatively low priority for TBT provisions in FTAs, because the issue does not figure highly in the national policy debate. The Canada-US Free Trade Agreement (CUSFTA) provisions on TBTs were just nine short articles that essentially reaffirmed the 1979 GATT 'Standards Code.' (Article 602)(CUSFTA). The agreement was limited to central government, requiring national treatment for TRs and CA and, again in line with the GATT Code, the use of the 'least restrictive measure' in any national policy. (Art 603). With regard to conformance assessment CUSFTA provided for recognition of assessment showing exports satisfying the TRs of the *importing* country. Regulators were expected to accept the results of the other country's CA, or provide a written explanation of why this was not possible. (Art 606)

There was no effort to harmonise regulations or standards. Although the Parties undertook to engage in further negotiations with a view to making 'standards-related' measures compatible, there was little progress. CUSFTA included weak wording on international standards requiring these to be used 'to the greatest extent possible'. Here CUSFTA also only required 'best endeavours' ('such reasonable measures as may be available') to promote the objectives of the agreement with respect to private standards

making bodies.

NAFTA uses the CUSFTA/GATT Standards Code model. As NAFTA was being negotiated at the same time as the Uruguay Round, negotiators were aware of the modifications to the TBT agreement being considered at the multilateral level. In its TBT provisions, however, NAFTA is only slightly WTO-plus with regard to some procedural measures.

The *coverage* of NAFTA is again limited to central governments, with sub-central government only covered by best endeavours wording requiring the Parties to take 'such reasonable measures as may be appropriate' (Art 902) to ensure implementation by these other levels of government and non-governmental (i.e. standards making) bodies.

As with the CUSFTA, the NAFTA requires national treatment for technical regulations, standards and conformance assessment. But unlike the GATT Code it did not require the use of 'least trade restrictive measures'. This was due to opposition from environment NGOs and US labour to what they saw as NAFTA resulting in a 'regulatory race to the bottom.'

On the other hand NAFTA appears to go further than the WTO TBT rules with regard to *transparency* in decision making (due process). For example, it requires a prior notification of 60 days for any new TR. Unlike the WTO, but in line with US administrative procedures practice, NAFTA extends national treatment to decision making. Given the access granted to interested parties by US legislation to administrative procedures, this means parties from NAFTA signatories have considerable access to regulatory decision-making.

In terms of *substantive rules*, the NAFTA middle ground between

harmonisation and regulatory competition is much closer to regulatory competition. It promotes ‘*compatibility*’ of national technical regulations, ‘to the greatest extent possible’. (Art 906(1))²⁹ but compatibility is not defined and appears to be used in broadly the same sense as policy ‘approximation’ in the EU. There is compatibility when the TRs of other signatories are treated as *equivalent*, which is achieved if the exporter has shown to the satisfaction of the importing country that its product meets the importing country’s legitimate policy objectives. (Art 906(4)). If the importing country does not accept equivalence it must say why, thus facilitating transparency in enforcement. The concepts of compatibility and equivalence are not defined and therefore leave considerable scope for national policy autonomy.

NAFTA conforms to the (weak) WTO rule on standards by urging the use of international standards unless these are ‘ineffective or inappropriate’. Similar to the EU and WTO rules, NAFTA specifies that conformance with international standards can be used as a defence against any challenge that a national TR constitutes an unnecessary obstacle to trade (Art 904 (3) and (4)). NAFTA also seeks ‘compatibility’ of *standards* and there have been some modest efforts to promote this, initially for transportation, telecommunications and textiles (labelling) through the NAFTA Committee on Standards Related Measures. Outside the formal NAFTA context, there is a Trilateral Standardisation Forum made up of ANSI, The Standards Council of Canada and the Direction General de Normas of Mexico that co-operates on technical standards. But such regional standards making in the Americas is modest compared to Europe, because of limited interest and resources devoted to the work.

Compatibility is also the aim for *conformance assessment (CA)*, although the NAFTA text itself states that there is considerable work to be done to achieve this aim.

As in the case of TRs and VSs ‘compatibility’ of CA is not defined. Consistent with the WTO there is a requirement to provide national treatment and non-discrimination in the operation of CA. But in contrast to the TBT Agreement of the WTO there is no reference to using agreed international CA norms. CA is, among other things, to be based on risk assessment. Finally, there is only a passing and non-binding reference to accreditation measures. “Parties may consult on the technical competence of conformance assessment bodies including verified compliance with the relevant international standards through such means as accreditation.” This reflects the US approach, which tends to wish to eschew any centralised accreditation, because of opposition from the private and state level accreditation bodies.

NAFTA includes considerable scope for *regulatory safeguards*, reflecting concern of the US environmental and safety lobbies. There are specific rights for the Parties to adopt higher regulatory norms and standards than any agreed in NAFTA or internationally. (Arts 901 and 906(1)). (NAFTA Secretariat)³⁰ This discretion is qualified, but only with wording that such measures *should* avoid arbitrary or unjustifiable discrimination. Elsewhere in NAFTA the stronger *shall* is generally used and the burden of proof is on the party wishing to show that the restriction is ‘an unnecessary obstacle to trade.’ NAFTA also uses a broad definition of ‘legitimate national objectives’³¹ and does not employ the ‘least trade restrictive’ criterion. Taken together these rules suggest that NAFTA provides considerably more scope for ‘regulatory safeguards.’ This reflects both the more relaxed practice with regard to interstate commerce in the USA, as well as the desire of US regulators to retain regulatory sovereignty.

The efforts within NAFTA to promote compatibility of technical regulations

have not made a great deal of progress. Work on textiles was close to achieving agreement on textile labelling in 2004, which does not suggest great progress over ten years. (Stephenson, 1997, p 59; NAFTA Free Trade Commission, 2004) NAFTA calls for Parties to make measures compatible to the greatest degree possible. But there is little internal dynamic in the political economy of the NAFTA processes on TBTs, with decisions based on unanimity. (Baldwin, 2000) There has been little progress in conformity assessment and accreditation or on compatibility or equivalence, although some mutual recognition negotiations have been undertaken and three agreed. These were however, between the private professional associations (engineering, accountancy and architects) rather than between the states. (Hufbauer and Schott, 1994; NAFTA Free Trade Commission, 2003, 2004 and 2006)

To sum up NAFTA follows GATT/WTO pretty closely. Both have fairly ambitious aims and objectives, but relatively weak implementing provisions. Rather than go beyond the multilateral rules in terms of limiting national policy autonomy, as NAFTA does in other policy areas such as services, investment and intellectual property rights, it's 'regulatory safeguard' provisions leave considerable scope for national regulatory policy autonomy in TBTs

In terms of trade facilitation NAFTA promotes transparency and broadly contributes to the implementation of the TBT Agreement. It's WTO-plus provisions on notification and due process is an important contribution to facilitating market access. But the policed non-discrimination approach of NAFTA provides less guaranteed market access than in the EU, due to the safeguards and the relatively weak provisions on compatibility and equivalence. Recognition of test results is also hedged by qualifications and the absence of any meaningful provisions on

accreditation raises questions about the viability of a once-tested-approved-everywhere policy. Finally, compared again to the EU, flanking measures in competition/anti-trust are weak. In a system that relies heavily on private standards making this leaves open the possibility of dominant firms using standards to limit competition.

4.5.2.2 Free Trade Agreement for the Americas (FTAA)

The active phase of negotiation on the FTAA was launched in Miami in December 1994, where 12 working groups were set up, including one on TBTs and one on SPS measures. One of the first tasks of this working group was to produce an inventory of the various regional and bilateral agreements within the hemisphere on 'standards and technical barriers to trade.'³² At the 1995 Denver ministerial meeting of the FTAA the agenda for the TBT Working Group was set out and included work on; (i) enhancing transparency, (ii) compiling information on conformance assessment and accreditation bodies, (iii) making recommendations on product testing and certification, with a view to mutual recognition, and (iv) recommending means of promoting WTO work on TBTs.

Despite annual meetings it was not until the preparation for the Fourth Trade Ministerial in Porto Rico in 1998 that agreement was reached on a Common Objectives Paper for the standards and technical barriers working group. From 1997 onwards TBT issues were subsumed into the general market access negotiating group and there appears to have been limited success negotiating specific provisions.

A draft FTAA text exists but is entirely in square brackets. For what it is worth the draft text appears to include elements of the NAFTA model based on compatibility as an aim for technical regulations (Draft FTAA Chapter XIII Article 9(2)) and

equivalence (Art 9(4)). (FTAA, 2003) The text urges the parties to negotiate mutual recognition agreements in order to facilitate trade and to coordinate work in developing international standards. On enforcement, the draft includes provision for a Special Committee on Technical Barriers to Trade in addition to the envisaged FTAA dispute settlement provisions. But there is no right of initiative for companies or other legal persons. With generally weak wording and no strong enforcement mechanism, it is doubtful that any FTAA would go beyond the WTO in any significant way, even if the most stringent version of the square bracketed text were to be adopted. The provisions on cooperation, technical assistance and other institutional features seem modest so that an FTAA also seems unlikely to go beyond the WTO in any procedural sense.

The participants in Mercosur, Brazil in particular, have a general preference for negotiating jointly as Mercosur with NAFTA, rather than as individual countries with NAFTA or the United States. Therefore in the area of TBTs the Mercosur countries envisage removing TBTs within Mercosur and then negotiating mutual recognition with NAFTA.

4.5.2.3 Mercosur

Progress in the FTAA is also dependent on developments in Latin America. Mercosur has also been working on a range of non-tariff barrier issues and its approach is modelled more on the EU than NAFTA.

Under the continuing Mercosur negotiations on non-tariffs barriers, Group 3 is dealing with technical regulations and voluntary technical standards. Decision-making structures within Mercosur are, like NAFTA, intergovernmental. Technical regulations

and standards issues are handled by a Standards Committee that established 15 sector committees. The latter have the task of exchanging information on technical regulations and promoting the development of common rules and standards throughout Mercosur. Although there have been standards bodies in the countries concerned for many years, for example the Brazilian standards institution ABNT was established in 1940, standards making has not been taken as seriously in Latin America as it has in Europe. One of the first objectives of the Mercosur in this area was therefore to raise awareness of the importance of technical regulations and standards and set targets for adopting common regional standards based on international standards.

Even if this target is reached the Mercosur countries are still likely to be standard takers rather than standard makers. In other words, access to European and North American markets is likely to require compliance with the local regulations and standards in those markets. For this reason efforts are under way to heighten awareness among exporters of industrial and food products of the need to comply with international standards. In the case of Brazil, for example, the aim has been to promote the use of ISO 9000 quality assurance.

With regard to conformance assessment, the aim is recognition of national certification and test results and ultimately full mutual recognition between members of Mercosur. Having established this, the participants of Mercosur would then seek to negotiate mutual recognition agreements with other regional entities or countries such as the EU and NAFTA.

4.5.3 Asia Pacific Economic Co-operation (APEC)

The APEC Eminent Persons Group (EPG) report of 1993 identified 'standards related issues' as an area where a concerted effort was needed to reduce divergence. In 1994 the EPG recommended that APEC work towards; (a) the adoption of an APEC Standards and Conformance Framework; (b) identification of target sectors for (selective) harmonisation, (c) the development of a model MRA; (d) identification of priority sectors for MRAs; and (e) acceptance of the conformity assessment principle 'tested once, accepted everywhere'.³³ Initially there were suggestions that there might be a common APEC policy in negotiations with third parties, but in TBTs as in other fields APEC has opted against regional preferences and in favour of a looser approach. This is reflected in the Guidelines for the Preparation, Adoption and Review of Technical Regulations in which regulators are urged to consider whether regulation is really necessary. The Guidelines also provide a checklist of possible alternatives to regulation including; reliance on general law, voluntary standards, liability laws and codes of conduct. (APEC Secretariat, 2001) If regulations are introduced, these are to conform to WTO rules in the shape of the TBT Agreement, including the use of least trade restrictive means available, 'performance' rather than 'prescriptive' standards and use international standards where these exist.³⁴ The guidelines equally refer to GATT rules on conformance assessment and transparency, indeed the only area in which these voluntary guidelines go beyond the GATT is the call for a 'sunset' provision which would ensure regular review of technical regulations.

APEC, through its Sub-Committee on Standards and Conformance, has developed a number of MRAs, notably in the fields of food, telecommunications, toy safety and electrical and electronic equipment. (DeVaux, 1999) These are open plurilateral agreements. In other words APEC Members can choose the MRAs they

wish to sign and implement. The most widely supported MRAs were telecommunications (adopted in 1998), toy safety (adopted in 1998) and the electrical equipment (adopted in 1999), MRAs with between 9 and 15 signatories in 2002. There are other MRAs in the service sector, where indeed most of the work in terms of APEC work on MRAs has been focused.

4.5.4 *The Australia-New Zealand Closer Economic Relations Trade Agreement (CER)*

The CER built on a series of preferential trade agreements between Australia and New Zealand that culminated in the 1966 New Zealand-Australia Free Trade Area (the first NAFTA). This contributed to the removal of tariffs and quotas, but there were no mechanisms for dealing with other non-tariff barriers. The CER was launched with a joint *communiqué* of the two countries in 1980 and took effect in 1983. Subsequent reviews in 1988 and 1992, considered, among other things, TBTs and in 1988 Australia and New Zealand signed an Understanding on Technical Barriers to Trade which rationalized existing cooperation between the countries and committed both countries to work for harmonization. (Australian Department of Foreign Affairs and Trade, 1997) This was followed by a further agreement, in 1990, on standards accreditation and quality. In 1991 a joint accreditation system (JAS-ANZ) was established. Thus over the years Australia and New Zealand have brought about a considerable degree of policy approximation.

Following the 1992 review, trade ministers requested officials to study the potential for a Trans-Tasman Mutual Recognition Agreement (TTMRA). (Council of Australian Governments, 1995) The TTMRA was adopted in 1996 and entered into

force in 1998. It effectively includes New Zealand in the mutual recognition agreement (MRA) concluded by the Australian States and Territories in 1993. (Sampson, 2003) The TTMRA provides that all goods legally sold in one State or Territory can be sold in any other participating State. There is also mutual recognition of professional qualifications. This compares to the European approach, which also encompasses professional qualifications. The Australian MRA was introduced to remove TBTs existing within the federal structure of Australia and allow for free movement of people between States. Mutual recognition within Australia was facilitated by the fact that the State regulations were broadly equivalent. The TTMRA was easier than most MRAs because of the similarity between the two regulatory systems. The TTMRA is therefore another example of how equivalence of policy objectives is considered to be a condition for the introduction of full mutual recognition agreements. (Majone, 2000)

4.6 The multilateral rules

During the 1980s awareness of and interest in TBTs increased in large part due to the developments in a number of RTAs and in particular the redoubling of efforts in the EU. This cleared the way for a serious effort at reaching effective multilateral rules on TBTs and an increased interest in the interaction between the regional and international standards making processes and the development of international standards.

The main improvements achieved in the Uruguay Round TBT Agreement were; (i) extended coverage to include all WTO members not just the 38 signatories to the 1979 Standards Code, (ii) extended coverage to include production processes as well

as products, and (iii) application of the general and strengthened WTO dispute settlement procedure to TBTs.

On more detailed points the Uruguay Round agreement: (i) consolidated the notification procedures; (ii) strengthened the requirement to provide least restrictive measures by offering a definition of a least restrictive measure as: ‘ ... not .. more trade restrictive than necessary to fulfil a legitimate objective, taking into account the risks of non-fulfilment’; (iii) encouraged, without requiring, the use of mutual recognition; (iv) established a Code of Conduct for Standards Making Bodies;³⁵ and (v) followed developments in the regional agreements by calling for recognition of test results.

As with previous multilateral rules, the 1994 TBT Agreement is still limited in its coverage to central government, due to the difficulties involved in implementing it in federal systems. The first sub-national level of government (i.e. the states) is, however, included in the notification and transparency requirements.

Broadly speaking the Uruguay Round agreement on TBTs strengthens and consolidates the existing GATT provisions and increases the scope of the agreement. But the effectiveness of this new agreement will depend crucially on the willingness of governments, private standards institutions, conformance assessment bodies and industry to make the agreement work. There is also an inevitable difficulty defining such concepts as proportionality in the use of regulatory instruments. (Mattoo and Subramanian, 1998) The enhanced dispute settlement provisions of the WTO may help to develop 'WTO case law' in the area of TBTs. But there remains a good deal of imprecision in the wording of the agreement to be sorted out, so it is likely to take many years to clarify the balance between policy autonomy and harmonisation at the

multilateral level. For example, the definition of what is 'a least trade distorting measure' seems not very much clearer.

There is also a lack of clarity in the WTO Agreement with regard to the application of Art XXIV to regional TBT rules. It is clear that regional TBT rules, such as harmonisation or mutual recognition, must comply with WTO principles of non-discrimination and the detailed rules of the Agreement on TBT. There is however, no clear view on how Art XXIV should be applied to regional TBT rules. For example, should common TRs, VSs or CA in an RTA be seen as 'other restrictive regulations of commerce' (ORRCs) within the meaning of Art XXIV:8 and thus prohibited.³⁶ Art XXIV: 8 is intended to prevent regulatory or non-tariff measures distorting trade within a customs union or FTA. It is fairly clear that quantitative measures are ORRCs.³⁷ But much less clear what kind of TBT measures would be considered as ORRCs. Clearly technical regulations and standards cannot simply be defined as ORRCs, because this would require them to be prohibited. One possible interpretation is that only discriminatory use of TRs, VSs or CA are ORRCs, but then the WTO rules prohibit such discriminatory measures in any case. Alternatively, one could argue that only RTA rules that constitute an 'unnecessary' restriction or protectionist measure might be seen as ORRCs and prohibited. But this still leaves the question of whether new regional rules restrict trade or whether the introduction of common non-discriminatory rules facilitates trade. If the latter is true then they should clearly not be seen as 'unnecessary restrictions' to trade.

The interpretation of Art XXIV for regional rules becomes even more complex when, for reasons of economic integration and in order to conform with the *internal* obligations in Art XXIV:8 (i.e. that an FTA or customs union removes all restrictions

to trade), the parties to an RTA agree to adopt common regulations or standards, but these are more stringent than those in one or more of the parties to the RTA. The material produced in this chapter suggests that such common regional rules facilitate trade for third parties, but those WTO members that previously sold products to the country with less stringent standards, will face higher standards and could thus claim that the incidence of protection has increased. Some leading developing country WTO members have indeed argued that this in the discussions on Art XXIV in the context of the Doha Development Agenda.³⁸

This leaves the question of how the WTO rules apply to MRAs. These are encouraged by the TBT agreement, but the WTO has no developed criteria for what conditions should be applied. Art VII of the General Agreement on Trade in Services (GATS) allows for all types (unilateral, bilateral, regional or plurilateral) of recognition agreement but requires that WTO Members be permitted to demonstrate that they meet the requirements for recognition under any MRA. In other words all third countries should have the opportunity to prove they meet the conditions and thus accede to the MRA. In the TBT area there appears to be no such obligation under GATT rules. (Trachtman 2002 pg 490) But even if such an 'open recognition' principle were to be assumed to apply to TBTs as well, there would remain considerable practical difficulties applying such a concept. In practice such an interpretation is unlikely to be much of a constraint on MRAs because differences in national rules, conformance assessment and accreditation regimes provide every opportunity for parties to find reasons why third country regimes are not 'equivalent'.

In short, existing WTO rules covering the regional technical regulations, voluntary standards and conformance assessment are unclear. Existing legal provisions

are open to widely different interpretations. The evidence from the TBT field is that the legal route to ensuring compatibility between the multilateral rules of the WTO and regional rulemaking is fraught with great difficulty.

4.7 Regional and bilateral initiatives after the Uruguay Round

The charts 4.2 and 4.3 summarize the TBT provisions in a number of post Uruguay Round RTAs that are indicative of the dominant EU and US centred agreements.

4.7.1 EU centred agreements

The EU agreements, differ depending on the partner countries. In the case of the immediate neighbours seeking accession to the EU, the *acquis communautaire* is the guiding principle. Thus the links between the EU and the accession states of central and Eastern Europe have been based on a progressive convergence with EU norms and standards.

The provisions on TBT with the Euromed partners also envisage approximation to the prevailing EU approach, but this is generally set out as a long-term goal. The only concrete measure that seeks to achieve this end is the provision of cooperation and technical assistance by the EU to promote the application of standards in the partner countries and institution building in the form of compliance and accreditation systems.

The 1999 EU-South Africa Trade and Development Cooperation Agreement (TDCA) contains similarly general provisions on TBT. In the case of South Africa however, there is no reference to the adoption of European norms and standards. In its

place is the aspiration of concluding mutual recognition agreements, but there are no implementing provisions.³⁹

The EU agreements with Mexico and Chile are typical examples of the kind of FTA the EU is negotiating with middle-income countries. The EU – Chile agreement is rather more developed than the EU-Mexico agreement. The EU- Mexico agreement is of interest because it fails to go beyond WTO commitments. This is surprising because EU exporters were concerned about TBTs in Mexico, in particular certain labelling requirements before the negotiations began. (Reiter, 2003) The absence of WTO-plus provisions, such as mutual recognition, appears to have been in part due to the EU, because the Mexican side was ready in principle to include provisions on mutual recognition. So in this instance the EU failed to take up an opportunity of ‘exporting’ the EU model of mutual recognition, due to the complexities of negotiating mutual recognition agreements. (Reiter, 2003)

The EU –Chile provisions on TBTs are not much more advanced. These are again basically WTO conform, but with some slightly stronger wording on transparency. The EU-Chile agreement uses ‘equivalence’ rather than mutual recognition, which is probably due to the influence of the NAFTA approach in Chile. Chile was of course negotiating an FTA with the US at the same time as with the EU, so the EU-Chile FTA includes a list of options, such as the use of international standards, equivalence, or mutual recognition, as a means of ensuring consistency between the FTAs that Chile was negotiating. Only with regard to the institutional framework for cooperation does the EU-Chile agreement go much beyond the WTO. It establishes a bilateral Special Committee on Technical Regulations, Standards and Conformance Assessment.

Chart 4.1

TBT provisions in EU – centred RTAs

Rule-making element	WTO TBT	EU	EU - Mexico
Coverage	central government for technical regulations and conformance assessment code of conduct only for standards bodies	central and local govt. as well as standards organisations	equivalent to WTO
Principles	national treatment and MFN for TR and CA	national treatment	equivalent to WTO
Transparency	notification to WTO and scope for comments from other parties; information clearing houses; central and first sub-national levels	prior notification or TR and VS; freezing of national rules while EU rules considered	equivalent to WTO
Substantive rules			
• approximation	use of performance standards 'whenever possible'	harmonisation	encourages efforts at approximation
• recognition	possible mutual recognition encouraged	full mutual recognition	no provision
Co-operation and technical assistance	TBT Committee and a Standards, Trade and Development Facility	common institutions for TR, VS and CA	regular bilateral meetings to promote co-operation
'Regulatory safeguard'	general exemption under Art XXIV to proportionality test	general exemption under Art XXIV subject to proportionality test	equivalent to WTO
Implementation and enforcement	TBT Committee to consult; horizontal dispute settlement	direct effect of EC law	bilateral dispute settlement provision

Chart 4.1 (cont.)

Rule-making element	EU-South Africa	EU-Chile	Euro-Med (e.g Tunisia)
Coverage	WTO conform	confirms rights under WTO TBT	WTO consistent
Principles	WTO conform		equivalent to WTO
Transparency	WTO conform	Reference to transparency but to be developed	WTO-consistent
Substantive rules			
• approximation	aim of reducing difference between the Parties	menu of options including, promotion of regional and international standards, mutual recognition or 'equivalence'	bring partners closer to EU norms
• recognition	aim of recognition for conformity assessment in sectors of mutual interest		recognition of test result 'when time is right'

Co-operation	cooperation on standards, metrology, certification and quality assurance; technical assistance	Special Committee on Technical Regulations, Standards and Conformity Assessment (SCTRSC); Intensification of bilateral co-operation with details to be determined	technical assistance for regulation, standards and conformity assessment
'Safeguard'	WTO-conform	'necessity and proportionality' tests; 'legitimate policy objectives'	equivalent to WTO
Implementation	joint committee to oversee implementation	SCTRSC working to Association Committee	conciliation in bilateral committee, recourse to WTO

4.7.2 US Centred agreements

The US centred FTAs negotiated after the Uruguay Round have not made TBTs a priority. The US-Chile agreement adopts the NAFTA approach and thus goes beyond the WTO rules by providing that all parties have access to national regulatory policy procedures. The US-Chile agreement encourages regulatory bodies to view other countries' regulations as 'equivalent' or give a reasoned opinion as to why they are not ready to do so. Mutual recognition of test results is also envisaged but as with NAFTA there are no implementing provisions. Finally a special committee is established to promote cooperation in the TBT area.

Contrary to the position in other policy areas such as procurement, investment and intellectual property rights, the FTAs negotiated post Uruguay Round have not, therefore been used to push WTO plus provisions in the TBT field. In the case of the EU agreements this appears to be due to disillusionment with the utility of mutual recognition as a means of facilitating trade with third countries. The EU has also not been aggressive in pushing its approach to TBTs in FTAs with developing countries, although the Euromed Association agreements do envisage the extension of the EU model in the future. The expectation must be that the EU will pursue a similar

approach in its region-to-region negotiations with the ACP states. There will no doubt be technical assistance and cooperation offered in order to promote conformance testing capacity in the ACP regions and general efforts to promote an approximation to European standards. In terms of the newer generation of EU FTAs one can expect a greater reliance of agreed international standards than mutual recognition.

In the case of the US, the lack of much impetus in TBT rules is probably down to the US preference for leaving much of the 'standards-related' work to the private sector.

Chart 4.2 US –centred RTAs

Rule-making Element	NAFTA	FTAA*	US-Chile
Coverage	WTO compatible	confirms WTO commitments all reasonable measures only for sub-federal government	reaffirmation of rights under WTO TBT; Chile applies to central government only;
Principles	National treatment	National treatment	National treatment
Transparency	prior notification; access to national regulatory processes for interested parties	transparency rules broadly in line with the WTO;	prior notification with right comment; access to national regulatory procedures
Substantive rules			
<ul style="list-style-type: none"> • Approximation • Recognition 	<p>harmonisation in some sectors; otherwise 'compatibility' sought;</p> <p>Equivalence; parties to give reasons for not accepting equivalence;</p>	<p>equivalence; must give reasons not accepting</p> <p>[Aim of negotiating mutual recognition agreements with Inter American Accreditation operation]</p>	<p>provision for 'sector specific initiatives';</p> <p>Range of options including recognition and equivalence</p>
Co-operation	Joint Committee promoting technical co-operation	Committee on Technical Barriers to Trade (CTBT) co-operation through COPLANT, SIM and IAAC; S & DT and technical assistance	Committee on Technical Barriers to Trade established; No technical assistance
'regulatory safeguard'	'less trade distorting measures may be below WTO standards' explicit right to adopt high standards	['right to adopt standards related measures' that fulfil 'legitimate policy objective']	no provisions (so WTO consistent)
Implementation, Enforcement	remedies for legal persons; bilateral dispute settlement provisions	conciliation through CTBT; [use of bilateral dispute settlement]	conciliation through CTBT; bilateral dispute settlement procedure

* based on second consolidated draft of FTAA, which is all square brackets

4.8 Comparison with Sanitary and Phytosanitary (SPS) rule-making

Space limitations make it impossible to cover SPS issues in full. This section, however, provides a brief summary of analogous research on the SPS topic. (Isaac,

2006) SPS issues have been prominent in recent years due to a number of controversial disputes such as the beef hormone (Redick, 2000) and GM foods (genetically modified foods) disputes between the US and EU. (Isaac and Kerr, 2003 and 2006) The issue of SPS measures as a barrier to trade has also been given some prominence in terms of developing country access to northern markets. (Henson et al 2000) Dispute the higher political profile of SPS the costs of TBTs are likely to be greater given that the latter affect all manufactures and thus a larger share of trade than SPS type barriers that affect only the 11% or so of agricultural trade.

Evidence from the SPS case corresponds to some of the findings in this chapter on TBTs, but diverges from others. First, the SPS case confirms the multi-level nature of rule-making. For example, in the early post 1945 period food safety rules were dominated by European standards in the shape of the Codex Alimentarius Europeas. It was not until the 1960s that food safety rule-making moved to the international level in the Codex Alimentarius under the UN Food and Agricultural Organisation (FAO) and World Health Organisation (WHO). (Frawley, 1987).

Food standards maintained a relatively low profile for many years. In the 1970s there were efforts to tighten-up GATT rules to limit the scope for the use of Art XX(b) of the GATT as a very broad based 'regulatory safeguard'. These were driven by North American agri-food exporters who were concerned that these safeguards were being abused. But the 'Standards Code' did not really address these particular concerns. A renewed and ultimately successful effort was made during the Uruguay Round to introduce more stringent multilateral rules covering SPS measures. These were based on the dominant approach to risk assessment at the time, which was the Risk Assessment Framework (RAF) developed by the US National Academy of Sciences

(NAS) and codified in the NAS's so called Red Book in 1983. (Isaac, 2006; Marceau and Trachtmann, 2002)

The SPS Agreement in the Uruguay Round embodied more stringent rules on SPS measures than TBTs. Exceptions from the rules were to be based primarily on scientific evidence and there was a direct link to the Codex Alimentarius standards that were to be used to indicate conformance with the current scientific opinion on risk. This contrasted with the lack of such a link to industrial standards in the ISO. But the SPS Agreement still contained ambiguities and regulatory safeguards that were subject to differing interpretations.

Isaac, in his application of an analytical framework similar to the one used in this thesis, argues that rules on SPS are subject to different 'drivers' of change emanating from the regional level of rule-making. (Isaac, 2006) On the one hand, there is pressure for *procedural* improvements in SPS rules to prevent delays in processing imported food products. Brazil has, for example, called for such rules in the context of the FTAA negotiations to reduce procedural barriers to exports in the US and Canada. These kinds of demands come from all developing countries that wish to ensure that testing and other controls in developed country markets do not place disproportionate costs on developing country food exports. (Unnevehr and Roberts, 2003)

On the other hand, there are calls for WTO-plus (or WTO-minus) rules of a more substantive kind coming from the EU that seek to shift from 'science-based rationality' to a more 'social rationality'. In concrete terms this would involve introducing the precautionary principle (as opposed to the precautionary approach used by the SPS Agreement) (Woolcock, 2001) and labelling rules that grant consumers the right to know if products are derived from GM crops.

Isaac argues that procedural WTO-plus rules do not pose a threat to the established multilateral rules, but that the substantive WTO-plus rules risk undermining the multilateral level rules and creating a form of regulatory regionalism in which the EU pushes social rationality approaches in its regional rules on SPS and North America pushes for scientific rationality. Indeed, there is evidence to suggest that this is already happening. (Isaac, 2006)

In other words the SPS case represents a rather different picture to that of TBT. It is possible to argue that there was a synergy between the regional and multilateral levels during the 1986-94 period as the SPS agreement was negotiated. Subsequently, however, responses to consumer pressure in the EU have led to a rethink and efforts to reform or reinterpret WTO rules. This suggests a state of flux between levels of rule-making with the focus of rule-making in SPS shifting from the regional to the multilateral in the 1960s. The multilateral level remained the focus for international rule-making through to the 1990s, but there are now signs that the regional level is reasserting itself. In other words the adoption of agreed multilateral rules does not mean that rule-making will henceforth always be carried out at the WTO level.

4.9 Conclusions

The chapter has illustrated that rule-making in the TBT field is multi-level. Relatively weak multilateral rules were augmented by more effective regional rules during the second phase of regionalism. Led by the redoubling of efforts in the EU, regional level initiatives contributed to the realisation of aims and objectives set out in the GATT rules on TBTs.

There appears to have been a close synergy between the regional and

multilateral rule-making. This can be put down to a number of factors. First, the EU initiative stimulated greater efforts from other countries, both at the multilateral level in the GATT/WTO and in other regional agreements. Greater effort was also made in the international standards organisations as a means of containing European dominance in this area of policy. At the same time the EU approach stimulated other regional initiatives that emulated elements of the EU 'new approach' or developed 'equivalence' approaches. Another reason for synergy was that the RTAs shaped and were shaped by multilateral rules. The RTA provisions on TBTs were consistent with the GATT rules on non-discrimination for technical regulations and conformance assessment. RTAs also followed the GATT rules on the use of international standards and the evolution of rule-making through the 1970s and 1980s was shaped by both the regional and multilateral approaches. Thus the idea of using mutual recognition or equivalence as a middle ground between (ineffective) national treatment and detailed harmonisation found its way into both the RTAs and the WTO Agreement on TBT.

Where RTAs went beyond the GATT rules they did so in a fashion that was broadly beneficial for signatories and third countries, and in such a way that they had no adverse systemic effects. For example, transparency rules in RTAs were generally GATT-plus in that they required prior notification. This benefited third country suppliers as well as signatories to the RTA. More effective RTA rules also meant that existing multilateral objectives on transparency were more effectively realised. In other words better transparency did not constitute regional preferences, except with regard to third parties being excluded from participation in some regional decision-making on technical regulations.

Substantive rules made market access easier for signatories through

harmonisation, mutual recognition or the use of 'equivalence.' This could be seen as a regional preference, but access for third parties was also facilitated in the sense that where regional agreements were really effective, access to one national market meant access to the whole region.

In the case of standards EU ambitions to promote more standards making were explicitly linked to international standards making in a manner that effectively channelled regional dynamism into the international standards making process. This illustrates that where there are international frameworks for rule-making they are likely to serve to discipline regional rule-making. Had there been no reasonably efficient international machinery in standards making there would have been no check on the hegemonic extension of European industrial standards making.

The cooperation provisions in RTAs have mostly taken the form of information sharing, technical assistance and closer links between the various national competent bodies. This has enhanced capacity, such as in the certification and testing capabilities of signatories. Contrary to the 'spaghetti bowl' analogy of conflicting rules, this kind of institutional capacity is fungible in the sense that capacity established through regional cooperation can be used to facilitate trade with third countries and enhance the ability of the countries concerned to comply with wider multilateral agreements.

Regulatory safeguards have been a recurrent issue in the TBT field. Discretionary provisions have often been seen as providing scope for protection. In this context RTAs appear to have reduced the scope for the use of discretionary powers by national regulators by codifying proportionality criteria and maintaining effective remedies and dispute settlement to ensure 'regulatory safeguards' are not exploited. The scope for continued use of safeguards is illustrated by the SPS case. Here the

effective 'right to regulate' provided by the precautionary approach in the WTO SPS agreement has been exploited by the EU to push for a 'social rationality' model for regulating food safety rather than the 'science rationality' embodied in the SPS Agreement.

Comparing the period between the mid 1980s and 1995 with the post Uruguay Round period, the RTAs in the latter contain much less in the way of TBT rules and have not been WTO-plus to any significant degree. The EU FTAs with non-accession states, such as with Mexico, Chile and South Africa have only very modest provisions on TBTs and seem unlikely to have much impact in the short term. The Euro-Med agreements are more ambitious in their objectives and include the progressive adoption of EU norms and standards by the countries concerned. But there are no specific commitments and any progress towards the adoption of EU norms by these countries will be based on consensual work in cooperation. Furthermore, the EU has not made significant progress in negotiating mutual recognition agreements. These were seen as a means of extending the EU approach to third countries, but MRAs have proved complicated to negotiate. As a result the kind of two-tier system in TBT rules envisaged by Baldwin has not (yet) emerged. (Baldwin, 2000)

Contrary to other policy areas, such as investment and intellectual property, the US has not placed great emphasis on setting firm rules for TBTs, but has been content to use the skeletal NAFTA approach based on national treatment and the aspiration of achieving 'equivalence' of regulatory policies.

There are significant differences between the EU and US approaches. The EU seeks comprehensive rules on TRs, VSs and CA whereas the US leaves much more to markets somehow leading to convergence towards equivalent standards within a loose

national treatment framework. This difference has not created many direct difficulties, but has probably contributed to the relatively weak multilateral rules for TBTs.

This finding for the impact of RTAs in the field of TBTs must be set against the SPS case. In the SPS field the underlying differences in EU and US approaches to regulation have resulted in considerable transatlantic tensions, and threaten to result in 'regulatory regionalism' with both the US and EU pushing their respective approaches to SPS rules in the FTAs they conclude.

Endnotes

¹ This is the terminology adopted in WTO agreements. North American writers, including the World Bank reports still use 'standards' or 'standards-related' barriers to cover all three types of barrier discussed here.

² The GATT Agreement on Technical Barriers to Trade has weaker 'best endeavours for sub-central government. This is important because environmental and safety rules are still adopted at the state or provincial government level.

³ Standards are 'documents approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may include or deal exclusively with terminology, symbols, packaging or labelling requirements as they apply to a product, process or production method.' Uruguay Round Agreement on Technical Barriers to Trade, 1994 Annex 1

⁴ Multinational producers sometimes coordinate work in various national standards bodies and thus ensure compatibility. This has for example, been the case in construction equipment (OECD, 2000b). But there are equally often companies competing to establish their designs as the industry-wide standard. In such cases standards making becomes a factor in market power.

⁵ Market based standards are those developed by individual firms or trade associations that rely for their legitimacy on the adoption of standards in the market place rather than agreement within a formal framework of agreed standards.

⁶ World Trade Organization, Agreement on Technical Barriers to Trade, Annex 1, 1994

⁷ Mutual recognition is seen as analogous to free trade agreements and harmonisation of 'standards' as analogous to customs unions, because the latter has a single policy.

⁸ Finger and Schuler (1999) have however, suggested that the costs of upgrading infrastructure to comply with the Uruguay Round rules will exceed total development budget of some least developed countries. TBT related infrastructure, such as conformance assessment bodies and metrology, is likely to be an important contributing factor in these costs.

⁹ It is not clear what percentage of the \$50bn Apec market in telecommunications equipment this represents.

¹⁰ The EU's original enthusiasm for mutual recognition agreements as a means of addressing TBTs around the world has faded. First, MRAs have proved difficult to negotiate. Second, MRAs with important EU export markets, such as the US, have been very constrained due to an inability to reach agreement on anything but very narrow sector agreements. Third, mutual recognition is recognised as inappropriate for many developing countries, with the result that the EU appears to be moving towards promoting international standards in bilateral FTAs rather than mutual recognition.

¹¹ For example, the US sought (unsuccessfully) a seat at the EU negotiating table on TBTs when the EU was working on the Single Market Directives. (US International Trade Commission, 1990)

¹² See section 4.6 below on the WTO.

¹³ In the field of standards making the importance of the facilitating role of common standards was recognized in the establishment of international standards organizations. These were established at the beginning of the century, for example in the shape of the International Electro-technical Commission (1908) and industrial standards, the International Standards Organization (ISO) was established in 1947 to rationalize the range of sector standards bodies.

¹⁴ Among the key cases was the Dassonville case discussed above. In this the European Court of Justice interpretation of what might constitute a barrier to trade was arguably broader than that of the US Supreme Court's interpretation of the equivalent provisions in the Interstate Commerce Clause in the United States. Experience with the application of the dormant commerce clause in the US has, however, been criticised as being too ad hoc and not providing sufficiently clear principles. (Sykes, 1995 pp 102-108)

¹⁵ Performance standards are those that set out certain requirements in terms of performance, for example structural strength, without specifying how this should be achieved. Design standards are those that require conformance with detailed specifications, such as the thickness of a component, and are thus much less flexible.

¹⁶ See EC Council Resolution of 7 May 1985. Official Journal C 136 4 June 1985.

¹⁷ For a comprehensive discussion of the EU programme from the point of view of a third country see United States International Trade Commission, 1990.

¹⁸ Council Directive 83/189/EEC Official Journal L 109 26 April 1983, the so-called Information Directive.

¹⁹ See Commission Green Paper on the Development of European Standardisation COM (90) 456 final October 1990. The European standards bodies seek to adopt standards by consensus, but there are formal voting rules that specify the minimum conditions for the adoption of a standard should a voluntary consensus not be possible. (Strawbridge 1993)

²⁰ For the Vienna Agreement see International Standards Organization/Council 1991 8.1/1 June 1991

²¹ See International Electrotechnical Commission Council Document 01 (Central Office) 838 of January 1991.

²² See Council Resolution of 21 December 1989.

²³ Trachtmann argues, drawing on Art VII of the GATS, that 'open recognition' is a means of ensuring that regional or bilateral mutual recognition agreements are compatible with multilateralism. Open recognition 'would establish regional conditions for recognition, but permit third states to meet these conditions.' (Trachtmann, 2002, pg 491)

²⁴ The EC Council Resolution of 21 December 1989

²⁵ Multinational companies including for example, US companies, could and did have access to standards making in the European system through their participation in national standards making bodies. But there was no third party access to decision-making on TRs

²⁶ North American literature does not make the same distinction between technical regulations and standards but (continues) to refer to regulations and standards as 'standards'.

²⁷ See for example, Sykes 1995 pg 106 for a brief discussion of the application of the dormant commerce clause in the US.

²⁸ If the US legal system cannot come up with an effective definition of 'least trade restrictive' measures interstate trade the prospects for multilateral agreement on the issue, or the WTO dispute settlement process developing such a definition seems remote.

²⁹ To make 'compatible means to bring different standards-related measures [technical regulations, standards and conformance assessment] of the same scope approved by different standardizing bodies to a level such that they are either identical, equivalent or have the effect of permitting goods or services to be used in place of one another or fulfill the same purpose.' NAFTA Art 915.

³⁰ For example neither the EU nor GATT provisions appear to include consumer protection as NAFTA does in their equivalent lists of legitimate domestic objectives.

³¹ A legitimate objective includes an objective such as (a) safety, (b) the protection of human, animal or plant health, the environment or consumers, including matters relating to quality and identifiability of goods and services and (c) sustainable development.

³² National practices on Standards, Technical Regulations and Conformance Assessment in the Western Hemisphere, 1997

³³ See Second Report of the Eminent Persons Group Achieving the APEC Vision: free and open trade in the Asian Pacific. August 1994

³⁴ Asia-Pacific Economic Co-operation, Standards and Conformance, 1996

³⁵ This is binding on all central government standards making institutions, but because of the difficulties producing a binding agreement for private institutions, use of the code remains voluntary for private standards bodies at the industry, national or regional level bodies. If the code is applied by these bodies it will enhance transparency and make deviations from international standards more apparent. But there will be no legal sanction against bodies that do not apply the code or do not comply with it fully.

³⁶ There are in fact two terms used in Art XXIV. Other restrictive regulations of commerce Art XXIV:8, which applies to internal factors, i.e. the facilitation of intra regional trade. 'Other regulations of commerce' (ORC) is used in Art XXIV:5 concerns extra-regional trade. The WTO does not clarify what if anything is the difference between these.

³⁷ See for example Turkey-Textiles Appellate Body Report WT/DS34/AB/R 19 November 1999

³⁸ Interview with DG Trade official. This argument seems to be more tactical than real. Any prospective member of an RTA could avoid falling foul of such an interpretation by simply raising the level of stringency of the TBT measure, which it is able to do under the TBT agreement, before signing up to the RTA.

³⁹ Council Decision 1999/753/EC of 29 July 1999 concerning the provisional application of the Agreement on Trade, Development and Cooperation between the European Community and its Member States, of the one part, and the Republic of South Africa, of the other part Official Journal of the European Union L 311 Vol 42 4/12/1999.

Chapter Five The interaction between levels of rule making in public procurement

5.1 Introduction

Public procurement was excluded from the GATT in 1948 because of a concern that compliance costs would be excessive, exclusions would undermine the effectiveness of an agreement¹ and that it would remove the scope to use procurement as an instrument of industrial policy. In the absence of any international discipline national rules evolved along divergent paths consolidating national procurement preferences. Since the establishment of the GATT there have been repeated efforts to contain this divergence and develop rules governing public procurement (PP). This chapter illustrates how these efforts have occurred on different levels. The leading proponents of wider international rules, initially the United States (US) and subsequently the European Union (EU), have used plurilateral and more recently bilateral/regional agreements to promote the application of rules on PP. On balance, however, the case of PP shows how synergy between different levels of rulemaking has resulted in development of more extensive rules.

5.1.1 The importance of public procurement

Public procurement makes up between 7 and 8% of GDP in developed economies, where central government procurement alone accounts for some \$ 1.795 trillion (2001) each year. In non-OECD countries procurement is estimated to average about 5% of GDP or a total of \$287 billion (2001) and 40 major developing economies account for most of this. Sixty of the 106 developing countries included in OECD figures had PP of less than \$1 bn per annum. (OECD, 2002a; Trionfetti 2002) In terms of the trade effects of procurement the lion's share of procurement is accounted for by

the OECD countries plus some 10 emerging markets. A plurilateral regime that covered these would therefore ensure better use of public funds, more competition and less corruption. Evidence from World Bank and other surveys suggests that developing countries find maintaining sustained reform of procurement practices to promote these aims difficult without external discipline. (Evenett, 2003)

5.1.2 Liberalisation, *de facto* and *de jure* discrimination

It is worth clarifying what is meant by 'liberalisation' of public procurement, because this is not as straightforward as removing a tariff. Explicit preferences for local suppliers are an obvious means of providing a national (or regional) preference. For example, the US maintained 'Buy America' price preferences of 6% for many years, the EU included the option of a 5% price preference for EU suppliers in its regional liberalisation measures for utilities and India has a 15% preference for small and medium sized companies. (World Bank, 2003) Rules that require national treatment prohibit such explicit preferences based on the nationality of the supplier and could therefore be said to constitute liberalisation.² But such *de jure* preferences pale in comparison to the *de facto* preferences in the allocation of public contracts.

Opaque or complex contract award procedures can constitute a form of *de facto* preference even when rules commit the procuring entity to national treatment and MFN.³ Where contract award procedures are complex or when different ministries or purchasing entities use different contract award procedures, it is likely to be much harder for suppliers or contractors not familiar with the different procedures to be successful.

De facto preferences can also result from the exercise of discretion in contract award procedures. Rules governing PP tend to be fairly flexible in order to

accommodate market practice. This flexibility provides scope for discrimination. For example, all major regimes provide for restricted or negotiated procedures, as well as open tendering.⁴ Contract award criteria, such as 'the most advantageous' or 'most economically efficient' bid, also provide scope to favour domestic suppliers. It is very difficult to exclude such abuse of discretion without making the rules excessively rigid.

The use of proprietary or design standards (as opposed to harmonised international standards or performance standards) in defining technical specifications can be a form of discrimination. Finally, *de facto* discrimination can result if national or international rules are not applied or not rigorously applied.

As in the TBT case therefore, the application of national and MFN treatment principles do not address such *de facto* discrimination. A lack of confidence that contracts will be awarded fairly then deters competitors and results in markets remaining closed. To address *de facto* discrimination and 'liberalise' markets rule-making is required that can enhance transparency and reduce the scope for the abuse of discretion on the part of the procuring entities.

In public procurement, as in other policy areas, the distinction between rule-making and market access has been complicated by the way rules have been negotiated over the years. It has been found expedient to divide discussion of the rules from questions of sector coverage. This has in effect enabled negotiators to separate the liberal aim of economically rational, transparent procurement rules for all, from the (mercantilist) objective of enhancing exports to previously closed markets. This has resulted in reasonably coherent framework rules for PP, but an intricate, opaque and illiberal set of lists and schedules pursuant of reciprocity. (Arrowsmith, 2003; Reich 1997)

What constitutes 'liberalisation' has an immediate bearing on the negotiations in the WTO under the Doha Development Agenda (DDA). With no agreement on the inclusion of PP in the WTO, a compromise was sought in which 'transparency' in public procurement would be included but not 'market access'. But the fact that one cannot distinguish between these two in reality created difficulties in the negotiations. From an economic point of view 'there is [also] little to be gained by separating negotiations on transparency from negotiations on market access.' (Evenett, 2003, pg 4; see also Jinarelli, 2003, pg 250; Evenett and Hoekman, 2004, pg 281)⁵ Developing countries have assumed that transparency is part of market access or at least the first steps towards liberalisation. This is a reasonable assumption given the history of negotiations on PP in which rule-making was seen by sectors seeking to open (and protect) markets as a means of facilitating market access. Rule-making in PP can therefore range from broad principles of non-discrimination through to detailed provisions aimed at addressing *de facto* discrimination. Research on the effects of rule-making in PP has found that it has resulted in more competitive markets and thus enhanced welfare, but paradoxically not in significant increases in market access. (Evenett and Hoekman, 2004). This has also been the experience in the EU that has the most developed and stringent rules on public procurement, but which has seen only modest increases in the share of public procurement markets being supplied by producers from other EU Member States.⁶ This suggests that economic benefits of rules on procurement result as much, if not more, from the domestic reform as from increased market access.

Chart 5.1 The elements of rules in public procurement

Coverage
Rules may cover procurement of supplies (goods) only or also works contracts (construction) and services. Rules covering central government covers roughly 30% of 'public purchasing,' with 30-40% at sub-central government

level and the rest in public enterprises such as utilities. Some rules cover private companies that benefit from 'special or exclusive rights' granted by government, because it is thought that such rights can be used to influence procurement. Coverage is also determined by thresholds below which contracts are exempt. Thresholds ensure that the most valuable contracts are open to competition, whilst avoiding significant compliance costs on the larger number of smaller contracts. Sector coverage is then determined by bilateral negotiations and set out in schedules.

Principles

As noted above public procurement was excluded from the GATT national treatment and most-favoured nation provisions, so one important issue in any negotiation is the extension of these principles to public procurement or any regulation or procedure associated with public procurement. A national treatment and MFN obligation would, for example, prohibit *de jure* discrimination between different national suppliers.

Transparency

Central to the aim of facilitating increased competition in public procurement is the provision of information. This can encompass the statutory rules on procurement, such as on contract award procedures (see below) as well as information on specific tenders and technical specifications. Without this information non-local suppliers would not be able to bid for contracts. In practice, transparency represents a major contribution to 'liberalising' public contracts.

Substantive measures

Standard (harmonized) *contract award procedures* can considerably enhance transparency, but these also need to accommodate the diverse nature of contracts. Rules on procurement do this by providing for open, restricted and negotiated tenders. Open tendering is used when procurement concerns standard commodities or products where price is the only or the predominant factor. Restricted or selective tendering is used when the purchasing entity wishes to be sure that the potential suppliers are qualified (both technically and financially) to complete the contract successfully. In restricted procedures the purchaser keeps a list of certified or approved suppliers, who are then invited to bid for tenders. This means that open and transparent procedures and criteria have to be devised to determine which suppliers are qualified to produce the good or service. When special expertise or knowledge is needed, negotiated tendering may be used, in which a specific supplier is selected and negotiations on a contract conducted.⁷ For all forms of tendering there are also important details concerning, for example, how calls for tender are made and what information is provided, what time limits are set for bidding and for awarding contracts. Short time limits may put foreign bidders at a disadvantage, while long time limits may be detrimental to the service provided by the procuring entity.

By requiring suppliers to comply with *technical specifications* or standards, a procuring entity can prefer certain suppliers over others. Rules on procurement may therefore require the use of international regional, national or other standards, or require the use of performance standards over design (or prescriptive) standards. Performance standards set out how the equipment or system should perform not the details of its components or dimensions.

Co-operation

Many agreements provide for co-operation in PP. This usually involves help drafting procurement laws, technical assistance and training for procurement officials and exchange of expertise. There may also be provision for a specialist committee.

Regulatory safeguards

As with other rules there may be scope for exclusions from national treatment and other obligations under PP rules, for reasons of human health, national security and national interest. Apart from such formal exemptions, discretion in contract award procedures, discretion not to award a contract or discretion in the use of enforcement provisions, such as waiving contract suspension rules can all be seen as constituting forms of regulatory safeguards.

Enforcement/compliance

Experience has shown that without effective compliance, rules on public procurement will have little effect. Given the thousands of contracts awarded every day it is very difficult to have an effective form of central compliance monitoring. Rules have therefore provided for bid-challenge procedures, which provide bidders who believe they have not been fairly treated with an opportunity to seek a review – by an independent body - of a contract award decision. Penalties in the case of non-compliance may involve project cancellation or financial penalties (limited to the costs of bids or exemplary damages). Rules requiring information on contracts awarded and reasons why bids failed can also be seen as facilitating compliance.

5.2 A History of Interaction Between Multilateral and Regional Approaches

5.2.1 The ITO debate

As in all rule-making, current approaches to procurement rules have been shaped by past negotiations and precedent and, in particular, a history of interaction between multilateral and regional regimes. This section covers the period from the ITO to the mid 1980s and argues that regional initiatives have had a significant and generally favourable impact on efforts to 'open' PP markets. The following sections cover the 'second phase of regionalism' and then the post Uruguay Round period.

Some of the central issues discussed above were on the agenda at the time of the Havana Charter. The US draft ITO charter included specific reference to PP, but with the MFN and national treatment obligations limited to central government. Opponents argued that existing buy-national measures in many countries would undermine the credibility of the rules. Britain opposed the inclusion of local government on the grounds that this would create insurmountable problems of compliance. The inclusion of services was discussed but rejected because here rules would affect the treatment of foreign nationals under national statutes, and the drafters of the ITO wished to avoid such entanglement. This opposition ultimately resulted in the explicit exclusion of PP from the MFN - and the removal of any specific reference to it in the national treatment -provisions of the ITO draft. (Blank and Marceau, 1997). As a compromise the US delegation accepted some weak wording in the provisions on state trading to the effect that where government was the purchaser it should provide 'fair and equitable treatment having full regard to the relevant circumstances'. The drafters appear to have made the incorrect assumption that state trading was the same as PP. (Blank and Marceau, 1997) The GATT followed the ITO drafting so PP was excluded from GATT coverage, but with the expectation that the issue would be revisited. At the regional level there was also no specific reference to PP in the Treaty of Rome, because of the nature of the treaty as a framework treaty, but there were provisions, on non-discrimination and

national treatment, which could have been – and subsequently were – used to challenge discriminatory practices. Other provisions, such as those covering competition and public enterprise (Art 87 -89 TEC) also might have been used for this purpose. But as in 1948, the sentiment at the time the Treaty of Rome, was negotiated did not support inclusion of European level disciplines in this sensitive policy area. (Blank and Marceau, 1997)

5.2.2 Work in the OECD

With no progress in the GATT attention shifted to the OECD where discussions began following a 50% increase in US preference for domestic defence contractors. European complaints led to an OECD survey of national procurement policies and practices in 1963, the results of which were published in 1966. (OECD, 1966) This work led to the drafting of a set of guidelines on public procurement rules covering transparency in contract award procedures. The work in the OECD also introduced the concept of thresholds to catch the economically most important contracts. At the same time as the OECD was working on PP, the European Commission was drafting the first EEC directives aimed at opening the European markets. The Commission's 1965 proposals used the model of the OECD code, but were not adopted until 1971 as the Directives on Public Suppliers and Works.

In 1969 the United States government, prodded by US suppliers seeking access to the European and Japanese heavy electrical equipment markets, proposed a sector agreement on the liberalisation of PP.⁸ The idea of a sector agreement was resisted by the Europeans, because it clearly targeted their industries and was unbalanced. Most European governments also used explicit, or more often covert, preferential PP as an instrument to support 'national champions.' There was no common position within the

EEC on how to treat procurement in the utilities sector. Germany had a number of powerful privately owned utilities that rejected inclusion in EU rules, but France and other Member States with public utilities refused to bring their publicly owned utilities under the EU rules unless all utilities, including the German private utilities, were covered. The issue of EC competence in trade negotiations on procurement was also not clear at this point.⁹

Opposition to a sector agreement led to discussions on the general a code. These made some progress in the OECD, but there were differences between the US and Europeans over the suitable level of thresholds and entity coverage, with the US wishing to limit coverage to central government and the Europeans wanting to adopt the approach taken in the EEC Directives that included central, regional and local government. On contract award procedures the US favoured open tendering, because it was seen to be more transparent and was the method used in US federal procurement, but European and Japanese negotiators argued that selective tendering was essential if procurement procedures were to ensure that suppliers could deliver and because it was the approach they used domestically.

5.2.3 The 1979 GATT Government Purchasing Agreement (GPA)

By 1975 discussions in the OECD had made progress towards an agreed text of a code. This included the procedural issues and transparency, but there was no agreement on sector coverage. In 1976 the chairman of the OECD working group submitted a draft instrument on government procurement, policies and practice to the GATT. This was the distillation of 15 years of work in the OECD, enriched by the EEC experience such as with the Directive of December 1976 that set out the revised procedures for the award of public supply contracts (i.e. goods) in all Member States.

(Bourgeois, 1982) The OECD draft was taken up by the GATT Sub-Committee on Government Procurement that had been set up early in 1976 as part of the Tokyo Round negotiations (1973-79). This Sub-Committee included developed and developing countries, the latter believing that public procurement was an area of some interest to them and one in which there was scope for special and differential treatment.

There is little doubt that 'to a very large extent the logic and wording of the OECD draft was incorporated into the draft integrated text for negotiations on government procurement of December 1977' and thus provided the model for the qualified MFN Government Purchasing Agreement (GPA) of 1979. (Blank and Morceau, 1997, pg 41) This reintroduced national treatment and most favoured nation treatment (Article II of the GPA) with regard to all laws, regulation, procedures and practice regarding procurement of products by the covered entities.¹⁰ The GPA included detailed transparency rules on advertising contracts and the submission, receipt and opening of tenders and awarding of contracts. All of these measures were more or less exactly as they had been developed in the OECD and adopted in EC Directives. On tendering procedures, the OECD compromise to allow open, selective and negotiated tendering was carried over into the GPA. This approach had also been used in the EEC Directives of the early 1970s.¹¹

But the GPA had a number of weaknesses. First, it only covered central government purchasing of supplies (i.e goods) above a threshold of 130,000 Special Drawing Rights (SDR).¹² It did not cover public works contracts, services, sub-national government (the states and local government) or utilities.¹³ Opposition to including utilities came from the European Union, which had made no progress 'domestically'¹⁴ and was therefore unable to make commitments on this in the GATT. So the US heavy

electrical equipment sector that had been one of the key forces pushing for market opening was excluded.

A second weakness was the absence of any effective enforcement provisions. More particularly the GPA provided no bid challenge/compliance measures, which would enable aggrieved tenderers to bring actions. The OECD had made proposals for a kind of bid challenge mechanism, but this was seen as too ambitious at the time. (Blank and Marceau, 1997) The 1979 GPA required purchasing entities to provide information on the contracts awarded and reviews of the contract award decision, but there was no requirement for reviews to be concluded by an independent review body. In the case of a government believing that benefits under the agreement were being nullified or impaired the only option was to the standard GATT consultation and dispute settlement procedures. But GATT dispute settlement could have no effect on contracts awarded and was aimed at changing laws, practices or procedures that systematically discriminated against suppliers from signatories of the GPA. With hindsight the absence of any effective bid challenge/compliance provision in the 1979 GPA was a major reason why it had little effect.

Although the agenda of the negotiations was set by the OECD countries, India, Korea, Nigeria and Jamaica participated actively in the negotiations of the 1979 GPA, but none of these became signatories. Their main concern was that the GPA threatened their ability to use of PP to promote industrialisation, although the GPA contained special and differential treatment provisions. They were also concerned about the compliance costs and unhappy about the way coverage was effectively negotiated on a bilateral basis as this put them at a distinct disadvantage vis-à-vis major developed countries and added to the costs and complexity of the agreement. The GPA therefore became a plurilateral agreement signed only by the OECD countries (less Australia and

New Zealand), Hong Kong, Singapore and later Israel. But coverage was determined by bilateral schedules using positive lists. The economic impact of the 1979 GPA was limited.¹⁵

5.3 Interaction during the ‘second phase of regionalism’ (1985 – 1994)

This section looks at the interaction between regional and the multilateral/plurilateral levels of rule-making during the ‘second phase,’ which broadly coincided with the Uruguay Round negotiations. It shows that regional level initiatives in the shape of the EU and US centred RTAs played an important role during this period by taking the approach used in the plurilateral 1979 GPA and developing it further. This, together with the fact that the regional and plurilateral rules were being developed at the same time, helped ensure a close synergy between the two levels.

Progress at the EU level opened the way to wider coverage of the GPA to include works contracts, services and above all the utilities. At the same time progress in the GPA negotiations led to a progression at the regional level. For example, NAFTA unlike CUSFTA included state-level government purchasing.

The regional initiatives adopted the same substantive rules as the GPA so were consistent. But the CUSFTA provided the model for GPA –plus enforcement provisions based on company initiated ‘bid-challenge.’ This was emulated by the EU as it offered more immediate redress and remedies for aggrieved suppliers. Finally, this more stringent enforcement brought forth new elements of ‘regulatory safeguards’ that allowed for exemptions from the tough penalties in the new enforcement rules.

5.3.1 The EU level

The EC Directives of the 1970s had very little effect in opening markets. Discretion under the rules, entrenched practices, technical requirements favouring domestic suppliers and splitting of contracts to bring the value of contracts below the thresholds all contributed to keeping markets closed. More importantly, with no confidence they would get a fair chance, foreign suppliers simply did not bother bidding, with the result that non-national suppliers accounted for only 4% of public contracts in Germany and less than 1% in Italy and Britain. (European Commission, 1986) Procurement represented a major gap in the European Single Market (SEM) just as it did in the GATT.

The EU SEM programme therefore included a range of Directives on public procurement.¹⁶ The EU Directives on supplies and works were revised to tackle evasion, but otherwise followed the pattern of the earlier Directives (and the GATT 1979 GPA). Stronger *transparency* rules were introduced and purchasers were obliged to use agreed European or international standards where these existed and performance (rather than design) standards where they did not. Like the GATT rules, the EU used thresholds, which for supplies (goods) were set at the same level as the GATT GPA.¹⁷ The EU provided a model for wider coverage of works (construction) contracts in that the EU threshold of 5 million Euro for construction was subsequently adopted in the 1994 GPA.

The SEM rules also covered purchasing of *services* by central, state and local government services.¹⁸ A two-tier approach was adopted in which the initial market opening effort was focused on the 'easier' service sectors such as telecommunications, financial and professional services. This mirrored the EU approach to GATS

negotiations, which was focused on the same sectors. The more sensitive sectors, such as rail transport, legal services, education and health were left for a later date, although calls for tenders in these fields still had to comply with the transparency provisions of the EU's Directives. The structure of the EU rules for procurement of services adopted the same approach as for supplies and works and were subject to the same compliance rules, but with a higher threshold of Euro 200k.

The most important 1979-GPA-plus coverage was, however, the extension of the EU rules to cover *utilities*. Alternatively it could be said that the EU finally acted to ease the inclusion of utilities in the GPA. The 1990 SEM rules extended coverage to telecommunications, power, gas, water and transport services.¹⁹ By 1990 privatisation and the general shift towards more liberal policies, opened the way for greater coverage, but it was still necessary to establish a 'level playing field' between the EU Member States by including private utilities that benefited from special of exclusive rights as well as public owned utilities.

The basic structure of the Utilities Directives was similar to that of the earlier directives. The fact that private utility companies were to be obliged to comply, however, meant there was a greater sensitivity to the costs of compliance and thresholds were set at a higher level, Euro 400k in the energy, water and transport sectors and Euro 600k in telecommunications. These EU thresholds were later adopted by the 1994 GPA. There was somewhat greater flexibility shown in the use of restricted and negotiated tendering to placate lobbying from powerful (private) utilities. The case of services procurement by utilities provides another example of how the coverage of the GPA was determined by the coverage of the EU rules. Services procurement by utilities was excluded from the EU offer in the GPA negotiations until 1992, when the EU adopted a directive covering this area.

When the EU SEM measures went beyond the GPA (1979) the issue of access for third country suppliers arose and some Member States argued for reciprocity provisions to ensure that third countries offered EU suppliers equivalent access. In the case of supplies (goods) and purchased by central government the 1979 GATT GPA Code prohibited any reciprocity provision. In the case of works (construction), companies tendering for contracts usually have a presence in the EU and would in any case use local sub-contractors, so local value added was less of an issue. This was also the case in services where a local presence was the rule. There was strong opposition to reciprocity provisions from a number of services sectors. An earlier 1989 Second Banking Directive had included reciprocity provisions and had precipitated the 'fortress Europe' debate between the EU and the US. The liberal EU Member States therefore sought to avoid a similar reaction in services procurement field. The EU rules on utilities did, however, include reciprocity provisions (Art 29 and 36 in the utilities services directives) that allowed purchasing entities to reject bids, if more than 50% of the value of the contract was non-EU origin. There was also scope to apply a 3% price preference for EU suppliers in the utilities. Normal EU origin rules were to be applied.²⁰ These reciprocity provisions were to feature in a major controversy in the final phase of negotiations of the GPA, see section 5.6 below.

The EU rules on utilities illustrate the interaction between trade rules and agreed *international standards*. Technical specifications posed - and pose - a particular problem in utilities, because of the need to ensure compatibility of equipment connected to the network. In the case of the EU utilities, there was a large backlog of agreed international standards. In other words firm specific or 'design' standards were still used that could prejudice competition for contracts. To counter this, the European

standards institutions were mandated to work on the technical standards needed to facilitate an opening of markets in the utilities sector.

The EU's SEM programme was being developed in parallel with negotiations on revision of the GPA in the GATT Working Group on Government Procurement and the negotiation of the CUSFTA. Indeed, GPA negotiations really only began in earnest in 1988 once the CUSFTA had been adopted and the EU had produced drafts of its planned Directives for power, telecommunications, water and transport.²¹ Apart for the potential coverage of the utilities, the EU had also proposed *stronger compliance*.^{22 23} The absence of a common compliance procedure was seen as a major weakness of the EC regime during the 1970s and early 1980s. National remedies existed but these varied dramatically, some Member States (France, Italy) had administrative review procedures others (Britain, Ireland and Demark) only judicial. In Germany public procurement was governed by private law of contract, a fact that was anchored in the constitution/*Grundgesaetz*. Enforcement powers also varied, some national rules provided the responsible review agencies with powers to suspend contract award procedures others did not. Some review agencies had powers to impose penalty payments others did not. These differences constituted impediments to effective reviews and remedies and thus enforcement for both EU and third country suppliers alike, so the replacement with uniform provisions would facilitate enforcement.

Emulating the CUSFTA 'bid challenge' rules, the EC Compliance Directive²⁴ set out minimum common requirements for review and compliance provisions. Each EU Member State was obliged to provide access to independent reviews for aggrieved suppliers, establish powers to suspend contract award procedures, set aside decisions taken unlawfully, require purchasing entities to remove discriminatory specifications from calls for tender and award damages.

The controversial issue of contract suspension illustrates how more stringent rule-making is invariably accompanied by a 'regulatory safeguard'. Concern that contract suspension would interrupt 'normal' commercial practice, resulted in the EC Directive providing a national interest waiver. The relevant provision reads 'when considering whether to order interim measures (including suspension) the body responsible (the local implementing body) may take into account the probable consequences of the measures for all interests likely to be harmed, as well as the public interest, and may decide not to grant such measures where the negative consequences could exceed the benefits' (Article 2(4)).' This waiver subsequently found its way into the 1994 GPA and thus provides another example, of the close interaction between levels of rule-making.

Compliance in the utilities sector caused some major difficulties, because private utilities opposed what they saw as onerous compliance costs and regulation. This led to the EU rules including a range of additional options such as the use of financial penalties for non-compliance or attestation of contract award procedures.²⁵ In practice countries were simply allowed to opt for the approach they preferred, so that the benefit of a common approach to compliance was lost.

5.3.2 EU bilateral agreements during the 1985-95 period

Article 65 of the EEA (European Economic Area) agreement extended the EC *acquis*, including all provisions on procurement to the EEA EFTA states. Annex XVI to the EEA agreement listed those acts referred to in the *acquis*. There were a number of modifications to the procurement directives of a largely technical nature and Liechtenstein and Norway were given transition periods to implement the utilities Directives until 1994 and 1995 respectively.

The reciprocity provisions were also extended to the EEA area. Thus products originating in the EEA were not included in the calculation of origin for the purposes of Article 29 of the utilities directive. The operation of Article 29 (3) (reciprocity) was based on the condition that no existing trade agreements were affected and that there was consultation between the Contracting Parties in their negotiations with third countries. The concrete result of this last requirement was that in the closing stages of the negotiations on coverage of the 1994 WTO GPA, the EEA members, including the prospective members of the European Union, submitted schedules identical to those of the European Union.

The second major set of EU bilateral agreements to include public procurement were the Europe Agreements with the Central and East European Countries (CEECs) of the early 1990s. Prior to these some of the CEECs had introduced elements of a coherent procurement policy. For example, Poland had established a Central Public Procurement Office that required notification of all contracts above a (fairly low) threshold and provided for a bid challenge/review of contract award decisions. But in Poland, as in most countries, these reasonably transparent procurement rules did not reach far beyond central government and public enterprises were not covered. Article 67 of the Europe Agreement with Poland offered non-reciprocal access to EU public procurement markets, whilst granting Poland a 10-year transition period. This meant that *de jure* preferences granted to domestic suppliers in Polish procurement (a 20% price preference and a 50% origin rule) were to be phased out over this period. Significant EU technical assistance was then channelled into training procurement officials in the CEEC countries, because this was identified early on as a major constraint on the development of a professional, competition based procurement regime.

The Europe Agreements therefore promoted reform in public procurement practices that had already begun in the CEECs and cooperation helped speed up the process. Without this top down pressure from the Europe Agreements it is unlikely that reform in Poland and other CEECs would have made significant progress. (Feldmann, 2003) The Europe Agreements began a process of reform and approximation to EU norms that was confirmed with accession for the CEECs to the EU. These bilateral agreements began a process that has continued into the 2000s in which bilateral FTAs and RTAs are effectively extending the reach of the GPA to more countries. All CEEC accession states were obliged to sign up to the commitments in the 1994 GPA as a condition of progress towards accession.

5.3.3 The US bilateral agreements in the 1985-95 period

The US concluded three major agreements during this period, with Israel, Canada and NAFTA. In the case of Israel, which was a signatory to the 1979 GPA, the provisions essentially confirmed commitments under the GPA. In the case of the CUSFTA there are clear signs of synergy between the bilateral and plurilateral (i.e. GATT) negotiations. The provisions governing government purchasing in the CUSFTA (Chapter 13) were based explicitly on the 1979 GPA. (Government of Canada, 1989)

CUSFTA did not go much beyond the 1979 GPA, because of the asymmetry in the size of the US and Canadian markets. With a US central government procurement market ten times the size of Canada's, the US was not willing to extend US schedules much beyond those of the 1979 GPA schedules. Coverage was also limited by the opposition of the sub-federal governments in both countries to inclusion of their purchasing. Only by lowering the threshold for supplies and services to US \$25,000

compared to some 150,000 SDR for the GATT and EU regimes, did the CUSFTA go beyond the GPA. (Hart and Sauve, 1997).

In line with the 1979 GPA, the CUSFTA required national treatment and thus prohibited *de jure* preferences. Contract award criteria had to be; (a) based on the bid that best meet the requirements specified in the tender documentation that had to be clearly specified in advance, (b) promote competition and (c) be free of preferences in any form in favour of national goods or suppliers. With its new bid challenge provisions the CUSFTA was significantly GPA - plus. The bid-challenge rule reflected US domestic practice and required, among other things, that each party established an independent review authority to consider bid challenges. (United States General Accounting Office, 1988) The respective authorities were given powers to suspend contract award procedures and terminate the contract, except in the case of urgency or 'where delay is prejudicial to the public interest'.

With regard to the issue of reciprocity an origin test was included in the CUSFTA according to which only 'eligible goods' shall be accorded national treatment in all measures concerning government procurement (Article 1305). Eligible goods were defined (Article 1309) as those manufactured in the territory of either Party 'if the costs of the goods originating outside the territories of the Parties and used in such materials is less than 50% of the cost of all goods used in such materials'. The CUSFTA therefore applied an origin test for central government purchasing of goods.

A comparison of the CUSFTA and the EU model shows large areas of similarity at least on the substance of the rules if not on coverage, where EU's SEM initiative went well beyond anything in the CUSFTA and GPA. There were however, some differences in emphasis, for example, the EU²⁶ placed more emphasis on centralised enforcement

than the CUSFTA, where the emphasis was very much on private actions, which procedural and information requirements were geared to facilitate.

5.3.4 The North American Free Trade Agreement

The NAFTA essentially adopted the CUSFTA rules, but went further on coverage, was more detailed and contained some important modifications in order to accommodate the less developed Mexico.

Coverage of NAFTA was greater than CUSFTA in large part because of developments in the GATT negotiations in Geneva. The active phase of negotiations in the Uruguay Round on public procurement occurred after 1990 once the EU had most of its domestic regime in place. By 1992 it was clear that works and services, sub-central government and public enterprises were going to be included in the revised GPA. NAFTA negotiations appear to have followed these developments and extended coverage to match the plurilateral developments by including the sub-central government level, services and public enterprise, forms of PP excluded from the CUSFTA.

The NAFTA rules also emulated the EU's rule in some respects. For example, NAFTA thresholds for public enterprises were adopted at a level equivalent to those of the EU (which had shaped the draft GPA rules) (\$250k for goods and services and \$8 million for construction/works). NAFTA however, drew a clear line between public enterprises, which were covered, and private enterprises, which were not, even when the later benefited from special and exclusive rights. So in this respect it reflected the less comprehensive approach that one generally finds in NAFTA.

In terms of other thresholds, that for central government purchasing of supplies was set at \$50,000, higher than the \$25,000 for CUSFTA in order to accommodate

Mexico. The threshold for works was set at \$6.5 million, in line with EU rules and the 5 million SDRs proposed in the GPA negotiations in Geneva. So here again is evidence of quite close synergy between the NAFTA and GPA negotiations. (Hart and Sauve, 1997)

There were transitional measures for Mexico to reflect its lesser developed status, such as the exclusion of Pemex, a general 'set aside'²⁷ for Mexican suppliers of around \$1 billion up to 2003 and Mexico was permitted local content requirements of 40% for labour intensive contracts and 25% for capital intensive contracts.

NAFTA provisions on tendering procedures were essentially the same as the GPA, but those on transparency slightly more detailed. NAFTA provided for open, selective and negotiated tendering. As in the EU, there remains potential scope for purchasing entities to use this flexibility to retain existing suppliers. Thus negotiated tendering, with selected tenders is possible when there is a need for network operators to maintain the compatibility of equipment used in the network. This provides an important *de facto* regulatory safeguard.

NAFTA rules on technical requirements are weaker than the EU. They require international standards to be used in preference to firm specific or national standards, 'where appropriate,' as in the GPA. But in contrast to the EU, which has made significant efforts to ensure the necessary international standards were drafted, the NAFTA approach simply relies on language preferring performance over design standards.²⁸ This reflects the general North American aversion to what are seen as 'bureaucratically' determined international standards in preference for industry or market driven standards. (see chapter 4)

The criteria for awarding contracts also reflect an awareness of the need for flexibility. The lowest tender or that 'determined to be the most advantageous' can be chosen. In determining the most advantageous tender the purchasing entity can consider

a broad range of non-price issues. As in the EU and GPA, there is also a public interest over-ride (Article 1015), which qualifies price and other economic criteria. Here then is another element of 'regulatory safeguard.'

The CUSFTA 'bid challenge' model was not surprisingly extended to NAFTA, so that the latter required the establishment, under national law, of an independent review body to deal with bid protests. These national rules must, however, offer common remedies for cases of non-compliance, such as the suspension of bids and cancellation of a contract once awarded. NAFTA like CUSFTA provides for contract cancellation. But as in the CUSFTA and the EU, NAFTA Article 1022 contained a general public interest override on the use of contract suspension.

There are no reciprocity provisions in the NAFTA rules on procurement, but there is a substantial presence 'origin' test for third country suppliers of *services* in Art 1005, which states that 'a Party may deny to an enterprise the benefits of (the procurement chapter) if: (a) nationals of any non-Party *own or control* that enterprise; and (b) that enterprise has *no substantial* business activities in the territory of the Party under whose laws it is constituted.' This 'origin' rule applies to services only because the 1979 GATT GPA, which prohibited such origin rules, did not cover services.

The NAFTA, as with the CUSFTA, required a renegotiation of the agreement in the light of the outcome of the multilateral negotiations.

5.3.5 Other agreements

There was no significant application of PP rules in FTAs outside the EU and US centred RTAs/FTAs during the 'second phase of regionalism.'²⁹ One exception was the Australia and New Zealand CER-GPA of 1991. Both countries had opted not to sign the 1979 GPA, but faced PP issues. In Australia individual state-level governments had

concluded a National Preference Agreement (NPA) in the 1980s that prohibited preferences in public procurement against each other. As part of the review of the Closer Economic Relations between Australia and New Zealand (CER) in 1991, New Zealand pressed for - and was successful in gaining - inclusion in the renamed Government Purchasing Agreement (CER-GPA) of 1991. As neither Australia nor New Zealand had signed the 1979 GPA, on the grounds that the procedures were too cumbersome and that they already had competition-based procurement policies, they still maintained preferences in procurement against third countries. (Walker, 1997)

5.4 Negotiations during the Uruguay Round

When discussions on a revision of the GATT GPA began in the Informal Working Group on Government Procurement in 1985 the objective was fourfold: (a) strengthened procedures; (b) increased entity coverage; (c) improved enforcement; and (d) more signatories to the agreement, including more developing and middle income countries.³⁰ The negotiations, which continued right through to 1993/94 were more or less successful in the first objective, although little really changed in terms of the rules for procurement. Increased entity coverage was achieved, but at the expense of a very complex and opaque set of schedules aimed at achieving reciprocity. The third objective was successful and the GPA of 1994 (implemented in 1996) is unique in that it provides for private companies to challenge purchasing decisions taken by governments under the national law of the host country. The negotiations failed, however, to increase the number of signatories. As will be argued below, regional and bilateral agreements have subsequently been used to achieve this aim after the failure of the multilateral route.

The proposals for the GPA closely reflected the status of the respective regional initiatives. Agreement was therefore reached without much difficulty on stronger rules

for supplies and works procurement. By late 1988 the CUSFTA had been agreed and provided the model for US and Canadian proposals in the GATT. The drafts of the key EU utilities directives had been produced, but not yet adopted.³¹ In 1989 the EU adopted a directive on compliance introducing bid challenge within the EU, which formed the basis of the EU proposals for the GPA. The US proposals were, word for word, the bid challenge rules of the CUSFTA.³²

The modalities of negotiation were to discuss the rules and then coverage. Coverage fell into three groups, central government (category I), regional, state and local government (category II) and other entities including public enterprises (category III). But the EU had still not sorted out the scope of its internal regime and the Member States had not signed off on the EU rules for utilities, so serious negotiations on extending coverage of the GPA had to await the adoption of a common position on utilities in the EU Council of Ministers and the formal directive that was adopted in 1990.³³ At the insistence of France, Italy and the European Parliament (but opposed by Britain and Germany) these proposals included the 3% price preference for EU suppliers and a 50% origin rule. In order to resolve the deadlock within the EU over reciprocity provisions, it was agreed that the European Commission would produce a report on progress in the GATT GPA negotiations before deciding what use, if any, to make of the third country rules when the directive was implemented in January 1993. (Woolcock, 1991)

The rules element of the GPA was more or less settled by 1991, when the Chair of the GPA negotiating group produced a draft for inclusion in the draft final agreement of the Uruguay Round in December 1991 (the so called Dunkel Text). This draft was essentially the framework rules that were to be adopted as the 1994 GPA. The remaining three years of negotiation were mostly concerned with the coverage. The

1994 GPA reflected the globalisation of production by prohibiting discrimination based 'on the degree of foreign affiliation or ownership' or country of production. It strengthened the transparency requirements concerning contract award procedure, by for example, requiring information on why a bid was unsuccessful. As in the 1979 GPA open, restricted, single and negotiated tendering were all possible under the agreement provided detailed procedural obligations aimed at ensuring fair and open competition are used. Contract award criteria are (i) the lowest cost or (ii) the 'most advantageous' bid, which still provides considerable scope for discretionary interpretations. Another area in which the 1994 GPA provides scope for discretion is in its provisions on technical specifications. These continue to be based on the view that international standards are encouraged, as are performance standards, but that any type of specification can be used when the international standards are not 'appropriate'. In terms of enforcement the GPA adopted the bid challenge employed in the CUSFTA and EU, granting aggrieved companies rights under the laws of the host state. The latter must provide independent review of decisions, offer agreed remedies, including contract suspension and damages, which may be punitive or limited to the costs of bidding. The GPA followed the RTAs by providing a public interest opt out from contract suspension.

But the issue of coverage remained contentious. The US withheld any commitment on categories II and III, until the EU decided what to do about its third country rules. The US saw these as a means of again denying market access for US electrical and telecommunications equipment suppliers. (Office of the United States Trade Representative, 2000; Congressional Research Service, 1993) A crisis emerged when the EU utilities directive came into force in January 1993 and it took further bilateral negotiations between the EU and US to reach agreement on a Memorandum of

Understanding on the treatment of US electrical equipment exports to the EU. In this the EU effectively waived the use of the third country provision for this sector. (Memorandum of Understanding, 1993)

The final agreement on coverage was reached in late 1993 and extended coverage to include works (construction) and services as well as supplies (goods) procured by central government, but with negative listing used for works and positive listing for services. This mix of negative and positive listing reflected the fact that GATS used positive listing. (Hoekman and Mavroidis, 1997) Coverage of sub-central government was new, but not comprehensive, for example only 37 US states agreed to be covered and local government still remained outside the agreement. Public enterprises in category (III) were also covered for the first time, but here sensitivities resulted in different and higher thresholds.

These bilateral negotiations illustrated how increased entity coverage of the GPA had come at the expense of a still greater emphasis on reciprocity in the schedules determining coverage.³⁴ (Arrowsmith, 2002; Reich 1996) This, along with the general complexity of the rules, resulted in developing countries and some developed countries again deciding not to sign the GPA and thus the failure to extend the number of signatories.³⁵ As a result, unlike other rulemaking aspects of the Uruguay Round, PP remained a plurilateral agreement excluded from the single undertaking. Some countries that signed the 1979 GPA, such as India and Hong Kong, opted not to sign the 1994 GPA.

It has been shown that the earlier period of rulemaking was shaped by the OECD, with the OECD codes finding application in both the plurilateral GPA and the EU regional initiatives of the 1970s. During the 'second phase,' most of the advances in rulemaking in this field came at the regional level. The advances in the EU regime

facilitated wider entity coverage in the GATT talks. The CUSFTA and EU rulemaking took the 1979 GPA as a starting point, but developed rules further, in particular in the area of bid challenge. Both North American and EU approaches built on the common OECD norms with the result that the regional rules were compatible with the plurilateral GPA. This was also helped by the fact that the GPA was to a large extent a transatlantic exercise. Progress at the plurilateral level fed back into regional rule-making, and regional rule-making was kept in conformity with the GPA rules. This synergy between the regional and plurilateral produced stronger more credible rules on transparency, enforcement and more competitive procurement markets compared to the rather weak rules that went before. The regional rules removed *de jure* preferences and eroded *de facto* national preferences, without replacing these with regional preferences. Although the EU introduced a *de facto* regional preference in its third country rules for utilities, this appears to have been used as negotiating leverage to ensure extension of the GPA to sub-federal entities in the US rather than a permanent preference. Whilst the rules began to tackle the *de facto* preferences and increase competition, thus benefiting the economies concerned, this did not bring about a massive increase in import penetration.³⁶

This all suggests a very close linkage between the regional and plurilateral negotiations in the GATT. (Blank and Moreau, 1997; Delsaux Pierre, 1997) In terms of the drafting of the framework rules this interaction was entirely positive. When it came to the coverage of the rules, however, the picture is mixed. Whilst EU initiatives facilitated wider coverage, plurilateral negotiations were held back until the EU could reach an agreed position. Regional initiatives also did little to temper the complex bilateral negotiations on the coverage of categories (II) and (III) that are likely to have trade diversionary effects.

5.5 Regional initiatives in the post Uruguay Round period

Initiatives at the bilateral and regional level during the post Uruguay Round period appear to have had less to do with developing the rules and more to do with extending the number of countries signing up to the 1994 GPA or GPA-like rules. Looking first at the EU centred RTAs, the eastern enlargement of the EU effectively added ten signatories to the GPA, since all accession states to the EU had to sign.³⁷

In terms of EU RTAs with non-accession states the EU-Mexico agreement of 2000 (implementing the EU-Mexico co-operation agreement) was the first EU-bilateral agreement to include substantial provisions on public procurement. This effectively extends GPA provisions to cover Mexico, which is not a signatory to the GPA.³⁸

Interestingly, when it comes to detailed provisions for advertising and awarding contracts, Mexico used the NAFTA text and the EU uses the GPA text, which illustrates how close the GPA and NAFTA models are. The EU-Mexico agreement includes a bid challenge procedure. The parties must facilitate independent reviews and rapid interim decisions, including contract suspension (but not contract termination as in NAFTA). Inclusion of these rules in the EU –Mexico agreement was not controversial and did not create significant new compliance costs because Mexico had already been required to provide independent reviews for NAFTA. Finally, the EU –Mexico agreement establishes a Special Committee on Government Procurement to promote mutual understanding of procurement procedures. This committee also has the aim of promoting technical co-operation and expertise in purchasing procedures.

The EU-Chile FTA provisions on procurement are interesting in that Chile had been consistent critic of the GPA as unduly complicated and costly to implement. For this reason Chile, despite its otherwise liberal trade policies, refused to sign it. But the

EU-Chile FTA, along with the US-Chile FTA, had the effect of bringing Chile into the fold of the GPA.

The provisions on PP in EU FTAs with developing countries, other than Mexico and Chile, are not at all developed. In the Euro-Med agreements, for example the EU-Morocco agreement, there is the aim of ‘a reciprocal and gradual liberalisation of public procurement contracts’ (Art 41).³⁹ The EU – Morocco Association Council ‘shall take necessary steps’ to achieve this aim, but there is no specific timetable or concrete provisions. Likewise the EU – Algeria agreement has as its objective the ‘reciprocal and gradual liberalisation of public contracts’ (in Article 46), but no reference to any concrete measures to achieve this aim. Even the EU South Africa agreement (Trade, Development and Cooperation Agreement of 1999), which is in other respects more developed than the Euro-Med agreements, only has a general provision, in article 45, calling on the ‘parties to cooperate to ensure that access to Parties procurement contracts is governed by a system which is fair, equitable and transparent.’

The expectation must be that the EU will continue to offer some kind of simplified approach to procurement in FTAs with developing countries or least developed countries, such as in the EPA negotiations, but seek GPA-type rules and market access in FTAs with major emerging markets, where the public markets are likely to be significant.

The US bilateral initiatives post-1994 appear to have had the same effect. As chart 5.2 shows the US bilateral agreements have effectively extended the GPA disciplines to Chile and Australia, which had previously not signed the GPA and even Morocco, which given its developing country status is rather surprising. The US-Morocco FTA goes far beyond anything that has been included in the Euro-Med agreements between the EU and the North African states. The US-Singapore agreement has little substance

on procurement because both parties are signatories to the GPA, so the bilateral agreement simply applies the existing obligations under the GPA. As the chart 5.2 shows the overall approach to procurement provisions within the FTAs is in line with the GPA. So that the US in particular and to a rather lesser degree the EU, appear to be using FTAs strategically to extend membership of the GPA, with the US and EU partners apparently ready to sign up to GPA type provisions in RTAs.

This raises the question of why developing countries or emerging markets should sign up to provisions on procurement in FTAs that they have rejected in the multilateral negotiations. (see the following section) One simple answer is that they had little choice if they have wanted an FTA with the US or EU. Some major developing countries/emerging market countries have however, balked at accepting procurement provisions. Mercosur in its negotiations with the EU and Thailand in its negotiations with the US have, for example, resisted pressure to include procurement, which has become one of the sticking points in these FTA negotiations. A more sophisticated answer would be that countries have signed up to procurement provisions in the FTAs because they have recognised that most of the benefits of procurement rules accrue to the domestic economy through increased competition rather than FTA partners through increased trade.

5.6 Issues in the multilateral negotiations

The Singapore WTO ministerial included PP in the work programme for the WTO and a Working Group on Transparency in Government Procurement (WGTGP) was established. (World Trade Organisation, 1996) Opposition to the inclusion of stringent rules from developing countries limited WTO work to transparency.⁴⁰ Market access issues (defined as the removal of preferences for national suppliers) were off the

negotiating table.⁴¹ This decision did little to make issues much easier because the lack of any clear distinction between market access and transparency.⁴² (Linarelli, 2003)

A wide range of issues was identified by the WGTGP. (Evenett, 2003, pp 35-42)

⁴³ ⁴⁴ Not surprisingly these were the same sort of issues covered by the GPA and regional agreements, for example, the scope or coverage of any agreement, procurement procedures, the requirements in terms of information that should be provided to make contract procedures transparent (both pre-bid and post-bid information), decisions on qualification of suppliers and provisions on domestic reviews etc. There were, in addition, questions concerning dispute settlement in the field of public procurement under the WTO, technical assistance and special and differential treatment for developing countries. (Arrowsmith, 1996)

In terms of coverage, the US and EU argued that transparency should apply to all procurement because of the general economic efficiency gains from more open and transparent purchasing.⁴⁵ The (developing country) WTO members seeking to restrict coverage, argued that WTO provisions should only apply to procurement 'open to competition,' in other words only procurement covered by schedules and above set thresholds in any agreement. This position appears to reflect a view on the part of developing countries (as well as OECD countries) that *market access* is central to the debate not *better procurement practice*. The dominant view in the WGTGP favoured limiting transparency rules to central government, with many countries pointing to the impracticability and costs of extending transparency rules to cover state or local government. (World Trade Organization, 1999)

There appeared to be a broad consensus in the WGTGP on a continued use of flexibility in contract award procedures, such as the use of open, restrictive and negotiated contracts, but differences over the degree of detail needed to ensure

transparency in the use of these procedures. The WTO members seeking an expansive approach (i.e. EU and US) argued that information was needed on a long list of things: contract details, contact points, delivery details for the bids, information of the type of contract award procedure (open, restricted or negotiated), the criteria for selection of bids, information on any existing preferences for national producers or categories of producers, technical specifications, the timetable for completion of the contract, etc. Other WTO members found such a long list burdensome and argued for more national discretion on what to include in transparency rules. One particularly sensitive issue was whether there should be transparency for existing *de jure* preferences. Potential suppliers should arguably know if they are facing a preference, but publication of such discrimination could also provide a focus for efforts to remove of such distortions. Another issue was whether there should be information on why bids had not been accepted or debriefing for unsuccessful bidders. Again the issue of compliance costs was raised by developing countries.

Implementation and enforcement was also discussed. WTO members, accustomed to bid-challenge and access to reviews in GPA or regional rules, argued that these were essential if the rules were to work. Non-signatories to the GPA argued that such enforcement provisions were only relevant for rules on market access and that maintaining the institutions necessary to offer an independent review of transparency in procurement was excessive. Access to WTO dispute settlement was also controversial. The US in particular argued that all WTO rules should be covered by the DSU (Dispute Settlement Understanding). Other WTO countries, especially the developing countries argued that the dispute settlement was only relevant when market access was at stake. This reflects the view that any transparency provisions under the WTO should take more the form of a voluntary code than a binding obligation.

Finally, the WGTGP discussed forms of special and differential treatment for developing countries such as a development exemption from the rules⁴⁶ and higher thresholds in terms of coverage for developing countries. The developed countries also offered technical assistance in drafting procurement laws and implementing the transparency rules. (World Trade Organization, 2002)

The work of the WGTGP produced some valuable material and there appeared to be a consensus on the value of transparency in government procurement.⁴⁷ But differences remained that precluded any agreement on inclusion on PP in the DDA.⁴⁸ In the run-up to the Cancun Ministerial in 2003 the EU's view was that the case for transparency had been accepted by all, reiterating that developing countries would still be able to retain (*de jure*) preferences. The EU further argued that many countries already had forms of transparency in place so that the costs would not be insurmountable. Compliance costs could be reduced by the use of thresholds and technical assistance would be forthcoming.

The developing countries did not accept the view that an agreement on the 'modalities' for negotiation on procurement was imminent. Brazil argued that all accepted that transparency in public procurement was a good thing, but the case for a WTO agreement on transparency had not yet been made. India argued that it was not yet time to enter negotiations, as it still remained unclear what the scope of any agreement on transparency would be. (World Trade Organization, 2003)

5.7 Conclusions

This case study clearly shows the interactions between different levels of rule making over time. Rules developed in OECD discussions in the 1960s and early 1970s provided the model for regional and plurilateral agreements on procurement during the

1970s. But limited progress in the EU held back advances in the GATT. When the EU's single market programme gained a new impetus in the 1980s this facilitated progress in the GATT negotiations. Developments in the CUSFTA helped shape the GATT rules. The concomitant regional and multilateral level rule-making during the 'second phase' helped ensure 'synergistic' interaction between the levels.

The post Uruguay Round RTAs and bilateral agreements appear to have been used more 'strategically' to extend the effective membership of the GPA. Through bilateral agreements with the EU, but more especially with the US, Mexico, Chile, Australia and even developing countries such as Morocco have now accepted obligations equivalent to those in the GPA. Most North-South FTAs typically include GPA type rules on procurement and the EU and US can be expected to seek GPA-equivalent rules for FTAs with large emerging market countries. Multilateral negotiations were initiated on transparency in public procurement and there appeared to be some areas of consensus on the possible shape of such rules. But if there is no progress at the multilateral level, it seems likely that RTAs or FTAs will continue to provide an alternative route to the establishment of rules in this policy area.

This raises the issue of the impact of the inclusion of PP rules in RTAs on the signatories, third countries and the wider system of rules. In the context of the existing RTAs it is worth differentiating between rules and the coverage of PP rules, because most of the controversy and complications in the field have stemmed from the issue of coverage. In general terms there has been less difficulty reaching agreement on the nature of the rules themselves. Coverage has raised difficulties due to the treatment of state and local government. More seriously perhaps a desire to achieve reciprocal market access in public procurement markets has resulted in complex schedules coming

out of bilateral market access negotiations. This desire to achieve reciprocity has been damaging to the aim of achieving clear rules for PP.

The analytical framework identifies principles of non-discrimination as key elements in any agreement. Certainly the GPA and RTAs include national treatment and MFN within their respective provisions. But the procurement case, like the TBT case shows that *de jure* non-discrimination is only the tip of the iceberg. It also shows that one cannot argue that non-discrimination, as a principle, should be permanently assigned at the multilateral level. In the debate within the WTO on public procurement the proposal was for signatories to have the right to maintain discriminatory policies, while adopting provisions on transparency. This is at odds with what one would expect given the conventional views on subsidiarity and shows that there may be a need to be flexible about which elements of rule-making are designated at which level.

Much of rule-making in PP is about increasing transparency. RTA measures that enhance transparency in PP are likely to improve contract award procedures and enhance competition in the sector. There is broad support for improved transparency, even among those developing countries that have to date been unwilling to support inclusion of rules on PP within the WTO. Improved transparency rules do not constitute a regional preference vis-à-vis third countries. Evidence on the impact of PP rules suggests that these tend to benefit the national economy, by promoting more competition and thus better use of public funds, more than other signatories or third parties in terms of enhanced market access. Enhanced market access may of course come as a result of increased investment by suppliers from signatories to an RTA or third country suppliers. This is important in the multilateral debate, because developing countries are unlikely to be significant investors in developed country markets, so the

benefits of PP rules in terms of access to large developed country markets may not be very great.⁴⁹

The substantive provisions of RTAs have been GPA compatible and therefore posed little challenge to the prevailing international (or in this case) plurilateral rules. Much of the detailed rule-making in PP comes in the form of transparency requirements. The rules on contract award procedures are flexible.

The introduction of more binding rules governing enforcement at a regional level has remained consistent with the GPA because the GPA has followed what has been done at the regional level. The idea of bid-challenge rights for individual companies under RTAs and GPA rules on PP is an important example of how regional rules may lead to more effective enforcement. The rights for individual suppliers that these rules provide have not been as controversial as investor-state rights for example. It is also interesting that more stringent enforcement rules have also been accompanied by a 'regulatory safeguard' under which national governments can set aside decisions of independent review bodies and allow illegally awarded contracts to continue 'if it is in the national interest.'

Chart 5. 2. Main elements of key agreements compared to the GPA

<i>1994 GPA (a)</i>	<i>EU-Chile(b)</i>	<i>EU-Mexico (c)</i>	<i>NAFTA</i>
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Coverage	<p>Cat I Central govt. Supplies and works – ve List. Service + ve list Thresholds supplies and services 130k SDR, work 5m SDR</p> <p>Cat II sub national govt ‘voluntary’ upon first sub-national level no local govt. Thresholds supplies and services 200k SDR and works 5m SDR</p> <p>Cat III Other entities e.g. Utilities thresholds; supplies and services 400k SDR and works 5m SDR</p>	<p>central, sub-central govt. and utilities as per the GPA for the EU and equivalent for Chile Annexes XI and XII</p> <p>Goods, services and work:</p> <p>thresholds; central govt. supplies 130k SDR, works 5m SDR Sub central 200k and 5m SDR and utilities 400k and 5m SDRs (as GPA 1994)</p>	<p>Coverage by Entities broadly equivalent to the NAFTA Mexico and GPA for the EU (Annex VI)</p> <p>goods, services and works covered as per schedule (Annexes VII VIII and IX)</p> <p>thresholds; as per GPA 1994 for the EU and NAFTA for Mexico</p>	<p>Central government; first sub-federal level coverage to be agreed this process was driven by negotiations in the GATT;</p> <p>goods, works and services through – ve listing;</p> <p>threshold slightly lower than GPA, \$50k for goods and services, \$6.5m for works, \$250k and \$8m respectively for public enterprises;</p> <p>private companies not covered even regulated utilities;</p>
Principles	national treatment and MFN for signatories	national treatment and non-discrimination	national treatment and non-discrimination Art 26	national treatment and non-discrimination (Art 10003)
Transparency	<p>information to be provided on national procurement laws and rules;</p> <p>contracts to be advertised to facilitate international competition;</p>	<p>provision of information sufficient to enable effective bids (Art 142);</p> <p>statistics on contracts to be provided only when a party does not comply effectively with objectives of the agreement (Art 158)</p> <p>information of why bids unsuccessful on request Art 154</p>	<p>provision of detailed info. on tenders and decisions</p> <p>statistics to be provided that help ensure no evasion of provisions (Art 31)</p>	<p>detailed information on tenders and decisions to facilitate private actions reviews;</p> <p>information on why bids were not successful</p>
Substantive rules				
Contract a Procedure:	option of open, restricted or single tendering;	open and selective (i.e. restrictive). Single tendering possible in exceptional cases (Art 143 –146)	open, restricted or single tendering;	open, restricted and single tendering;
Contract award criteria	lowest price or most economically advantageous bid	lowest price or most advantageous bid based on previously determined criteria	Mexico applies NAFTA Rules, EU applies GPA Rules; two essentially equivalent; lowest price or most advantageous bid based on previously determined criteria	detailed procedures vary slightly from GPA; lowest-priced or most advantageous bid based on previously deter. criteria
Technical specifications	use of international standards encouraged; performance standards preferred to design standards	performance rather than design or descriptive standards (Art 149); international, national or recognised standards to be used, but exceptions possible	no mention	performance standards rather than descriptive standards; encourages use of international standards, but exceptions always possible (Art 1007)
Regulatory safeguard	public interest override (Art XXIII)			
Compliance provision:	bid challenge introduced in GATT for the first time	bid challenge (Art 155)	bid challenge (Art 30)	elaborate bid challenge provisions;
	independent review	independent review	independent review body with detailed provisions relating to proceedings in	independent review body

interim remedies, but no contract suspension	rapid interim remedies that may include contract suspension; compensation but may be limited to cost of bid and protest	the review hearings (as in NAFTA); rapid interim measures including suspension but with over-ride in public interest; compensation but may be limited to costs; bid-challenge	rapid interim measures including suspension and termination of contract
national interest waiver or contract suspension			national interest waiver on contract suspension
Institutional provisions	vague technical cooperation commitment Art 157	Special Committee on Government Procurement established to promote mutual understanding of procurement procedures; bilateral dispute settlement under Title VI of the agreement	technical cooperation;

Chart 5.3. Main elements of recent regional/bilateral agreements (cont)

	<i>US - Chile</i>	<i>US - Australia</i>	<i>US - Morocco</i>	<i>US-Singapore</i>
Coverage	Central govt. supplies and works Sub national govt, supplies Services and works Thresholds (I) Central govt \$280k and \$6.5m for Supplies and works (II) \$518k for sub-central govt. for supplies and services: \$6.5m for works	Central govt. supplies and services Sub-central (regional) govt. supplies, services and works Some public enterprises Thresholds (I) Central govt. US \$ 58k and \$6.7m for supplies and services, and works respectively; (II) Regional govt US \$ 477k and \$6.7 m; (III) Public enterprises US \$ 292k or \$ 538k and \$6.7m	Central govt. supplies and services Sub-central govt. supplies services. Thresholds (I) Central govt. US\$ 175k for supplies and services and \$6.7m for works (II) Sub-central govt US\$ 500k for supplies and services and US\$ 6.7m for works	Central govt. supplies, Services and works; as per GPA Sub-central govt as per GPA schedules Some public enterprise as per GPA schedule Thresholds as for US-Australia
Principles	national treatment Art 9.2	national treatment Art 15.2	national treatment Art 9.	national treatment and non-discrimination as in GPA
Transparency	information to be provided on national procurement laws, regulations and judicial decisions (Art 9.4); contracts to be advertised to facilitate international competition (Art 9.4-9.6)	Information on national laws, regulations and judicial decisions (Art 15.2) notice of intended contracts to facilitate international comp (Art 15.3 -6)	Information on laws, regulations and judicial decision Art 9.3 notice of intended contracts to facilitate international comp (Art 9.4-9.6)	As in GPA 1994 provisions As in GPA 1994 provisions
Substantive rules				
Contract award procedures	Open procedure with option of restricted, Art 9.9	open, selective and limited Art 15.7	Open tendering with option of restricted. Art 9.9	as in GPA 1994
Criteria	most advantageous in terms of the requirements and evaluation criteria set out in the tender documentation (Art 9.10)	lowest price or most advantageous bid based on previously determined criteria (15.13)		as in GPA 1994
Technical	use of international	performance standards and	performance standards	as in GPA 1994

specifications	standards encouraged, performance standards preferred to design standards (Art 9.7)	use of international standards (Art 15.6);	and use of international standards when possible (Art 9.7)	
Compliance provisions	bid challenge with independent review (9.13) interim remedies, incl. contract suspension	bid challenge with independent review (Art 15.11) interim remedies, incl. contract suspension	bid challenge with independent review (Art 9.12) interim measures incl. contract suspension	as in GPA 1994
Local content or presence	determination of origin on non-preferential basis	origin determination as in normal trade	origin rules as in normal trade	as in GPA 1994
Institutional provisions	Committee on Government Procurement established to promote cooperation (9.18)	review under general Joint Commission on US-Aus FTA	no special committee	no special committee, no technical assistance or S& DT

Endnotes

¹ The US was the main protagonist in favour of including provisions on 'government procurement' because it saw this as a means of addressing the distortions to trade that resulted from the greater role of government and the public sector in Europe and other developed economies.

² There is an interesting question as to whether price preferences that discriminate between classes of suppliers are discriminatory. For example, preferences for companies that agree to create new jobs as a result of winning a contract could be applied to all suppliers regardless of their nationality and therefore be consistent with national treatment.

³ This characteristic of public procurement is of course common to most non-tariff barriers and is a feature of all of the cases discussed in this thesis to some degree.

⁴ Restricted tendering is when a limited number of contractors are invited to tender and negotiated contracts are used when only specific companies can supply the goods or services.

⁵ Evenett and Hoekman (2003) argue that transparency needs to be driven by domestic factors and interests and that international rules must be seen as complimenting such domestic efforts. They suggest that the introduction of bid challenge provisions in international rules may particularly helpful.

⁶ The process of creating a Single European Market was however associated with structural changes in the major sectors supplying public markets. This has meant that the national identity of companies has become blurred as a result of cross border industrial reorganization. Thus national public procurement contracts are now supplied by the local branch of international or pan-European companies. This market-led development was indeed perhaps more important than EU level rule-making in introducing competition in the key markets. (Woolcock, 1991)

⁷ Note there is a difference between negotiated procedures for contract award and post award negotiations.

⁸ The US government was pressed by the US electrical equipment sector because the US market, which was made up of more than 1000 purchasing entities was less centralised and more open than the

European markets that were dominated by centralised procurement of nationalised utilities that saw procurement as a means of promoting their national equipment industries. In the late 1960s European suppliers with massive surplus capacity supplied 50% of the US market (with most purchasing decisions made at the municipal level). Foreign penetration of the British, French, Italian and German markets was zero. (Epstein, 1971, pg 119)

⁹ It was only with the adoption of the Tokyo Round Code on Government Procurement in 1979 that the issue of EC competence in procurement negotiations with third countries was sorted out. (Bourgeois, 1982)

¹⁰ For the text of the 1979 GPA see GATT (1979)

¹¹ For a legal comparison of the EU and GPA rules see Jones (1984)

¹² The original agreement negotiated during the Tokyo Round of GATT and concluded in 1979 provided for 150,000 SDRs but this threshold was reduced in 1988.

¹³ Except in Japan, where purchasing by NTT and Japan Railways was included as part of reciprocity negotiations.

¹⁴ See for example *Official Journal of the European Communities*, Directive on Public Supply Contracts of 15. 1.1977 L 13/4 1977.

¹⁵ See for example, A Frignani (1986, pg 567) who reports on survey evidence carried out by the International Chamber of Commerce that showed the GPA has had little effect.

¹⁶ For a brief general description of the EU programme at this time see Arrowsmith, 1992

¹⁷ See *Official Journal of the European Communities* Directive 80/767/EEC.

¹⁸ Council Directive 92/50/EEC relating to the co-ordination of procedures for the award of public service contracts, June 1992.

¹⁹ See Council Directive 90/531/EEC on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors (Utilities Directive)

²⁰ As per EC Regulation 802/68.

²¹ See *Bulletin of the European Communities* Supplement 6/88 for information on the draft directives.

²² See Compliance Directive 89/665/EEC *Official Journal of the European Communities* L395 1989.

²³ The original EU programme included seven directives on public procurement, but a number of these were largely updating the existing supply and works directives. The main interest for the EU's trading partners was in more extensive coverage and more effective enforcement. See European Commission 1986 for the full programme.

²⁴ For the texts of the various EC Directives see *European Commission* 1994a

²⁵ See Utilities remedies Directive 92/13/EEC.

²⁶ It was in fact the European Commission that pressed the case for centralised enforcement at the EU level in order to open the EU market. The EU Member States resisted this and a compromise was reached on a 'collaboration mechanism' between the European Commission and the Member State governments in cases of non-compliance.

The final thresholds in the 1994 WTO GPA were set somewhat higher at 400,000 SDAs for 'other entities' including public enterprise. So NAFTA coverage in this regard is more extensive.

²⁷ The set-aside meant that Mexico could place contracts up to this ceiling outside of the rules governing PP.

²⁸ There have been some selective efforts to promote standards in sectors such as telecommunications and transport.

²⁹ The World Bank did however, develop its own rules for PP that were applied to World Bank and other funded programmes in developing countries.

³⁰ Public procurement was not formally part of the Uruguay Round so this work took place under the auspices of the 1979 GPA, which provided for revisions. In practice the negotiations on procurement were linked to the wider multilateral negotiations.

³¹ The EU had produced an action plan for seven directives on public procurement in 1986 covering further revisions of the supplies and works directives, stronger compliance rules, the inclusion of the utilities and services.

³² For a general discussion of compliance systems which argues that larger companies will tend to make use of them see Dalby, 1996.

³³ See *Proposal for a Directive on public procurement in the excluded sectors* COM(90) 297 July 1990.

³⁴ Smaller economies have little to offer in reciprocal negotiations with the EU or US and therefore stand to gain little in terms of improved access to these markets.

³⁵ In addition to the EU Member States, the US, Canada, Japan and South Korea, countries acceding to the WTO have been asked to join the GPA. Thus China as well as a range of smaller developing and transition countries have signed up to the GPA commitments. See for example, China WT/ACC/CHN 49 and Art 2 of the Protocol on the Accession of the People's Republic of China WT/L/432.

³⁶ See Hoekman and Evenett 2004 which explores the reasons why there is not much increase in trade.

³⁷ For a similar comparison of the various regional rules with the GPA, see OECD 2002b.

³⁸ The NAFTA had already extended the GPA rules to Mexico.

³⁹ EU *Official Journal* L 70/2 18 March 2000

⁴⁰ In the WTO discussions a number of developing countries led by India, with the support of Malaysia, Pakistan and Egypt have consistently questioned the benefit of including any form of rules on PP in the WTO. See *Report of Meeting* of 4 May 2001 WT/WGTGP/M/12.

⁴¹ This was confirmed in the *Doha Ministerial Declaration that launched the Doha Development Agenda* (WTO, 2001)

⁴³ See Reports of the Working Group on Transparency in Government Procurement especially WT/WGTGP/W/03 3 Oct 2002.

⁴⁴ The work in the WGTGP was also informed by the experience with the World Bank Guidelines on procurement for IBRD projects (World Bank, 1995) and the UNCITRAL model law on procurement (UNCITRAL, 1994) The UNCITRAL Model Law on Procurement of Goods and Construction promotes a voluntary approach that is broadly in line with the GPA type procedures in terms of its emphasis on transparency and the provision for domestic reviews. But the UNCITRAL model law allows for *de jure* discrimination, for example, on development grounds and leaves much more discretion in the hands of national purchasers. (Evenett, 2003, pp 27-31) As such it offers the model preferred by many developing countries to that of the GPA.

⁴⁶ The scope of the security exemption under the GPA has not been tested. There was some discussion of whether the EU should challenge US contracts for reconstruction in Iraq on the grounds that these excluded signatories to the GPA (such as France and Germany) which had not supported the US action in Iraq, but the EU chose to avoid confrontation for obvious political reasons.

⁴⁷ See Minutes of the Meeting of 13 June 2003

⁴⁸ Evenett and Hoekman argue that more work is needed before one can assess the benefits of rules on procurement for developing countries (Evenett and Hoekman 2005)

⁴⁹ One can however, envisage circumstances in which developing country contractors would be very competitive in certain public works contracts thanks to lower labour costs.

Chapter Six A multi-level regime for investment

6.1 Introduction

This chapter looks at the case of rule-making in investment, a topic that has generated considerable controversy in the shape of the debates surrounding the plurilateral “Multilateral” Agreement on Investment (MAI) between 1996 and 1998 and the discussion on inclusion of investment in the multilateral Doha Development Agenda (DDA) between 1996 and 2003/4. Whilst the controversy has focused on multilateral negotiations on investment, this constitutes only one part of rule-making in the field. Indeed, investment is perhaps the clearest case of multi-level rule-making. Although repeated attempts to establish comprehensive multilateral rules for investment have failed, starting even before the Havana Charter in 1948, rule-making has proceeded through bilateral, regional, plurilateral agreements as well as partial coverage of investment in multilateral agreements.

Perhaps more than trade liberalisation, investment is the driving force behind the post 1980s shift towards liberalisation and global markets. Rule-making as it affects investment is therefore arguably more important for the globalisation process than many areas of trade policy. Furthermore, since access to markets has increasingly involved access for foreign direct investment or investment *per se*, rule-making in the field of investment is inextricably linked to market access. To argue that negotiations on market access in the shape of manufacturing tariffs and agriculture should be the limit of ambition in multilateral trade negotiations may make tactical sense from a developing country or development perspective in multilateral negotiations. But as this chapter shows, it should be recognized that rule-making in investment is proceeding at other

levels. It is therefore important to understand the nature of the interaction between different levels.

The chapter illustrates the role of RTAs and FTAs in the multi-level rule-making that has created a *de facto* international regime for investment, even though there remains no comprehensive 'multilateral' regime. It shows how precedents set at one level shape rules on other levels. It also shows how countries use the interaction between levels strategically to further their national policy objectives. Finally, the chapter illustrates differences between the predominant US and European approaches to investment in FTAs and discusses a number of reasons for these differences.

After sketching out the elements that go to make up any set of investment rules using the analytical framework from chapter three, the chapter discusses the historical evolution of rule-making in investment showing how this has indeed been characterised by multiple levels of rule-making. It then focuses on 'the second phase of regionalism' illustrating the role of regional and other levels of rule-making. Finally, section five addresses developments after the conclusion of active multilateral negotiations in the Uruguay Round.

6.2 Elements in investment rules

This section provides a summary of the key elements in investment rules¹ in a typology that facilitates a comparison between the various provisions in regional and other trade and investment agreements.

Chart 6.1 Elements of investment rules

Definition of investment:

The scope of an agreement will be shaped by the definition of investment it contains. The definition of investment has changed over time and as the world economy has developed. There are three major types; (i) foreign direct investment in which the foreign investor has effective control, (ii) portfolio investment in

which the relationship with the foreign investor is more arms length in the shape of shareholdings, and (iii) other assets, such as intellectual property, licences etc. Broad definitions of investment tend to be used in agreements that focus on investment protection, while narrower definitions have been used in investment liberalisation agreements. In recent years the trend has been towards broader definitions, especially in comprehensive agreements, such as NAFTA, that encompass both liberalisation and protection.

Coverage:

As in the other chapters, coverage of investment rules is determined by schedules of sectors covered (positive listing) or sectors and activities not covered (negative listing). This provides for the exclusion of sectors considered too important for national policy objectives to be liberalised, such as energy or raw materials, air transport or cultural activities. Developing countries would be expected to have more exclusions. Negative listing tends to be biased towards more liberal outcomes, because everything is liberalised unless it is listed. Negative listing may also include horizontal measures, such as FDI screening, a policy used by most countries until the 1980s and is still used by some today.

Principles:

As in the other chapters, national treatment and most favoured national status are central features of investment rules. It is important to differentiate between post- and pre-investment or entry national treatment and MFN. Post investment non-discrimination rules in the form of MFN and national treatment have been more readily granted, especially in recent years, because these are not seen as threatening national regulatory objectives. Pre-investment national treatment effectively means *right of establishment*, subject to the application of other policies such as competition policy, and as such represents a significant degree of liberalisation. Consequently this has been less readily granted or granted only with exceptions. Pre-investment MFN means non-discrimination between investors according to their nationality and is generally not a major issue.

Transparency:

Provisions on transparency can include information on sectors or activities excluded from the scope of the agreement. Such transparency requirements are thought to assist liberalisation by drawing attention to the remaining restrictions and thus resulting in pressure for their reform. Transparency provisions can also be more extensive and include the obligation to list all rules and regulations that might affect investment.

Substantive provisions:

In addition to the general principles of NT and MFN agreements may also include a number of other substantive rules on liberalisation and investment protection.

Liberalisation measures: These typically include:

- prohibition on *any form of control* (subject to exceptions), such as provided in the OECD Code on the Liberalisation of Capital Movements;
- prohibition or control of *performance requirements*, such as local content, export and trade balancing requirements on investors and a range of other requirements used by governments to influence the activities of investors, such as in the multilateral TRIMs agreement and many RTAs and the US Model Bilateral Investment Treaty (BIT);
- prohibition or control of *investment incentives*, such as subsidies, tax concessions or other inducements that governments use in order to influence investment;
- right of entry into a host country for *key personnel*, such as managerial or technical staff needed to support an investment project;
- in addition to such 'negative' integration measures, investment rules may require '*fair and equitable treatment*', a form of wording carried over from customary international law; and
- provisions aimed at ensuring *contestable markets* by, for example, prohibiting the abuse of monopoly or market dominance to keep out investment or to distort competition in the reference market for inward investors, such as the non-binding provisions of the UNCTAD Set (for more on this see chapter 7). There may also be provisions on corporate governance issues, for example, cross shareholdings to ensure market-based investment.

protection measures: Originally included in bilateral investment agreements, investment protection provisions are now also finding their way into FTAs. Investment protection can cover:

- rules on *classical/conventional expropriation*, such as nationalisation that allow expropriation but only when it is done fairly with 'prompt, adequate and effective' compensation;
- rules on *transfer of funds* that protect the flow of profits, transfer and repatriation of capital, such as those in the OECD Code on Capital Movements;
- rules on *regulatory taking/measures equivalent to expropriation*. These seek to protect investors and investment against actions by host governments that have an effect equivalent to expropriation and can be found in more recent BITs and FTAs. This element of investment rule-making has moved to centre stage as rules on classical expropriation have been widely accepted. It is an element of rule-making in which much turns on how rules are interpreted.

Obligations on investors:

Whilst most of the rules in international investment agreements have been aimed at limiting the powers of host country governments and regulators, some rules may place obligations on investors or companies. These rules have tended to be non-binding in nature, such as the 1979 OECD Code on Multinational Companies. International codes concerning restrictive business practices, such as the UNCTAD Set or the OECD Code on hard core cartels, might also be considered as rules that relate to the actions of companies rather than governments.

Regulatory safeguards:

As in the other case studies covered, more stringent rules in investment have been accompanied by some form of regulatory safeguard. In the various agreements these have taken the form of:

- *excluding sensitive sectors* or types of investment from the coverage of agreements;
- *general exemptions* on the grounds of public policy, human health or national security;
- *right to regulate* provisions to defend the ability of host governments to pursue public policy objectives. These may relate to liberalisation measures or more specifically national treatment or MFN commitments, such as under the GATS, or to investment protection rules.

Interpretation of such provisions is crucial, which brings us to the next element in rule-making namely implementation and dispute settlement.

Implementation, enforcement and dispute settlement:

Broadly speaking there are two general categories of enforcement or dispute settlement for investment rules.

- *conventional state-state dispute settlement* in which actions can only be brought by governments; and
- *investor-state dispute settlement* in which investors may challenge the actions of host governments or regulators under the national law of the host state

Both state-state and investor-state systems may make use of international arbitral bodies such as UNCITRAL whose findings must generally speaking then still be implemented under the national law of the host state.

6.3 A history of investment rules

It is not accurate to describe investment as a 'new' issue, as it often is, since investment rules have been the subject of debate for over a hundred years. The initial impetus for investment rules came from capital exporting countries seeking investment protection. These interests were countered by capital importing countries that supported the Calvo doctrine, after the Foreign Minister of the Argentine in the 1870s, according to which investment was to be solely governed by the national laws of the host countries.

Efforts to strengthen multilateral rules on investment (protection) continued through the 1920s and 1930s in response to the widespread nationalisation of assets by the Soviet Union and developing countries such as Mexico. In 1929 the US pressed, without success, for multilateral investment protection rules including 'fair, prompt and effective' compensation (the so called Hull formula, after Cordell Hull the US Secretary of State and staunch proponent of multilateralism) in cases of expropriation during negotiations in the League of Nations. These US aims were carried over into its draft proposal for the ITO that included 'just compensation' for expropriation, but rules on investment protection were dropped in the final Havana Charter. The Charter included calls for the parties to avoid 'unreasonable or unjustifiable' actions injurious of private foreign investment, 'reasonable security for existing investment' and 'due regard for the desirability of avoiding discrimination as between foreign investors'. (Havana Charter, Art 11) But counterbalancing provisions were added granting capital importing states rights to screen and restrict ownership and impose other 'reasonable requirements'. (Havana Charter Art 12). The weakness of the rules on expropriation was a key reason why US international business failed to support the ITO, a fact that contributed to its demise. (Diebold, 1954) Even though there was no explicit coverage of investment in the 1948 GATT certain provisions, such as Article III national treatment, could have been defined as covering investment measures had there been sufficient support for this among the Contracting Parties (CPs).²

After a failed attempt on the part of the US to include compensation rules for expropriation at a regional level in the Economic Agreement of Bogotá in 1948, (Mezger, 1968) attention shifted to the plurilateral level of the OECD. Backed by the Council of Europe, Swiss and German bankers and the - in today's terms somewhat improbably named - British Parliamentary Group on World Government put forward proposals in the

form of the so-called Abs/Shawcross draft convention of 1959. This called for (i) non-discrimination, (ii) equitable and fair treatment, and (iii) prompt adequate and effective compensation in cases of expropriation. An OECD draft Convention sought to be more even-handed than the Abs/Shawcross draft with respect to capital importing and exporting countries, and as a result was not supported by the US. (Snyder, 1963) After these three attempts to negotiate multilateral rules the US concluded 'that the bilateral treaty of friendship, commerce and navigation offers the most practical means of affording treaty protection for American investors.' (US State Department 1957, quoted in Mezger, 1968, pg 294).

6.3.1 Bilateral investment treaties (BITs)

The vacuum left by the absence of agreed multilateral rules on investment was filled by BITs for investment protection and the plurilateral investment rules developed in the Organisation for Economic Co-operation (OECD) for liberalisation. The first BIT, negotiated between Germany and Pakistan in 1959, was based on the Abs/Shawcross draft convention and provided the model for a steady flow of BITs between capital exporting European countries and developing countries for the following decades. During the 1960s 68 BITs were concluded, mostly by France and Germany, to protect investment rather than to liberalise national investment policies. There were just 3 BITs between developing countries during this period. These BITs did not contain rules on national treatment or any of the other provisions associated with investment liberalisation. In terms of investment protection they relied on customary international public law and were limited to compensation for 'classic' expropriation.

The steady stream of BITs continued during the 1970s with 68 new agreements, again mostly between capital exporting developed economies and capital importing

developing countries (UNCTAD, 2000), and the 1980s (204 new agreements) until the 1990s when there was an explosion in the number of BITs (970 new agreements, including 436 between developing countries and 230 between the transition economies of central and eastern Europe). The US launched its BITs programme in 1977 in direct response to the UN General Assembly debates on the rights of states in the 'New International Economic Order' (NIEO), although it did not conclude its first BIT until 1982. (Vandeveldt, 1998) In 1974 the UN passed the Resolution on the Charter of Economic Rights and Duties of States (UN Res 3281 (XXIX) 1974) as developing countries pushed for a reorientation of investment rules. This charter focused on the host state right to regulate and, by referring to 'appropriate compensation' for expropriation under national law, tended to restate the Calvo rather than the Hull doctrine. (UNCTAD, 2004) The shift to the wider use of BITs in the 1970s, led by the US but joined by the UK (first BIT in 1975) and Japan (first BIT in 1977), therefore seems to have been in reaction to developments in multilateral negotiations that were not to the liking of the major liberal economies.

The growth in BITs during the 1980s and in particular the 1990s reflected a major shift toward liberal investment policies among DCs. The growth in BITs *between* developing countries has been a phenomenon of the 1990s and 2000s and reflects a wider acceptance of the rules used in the North-South BITs. It is noteworthy that increased recourse to BITs occurred throughout the period of negotiations on investment rules in the Uruguay Round, the 'Multilateral' Agreement on Investment (MAI) and on the inclusion of investment in the WTO agenda after the 1996 Singapore Ministerial meeting. By 2002 well over 2000 BITs had been negotiated, so the bilateral route clearly provided at least a partial alternative to regional or multilateral rules.

It was not until the 1980s that the US began to negotiate BITs. These were based on the US model BIT that in turn drew on the wording of the Friendship, Commerce and Navigation (FCN) treaties the US had negotiated since the 18th century. The US model also drew on the European experience, but was comprehensive including both liberalisation and investment protection. As the BITs developed to fill the vacuum left by the absence of comprehensive, multilateral rules, there were already two models in play. The European model dating from the 1950s and the US model dating from the 1980s. Detailed aspects of each BIT would vary to meet the specific requirements of the signatories, but the US and European models shaped the evolution of rules.

All the BITs used a broad definition of investment including intangible assets and used schedules to determine coverage and thereby exclude sensitive sectors. Originally the European BITs placed less emphasis on national treatment and MFN and did not extend these to pre-investment i.e. right of establishment. The US model BIT of 1982 extended national treatment and MFN to pre-investment regulation thus giving an impetus to the use of BITs as comprehensive agreements covering liberalisation as well as investment protection. The US model also prohibited performance requirements. The European BITs remained limited to provisions of 'fair and equitable treatment.' With regard to investment protection the US model fulfilled the long term objective of US capital exporters of extending coverage to measures equivalent to expropriation, (indirect taking) while the European BITs covered only classical expropriation. Finally, the US, but not the European BITs, introduced investor-state dispute settlement although both models made reference to international arbitration via ICSID and/or UNCITRAL (United National Commission on Trade and Investment Law) and ICC (International Chamber of Commerce) procedures. (US Senate, 1982)

6.3.2 *Plurilateral rules for liberalisation*

The OECD has been the major rule-making forum with regard to the liberalisation of investment. Although the draft OECD Convention on investment (protection) failed in the 1950s, agreement was reached on the codes on Liberalisation of Capital Movements and Current Invisible Operations in 1964. (OECD, 1987a) These codes were binding on OECD members and required the progressive liberalisation of controls on capital movements. They remain in force.

The basic approach of the codes has been to enhance transparency, promote best practice and achieve enforcement by means of peer pressure. Member countries are required to notify any 'reservations' or exceptions from the free movement of capital. Until the late 1980s these reservations were extensive, covering sensitive sectors such as energy and telecommunications as well as horizontal controls or screening of inward or outward investment.³ Once barriers to investment were identified, peer pressure, in the shape of reviews of exceptions in the Committee on International Investment and Multinational Enterprises (CIIME), then served as the 'enforcement mechanism'. In practice this meant that the pace of liberalisation was really determined by the unilateral decisions of each national government. However, the codes had a 'ratchet effect' that precluded any reintroduction of controls. Thus whilst the OECD rules contributed towards a progressive opening of investment, the main impetus came from unilateral liberalisation starting with the US and Britain in the late 1970s. Flows of FDI then increased significantly in line with this liberalisation.⁴

The OECD Codes have been developed and strengthened to cover more issues. In 1976 a national treatment instrument (NTI) was added in the form of the Declaration and Decisions on International Investment and Multinational Enterprises of 1976. Together with the MFN provisions in the Codes this provided for non-discrimination among OECD

countries. The NTI employed the same approach as the codes in that it ensured transparency through notifications of exceptions to national treatment. Progressive liberalisation was then encouraged through peer pressure. (OECD, 1993) Unlike the Codes the NTI was, however, not binding so new laws could be introduced that discriminated against inward investors.

In 1984 the Codes were further strengthened effectively to require the OECD countries to offer right of establishment to signatories, subject to the remaining reservations, although investors still had to comply with host country regulations of course. At the same time there was a debate on whether national monopolies, such as in telecommunications services, were compatible with liberal investment policies, but the right to allow such monopolies was retained. In 1986 changes were made requiring notification of 'reciprocity' provisions in national regulations (the conditioning of access for FDI upon equivalent access). Existing reciprocity rules were 'grandfathered'.

In 1990-91 there was a review of the OECD instruments including in particular the NTI, which involved efforts to make the NTI binding and extend its coverage. (OECD, 1992) But the negotiations failed due to US - EU differences over the inclusion of sub-federal level government (sought by the EU), provisions on regional preferences (sought by the US) and difficulties defining the scope of national security exemptions. In its 1988 Omnibus Trade and Competitiveness Act, the US had reaffirmed its powers to exercise control (a 'regulatory safeguard') on national security grounds through decisions of the CFIUS (Committee on Foreign Investment in the United States). But the lack of transparency in how these rules were to be applied raised concerns that such security exemptions might be used for protection. These factors resulted in modest results from the review that only succeeded in making transparency rules on the notification of exemptions to NT binding, not the substantive rules.⁵

Work continued on the feasibility of what was at the time called a 'wider investment instrument' that would consolidate and strengthen the codes and the NTI as well address the unresolved issues. (OECD, 1992a) The negotiations on a Multilateral Agreement on Investment (MAI) that began in 1995 should therefore be seen as a continuation of this existing OECD work. The MAI negotiations had thus already been framed and most of difficult areas were already apparent during the 1990 review.

6.3.3 Regional rules of little practical importance

The treaties establishing the European Community offered *de jure* right of establishment for all investors throughout the EU (Art 56 EEC), with a very limited number of exceptions, such as national security and broadcasting. Notwithstanding these rules there was no *de facto* right of establishment due to national regulation of services, investment screening/controls in manufacturing and the exercise of national competition policies that retained discretion to block mergers and take-overs on the grounds of broad public interest criteria. It was not until the 1980s that there was *de facto* right of establishment across the EU, once the national champion strategies of the EU Member States gave way to the creation of a genuine single European market.⁶

6.4 Multi-level investment rule-making in the 1984-95 period

As noted above the US had already sought, on at least three occasions, to negotiate multilateral rules on investment protection and had pursued the plurilateral route of investment liberalisation within the OECD. In the 1970s the US had also proposed a 'GATT for investment'. Again in the early 1980s, at the time the US was developing a comprehensive approach in the US model BIT, it pressed for the coverage of investment

in the GATT in the Consultative Group of 18. At the (failed) 1982 GATT Ministerial Meeting the US pushed for a code on investment in the GATT covering, among other things, 'performance requirements'. (Graham, 1990) The US also used dispute settlement within the GATT to test the scope of existing GATT rules on investment. In 1982 the US brought a case against Canada claiming that it's FIRA (Foreign Investment Regulation Act) infringed, among others, GATT Art. III.4 on national treatment. The GATT Panel on the case ruled in favour of the US, but argued that developing countries could use GATT Art. XVIII (c) (government assistance to promote economic development) to justify the imposition of performance requirements. This led to US investors, especially those in sectors in which FDI was a relatively new development, such as information technology and pharmaceuticals, to press for stronger GATT rules.⁷ This pressure was resisted by India and Brazil in the run up to the Punta del Este launch of the Uruguay Round, with the result that only trade related investment measures (TRIMs) were included in the agenda. But before the Uruguay Round had started the US had already negotiated its first bilateral investment treaties and had reached agreement on more effective plurilateral rules in the OECD.

6.4.1 North America; towards a consolidated model

In 1986 the US began negotiating the Canada US FTA that included investment on the agenda. Not surprisingly, in the light of the FIRA case, the 1988 *Canada US Free Trade Agreement* (CUSFTA) provided for national treatment of investment and the phasing out of export and production based performance requirements. In line with the approach adopted in the BITs and OECD, CUSFTA excluded certain sensitive sectors, such as energy, mining, air transport, fishing etc. from the national treatment obligation. The automobile sector was also excluded from the ban of performance requirements. But

CUSFTA eliminated Canadian screening of all but the very large investments and, in line with the model US BIT, provided for wide investment protection including, in particular, 'regulatory taking' or *de facto* expropriation rules.

The final level of the US multi-level approach to investment rules took the form of tougher legislation to facilitate the aggressive use of unilateral policy instruments in the 1988 Omnibus Trade and Competitiveness Act. This considerably strengthened the Section 301 provisions, so that the US could use trade sanctions in cases when its trading partners did not pursue 'fair' investment policies.⁸ For its part the US had no general controls on investment, so restrictions on US investment that prevented market access was seen as 'unfair.'

The *North American Free Trade Agreement*, (NAFTA) extended the approach developed in the US model BIT and applied in the CUSFTA, to Mexico, a developing economy. In terms of coverage the NAFTA uses the top down, negative list approach to coverage, with Mexico understandably having a longer list of exceptions. See chart 6.2. NAFTA diverges from the 'WTO approach' embodied in the General Agreement on Trade in Services (GATS), finalised after NAFTA, in that it has one chapter covering 'cross border' provision of services, or the three other modes of service provision. NAFTA requires pre-investment national treatment at the central government and state/provincial level and thus right of establishment, subject of course to the negative listing of sensitive sectors.

In terms of *substantive rules* a long list of performance requirements (PRs) are prohibited, including export requirements, domestic content, local preferences, trade balancing requirements (both with regard to exports and foreign exchange), domestic sales requirements, the obligation to transfer technology and exclusive sales requirements. The granting of incentives depending on location of investment is possible, but these

cannot be conditional upon performance requirements, such as using a certain percentage of local products. Here the US was able to get at the regional level what it was unable to get in the TRIMs negotiations in the Uruguay Round, which were limited to discussion of a narrow list of PRs, in the face of developing country defence of their 'policy space' and a lack of support from the EU and Japan.

Investment protection including 'regulatory taking' and transfer of funds, were likewise included in the NAFTA. A significant part of the NAFTA provisions on investment concern the investor – state dispute settlement procedures that are set out in great detail and include use of the arbitration procedures under the ICSID⁹ and UNCITRAL.¹⁰

The NAFTA provisions on investment are therefore entirely consistent with previous US initiatives on investment. When negotiated they embodied a clear US/North American model for comprehensive investment agreements covering both liberalisation and investment protection.

6.4.2 European Approaches

Although provided for in the Treaty of Rome, there was no *de facto* right of establishment in all sectors within the EU until the late 1980s. During the 1980s the EU Member States moved away defending 'national champions' and therefore reduced the bans and screening of inward FDI needed to defend these companies. Progressively the EU Member States also shifted to a policy of attracting FDI, although there were controls on FDI in certain markets. The introduction of the SEM legislation and 1988 Directive removing all forms of capital control, however, brought about more or less complete liberalisation of investment within the EU.¹¹ With the exception of France and Greece this liberalisation was extended *erga omnis* to at least other OECD countries. This left

monopolies or oligopolistic market structures in such sectors telecommunications, gas distribution, power generation and distribution, postal services and rail and air transportation, which have been addressed more or less effectively through specific sector directives and horizontal European competition policy. (See chapter seven) European competition policy has also been used to control the use of investment subsidies or incentives to attract FDI. Within the EU there has been a harmonisation of environmental and to a lesser degree social and tax policies, which has reduced, but by no means removed regulatory competition between investment locations within the EU. (Thompson and Woolcock, 1993) This approach to investment has been adopted by countries neighbouring the EU, especially those that have negotiated - or are seeking accession - and that are therefore obliged to adopt the European *acquis*.

6.4.3 The negotiations in the GATT Uruguay Round

As noted above there had been efforts to negotiate multilateral investment protection agreements in the 1920s and 1930s, and the first real attempt at liberalisation in the 1940s in the shape of articles 11 and 12 of the Havana Charter. Although GATT provisions on national treatment and quantitative restrictions were arguably applicable to some investment policies, these were not applied. Reviews of the GATT's coverage of investment in the 1950s, 1960s and 1970s did not create a consensus favouring the application of these rules to investment.

6.4.3.1 Trade Related Investment Measures in the Uruguay Round

In the Uruguay Round differences between the US, which favoured inclusion of investment in the GATT agenda, and the leading developing countries, which opposed it, resulted in the compromise inclusion of only 'trade related' investment measures. It was

also agreed that the negotiations would first examine how the existing GATT operated with regard to TRIMs and only then elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects.¹²

The US negotiators, backed by leading US MNCs in sectors such as information technology and the service sector in general, were the *demandeurs* in TRIMs and sought to prohibit some 14 TRIMs. India and Brazil at the other end of the spectrum argued that developing countries should (continue) to have the right to use performance requirements as legitimate instruments of development policy and that the GATT already covered key TRIMs. The EU assumed an intermediate position favouring the prohibition of a short list of five TRIMs, some of which, such as local content requirements, were arguably already covered by the GATT, with a longer list being 'actionable' (i.e. subject to complaint) under the GATT. This position was also adopted by Japan and some of the Newly Industrialising Countries (NICs). Japan was concerned about local content requirements in the US and EU. Confirmation that the GATT already covered certain TRIMs was not sufficient to satisfy the Americans, but developing countries opposed any extension of GATT rules. As a result there was no agreement on investment for four years during the Uruguay Round. (Crome, 1997) Even in the run up to what should have been the concluding ministerial meeting in Brussels in December 1990, there was still no text on TRIMs. Following the Brussels Ministerial views converged towards a compromise position, which enabled a draft TRIMs agreement to be included in the Dunkel text of December 1991.

The Dunkel text and final agreement required all TRIMs contrary to the GATT to be notified. An annex to the agreement provides a non-exclusive list of TRIMs that fall foul of the existing GATT. This includes; local content or trade balancing requirements (contrary to Art III (1)); trade balancing requirements (contrary to Art. XI (4)); foreign

exchange restrictions and export requirements (contrary to Article XI). Developed countries had to eliminate these by 1997, developing countries by January 2000 and the least developed countries by 2002 (Article 5). Finally, the agreement established a Committee on TRIMs to review progress towards the objectives of the agreement. Any dispute was subject to the general dispute settlement provisions of the WTO, i.e. state-to-state dispute settlement. There was also provision for a review of the agreement after five years. This along with the question of the implementation in LDCs then formed part of the WTO's ongoing work.

From the point of view of those seeking a comprehensive agreement the TRIMs was inadequate and did little more than prohibit measures that were arguably already contrary to the GATT. (Sauvé, 1994) This lack of satisfaction in progress within the GATT/WTO had an important bearing on the post - Uruguay Round debate in which the US pursued tougher investment rules in other forums such as the OECD, BITs and - of progressively greater importance during the 1990s – free trade agreements.

The plurilateral route was not without its difficulties, because as the 1990 debate on a NTI in the OECD had shown, there were important differences between the major OECD members. It should be recalled that negotiations on NAFTA were being conducted at the same time as the Uruguay Round. By the time of the Dunkel text if not before, it would have been clear to US business lobbies and negotiators that the results of the Uruguay Round on investment rules were going to be very modest. In comparison NAFTA offered an opportunity of establishing a much higher set of 'standards' for investment. Although these were limited to the regional context in the first instance, they might be seen as a precedent for future agreements. Contrary to other policy areas, such as intellectual property rights and SPS, where there was considerable progress in multilateral negotiations, the option of regional level agreements in investment therefore provided an

attractive alternative. Before looking at the use of RTAs and FTAs to promote comprehensive investment rules in the post-Uruguay Round period, it is first necessary to complete the patchwork of agreements by looking at the GATS.

6.4.3.2 The General Agreement on Trade in Services (GATS)

The GATS is concerned with opening markets in services, but establishment is often the only way to access services markets. The GATS in fact envisages four modes of supply for services, one of which (mode 3) is through establishment. The GATS agreement also includes post establishment national treatment obligations on host country regulators.

GATS coverage is determined by a combination of positive listing of sectors covered by the general agreement, and negative listing of exceptions within each of the covered sectors. This makes for a complex set of schedules (similar to the GPA for procurement), but one that provides considerable flexibility for countries to choose which sectors they wish to liberalize. This was one of the reasons why developing countries were able to support the GATS. As in RTAs, certain key service sectors, such as financial services and telecommunications are covered by sector specific agreements, which go further than national treatment and require a degree of policy harmonisation. In these sectors the GATS contains important substantive rules.¹³

The GATS provides for national treatment, MFN and transparency as well as exceptions from MFN for FTAs and customs unions (Art. 5 GATS), but there are no provisions on investment protection and dispute settlement is state-to-state rather than investor-to-state. Even if the coverage of GATS were to be extended therefore, those interested in comprehensive investment rules would find the GATS a weak agreement.

As the GATS is signed by all WTO members it is unlikely that there will be revisions that include comprehensive investment protection measures.¹⁴

The WTO agreement on *Trade Related Intellectual Property Rights* (TRIPs) does on the other hand provide some elements of investor protection, at least with regard to intellectual property. As one of the major motivations for FDI is to exploit the intellectual property of the investing company, protection against the 'expropriation' of intellectual property rights is of considerable importance in some sectors.

Summing up therefore on the period 1985 - 95 there can be little doubt that rule-making in the field of investment has been the product of a multi-level process in which developments at the bilateral, regional, plurilateral and multilateral levels have interacted. (UNCTAD, 2004) There is no simple relationship between the levels. Most pressure for comprehensive investment rules, including investment protection and liberalisation in one agreement, appears to have come from the US that first introduced such rules in its model BIT in the early 1980s. These subsequently provided the model for the US approach to investment in FTA negotiations and in the negotiations on the MAI at the plurilateral level. Therefore as in the US position in the 1940s and 1950s, the bilateral/regional option appears to have offered a better prospect of making progress.

Although European countries were the first to negotiate BITs, these were limited to investment protection. Many European governments restricted inward FDI in the 1960s and 1970s to defend their national champions in the face of '*le defi Americain*.' Another factor limiting European investment agreements was that investment remained a national rather than EC competence, so there was no scope for the European Commission to negotiate EU BITs. (Reiter, 2006)

6.5 The Post Uruguay Round Debate

In the period following the conclusion of the Uruguay Round in 1993/94 there was a consensus in the international investment policy community (largely consisting of government officials and private sector experts) on the desirability of new negotiations on a comprehensive multilateral agreement on investment. It was felt that this offered a window of opportunity for a regime change.¹⁵ The expectation was that the negotiations on investment would not be controversial. (Henderson, 1999) As noted above the Uruguay Round negotiations had been a disappointment for those pressing for effective, multilateral rules of a high standard. There was also support among the policy makers for the liberal view that 'investment (could) provide the next great boost to the world economy following the powerful impulse given by the removal of trade barriers during the Uruguay Round'.¹⁶

If there was this consensus among business and governments in OECD countries on the desirability of further negotiations, there were differences over the right forum for negotiations and continued sharp differences over some of the issues that had contributed to the collapse of the 1991 OECD negotiations.¹⁷ The choice of forum pitted the US against the EU. The US pressed for negotiations in the OECD on the grounds that the kind of high standard multilateral agreement it wished to negotiate could not be negotiated in the WTO. The NAFTA model the US was basing its negotiating position on called for investor protection extending to *de facto* expropriation provisions, investor - state based dispute settlement and a top down (negative list) approach to coverage. The US also wished to have another attempt at prohibiting European discrimination against US film and audio visual products and services, which escaped GATS discipline thanks to the EU sticking to its GATS Art 2 exemption for this sector. Developing country members of the WTO were not ready to begin negotiations on global comprehensive rules for investment of such ambition and were probably not even ready to consider the

extension of the list of performance requirements sought by the US. By building on past OECD work, and in particular the feasibility work on a 'wider investment instrument' undertaken in the OECD after 1991, the US believed a high standard agreement could be concluded and then opened for non-OECD countries to sign. (OECD, 1992a; US Council for International Business, 1995a)

The EU preferred negotiations within the WTO on the grounds that most barriers to EU investors were in developing countries and not in the OECD. As set out in a European Commission 1994 Discussion Paper of December 1994, the balance of opinion in the EU favoured the WTO because it was more inclusive and because it was unrealistic to expect developing countries to sign up to a *fait a complit* negotiated in the OECD. (European Commission, 1994) Negotiating in the WTO inevitably meant a more modest agenda, which would, in any case, make it easier for the EU to maintain consensus among its Member States.¹⁸ The EU agenda therefore included transparency, national treatment and MFN, as well as effective dispute settlement. Issues such as a ban on further performance requirements and expropriation provisions were seen as secondary. The EU sought continued exclusion for 'cultural industries' and exceptions for regional preferential agreements, whilst pressing for the coverage of 'sub-federal' government. The states and provinces of the USA, Canada and Australia are not generally covered by OECD or WTO rules and the EU wished to ensure that they were. Finally, the EU wished to deal with the issue of the extraterritorial reach of national laws governing investment. The long-standing European opposition to the extraterritorial reach of US law had been further strengthened by the US efforts to deny European investors in the US rights they would expect under OECD and WTO agreements when they failed to comply with the US sanctions against Cuba under the Libertad (Helms-Burton) and Iran and Libya Sanctions Acts. (Roy 1997; Elliot and Hufbauer, 1999; Perl, 2005)

6.5.1 The negotiations on the Multilateral Agreement on Investment (MAI)

Despite the EU preference for the WTO as a forum, (Brittan, 1995; European Commission, 1994) EU Member States agreed to begin negotiations in the OECD, thus confirming the multiple level nature of rule-making in investment. The May 1995 OECD Ministerial Meeting launched the MAI negotiations and set 1997 as the target date for completion. (OECD, 1995) From this it was clear that any OECD text would be concluded before the WTO negotiations could realistically be started. The WTO Working Group on Trade and Investment (WGTI) had been established at the Singapore Ministerial meeting of the WTO, but given the more heterogeneous nature of the WTO consensus was clearly going to be more difficult to achieve. On the other hand, the view in the OECD at the time, reflecting business sentiment, was that there had to be an ambitious agenda to make the MAI exercise worthwhile.¹⁹ This meant that the effort and risks involved in a new negotiation would have to be justified in terms of results.

The mandate for the MAI was to negotiate a comprehensive and fully binding agreement at the highest standard in every respect. This meant that the negotiations had to succeed where the earlier OECD negotiations in 1991 had failed in agreeing on binding national treatment. In order to achieve this, the negotiations had to deal with the unresolved issues, including for example, coverage of sub-federal government, which the US Administration could not deliver in the face of Congressional opposition and the EU sought. An ambitious agenda also meant resolving the issues of carve outs for cultural industries and regional preferential agreements, on which the EU was not ready to move, and finding compromise wording for security exemptions from the agreement. On top of resolving these old issues, the negotiations had to agree on a range of new issues. In

practice the MAI negotiations had to find a consensus on all of the elements listed in section two above as typical elements in an investment agreement.

Progress was made with this ambitious agenda up to 1997 when a draft negotiating text was produced. This showed progress on many fronts: the definition of investment was to be a broad asset based definition including FDI and portfolio investment; there was to be pre-investment national treatment and MFN for investors and rules for transparency; coverage was to include all sectors and all levels of government, but subject to 'a balance of commitments' (in other words key issues of coverage such as the cultural exclusion and sub-federal government, would depend on reciprocity negotiations in a final package); there were to be additional disciplines for performance requirements, privatisation, monopolies and key personnel; investment protection was to include provisions on expropriation and measures having an equivalent effect to expropriation; the draft also envisaged investor – state dispute settlement of disputes.²⁰

During 1997 opposition from non-governmental organisations (NGOs) began to grow and the posting of the draft negotiating text on the internet provided a rallying point for organised labour and environmental groups with concerns about the agreement. (Walter, 2000) These NGOs feared the agreement would undermine national standards of environmental protection and labour conditions. There was also opposition from development NGOs, which feared that developing countries would have little choice but to sign the agreement and in so doing significantly limit the scope of their development policies. The negotiations and the OECD were damaged by claims that the MAI negotiations had been conducted in secrecy. This is inaccurate since the negotiations had been launched with public statements by the OECD Ministers. But the policy community engaged in the negotiations was a fairly select group. In defence of those responsible for negotiating the MAI, few people outside of business and the specialist departments of

government had paid much attention to previous OECD negotiations. Even within the business community there was no widespread interest in the negotiations. The negotiators simply assumed that the negotiations would continue with little public interest as they had in the past.

With hindsight it is perhaps surprising that the NGO response was not anticipated. The NAFTA negotiations had generated considerable opposition from labour and environmental groups, and if NAFTA could be seen as a model for investment negotiations in the MAI, why could the negotiation of the side agreements not be seen as a model by labour and environmental groups? The opposition from development NGOs was anticipated in the sense that it was known that developing countries would resent being excluded from negotiations and then presented with an agreement to sign. Perhaps the fact that the NAFTA and the results of the Uruguay Round had been ratified in the US Congress and other parliaments, led negotiators to believe that there would be little opposition among developed countries for an MAI. There was also clearly a strategic calculation on the part of the US negotiators and interests behind the use of the OECD as a forum for negotiation rather than the WTO. Perhaps negotiators were too busy listening to private sector interests that favoured proceeding with the negotiations. But the political masters of those negotiating the MAI were surprised by the popular opposition to the MAI co-ordinated by NGOs at an international level. Such opposition meant that the negotiations could turn out to be a vote loser, with the result that governments had to act.

In an attempt to defuse the opposition, concessions were made to environmental and labour interests and general wording was inserted into the draft agreement covering these issues. These amendments did little to placate NGO opposition, which saw the MAI as promoting globalisation in the interests of multinational companies. But the inclusion of social and environmental provisions weakened the utility of the agreement for business.

Furthermore, difficulties finding agreement on other existing issues meant that the agreement would have to be watered down. Taken together these developments reduced the value of the MAI for international business. Growing doubts on the part of the governments negotiating the text, opposition from the NGOs and a weakening in support from business combined to bring negotiations to a halt in the spring of 1998. A six month pause was agreed, during which opposition only grew. In the end the French government, under strong pressure from public protest, withdrew from the negotiations just before they were due to resume in October 1998, which had the effect of killing the MAI. The report produced by a French Parliamentarian on the MAI provides an indication of the kind of watering down that was being called for in the public debate. The Lalumiere report argued for a more limited definition of investment (excluding portfolio investment and asset based definitions), removal of provisions on investor-state dispute settlement, no *de facto* expropriation, an abandonment of the 'ratchet' and limits on the coverage to TRIMs (so that the MAI would only extend the prohibition of TRIMs agreed in the Uruguay Round to services). (Lalumiere, 1998) The recommendations of the report were that the negotiations be started anew and that developing countries should be included.

6.5.2 Investment in the WTO

Thanks in large part to the EU a WTO Working Group on the Relationship between Trade and Investment was established at the Singapore Ministerial meeting in December 1996. Given the continued opposition from many developing countries to anything that might be seen as the first step towards comprehensive negotiations on investment in the WTO, and the prevailing US view that a WTO agreement on investment would be too weak to be of any value, the remit of the Working Group was constrained to studies. The mandate given to the Group was that it should consider: (a) the implications of the

relationship between trade and investment for developing countries and economic growth; (b) the economic relationship between trade and investment, (c) the existing instruments and activities regarding trade and investment and (d) identification of common features and differences, as well as, the advantages and disadvantages of entering into bilateral, regional and multilateral rules on investment. (World Trade Organisation, 1996) In other words there was an explicit recognition of the existence of multiple levels of rule-making in the field of investment. There was a similar recognition of this 'multifaceted' nature of rule-making in investment in the work initiated in UNCTAD. (UNCTAD, 2002) The work of the WTO Working Group between 1996 and 1999 provided little by way of convergence of views.

In the preparatory work in Geneva on the agenda for the Seattle Ministerial and the draft *communiqué* to launch the WTO millennium round, it was the EU that remained the main *demandeur* for including investment the round. In the EU's Council conclusions of October 1999, the Council called for negotiations to begin within the WTO on investment. (European Commission, 1999) Whilst the conclusions do not indicate a great deal of detail concerning the Council's mandate to the Commission on this issue, they did limit the scope of negotiations to FDI (excluding negotiations on portfolio investment), whilst calling for negotiations to address access to investment opportunities, non-discrimination and protection of investment. The US was opposed to including investment in the WTO. Given the legacy of the MAI the US administration wished to avoid provoking US labour, environmental and anti-globalisation NGOs in agreeing to negotiate an agreement which US business was convinced would not be worth the paper it was written on.²¹ Leading developing countries, such as India and Brazil also continued to actively oppose including investment in the WTO agenda, whilst most LDCs simply had more pressing objectives in the WTO negotiations, such as improving market access

to developed country markets. The Geneva process failed to make any real progress although the draft *communiqué*, which was all in square brackets, (meaning it had not been agreed) appears to reflect the general EU line as reflected in statements by the Commission.²²

In Seattle the EU, jointly with Hungary, Japan, Korea and Switzerland tabled a common paper. This reflected the EU's objectives and its assessment of what sort of investment coverage would be acceptable to the developing countries. The Common paper called for a multilateral framework for investment in the WTO that would: (i) be based on non-discrimination; (ii) ensure transparency; (iii) address the relationship between the WTO rules and those of the OECD, regional and bilateral agreements; (iv) seek progressive liberalisation using a positive list approach; (v) address policies and practices not covered by the existing WTO; (vi) exclude investor - state dispute settlement; (vii) and take into account developing country needs. This text was presented to the negotiating group on 'new issues', but the group made little progress on this or other issues in Seattle, as most negotiating efforts went into addressing agriculture.²³ It should be stressed that the WTO framework proposed by the EU and supported in the end by about another 14 WTO members, was very different from the agreement proposed in the MAI. But there can be little doubt that the manner in which the MAI failed contributed to the absence of support for the inclusion of a framework for investment on the WTO agenda. (Woolcock, 1999)

The EU continued to push for the inclusion of investment in the Doha Development Agenda as one of the so called Singapore issues. At the 2001 Doha Ministerial meeting these efforts were actively opposed by a number of developing countries led by India, which refused to accept the inclusion of the Singapore issues in large part because of investment. A decision on the Singapore issues was postponed until the next Ministerial

meeting and India was able to get agreement that the decision on inclusion of the Singapore issues would be taken on the basis of an explicit consensus. The position in 2003 in Cancun therefore differed from that in Punta del Este in 1986 where India and Brazil had been isolated. In Cancun a larger number of developing countries were opposed to including the Singapore issues. Possibly equally important the US was not a *demandeur* on investment as it had been during the early 1980s, because business interests had come to the view multilateral agreements as inferior to bilateral or regional agreements.

Efforts to promote a consensus in the WGTI therefore brought little progress between Doha and Cancun, with the result that the requisite explicit consensus on inclusion of investment was not forthcoming.

6.6 The move to regional and bilateral agreements

6.6.1 The NAFTA model rules

As noted above the US first introduced BITS in the early 1980s. This was the time when FDI liberalisation was in full swing and expectations in terms of the standards of investment rules were high. This compares with the 1950s and 60s when the European model of BITs was developed. The difference between generations of BITs goes some way towards explaining the differences between the current US and the EU approaches to investment. When the regional dimension was added to US trade policy in the 1980s, the investment aspects of the US BITs were integrated with the market access/liberalisation provisions. The result was a comprehensive set of investment rules that found expression in the investment provisions in the CUSFTA negotiated between 1986 and 1988 and in particular in the NAFTA negotiated between 1990 and 1993. As noted above in section 6.4.3, the outlines of the future WTO rules on investment were clear by the time of the

Dunkel text in December 1991. So the NAFTA negotiations can be seen as an alternative regional route to higher standard investment rules to that offered by the WTO.²⁴

This desire for higher standards was reflected in most elements of the NAFTA investment rules. (See chart 6.2) NAFTA has a broad definition of investment covering tangible and intangible assets with coverage determined by negative listing of exceptions. There are clear provisions on pre and post investment national treatment and MFN. The rules on performance requirements were 'TRIMs plus' in that they covered more performance requirements with seven explicitly prohibited. There was also a ban of linking a further four performance requirements to investment incentives, such as subsidies or tax breaks. The NAFTA rules provide protection against *de facto* expropriation and offer investor-state dispute settlement. The emphasis on investor-state dispute settlement reflects the general US approach to rule-making that stresses the role of private actions in cases of non-compliance. The importance placed on facilitating private actions is reflected in the number of articles dedicated to the detailed procedural rules for such actions. Of the 39 articles in the chapter eleven rules on investment in the NAFTA, half are concerned with setting out the procedures for investor state actions.

Two other aspects of the NAFTA are worth noting. First there is some reference to other regulatory aims in the sense that NAFTA states that lax regulation of environmental protection is seen as 'inappropriate'. Second, the 'rules of origin' provisions are broadly liberal although not well defined. Any investor within NAFTA can benefit from the provisions of chapter 11 including investors from third countries, provided these have 'substantial business activity' within NAFTA.

The NAFTA chapter 11 provisions and associated NAFTA rules that touch on investment, such as the general rules on transparency, have provided a model for all subsequent investment rules in the FTAs negotiated by the US. Chart 6.2 illustrates how

the investment provisions in US FTAs are more or less identical to NAFTA, except for some of the scheduling of coverage. Having established such high standards in bilateral/regional FTAs the US negotiators and US business interests had a clear alternative to the WTO or MAI. Therefore there was little incentive to make concessions in such negotiations. Indeed, if the WTO or MAI standards turned out to be lower than those in the NAFTA/BIT model there was a danger that the weaker standard might prevail.

6.6.2 The wider application of the NAFTA model

The NAFTA model has also been emulated by a number of leading developing countries. The spread of BIT in the 1990s and 2000s has included a significant growth in south-south BITs. Countries such as Mexico, Chile and Singapore have been actively negotiating FTAs that include investment rules. In this process the NAFTA model has found wider application.

The NAFTA investment rules have provided the model for a series of FTAs negotiated by Canada and Mexico throughout central and South America. Chile has also used the NAFTA model in its FTA negotiations. With the expansion of US centred FTAs beyond the western hemisphere to include countries in other continents the NAFTA model has also found even wider application. This is illustrated, for example, in the US-Singapore FTA provisions on investment, which replicated the NAFTA rules. Just as Mexico has taken the NAFTA model and included it in its FTA negotiations, there are some indications that Singapore, the most active negotiator of FTAs in Asia, is also using the NAFTA investment rules as a model. The FTAs negotiated by Singapore have been based on the NAFTA framework, but some, such as the Singapore – Japan New Era

Economic Cooperation Agreement or the Singapore –Australia FTA, have not been as extensive. This appears to be due to Singapore’s negotiating partners. (Reiter, 2006)

6.6.3 The absence of provisions on investment in EU free trade agreements

In comparison the provisions in EU centred FTAs on investment have been very much more modest. As Chart 6.2 shows these are often little more than token statements and do not go beyond the existing OECD or WTO provisions. The EU FTAs tend to restate existing GATS obligations. There are no investment protection rules, no specific rules on performance requirements although anti-subsidy rules in the competition provisions in the EU-centred FTAs may have some bearing on performance requirements linked to benefits. Nor does the EU include investor – state dispute settlement in any of its FTAs.²⁵

The reasons for the absence of EU ambition on investment in its FTAs is probably threefold. First, the European approach to investment protection has long been anchored in BITs between the individual EU Member States and capital importing countries. This generation of investment agreements had limited ambitions and did not extend beyond classic investment protection. Second, the European Commission has explicitly favoured multilateral negotiations on investment since the mid 1990s, so that developing countries can be involved and it has a chance of extending EC competence to investment. Third, investment remains an issue of national competence rather than European Community competence. This prevented the EU negotiating investment liberalisation provisions in its FTAs, although there was some reference to investment in the EU – Chile FTA.

6.6.4 Developing countries and investment rules in FTAs

Given opposition from developing countries to the inclusion of investment in the WTO, why do they appear willing to sign up to FTAs including investment rules? This paradox is probably best explained by the desire of smaller developing countries to gain first mover advantages in attracting foreign direct investment. Smaller developing countries, such as in Central America, cannot expect to attract much FDI when competing with the larger emerging markets. But if they are able to offer a relatively low cost location for production or the supply of services within a free trade area including, for example, the United States, then their prospects of attracting investment are considerably greater. The costs in terms of lost 'policy space' are thus more than compensated by the economic benefit accruing from the inward investment.

In the case of larger countries or more developed economies such as Chile or Singapore, the aim of concluding FTAs with investment rules appears to be more one of becoming a hub for MNC activity. In other words companies might be attracted to work from such hubs if they offer FTAs including suitable investment rules with a range of other countries. This kind of consideration helps to explain FTAs such as Singapore – Jordan, which would otherwise appear to have little economic ration.

6.7 Conclusions

The analytical framework developed in chapter two fits the case of investment as well as it does technical barriers to trade and public procurement and thus enables a comparison between investment rules on different levels. This suggests that the framework encompasses the 'universe of rule-making elements,' regardless of whether one is concerned with trade in goods or investment.

This chapter has clearly shown that, for investment, an international regime is emerging based on a patchwork of bilateral, regional, plurilateral (OECD) and multilateral

(WTO) rules. Unilateral policy has also been a shaping factor, both in a liberal sense when countries opted for unilateral liberalisation of investment controls during the 1980s as a means of attracting FDI, and in a more mercantilist sense in that the threat of trade sanctions has been used as leverage in an effort to open certain national investment markets.

It is worth recalling that the vacuum left by repeated failures to agree on multilateral investment rules was filled by bilateral rule-making on investment protection and plurilateral rule-making on investment liberalisation. As in the cases of TBT and procurement therefore there appears to have been a demand for rules. This experience suggests that rule-making at other levels will and always has filled the vacuum left by the absence of multilateral rules. We shall see the same thing applies in competition.

The shift from defensive policies on investment to greater openness to FDI resulted in a dramatic growth in investment during the 1980s that was, rather paradoxically, accompanied by demands for more rules at all levels to ensure predictable conditions for investment. The US in particular negotiated across all fronts during the 1980s. Efforts, by the US to initiate a 'GATT for investment' during the 1970s failed and cases brought in the GATT, such as the US challenge to Canadian investment controls under the Foreign Investment Review Agency Case (FIRA), illustrated the limits of the existing GATT rules. The US had already developed a model BIT and this began to find application in the early 1980s. Unsurprisingly, following the FIRA case, the bilateral negotiations on a Canada US FTA included investment when they began in 1986. At a plurilateral level the US supported efforts to strengthen the OECD rules by seeking to agree on a binding National Treatment Instrument and pushing for a wider investment instrument after 1990. In the GATT the US was the main *demandeur* for inclusion of investment in the Uruguay Round, which led to the negotiations on Trade Related Investment Measures (TRIMs) and

rules on investment in services in the shape of Mode 3 of the General Agreement on Trade in Services (GATS). But these efforts all fell short of the aim, codified in the US model BIT in the early 1980s after extensive consultations with the US private sector, of a comprehensive investment agreement.

Compared to the 1960s when the European BITs and the OECD Codes had been adopted, there was a demand for higher standards in the substantive provisions of investment rules in the 1980s, both for investment protection and liberalisation. Perhaps more importantly there was also a desire for comprehensive investment agreements that covered both protection and liberalisation and had effective enforcement mechanisms in the shape of investor-state dispute settlement. This aim was achieved at the regional level in the shape of the CUSFTA and NAFTA. There would therefore seem to be grounds for arguing that the US-led push for comprehensive investment rules was redirected to the regional/bilateral level after the failure to achieve this aim on both the plurilateral and multilateral levels.

6.7.1 Evidence of complex interaction between rule-making on different levels

There is clear evidence of a close and complex interaction between rule-making on different levels. On the one hand, the principles and overall framework of rules developed at one level have found application on other levels. In the case of investment there has been the distinction between investment protection and liberalisation. Rules have been developed on different levels to address these before being combined at the regional level. The case of investment also tends to support the view that regionalism should be seen as a product of the global liberal system rather than either a building or stumbling bloc for multilateralism. That developing countries are lining up to sign FTAs (with the US) that include precisely the rules on investment that they have opposed in the

WTO is consistent with the thesis that they sign FTAs in order to attract FDI and thus become a part of the liberal global economy. (Ethier, 1998)

On the other hand, forum shopping has clearly been used by the US to promote higher standards of investment. On the question of consistency, the fact that a dominant model, that of NAFTA, has emerged, aids consistency and this model has now found wider application away from the US hub. But the dominance of the NAFTA model and the way it has been promoted through bilateral agreements clearly raises questions about the strategic use of forum shopping and interaction between levels of rule-making by the US. Bilateral and regional initiatives have been used to push for high standards of rules for investment and establish a *de facto* international regime.

The case of investment illustrates differences in the approaches of the major economic powers towards investment. The US has sought higher standards and, as in other policy areas, focused on facilitating access to remedies for private parties in the shape of investor – state dispute settlement provisions. Investment may, however, illustrate the limitations of the use of private action in the sense that it has reached a point at which private actions by foreign legal persons may begin to threaten US domestic regulatory interests.²⁶ This US approach has been widely emulated in the western hemisphere and is finding wider application in some FTAs including Asian countries.

The European approach to investment rules has been less ambitious in terms of the standard of protection for investors, liberalisation and has not embraced investor-state dispute settlement. The EU has also retained a nominal preference for multilateral negotiations on investment, for example pressing for investment to be included in the Doha Development Agenda as one of the Singapore issues. The EU favoured the multilateral approach over the plurilateral approach in 1995 when the MAI negotiations were starting up, but negotiations began in the OECD on the MAI with the EU Member

States. In its bilateral FTAs and region-to-region negotiations the EU has not pressed for comprehensive or even significant rules on investment. The provisions on investment in the EU FTAs with third countries remain little more than general statements. This preference for the multilateral over plurilateral, or apparently regional/bilateral fora, has meant the effective recognition that standards would be weaker given the need to find a consensus among a wider group of actors.

But it is important to understand the factors behind this EU approach. This is no doubt in part a belief that the multilateral rules need to be strengthened and a recognition on the part of the capital exporting EU that the main issues in terms of investment lie in the developing countries so that these need to have ownership of any investment rules. But the absence of an EU push for high investment standards in FTAs is also due to the fact that the European Community has no competence for investment. Competence for investment has remained with the Member States of the EU. Internally the *acquis communautaire* provides for full liberalisation of investment and right of establishment, but in relations with third countries individual EU Member States have retained the leading role. For example, it is the individual EU Member States that negotiated and retain BITs on investment protection. It was also the individual EU Member States that negotiate on investment in the OECD and that agreed to launch the MAI negotiations in 1996.²⁷

Chart 6.2 The NAFTA model of investment agreement²⁸

Provision	US model BIT	NAFTA	US-Chile	US-Singapore
Definition of investment	broad tangible and intangible assets 'every kind of investment owned or controlled'	broad tangible and intangible asset based	broad tangible and intangible asset based	broad tangible and intangible asset based
Coverage	investment agreement only	chapter covering all investment (distinct from cross border services)	separate investment chapter	separate investment chapter
Principles	negative lists tailored to 1 country concerned pre and post investment national treatment and MFN	negative list pre and post investment national treatment 11.2 MFN 11.3	negative list pre and post investment national treatment and MFN	negative list pre and post investment national treatment and MFN
Transparency and due process	some general measures	general rules under Arts 1800 1804	general rules for agreement as a whole	general rules for the agreement as a whole
Substantive rule				
liberalisation	general ban on performance requirements Fair and equitable treatment	7 performance requirements banned ban on linking incentives performance requirements fair and equitable treatment	as in NAFTA	as in NAFTA
investment protection	classic and effective protection	classic and 'effective' expropriation rules and protection of capital transfers	as in NAFTA	as in NAFTA
Regulatory safe guards	scope for exclusion of sectors	negative list exclusions, reciprocity	as NAFTA	As in NAFTA
Enforcement dispute settlement	general exemptions for security etc investor-state and state-state dispute settlement	detailed procedural rules on investor state actions	detailed procedural rules on investor state actions	detailed procedural rules for investor state dispute settlement

6.3 The progressive liberalisation model of investment agreement

	WTO	OECD	EU- Chile
Definition	provision of a service by means of establishment	broad	FDI, real estate and securities
Coverage	services covered by GATS using positive and negative listing	positive listing	
Principles	post-investment national treatment for services and MFN subject to exceptions	national treatment (not binding for pre investment) and MFN	reference to existing obligations under OECD codes
Transparency	rules for services investment under mode 3	binding rules on transparency with ratchet mechanism	general transparency rules for the agreement
Substantive rules			
• liberalisation	ban on six performance requirements in TRIMs	progressive remove all restrictions	as under existing agreements
• investment protection	none	financial transfers protected	none but reference to existing BITs that provide protection
• obligations on investors	none	non-binding provisions in the Code of Conduct for MNCs	none
Regulatory safeguards	exclusion of sensitive sectors	OECD codes on restrictive business practices scope for exclusion of sensitive sector	n/a
	general exclusions (e.g security, health, environment)	public policy, health and security exemptions	
	pursuit of 'legitimate' regulatory policy objectives	derogations in cases of economic disturbance	
Implementation and enforcement	general state – state under Dispute Settlement Understanding	consultation and peer pressure	bilateral state – state

Endnotes

¹ An extensive discussion of the typical elements of investment rules can be found in UNCTAD (2004)

² This began to change in the early 1980s and the United States brought the case against the Canadian Foreign Investment Review Agency (FIRA) in 1983. When the GATT Panel in the FIRA case interpreted the coverage of investment by the GATT in a fairly restrictive way, the incentive to push for a reinterpretation of the GATT rules led to pressure to include investment in multilateral negotiations during the 1980s.

³ For a summary of OECD country controls in the mid 1980s see OECD 1987.

⁴ Julius identifies five historical phases in the evolution of what she calls international direct investment (IDI); the heydays of the 19th century from 1870 - 1914 when there was an essentially liberal regime; the collapse of IDI and trade during and between the two world wars 1914 - 1945; trade growth with investment controls 1945 and 1973, but some recovery of IDI, especially US investment into Europe; the years of oil shock induced recession during the period 1973 -1983; followed by the current phase of explosive growth of IDI post 1983. (Julius, 1994)

⁵ There have been only a few cases of the US blocking foreign takeovers of US firms for reasons of security.

⁶ The fact that some cross border acquisitions are still challenged in the EU should not blind one to the fact that the post 1990s regime is clearly liberal in character compared to what existed in the 1970s and 1980s.

⁷ Existing investors had already 'paid the entry fee' for establishment by accepting various performance requirements so were not as motivated to remove them. This partially explains why the EU did not press on investment rules at the time because much European FDI was already established.

⁸ The US threatened to use Section 301 against India, but did not actually apply sanctions.

⁹ The Convention establishing the ICSTD has 126 signatories. It is referred to as a possible means of resolving disputes in no less than 350 regional and bilateral agreements as well as NAFTA, but had only dealt with 35 cases in the 30 years of its life up to 1996.

¹⁰ The United Nations Centre on Investment and Trade Law

11. The OECD (see Foreign Direct Investment Trends in the 1980s) describes three waves of liberalisation in Europe. The first national unilateral from 1979, the second from the mid 1980s as a result of the Single European Market, and the third from the late 1980s in which Scandinavia and other applicant countries followed the trend.

¹² The wording of the relevant Punta Del Este declaration of September 1986 was 'Following an examination of the operation of the GATT articles related to the trade restrictive, distortive effects of investment measures, negotiations should elaborate as appropriate, further provisions that may be needed to avoid adverse effects on trade.'

¹³ Neither the GATS, nor the sector agreement on financial services, prevent governments from introducing capital controls, maintaining essential prudential regulation or managing exchange rates. This is worth mentioning because opponents to multilateral investment agreements have argued that these would make it harder for governments to deal with financial crises.

¹⁴ For a comparison between the GATS and provisions on services in RTAs see UNCTAD, 2002b

¹⁵ See DeAnn Julius op cit.

¹⁶ Sir Leon Brittan since the beginning of 1995, see '*Smoothing the Path for Investment Worldwide*' speech in Washington January 1995.

¹⁷ As will be shown below, the cohesive nature of the international investment policy community in developed countries was irreversibly changed from 1997 onwards when labour, environment, development and other NGOs chose to enter the debate.

¹⁸ Negotiating within the WTO would also give a boost to the prospects of extending EC competence to investment as the European Commission was by convention the sole negotiator in the WTO.

¹⁹ See Henderson 1999, op cit.

²⁰ For the US Business position on the MAI see United States Council for International Business (1995) *Guide to the Multilateral Agreement on Investment*, November 1995 US Council for International Business New York.

²¹ For a summary of the US aims in the round see '*Toward Seattle: The Next Round and America's Stake in the Trading System*,' speech by Charlene Barshevsky at the Council on Foreign Relations, New York, 19 October 1999.

²² Compare the draft Ministerial Text of 19th October 1999 with the EU's objectives as consistently outlined by the Commission, see endnote 19.

²³ See World Trade Organization (1998) for a detailed summary of the work of the Working Group.

²⁴ NAFTA has been seen as a model for the subsequent Uruguay Round agreement. But the outline of the rules on investment were already clear by late 1991.

²⁵ The Europe Agreements were of course different in that they were a prelude to accession.

²⁶ In July 2001 The Free Trade Commission (the intergovernmental body that brings together the three signatories to NAFTA) adopted a clarification of the Chapter 11 investment provisions of NAFTA that aims to limit the excessively intrusive application of the *de facto* expropriation rules.

²⁷ There has however, been some progression in this respect. The EU-Mexico agreement included virtually nothing on investment, despite the strong NAFTA provisions. By the time the EU-Chile negotiations were concluded there was some movement towards accepting stronger rules on investment by the EU Member States.

²⁸ For a similar comparison see OECD 2004.

Chapter Seven Competition policy

7.1 Introduction

The history of rulemaking in competition, like investment, goes back at least to the 1947 draft provisions of the ITO that included measures on restrictive business practices (RBPs). The proposals for rules on competition were drafted against the background of the experience of the 1930s, when international cartels had been widespread and damaging to the world economy. When the ITO failed discussions were held within the GATT in the 1960s on whether there was a need to include provisions on RBPs, but these made little headway because perceptions had changed by that time and cartels were no longer seen to be a major problem or priority.¹ The globalisation of markets in the 1980s and 1990s, and in particular the growth of cross border merger and acquisition activity, led to a growing number of national competition authorities seeking to co-operate at regional, bilateral, plurilateral or multilateral levels.² The 1990s also saw a growing awareness of the relative importance of competition policy, or the absence of effective competition, as a factor in market access, such as in the discussions on the Structural Impediments Initiative (SII) in US-Japanese relations. (Davidow, 1994)³

The progressive liberalisation of public restraints on trade (tariffs as well as non-tariff border and domestic regulatory measures) raised the question of whether public restraints on trade might not be in danger of being replaced by private restraints on trade. This was especially the case when widespread privatisation and deregulation increased the scope for private monopolies or market dominance. Policy reform therefore led to a need for more effective competition policies, but in an increasingly global economy.

This chapter follows the same pattern as the previous case studies. It applies the analytical framework to competition and then discusses the evolution of rule-making

before assessing the roles of multilateral, plurilateral, regional (28 agreements with competition rules) and bilateral (20 plus) agreements.⁴

7.2 Elements of rules in international competition agreements

This section identifies the core elements in competition rules along the lines of the analytical framework provided in chapter three. As in the other case studies the aim of this typology is to facilitate comparison between competition rules on different levels of rule-making and thus assess the impact of RTAs.

Chart 7.1 Elements of rule-making in international competition agreements

Coverage

Coverage of competition rules is determined by sector, entity and instrument as well as by the definition of competition policy. Sector coverage takes the form of schedules that may, for example, exclude specific sectors such as aviation or shipping. There are also certain activities, such as co-operation in research and development or restructuring in times of crisis (crisis cartels) that may be excluded.

In terms of entity coverage, rules may apply to legislation, by for example, requiring parties to an agreement to have competition laws prohibiting restrictive practices or cartels, or they may also apply to the implementation of (national) competition laws. The more comprehensive rules therefore cover *de facto* application of national laws.

A broad definition of competition policy would cover restrictive business practices (RBPs), including horizontal agreements or collusion, vertical agreements and merger controls. Rules may also cover public enterprises in the sense of requiring these to operate according to commercial criteria, as well as state subsidies.

Non-discrimination

MFN status is seldom controversial in the sense that restrictive business practices of foreign companies is likely to be treated the same by national competition policies.

National treatment is more controversial because competition authorities often use discretion when deciding whether the potential gains from concentration in terms of productivity or technical advancement outweigh the costs in terms of reduced competition. Such discretion can be used to promote international competitiveness and national champions (by allowing mergers between national companies and blocking foreign acquisitions).

Transparency

Rules on transparency can include:

- the *statutory (de jure rules)*. This is seldom controversial and involves limited compliance cost.
- the *application of competition law (or de facto rules)* such as decisions and guidelines handed down by courts or competition authorities. Given the case dependent nature of competition policy, such 'case law' can be vital for an understanding of policy, but involves significant compliance costs.
- *Investigations initiated* by the national competition authorities to facilitate co-operation in enforcement.

Substantive provisions

Substantive rules concerning private restraints on trade can include:

- the requirement to have an *(effective) national competition* or anti-trust policy;
- the establishment of an *independent competition authority*. Competition policy implemented by national ministries are seen as being more likely to be shaped by political or competitiveness

criteria than those implemented by independent agencies or the legal system;

- prohibition of *cartels* (or agreements that significantly influence prices or output and thus trade, without having any beneficial effects in terms of improved productivity);
- the prohibition of *export cartels*;
- rules on *horizontal agreements*, i.e. between firms working at the same level of processing or marketing. There is a consensus that horizontal agreements can be detrimental, but national policies vary on how to treat them;
- rules on *vertical agreements*, i.e. those between suppliers at different levels of the production or distribution process. National policies vary considerably on this issue with some favouring vertical integration as a means of promoting productivity improvements and others treating them the same as horizontal agreements. Policies on vertical agreements have also varied over time, with changes in markets and competition theory.
- rules on *mergers and acquisitions* (possibly including strategic alliances). This area is even more controversial with some countries using merger control or its absence as an instrument of national industrial strategy and others basing their policies on competition criteria.

Trade agreements often also include provisions concerning public restraints on trade or distortions including:

- rules restricting or prohibiting the use of *state subsidies*. These are present in many RTAs and in the GATT; and
- rules requiring *public monopolies* (or private companies granted special or exclusive rights) to operate according to commercial criteria and not to compete unfairly by subsidising their activities in competitive markets with rents from monopoly operations.

Co-operation

With global markets, but competition constrained by national (or regional) jurisdiction, many agreements include co-operation provisions. These can be binding or voluntary. Rules on co-operation may include:

- *policy co-operation*. This generally takes the form of the establishment of a committee or forum to discuss developments in competition law and policy and can provide varying degrees of peer review or technical assistance. The OECD provisions include scope for peer pressure to adopt 'best practice'. The UNCTAD similarly provides for co-operation and support on the adoption of laws and on their implementation. In recent years new forums have been set up in the form of the OECD's Global Competition Forum and the International Competition Network.
- *co-operation in enforcement* constitutes the main focus of many bilateral competition agreement and takes two general forms:
 - *negative (or traditional) comity* in which national competition authorities take account of the interests of third parties in any investigation and
 - *positive comity* in which the relevant authority in a country 'A' can request the competition authority in another country 'B' to investigate anti-competitive practices within its jurisdiction that affect the market conditions in 'A'.
- *commercial confidentiality* has been an important limiting factor in co-operation and nearly all agreements contain exclusions for commercial confidentiality.
- *technical assistance* can help to promote the use of best practice in competition policy and provide support for developing or transition countries. Technical assistance may take the form of exchanges of personnel (as in the case of the Europe Agreements), the provision of model competition rules/law (as in UNCTAD), or assistance in dealing with specific cases.

'Regulatory safeguards'

In competition these take the form of exclusions for sensitive sectors or policies, exceptions for national security reasons or the use of discretion in choosing between competition and competitiveness.

Independent competition authorities or courts may have less discretionary powers.

Enforcement measures

Few international agreements, with the notable exception of the European Union and European Economic Area provisions, subject competition policy rules to dispute settlement. The NAFTA, which is otherwise characterised by strong dispute settlement rules, explicitly excludes competition (anti-trust). Again the question of *de jure* and *de facto* compliance is relevant:

- *De jure compliance*, means that only the letter of the competition laws can be challenged;
- *De facto compliance* means the application of rules by the national competition authority can also be challenged, which means a much greater coverage of the rules and higher compliance costs;

- *Due process* rules may be included to ensure that national investigation and enforcement are fair and transparent. These can, for example, provide rights for the parties to any case to participate in any decisions and/or have recourse to a judicial or administrative review of decisions by national competition authorities.

7.3 Interaction between levels of rulemaking up to 1985

7.3.1 *The ITO and the GATT*

The experience with international cartels during the 1930s provided the incentive to include restrictive business practices in the draft ITO. Chapter V of the ITO devoted nine articles to the subject with the aim of *'prevent(ing), on the part of private or commercial public enterprises, business practices affecting international trade which constrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade and interfere with the achievement of any of the other objectives set forth in Article 1 [of the charter]'*⁵

The ITO provisions listed six practices that were considered harmful to trade. The ITO itself was to investigate any complaint brought by a member and if upheld the country concerned would have had to do everything possible to remedy the situation.⁶

As the ITO was never ratified one can only speculate whether these comprehensive provisions would have been implemented in practice. At the time, differences over the substance of policy were not a major problem, since only the US really had a competition policy, but even so the US Congress was concerned about loss of regulatory sovereignty.

In 1954 and 1955 a number of Contracting Parties (CPs) pressed for the inclusion of RBPs in the GATT. In 1960 the GATT CPs reached a Decision on Arrangements for Consultations on Restrictive Business Practices that recommended the Parties to enter into consultations in the event of harmful restrictive practices in international trade, either on a bilateral or multilateral basis.⁷ A Group of Experts on RBPs reported in 1961, after considering the subject for a number of years and although it found 'that the [GATT] should now be regarded as the appropriate and competent body to initiate action in this field,' the experts also found that 'there was no consensus on the substance of GATT rules.' (Lloyd and Sampson, 1995, pg 687) This lack of consensus was probably due to the perception that cartels were not a major problem at the time and the fact that governments were busy promoting (national) concentration of industry to enhance competitiveness. The notification procedures for RBPs provided for in the 1960 Decision were never used.⁸

7.3.2 The OECD

As in the other case studies considered, the OECD has played an important role in developing approaches to international rules on competition and filled the vacuum left by the absence of GATT rules. The approach adopted in the OECD was likewise to set a precedent for future agreements at the regional and bilateral levels. The OECD rules were aimed not at developing common norms or policies on substantive issues, but at

cooperation between national competition authorities in cases that affected the markets in more than one country. These were drawn up by the Competition Law and Policy Committee and set out on the 1967 recommendation on voluntary provisions for cooperation between OECD competition authorities. Revised recommendations were drawn up in 1973 and 1979 that included voluntary provisions on notification of investigations that affected other parties, exchange of information and coordination when investigations in one country had implications for another country. The 1979 Recommendation also included voluntary provisions encouraging bilateral or plurilateral cooperation within the OECD on the implementation of national competition policies. If such co-operation could not resolve a conflict there were provisions in the 1979 recommendation for the OECD Committee of Experts on Restrictive Business Practices to conciliate. These conciliation procedures were never used, (Sheldon, 1998) but there was an increase in notifications under the 1979 Recommendation. Between 1976 and 1979 there had been an average of 37 notifications a year. This rose to an average of more than 100 notifications a year between 1980 and 1985. Most of these were between the US and the EU. In addition to promoting transparency the OECD Recommendations included elements of positive comity and provided the model for the bilateral agreements that were concluded between the US and Germany (June 1979), Australia (June 1982) and Canada (March 1984), the latter replacing a much earlier bilateral agreement between the US and Canada.

In 1982 the OECD Ministerial called for a further review of OECD rules on competition policy and in particular more work on the interaction between trade and competition. This led to a Report on Trade and Competition Policy that pointed to a lack of coordination between trade and competition policies at a national level. The review also led to a Memorandum on Cooperation Between Competition Authorities that

contained more extensive guidelines on notification, exchanges of information and consultations between national competition proceedings. (OECD, 1986; OECD 1987a)

7.3.3 The UNCTAD 'Set'

At the end of the 1970s developing countries sought a defence against potential restrictive practices of Multinational Companies (MNCs). The ensuing debate led to the establishment of the Code of Conduct for Multinational Companies with regard to investment (see chapter 6) and in the field of competition policy, the UN Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (the "UNCTAD Set"), adopted by the UN General Assembly in 1980. The Set remains the only truly multilaterally agreed instrument on competition law and policy. Its aim was 'to ensure that restrictive business practices do not impede or negate the realization of benefits that should arise from the liberalization of tariff and non-tariff barriers affecting world trade, particularly those affecting the trade and development of developing countries.'

But the 'Set' does not contain any binding substantive or procedural rules. Its main function has been to provide a model law for national competition policies in developing countries. As such it has sought to adapt rules to the needs of developing countries, provide technical assistance and serve as a resource for national competition authorities.

Similar to the OECD, the approach of the 'Set' was to promote cooperation between national competition authorities. Section E provides that 'states should establish appropriate mechanisms at the regional and sub-regional levels to promote exchange of information on RBPs and on the application of national laws and policies in this area, and to assist each other to their mutual advantage regarding control of RBPs.' Section 9 states that governments should 'on request, or at their own initiative when the need

comes to their attention, supply other states, particularly developing countries, with publicly available information, and, to the extent consistent with their laws and established public policy, other information necessary to the receiving interested State for its effective control of restrictive business practices.’ The aim here was to help ensure that developing countries also benefit from cooperation between competition authorities.

7.4 Interaction during the ‘second phase’

Up to the 1980s international rules on competition were therefore largely based on voluntary cooperation promoted by recommendations of the OECD and UNCTAD. There were few detailed agreements covering competition outside of the EU. The 1985 - 95 period saw a further development of the European approach to competition policy and efforts by the EU to extend this model more generally through regional, bilateral agreements and multilateral agreements. Competition was one of the issues the EU included in its 1999 negotiating mandate for a comprehensive WTO round. The 1985 – 95 period also saw a growth in bilateral competition agreements. (UNCTAD, 2002c) As section 7.4.4 shows, the US had a clear preference for bilateral agreements. Unlike the cases of investment, intellectual property or services, the US excluded competition from its FTAs and opposed inclusion of competition in multilateral negotiations.

7.4.1 Bilateral Competition Agreements

There have been a number of bilateral co-operation agreements in the field of competition policy. These have mainly involved the United States, which has concluded agreements with: Germany (1976) that reflected the close links between US and German authorities⁹; Australia (1982) as a means of resolving disputes over raw materials exports and Canada (1984). In September 1991 the US also concluded an agreement with the

European Commission.¹⁰ This was based on the approach developed within the OECD, indeed it makes specific reference to the 1986 OECD Recommendation in its preamble. Various articles in the US-EU bilateral use identical wording to that in the OECD text. See chart 7.4. The agreement was limited to cooperation between the European Commission and the US authorities on enforcement and implementation. Article V of the agreement provided for 'positive comity'. One of the main aims of the agreement was to minimise conflicts resulting from the use of the effects doctrine (by the EU) and extraterritoriality application of (US) anti-trust enforcement. Increased transatlantic merger and acquisition activity meant that conflicts of this kind were on the increase, as reflected in the number of notifications to the OECD.

The US-EU agreement included transparency provisions relating to information on the initiation of cases and exchange of non-commercially sensitive information. But differences between US anti-trust law and policy and the EU's competition regime, along with opposition from the US Department of Justice to any discussion of policy convergence meant the agreement contained no substantive rules.^{11 12}

The US-Japan Structural Impediments Initiative (SII) included a considerable discussion of competition policy issues. Indeed the US complaints concerning Keiretsu and Japanese distribution networks were essentially competition policy matters. In April 1992 the US Department of Justice announced its view that US anti-trust law could be used to challenge restrictive practices or agreements within another country if these affected market access for US exporters. This represented an extension of the extraterritorial reach of US anti-trust law. Hitherto this had only been applied extraterritorially when restrictive agreements or practices in another country affected competition *within* the US market.

In its bilateral discussions with Japan the EU also raised competition policy questions. For example, the European Commission's paper of April 1992 on EC-Japanese relations, argued that Japan had to develop a stronger, more aggressive competition policy if it was to avoid external pressure for change in the structure and transparency of the Japanese market. But the EU limited the use of the effects doctrine to measures that restricted competition within the EC.

7.4.2 The Australian-New Zealand Closer Economic Co-operation Agreement (CER)

Australia and New Zealand adopted an interesting intermediate approach between policy approximation (the EU approach discussed next) and the co-operation in enforcement approach favoured by the US. This amounted to what might be called mutual recognition of the extraterritorial application of national competition law. The CER Agreement is also interesting in that it replaced anti-dumping with general competition rules. Such an approach has been proposed as a means of dealing with the problem of the abuse of anti-dumping actions, but has not been included in any multilateral, or for that matter regional agreements outside of the CER and the EEA (see below).

The CER proved successful in the sense that trans-Tasman trade doubled between 1983 and 1987. But in 1988 a review of the CER looked at a number of outstanding issues including competition policy. Australia and New Zealand had similar competition policies, but the 1988 review called for harmonisation of business law, including especially competition law as it related to predatory action (i.e. predatory pricing or marketing to undermine competition in other markets). As a result changes were introduced in 1990 that brought the two national laws, including those that prohibit RBPs or the abuse of market dominance as it affected Trans-Tasman trade, still closer together.

This policy approximation facilitated the CER mutual recognition of competition policy, which extended existing extra-territorial application of competition law to include actions taken in the other country and to remove immunity from the application of competition law in the other country. New Zealand competition authorities could take actions against the anti-competitive practices of companies operating in Australia that had an impact on trans-Tasman markets and vice-verse. The courts in each country were authorized to require companies or economic agents in the other country to provide the information necessarily for the investigation of any case.

The 1990 Protocol on the Acceleration of Free Trade in Goods brought forward the deadline for completing the removal of tariff and other restrictions on trans-Tasman trade and Article 4.4 required revision of competition laws in order to enable the suppression of anti-dumping actions from July 1990.

The CER therefore provided an alternative to the US and EU approaches and one that got rid of anti-dumping duties. But one has to recognize that the CER agreement was based on rather special circumstances. Australia and New Zealand had similar competition laws and similar approaches to their implementation. The 1988 review also led to the effective approximation or harmonisation of substantive rules. These special conditions probably explain why the approach has not been emulated elsewhere. It could provide a model in cases where policies converge, but the countries concerned are not ready to cede responsibility for implementation to a supranational enforcement agency.

7.4.3 The European Approach

The EC has extensive provisions on competition policy covering restrictive business practices (both vertical and horizontal agreements and abuse of market dominance), mergers, public enterprise, public monopolies and provisions on state subsidies. The foundations of these provisions are in the Treaty of Rome, which included

provisions designed to ensure that private restrictive practices or subsidies were not used to countermand the effects of liberalisation. Article 81 and 82¹³ granted the European Commission powers to intervene, subject to review by the European Court of Justice, in the cases of restrictive agreements or the abuse of market dominance. Article 86 applied these rules also to public enterprises and Article 89 banned state subsidies. All bans were subject to exemptions and exclusions. Over a period of forty years case law has developed a body of European law by first increasing transparency through the notification of private agreements, state subsidies and finally mergers. Once there was information available the European Commission acted on specific cases and, with the support of the European Court of Justice, built up a body of case law that was then codified, adopted as EU policy and ultimately as national policy in the Member States. The EU has therefore succeeded in bringing about a convergence in national competition policies, but it has taken forty years and the EU benefited from the supranational powers of the European Commission and the European Court of Justice (ECJ).

The EU powers under Article 86¹⁴ were also important. These enabled the European Commission to act against restrictive practices of *public enterprises* and, more contentiously, public monopolies. Commission surveys found that 7% of national aid to manufacturing was in the form of cheap credit provided by government to public enterprises. With this information the Commission applied Article 86 arguing that whilst Art 222 (EEC) guaranteed impartiality on the question of public ownership, this could not be used as a covert subsidy. In 1990, following backing from the ECJ the Commission adopted guidelines for public enterprises based on the 'market economy investor principle'¹⁵

Telecommunications provided the precedent for EC policy towards public monopolies. The dynamics of technology and international competition in the sector

challenged the status quo of national public monopoly provision sooner than other sectors. In response the European Commission moved to first ensure the separation of regulatory and operational functions of the telecommunications networks and then to liberalise the various elements of the telecommunications sectors using powers under Article 86 (TEC) to force open the terminal equipment and services sectors.¹⁶ (Thatcher, 1995) The liberalisation process therefore took the form of specific sector initiatives and the application of general competition powers. (Woolcock and Wallace, 1995) The European Commission followed a similar approach in other sectors such as gas and electricity and postal services, but progress in these sectors has been very much slower. In general competition policy played a significant supporting role in liberalising sectors that had long been dominated by national public monopolies.

Article 88 (TEC) contains a ban on *state subsidies* in 'any form whatsoever which distort or threaten to distort competition by favouring certain undertakings or the production of certain goods.' The treaty required all subsidies to be notified to the European Commission, which alone could grant exceptions under set conditions. But these transparency rules were, like those in the GATT provisions on subsidies and countervailing duties, not effectively implemented. Member State governments were not ready to accept EU or GATT control of subsidies, maintaining that these were a legitimate instrument of public policy and should not be prohibited under GATT rules.

The situation began to change in the 1980s as a result of changes in national policy towards reduced dependence on subsidies and pressure at an EU level to impose more effective control. In 1985 a Task Force on subsidies was set up to improve transparency and in 1988 a comprehensive survey of national schemes showed that these were equivalent to 4% of value added in manufacturing. (Gilchrist and Deacon, 1991) Thanks to more effective EU level controls and unilateral policy decisions by national

governments, these levels fell before levelling out at the end of the 1980s and shifted from sector specific aid for declining industries, towards less selective support for research and development, regional development and environmental subsidies. The EU efforts therefore contributed significantly to transparency and thus achieved what the GATT agreement had not. They also increased competition within the EU and for third country suppliers.

The codification of EU rules on state subsidies went hand-in-hand with refinements in the multilateral rules on subsidies during the Uruguay Round. During the Tokyo Round the EU opposed tighter GATT rules on subsidies, but in the 1980s it shaped the GATT rules. In 1985 the EU codified rules for research and development subsidies (e.g. setting a ceiling of 50%)¹⁷ In 1988 it codified rules on subsidies to compensate for regional economic underdevelopment geared to per capita GDP and unemployment figures. The EU also set a ceiling of 15% of total investment for environmental subsidies. These advances at the regional level facilitated more effective GATT rules on state subsidies.

The GATT negotiations adopted what became known as the traffic light approach, in which subsidies would be classified as prohibited (red), permitted but actionable i.e. subject to countervailing duties (amber) and permitted non-actionable subsidies (green).¹⁸ The EU rules were reflected in the GATT rules that adopted ceilings and criteria very close to those of the EU. See for example chart 7.1. Only with regard to R&D subsidies did the EU have to modify its policy, by increasing permissible ceilings, in order to bring EU policy in line with the GATT rules. Paradoxically this was due to the US Clinton Administration seeking higher ceilings.

There was no EU merger control until 1989. When the Treaty of Rome was signed most governments sought the economies of scale from concentration as a means

of promoting international competitiveness.¹⁹ Efforts to introduce merger control in the 1970s failed because some Member States used merger policy to support industrial strategy aims while others used it to see it promote competition. There was also resistance to granting the European Commission more power in such a sensitive area. It was only when the Commission used Art 82 (TEC) to challenge mergers that the deadlock was broken. This raised the prospect of double jeopardy (.i.e. facing EU level and national controls) for European business, which then switched to support a unified EU policy on mergers. This had become more important because of the growth in cross border mergers and acquisitions towards the end of the 1980s as companies restructured to operate at the European and international level rather than the national level. The issue of industrial policy or competition criteria was resolved in favour of the latter although some flexibility remains that could be used to promote a more interventionist policy.²⁰

The EU merger rules involve a division of labour between the EU that deals with mergers involving firms with more than a total of 5 billion Euro world wide turnover, provided the firms concerned have a turnover of more than 250 million in at least two member states of the EC. The second threshold catches only those mergers that affect intra EU trade. Anything smaller than this or any merger involving firms with 66% of their turnover in one member state is dealt with by the national competition authority.

These thresholds reflect the EU's application of the effects doctrine²¹ in that *any* merger exceeding them must be notified to the European Commission, and suspended while the Commission decides if it falls under EU merger rules. Thus a merger between two US companies that have important subsidiaries in the EC (with turnovers of more than 250 million Euro) would have to notify the merger to the European Commission.

7.4.3.2 *The European Economic Area*

This comprehensive EU competition policy was applied lock-stock-and-barrel to the EEA including the rules on cartels/abuse of market dominance, public enterprises, mergers, state subsidies etc. But there was disagreement about enforcement of the rules. The EU member states had insisted on common enforcement, through a common Court, to ensure that private or public restraints on trade did not countermand the market opening provisions of the EEA agreement. But the EFTA countries had, naturally, resisted the extension of ECJ jurisdiction to EFTA. When the ECJ rejected the initial proposal of an EEA Court a compromise was found in the establishment of a supranational EFTA Surveillance Body (ESB) with powers the same as those of the European Commission, and a separate EFTA Court to parallel the ECJ. (Charlton, 1994)

In the EEA the issue of regulatory sovereignty was therefore resolved by a common-rules-but-two-enforcement-agency approach. This required detailed rules. The European Commission was competent in 'pure EU cases' when a restrictive agreement or abuse of market dominance only affected trade between member states of the EU. In 'mixed' cases that affected intra-EU trade and trade between the EU and EFTA states, the European Commission also had sole jurisdiction (Article 56(1)c EEA), as long as no more than 33% of the turn over of the companies concerned was within EFTA. The ESB had jurisdiction in 'pure' EFTA cases, i.e. when there was no effect on EFTA-EU trade or in so-called 'specific mixed cases' in which intra EU and EU- EFTA trade was affected, but more than 33% of the turnover of the companies concerned are in EFTA. Similar rules applied to horizontal and vertical agreements as well as mergers.

The EFTA states were also obliged to adopt the *acquis* on state subsidies, public enterprises and public monopolies. There was some concern in the EU and EFTA concerning the application of the provisions on state aid. If there were doubts about the

implementation, the European Commission and EFTA Surveillance Body had to first seek a solution. If this did not succeed the EEA Joint Committee then had to attempt to resolve the dispute. If that failed the Party affected, i.e. either the Commission or the SB could act (i.e. apply countervailing duties) to remedy the distortion to competition resulting.

The impact of these rules is now limited after the Nordic enlargement of the EU that left just Norway, Iceland and Lichtenstein in EFTA. But the approach, like that of the ANZCERTA arrangements on competition, provides an interesting model for how to reconcile national competition rules and integrating markets.

7.4.3.3 The Europe Agreements

The Europe Agreements are of interest in that they illustrate how the EU might shape transition arrangements in RTAs or FTAs that adopt comprehensive approximation with the EU competition rules. As in the case of the EEA, the Europe Agreements themselves have been overtaken by the enlargement of the EU. The Interim Agreements, of February 1992, implementing the Europe Agreements concluded in December 1991, set out the aim of the progressive extension of the EU's competition regime to the central and east European countries. (European Commission, 1998)

Restrictive practices (i.e. cartels), abuse of market dominance and any public aid that distorted or threatened to distort competition were incompatible with the Europe Agreements.²² Any such practices were to be 'assessed on the basis of criteria arising from the application of the rules of Articles 81, 82 and 86 (TEC). Initially, there were no details for how this should be brought about or which authorities in the Poland, Hungary, and the Czech and Slovak republics etc. were to be responsible for ensuring this was done. Joint Committees were established, both to deal with any dispute by means of

mutual agreement and to provide technical assistance for the CEECs. In cases when no agreement could be reached, the *de fault* option for the EU was the use of the effects doctrine for cartels or mergers. On state subsidies, the transition rules effectively granted the whole of the territory of the eastern partner the status of a development region within the meaning of Article 86 (3)(a)(TEC), meaning that higher levels of subsidy were permitted. Any dispute over state subsidies also first had to be considered by the Joint Committee. Only if a mutually satisfactory solution could not be found could either party then have recourse to countervailing action or dispute settlement under the WTO Code on Subsidies and Countervailing Duties.

There was a transition period for public enterprises after which the Joint Committee had to ensure that EU rules (under Art 86) were applied to public undertakings in the eastern parties.

In other words the Europe Agreements envisaged the progressive extension of the entire EU *acquis* on competition policy including Directives, codes and case law to the central and east European parties to the agreements. In the interim the EU continued to adopt measures at the border to compensate for distortions to competition, i.e. anti-dumping, countervailing duty and safeguard actions.²³

7.4.4 The North American Free Trade Agreement

As with virtually all of the NAFTA agreement, the competition provisions were shaped by the Canada-US negotiations on the CUSFTA. Efforts to reach agreement on common criteria for competition policy failed in the US-Canada negotiations, despite Canada's interest in rules that would replace contingent protection in Canada-US trade. As a result the anti-dumping and countervailing measures continued to apply. By way of a substitute for such an agreement the CUSFTA included the provisions of Chapter 19 on

review of anti-dumping and countervailing duties. These were initially limited to 5 years, but the equivalent provisions in the NAFTA have no cut off.

The CUSFTA did set up a Working Group to 'seek to develop more effective rules and disciplines concerning the use of government subsidies.. and a substitute system (to replace anti-dumping and countervailing duties) for dealing with unfair pricing and government subsidization' (Article 1907 CUSFTA). By the time the NAFTA Agreement was initialled in September 1992 these consultations had not born fruit.

In contrast to the expansion of the EC *acquis* on competition policy the NAFTA merely calls for each Party to adopt or maintain measures to proscribe anti-competitive business conduct (Article 1501). It also urges cooperation between the respective competition authorities and mutual assistance in enforcing national competition laws.

There are provisions covering monopolies and state enterprises, but these are considerably weaker than the Article 86 (TEC). The right to maintain a state monopoly or public enterprise is safeguarded. In general the national authorities must ensure that state monopolies comply with the provisions of the Agreement and not be used to provide a national preference or abuse their market dominance to restrict competition and trade in other sectors.

As in the CUSFTA a working group was established, this time entitled the Working Group on Trade and Competition Policy and given the remit of reporting to the NAFTA Commission within five years on 'further work' concerning the link between trade and competition policy. But this has produced no change in NAFATA provisions on competition.

The other areas in which competition policy issues were addressed in the NAFTA agreement are in the chapters concerning service sectors. The chapter on telecommunication obliges the parties to ensure that monopoly operators of basic

telecommunications services do not use their market power to distort competition in other telecommunications markets. These provisions seek to achieve similar objectives to those pursued by the sector agreements under the GATS.

Indeed the GATS, or rather sector Reference Paper on Basic Telecommunications negotiated in 1997 includes some concrete elements of competition policy. The anti-trust clause in the Reference paper, when read in the context of the Telecommunications Annex to the GATS, 'contains the only set of anti-trust prohibitions in the WTO.' (Fox; 2006 pg3) Until the Uruguay Round the only option open under the GATT was a non-violation case under Art XXIII (b). This enables WTO members to bring a case if, for example, the failure of a WTO member to implement competition law against market closing restraints nullifies the benefits expected from tariff reductions or other concessions made under the GATT. The Kodak-Fuji case showed the difficulties of applying Art XXIII to competition, although the case turned on Japan's application of certain legislative measures in retain price maintenance rather than its competition provisions as such. (Fox, 2006; Tarullo, 2002)

7.4.5 Conclusions on the interaction during the 'second phase'

Developments in international competition policy during this period progressed on different levels. At the regional level the most notable development was the further development of EU policy and its extension to its immediate neighbours, namely the EEA and CEECs. In contrast to US ambition on investment, services or intellectual property, the competition provisions in NAFTA are exceptionally modest. And even these were explicitly excluded from NAFTA bilateral dispute settlement rules. Again this contrasts with other policy areas where NAFTA included elaborate provisions on investor-state dispute settlement (investment) and bid-challenge (procurement). The

explanation for this appears to be a desire on the part of the responsible national authority in the US, the Department of Justice, to keep anti-trust policy out of trade agreements and firmly within its control. The preference of the DoJ was for voluntary, bilateral cooperation agreements on enforcement in order to address any conflict between US policy and other jurisdictions. In this sense the conclusion of the bilateral US-EU cooperation agreement in 1991 was a key development.²⁴ This built on the approach developed in the OECD and provided the precedent for a further 20 bilateral cooperation agreements on enforcement negotiated by the DoJ between 1995 and 2000. At the multilateral level elements of competition policy were included in the Uruguay Round results in the shape of a strengthening of controls on state subsidies and the provisions in the GATS such as the Reference Paper on Basic Telecommunications (Woolcock, 2003), but these clearly did not constitute a comprehensive agreement.

7.5 Developments since the end of the Uruguay Round

7.5.1 WTO dispute settlement

For competition the Uruguay Round is of much less significance than in the other case studies as there were no real negotiations on competition apart from those mentioned above. The Reference Paper on Basic Telecommunications did provide a model for bilateral and regional FTA provisions on telecommunications. (Ullrich, 2006) But there must be some doubt that the Reference Paper constitutes a first step towards the inclusion of competition in the WTO. The 2004 Mexican Telecoms case, in which the US challenged cartel-like pricing practices actively encouraged by the Mexican regulator COFETEL, and won, has been seen by some as such a first step. But the case did more to highlight the difficulties of dealing with competition cases in the WTO than provide a precedent for future cases. The WTO panel had difficulties reaching a

coherent decision on the specific case and its decision has been criticized for failing to get to grips with the detailed economic, legal and political issues involved in such specific cases. (Marsden, 2004) But there are clearly some elements of competition policy embodied in the GATT/WTO rules and these could possibly find wider application should there be a political will to use them.²⁵

Work in the OECD did however, continue, as did the extension of bilateral agreements on co-operation in enforcement. (OECD, 1999c)²⁶

7.5.2 *The OECD*

As noted above the OECD instruments were explicitly seen as the model for bilateral co-operation between OECD members. But work continued in the OECD to further develop these and to include some substantive rules. (Feketekuty, 1993; OECD 1993b) In 1995 a further revision of the Recommendation on Cooperation between Competition Authorities was made. (OECD; 1995b) The basic provisions of the Recommendation remained the same, but the guidelines on co-operation were developed still further to include co-operation on mergers. In this regard the 1995 Recommendation states that OECD competition authorities should: (i) inform each other of possible violations of the other's law; (ii) forewarn each other of cases that may affect the other's interests; (iii) request the other's agencies to act against practices that affect the requesting country's interests (positive comity); (iv) collect and share information to the extent permitted under national confidentiality laws; (v) co-ordinate in investigations and remedial actions. The 1995 Recommendation like its predecessors was consciously drawn up as a model for bilateral agreements. (Sheldon, 1998)

In addition to developing guidelines for procedural co-operation the OECD has undertaken considerable research on the impact of anti-competitive practices. This led to

the 1998 Recommendation on co-operation of national measures against hard-core cartels. (OECD, 1998) The evidence on the presence of cartels²⁷ has been the subject of some debate and the private sector and some commentators have argued that the main problem lies with public restraints on trade rather than private cartels.

The OECD research considered 116 international cartels that had been challenged by national competition authorities, mainly in the OECD countries.²⁸ These cartels were identified thanks to the investigatory powers of competition authorities and laws in the US that encourage 'whistle-blowing'. The OECD argued that these did not represent the whole picture and that there was evidence that companies were setting out to establish cartels and to run them professionally.

The OECD study suggested that the median price mark-up resulting from the cartels studied was about 10%, with mark-ups ranging from 5% to 65%.

In other words the OECD has progressively developed a set of principles for co-operation between national competition authorities. These principles have both drawn on and shaped bilateral agreements. So there appears to be synergy between bilateral agreements and the OECD rule-making. Rather than bilateral agreements distracting from the wider multilateral negotiations within the OECD, the picture that emerges is one of bilateral and plurilateral agreements building on one another in a progressive evolution of negotiations towards a consensus on the scope of international consultation and cooperation in the area of competition.

7.5.3 US bilateral cooperation agreements

As noted above bilateral agreements on cooperation in the enforcement of competition policies has been the predominant pattern in US international competition policy. Following the US-EU agreement others were concluded with Canada (1996),

Australia (1997), again with the EU (the so called enhanced positive comity agreement of 1998) (US Department of Justice 1999; European Commission, 2002), Israel (1999), Japan (1999), Brazil (1999), Mexico (2000) and Canada (positive comity agreement) 2004. During this period the EU negotiated a further bilateral with Canada. (Department of US Justice, 1997)

These agreements provided for cooperation in enforcement using negative or increasingly positive comity, but included no provisions on policy approximation or harmonisation. While the general experience of the bilateral agreements has been positive in the sense that competition authorities in the countries covered have begun to cooperate effectively, a number of cases have illustrated that ‘cooperation alone will not resolve some significant areas of difference among anti-trust regimes that must be addressed if the “integrity of anti-trust on a global stage” is to be maintained. (Evenett et al, 2000)²⁹ The problem with no approximation of substantive rules is that national authorities will continue to have different positions on the balance between competition and other policy objectives, such as market access. When there is no agreement on these types of issues the scope for co-operation will always be limited. In this context it is interesting to note that the positive comity provisions in the US-EU bilateral agreement had also only been used once up to 2001, suggesting that it would take some time before one could conclude that such cooperation was really effective.

7.5.4 The EU approach to competition in FTAs

The European approach to international competition agreements has been rather different to that of the US. The EU has championed the idea of including competition in the WTO level negotiations and has included provisions of substance in the RTAs it has negotiated, even if these remain modest.

Since the mid 1990s the EU, or rather the European Commission, has pushed for a comprehensive international agreement on competition. (European Commission, 1996)³⁰ This has made limited progress in the face of opposition from US, scepticism from developing countries and disinterest or opposition from the business community, except for the European service sector, which sees a link between competition rules and access for services trade. (European Services Forum, 2003; UNICE 2003) Competition was rejected along with investment and transparency in government procurement at the Cancun WTO Ministerial, despite the fact that what the EU was asking for was not much more than already existed in the UNCTAD 'Set'. See the discussion below on the WTO Working Group on Trade and Competition Policy.

The EU has pushed its agenda in other forums. At a regional level it has continued to include approximation of EU laws and practice as a goal in its association agreements with neighbouring countries. In this sense the EU continued the policy it pursued with the Central and East European Countries before 1995, with other near neighbours such as the Euro-Med partners. As Chart 7.3 indicates the Euro-Med Association agreements include general provisions that set out the progressive adoption of EU competition law and practice. But this is clearly a long term objective, except in the area of state subsidies, where the measures are more concrete.

The EU –South Africa Trade, Cooperation and Development Agreement (TCDA) of 1999 illustrates a more ambitious approach in that it sets out the principle that RBPs that affect trade between the EU and South Africa are inconsistent with the Agreement. It also defines competition policy along EU competition policy lines, but there is no immediate expectation of policy approximation to EU policies. As with the Euro-Med agreements the TCDA goes further on state subsidies. Indeed it bans subsidies, but then offers a general exemption when these serve a 'specific policy objective.' Finally, there

are provisions on cooperation between the EU and South African competition authorities using positive comity.

The EU-Chile FTA of April 2002 provisions on competition are closer to those of a limited bilateral cooperation agreement, providing for negative comity in policy enforcement between the European competition authorities and the Chilean.

Finally, the EU has ambitions of including competition policy provisions in the European Partnership Agreements (EPAs) it is negotiating with the various ACP regions. The most that might be expected however, is something on co-operation and possibly some general wording seeking policy approximation as a long term goal. It is worth noting that the main ACP regions already have some provisions setting out the basic aims of regional competition policies that are based on the model of Art 81 and 82 (TEC). This is for example, the case for COMESA, CEMAC and CARICOM. The latter established a common Competition Commission as long ago at 1973 (Protocol VIII of the CARICOM Treaty). But there is clearly still much to be done at the national level, let alone the regional level before one could say that these regions are following the EU model.

In the case of competition therefore we have almost the reverse of the position in investment. The EU is actively pursuing international competition rules at all levels, while the US is blocking international rules and excluding competition from FTAs in preference for bilateral agreements between competition authorities.³¹

7.5.4 The WTO debate

Work in the WTO on competition began after the Singapore WTO Ministerial in 1996.³² EU pressure resulted in paragraph 25 of the Doha Declaration that established a programme of work for the Working Group on Trade and Competition Policies

(WGTCP) covering; core principles (i.e. transparency, non-discrimination and procedural fairness); hard-core cartels; the modalities for co-operation; and support for the progressive reinforcement of competition institutions in developing countries. (Anderson and Holmes, 2002; World Trade Organisation, 1998, 2002a)³³

The starting point for those favouring a framework agreement on competition in the WTO (i.e. the EU) was that each country should have *a competition authority endowed with sufficient powers* to enable it to act effectively against RBPs.³⁴ The trend in most countries is also to have an independent competition authority, rather than one subordinated to a government department. This is not an issue for most developed WTO members, or for a growing number of developing countries, which already have such authorities. But many developing countries do not see the establishment of national competition authorities as a priority in their development aims. (Hoekman and Holmes, 1999, pp 875-893) A consensus emerged fairly soon in the WGTCP on the need for flexibility in the application of any WTO provisions, on the point that one size-fits-all policies would be inappropriate and on the need for effective and co-ordinated support for developing countries.³⁵

With regard to core principles, the WTO debate focused on the classic WTO concepts of *transparency* and *non-discrimination*. But these were not so easy to apply to competition. On transparency the issue was whether the existing transparency obligations in the GATT, GATS and TRIPs could be extended to include national statutory measures on competition (*de jure* transparency), or more ambitiously, to include secondary and implementing measures (*de facto* transparency) as well. A further issue was whether any agreement should require explicit (negative) listing of sectors excluded from competition rules. Whilst transparency on statutory measures was not very controversial, developing countries (DCs) argued that *de facto* transparency was too costly, even for those DCs that

had national competition authorities. Developing countries also resisted the listing of excluded sectors on the grounds that this would make them targets for developed country pressure in market access negotiations. There appeared to be a consensus on the need for commercial confidentiality exceptions to transparency rules. (World Trade Organization, 2003a)

The application of the WTO core *principles* of national treatment and MFN were not seen to create any difficulties when applied to *de jure* to national competition measures. National rules are geared at controlling restrictive business practices and do not discriminate between the sources of market restrictions. But there was general scepticism about the ability to apply non-discrimination *de facto* i.e. to how the rules are applied. (World Trade Organization, 2003b)

If competition policy were to be included in the WTO, this would raise the question of how to treat preferential agreements that include rules on competition, such as positive comity or substantive rules. Existing competition agreements fall outside the scope of the current WTO rules. RTAs (and bilateral agreements) notified to the WTO that include competition provisions, might perhaps be subject to the (currently largely ineffective) rules on RTAs in GATT Article XXIV and GATS Article V. But this would not provide access to information or co-operation procedures for non-signatories.³⁶

Again there is a need to differentiate between *de jure* and *de facto* provisions on *transparency*. Competition policy is by its nature case dependent and many national competition policies including the US are also based on a 'rule of reason' approach. In other words, a competition authority or court will judge whether a given business practice is a restraint on trade on a case-by-case basis. Some competition policies, such as the EU, are based more on *per se* prohibitions, with quantitative measures of what is, for example, market dominance. But for enforcement that uses rule of reason each case

will be different. There is therefore no analogy with the 'like product' concept in the GATT. For this reason the proponents of WTO rules appear to have conceded in the WGTCP that non-discrimination will have to be limited to *de jure* competition law.³⁷

Developing countries (DCs) argued in the WGTCP that they needed special and differential treatment and should, for example, be able to discriminate in order to defend national companies from more powerful multinational firms. DCs also pointed out that they are likely to have few companies large enough to acquire companies in developed markets so that the benefits of national treatment in cases of takeover, for example, were likely to accrue more to investors from developed economies. In the discussions a compromise based on listed exclusions from national competition policies appears to have been proposed.

Procedural fairness was another 'core principle' considered in the WGTCP and one that forms part of most international competition agreements. For example, should the parties in any case have an adequate opportunity to make representations to competition authorities once an investigation has been announced? Generally speaking DCs were concerned that any binding obligations (such as on the right to reviews or the right to a reasoned opinion) on procedure fairness would be too costly to implement. Developed WTO members argued such measures promoted best practice.

There were other proposals for core principles that were not really discussed due to a lack of broad support. These included for example; (a) enabling small firms to cooperate in order to enhance competition (a point that would be relevant for developing countries in the WTO); (b) the integration of anti-dumping under general competition criteria (a point championed by some WTO members, but one that was opposed by the US in particular); (c) provisions on restrictive practices resulting from the protection of intellectual property rights (favoured by some DCs)³⁸; and (d) the application of pro-

competitive practices in all policy areas, such as regulatory policies (an idea introduced by the US, but one that was seen as far too open-ended a commitment by DCs).

Also mentioned in the Doha text was the *substantive issue* of hard-core cartels. This is an area in which there is a broad measure on consensus, compared, for example, to vertical integration agreements. As noted above an OECD study suggested that hard-core cartels could have a considerable impact on DCs. No non-OECD countries have as yet taken up to invitation to sign up to the OECD Recommendation on Hard Core Cartels, but there is a debate within the UNCTAD 'Set' of the costs associated with such cartels for developing countries. At issue in the WGTCP was whether WTO members would be required to adopt legislation banning such cartels, what penalties should be applied and what scope there should be for countries *not* to act against such cartels on the grounds of more important national interest.

Co-operation in drafting laws and helping to promote the establishment of effective national competition authorities was largely uncontroversial. But this was another area in which the WTO discussions did not go beyond what was already being done elsewhere, such as in UNCTAD that has been promoting this kind of co-operation under the 'Set' for years. The new voluntary forums such as the OECD Global Forum on Competition and the International Competition Network also fulfil the function, which raised the question of the value-added of such general WTO rules. It has been argued that discussions within the WTO would be more effective because of the intrinsic link between trade, investment and competition policy. The WTO might also monitor the (systemic) impact of different regional and bilateral agreements, although this point does not seem to have been discussed in the WGTCP.

Cooperation on enforcement proved controversial in the WGTCP because it touches on regulatory autonomy. The issues here were whether co-operation should be

voluntary; should WTO rules provide for negative or positive comity; and should it be possible to decline a request for co-operation, perhaps with a reasoned justification? Countries with existing co-operation agreements wanted something more than best endeavours, but the ability to co-operate is clearly linked to the capacity and resources of the countries concerned. In the WGTCP there was a broad acceptance of this link and the need to provide technical assistance for DCs. Controversial was whether the provisions on co-operation should be covered by dispute settlement. As noted above the US has explicitly excluded competition/anti-trust from the dispute settlement provisions of NAFTA and other FTAs such as US-Chile. But the US has argued elsewhere against the precedent that any WTO rules would not be subject to the WTO Dispute Settlement Understanding.³⁹

The final topic identified in the Doha text was special and differential treatment (S&DT) for DCs. Currently 87 WTO Members have some form of competition policy, but clearly the importance of national competition policy differs. For example, small open economies are likely to need a different kind of competition regime (if they need one at all) to large relatively closed economies. It is clearly not a question of one size fits all.⁴⁰ Various options for accommodating DC interests were considered in the WGTCP. These included scheduling sector exclusions from any competition rules analogous to the GATS approach, providing long transition periods before any obligations would have to be met, or concluding a plurilateral agreement within the WTO. The latter is an approach debated in the EU for some time.⁴¹ Here there are analogies with the US approach on investment, although in the case of competition in the WTO, the EU argued for a plurilateral agreement *within* the WTO, where plurilateral agreements under Annex IV still need to be approved by all WTO members.

Finally, S&DT for DCs could take the form of technical assistance. Surveys conducted within the framework of the OECD's Global Competition Forum suggested that there was wide spread recognition of the need to provide more technical assistance for the development of competition policies in developing and transition economies.⁴² At issue was how to ensure that commitments on technical assistance could be made more concrete. In the past many such provisions in WTO agreements have been more rhetorical than real.

7.5.5 UNCTAD

With the failure to agree on inclusion of competition in the WTO, the UNCTAD remains the only multilateral organization formally discussing competition although the OECD's Global Competition Forum and the (US Department of Justice inspired) International Competition Network (ICN) also provide forums in which national competition authorities and experts exchange information on developments.⁴³ The ICN started with 16 member competition agencies and expanded rapidly to 85. Cooperation takes place in various working groups with overall steerage coming from an annual conference. The various working groups produce nonbinding guiding principles on a range of competition topics. (Evenett, 2004)

The UNCTAD work under the 'Set' continues. Indeed, this 'soft' approach to policy harmonization and cooperation appears to be the prevailing method in the early 2000s. As the review of work on the 'Set' has put it in *'intensive discussionssuch as in WTO, UNCTAD, OECD and the World Bank on the need to create, encourage and protect competition at the national, regional and international levels, consensus has gradually been building regarding the need for all countries – developed as well as developing countries, LDCs and economies in transition – to adopt and effectively*

implement competition law and policybut that there is “no one size fits all” solution in competition law and policy – that national competition laws must be tailored to the actual needs of developing countries, taking into account their level of development, social and economic conditions, political priorities and so on. ‘ (UNCTAD, 2005)

UNCTAD also appears to be moving towards a view that anti-competitive practices have major negative effects on DC growth and development, and that while efforts are needed at the domestic level in terms of adopting national competition policy and law, close cooperation will be needed at the international level if such RBPs are to be effectively addressed. This appears to be based on the evidence that countries without adequate competition rules or countries that are not engaged in international co-operation on rule enforcement could be adversely affected by cartels. (Evenett 2004)

7.6 Conclusions

As with the other chapters there is clearly evidence of multi-level rule-making in competition policy. As in the case of investment the failure of the ITO was followed by talks in GATT that led nowhere. The vacuum was then filled by work in the OECD. Again analogous to the case of investment the OECD approach provided the model for bilateral agreements. But in the case of competition these came later and focused on transparency and ‘co-operation in enforcement.’

A regional alternative model was developed in the shape of the EU. As in the cases of TBT and to a lesser degree procurement, the EU developed a clear comprehensive set of rules in competition policy perhaps in part thanks to a clear EC competence. Nevertheless it took thirty years for the comprehensive EU rules to be developed and implemented.

Contrary to the cases of TBT and public procurement, but similar to the case of investment the years of multilateral negotiations between the mid 1980 and the mid 1990s had little impact on competition rule-making. With no significant multilateral negotiations on competition topics apart from subsidies, where the evolution of EU rules clearly shaped the WTO Subsidies and Countervailing Duty Agreement, the OECD remained the main forum. OECD rules continued to evolve during the period and advances in OECD codes on co-operation were then implemented in bilateral agreements on enforcement co-operation. The most important of these being the US-EU agreement(s) of 1991 (1995).

The EU also continued to develop its comprehensive model during the 1980s. EU rules for public enterprises were codified and applied, and merger control rules adopted. The EU also began to extend the application of this comprehensive model to the EEA and the accession states to the EU in central and Eastern Europe.

The position after the mid 1990s has not changed much. The OECD has continued to develop its codes on co-operation and these have been implemented in bilateral agreements. There was another US-EU bilateral in 1998 that provided for enhanced positive comity. If anything the US has been more active negotiating bilateral enforcement co-operation agreements after 1995. At the same time the EU sought to promote comprehensive rules on competition within the WTO and included competition in its comprehensive agenda for the millennium round/Doha Development Agenda. Given the lack of support for inclusion of competition the EU contemplated plurilateral rules on competition in the WTO from the outset of its efforts in the context of the DDA. The EU also included competition provisions in its post Uruguay Round FTAs, but as in the case of investment it did not press these on its trading partners. Given that there is clear European Community competence in competition, this suggests that the lack of

much pressure for rules in EU FTAs is not only a competence issue as the investment case study suggested.

In the period since the mid 1990s a third open forum voluntary approach has emerged. The voluntary approach has of course, been followed by UNCTAD since the early 1980s, but it was given more impetus by the creation the Global Competition Forum and the International Competition Network. The latter must be seen at least in part as the DoJ's effort to keep the discussions on competition on a voluntary basis and off the trade negotiators agenda.

One distinctive feature of the competition case is the absence of any US interest in international rules on competition/anti-trust. The US has not supported the idea of including competition in the WTO. Following the NAFTA model it has included very little on competition in its FTAs and has explicitly excluded competition from any FTA dispute settlement rules, which is at odds with the US policy of emphasizing effective enforcement. The US has preferred to retain national policy autonomy and promote co-operation between competition authorities in the OECD and bilateral agreements to any substantive rules on competition.

The main reason for this is that the US has for many years pursued a policy of extraterritorial application of US anti-trust legislation to reconcile the internationalization of markets and the constraints of national jurisdiction. Another reason is the defense of its competence in international anti-trust policy by the US Department of Justice, that has sought at all times to keep competition out of trade negotiations.⁴⁴ The US is opposed to harmonization or approximation of policies because it believes that anti-trust policy must evolve as markets change and that signing up to agreed international rules will lock-in policies that may be inappropriate in a few years. In the absence of US interest in WTO rules on competition the EU has had little success in its pursuit of that agenda.

The impact of RTAs on multilateral rules has therefore been fairly limited. There have been few substantive rules at a regional level. Enhanced transparency and the EU competition rules have brought about more effective controls on state subsidies and public enterprises than had been achieved by multilateral rules. So in this respect the EU competition rules have facilitated trade for signatories and for third country suppliers alike. Much the same could be said for the EU rules on cartels and abuse of market dominance as well as merger controls, which have helped to maintain open competitive markets. But the 'regulatory safeguards' built into these rules means there is still scope for national governments to claw back some policy discretion should they wish to pursue national champion strategies.

The EU has had little systemic impact beyond a tendency for a range of other regions to emulate the general EU policy approach. Thus ANZCERTA, COMESA, CARICOM and other regions have looked to the EU as a model in terms of their own regional rules. But these are in the early stages of development.

This brings us to the comparison of the EU and US approaches. The EU approach as described above has been to develop a comprehensive set of rules. This has been developed over decades and includes important elements of *per se* rules. The supranational competition authority in the shape of the European Commission has real power, even if there has been some delegation of responsibilities back down to the national competition authorities. This EU model has been applied to the EU's accession states and those states that are effectively part of the single European market (i.e. the EEA states). In line with the general EU policy of closer links with its near neighbours the Association Agreements with the EU's Euro-Med partners also envisage the progressive approximation of competition policies in these states to EU law and jurisprudence on competition.

This contrasts with the US approach to competition, which has been to eschew international agreements and retain national policy autonomy, while promoting cooperation in enforcement.

Chart 7.2 Criteria for non-actionable state subsidies under EU and WTO rules

	European Union Policy	Outcome of Uruguay Round
Regional subsidies	Activities in regions with levels GDP per capita at less than 85% of the European Union average and unemployment at 110% are no-actionable	The region must be defined by clear criteria including economic criteria based on at least one of the following factors; GDP per capita not above 85% of the average for the territory and/or unemployment at 110% of the average
Research and Development	50% ceiling for fundamental research and progressively less for more market oriented R&D	70% for 'industrial research' which is research aimed at discovery of new knowledge and 50% for pre-competitive R&D aimed at translating 'industrial research into new products
Environmental research	Ceiling of 15% of total investment	20% of total investment

Chart 7.3 Policy approximation model

	European Union	Euro-Med Association Agreements	EU-Chile	EU-South Africa
Coverage	horizontal exclusions (i.e. specific activities such as crisis cartels and R&D cooperation)	not applicable	not applicable	not applicable
Transparency <ul style="list-style-type: none"> • Laws • Secondary instruments • Notice investigations 	<p>all laws and secondary measures to conform to EU law</p> <p>all agreements must be notified or they are null and void</p> <p>transparency obligations for state subsidies</p>	<p>not applicable</p> <p>transparency for state subsidies</p>	<p>notification of investigations that affect trade</p> <p>transparency in state subsidies</p>	notification of investigations
Non-discrimination <ul style="list-style-type: none"> • National treatment • MFN 	n/a	n/a	n/a	n/a
Substantive provisions <ul style="list-style-type: none"> • Requirement for national competition policy • Ban on hard core cartels • Rules on horizontal and vertical RBPs and mergers • Ban on state subsidies • Control of public monopolies 	<p>prohibition of agreements or abuse of dominance that restricts intra EU trade</p> <p>merger control shared between EU and national levels</p> <p>ban on subsidies but exceptions</p> <p>public monopolies and enterprises covered</p>	<p>progressive approximation to EU laws and practice in competition but no deadlines</p> <p>ban on state subsidies but infant industry exceptions for Meda partners</p> <p>technical assistance</p>		<p>RBPs are 'incompatible' with the TDCA</p> <p>requirement for national competition authorities to act against RBPs</p>
Cooperation <ul style="list-style-type: none"> • Policy • Enforcement through negative or positive comity • Due process • Technical assistance 	<p>joint enforcement by European commission and member states</p> <p>procedural rules subject to review by European Court of Justice</p>	<p>general provisions on cooperation</p> <p>Association Council assesses progress</p>	cooperation in enforcement with negative comity	<p>consultation on investigations</p> <p>positive comity</p> <p>specific provisions on technical assistance</p>
Dispute settlement	direct effect under EU law	consultations in Association Council	not subject to dispute settlement	under Association Council
Regulatory safeguards	competition based policy with exceptions for agreed objectives e.g. coop on R&D	significant scope for policy space for Meda states		

Chart 7.4 Cooperation in enforcement approach

	OECD	UNCTAD	US-EU
Coverage	exclusions <ul style="list-style-type: none"> • sectors such as aviation and shipping • R&D consortia • crisis cartels • regulated monopolies 	no provisions	no substantive rules so no exclusions, competition defined broadly for cooperation purposes
Transparency <ul style="list-style-type: none"> • Policy • Secondary Instruments • Notice of investigations 	peer reviews on national policies	no provisions	notification of investigations that affect the other party
non-discrimination	n/a	n/a	n/a
substantive rules	recommendation on ban on hard core cartels	no obligations but countries are urged to consider adopting UNCTAD model law flexibly	no provisions
Cooperation	peer review of policies negative and positive comity in investigations	exchanges of information on policy developments in competition technical assistance of all kinds	twice yearly meeting of comp. authorities to discuss developments consultations to resolve conflicts coordination and synchronisation of investigations enhanced positive comity
dispute settlement	conciliation mechanism but has not been used	UNCTAD International Group of Experts explicitly proscribed from any mediation	no recourse to reviews or dispute settlement
regulatory safeguard	policy freedom subject to peer pressure	full policy freedom	

Endnotes

¹ Another reason for the lack of support was that, with the exception of the United States and West Germany few GATT Contracting Parties had national competition or anti-trust policies. Indeed, many countries still saw the need for greater concentration or rationalization of production in industry in order to promote international competitiveness.

² In the 1970s the growth of investment by multinational companies had created some concern among developing countries that these companies might abuse their market power. These concerns shaped the discussion in UNCTAD on restrictive business practices.

³ For general background on the debate see for example, Graham and Richardson, 1992; OECD, 1984; Mavroidis, 1994; Consumers International, 1995; Nicolaidis 1994; Jacquemin, 1995; Hauser 1994; Messerlin, 1994.

⁴ See *Experiences gained so far on international cooperation on competition policy issues and the mechanisms used* revised Report for the UNCTAD Secretariat, UNCTAD TD/B/COM.2/CLP/21/Rev.1 12 April 2002.

⁵ Quoted in WTO Annual Report 1997, Chapter 4 Special Study on International Competition Policy

⁶ These were: (a) price fixing or agreements on terms and conditions of supply of a product; (b) agreements to exclude suppliers or allocating markets between suppliers; (c) discrimination against particular enterprises (d) limiting production or fixing production quotas; (e) agreements preventing the development of particular technologies; and (f) unjustified or unlawful extensions of patent or intellectual property rights. See Article 46 bis ITO.

⁷ BISD 9S 28-29

⁸ See Ernst-Ullrich Petersmann 'Competition Rules for Governments in the GATT/MTO World Trade and Legal System', paper for St Gallen conference on Competition Policy in International Trade, September 1993. This also includes a detailed discussion of the elements of competition policy embedded in the Uruguay Round agreement.

⁹ See Catherine Distler 'Convergence and Conflicts over Competition Law', in *Conflict, Competition and ... Cooperation* Promethee Vol I No 15 January 1991.

¹⁰ The legal basis of the agreement concluded by the Commission was found to be contrary to European law, so the agreement was subsequently concluded between the European Community and the US in 1995.

¹¹ US anti-trust policy is based on a rule of reason approach in which US statutes are applied on a case by case basis by the Department of Justice and the US courts. This contrasts with the EU approach, which although also based on similar principles to those of the US Sherman Act, has evolved into a per se system. In other words specific criteria for competitive markets are used such as a given percentage of the reference market as a measure of market dominance. EU competition law and policy was also driven by the desire to ensure that restrictive practices do not restrict intra EU trade and investment

¹² In August 1994 the European Court of Justice struck down the agreement on the grounds that the European Commission, in concluding it, had exceeded its competence. This resulted in a revised legal form for the agreement, but the objectives and content will remain essentially unaffected.

¹³ Formerly Articles 85 and 86 EEC

¹⁴ Formerly Art 90 EEC

¹⁵ This defined the subsidy element in any injection of public capital into a public enterprise as the difference between the cost of capital provided and the market economy rate.

¹⁶ The member states opposed to the use of Article 86 (TEC formerly Art 90 EEC) argued that the move

represented a new policy and should therefore be agreed by the member states in the Council of Ministers. The Commission argued that it was merely implementing the provisions of the Treaty and therefore had powers to act alone.

¹⁷ Community Framework for State Aid for Research and Development Official Journal 1986 C83.

¹⁸ This approach was included in the draft agreement on subsidies and countervailing duties produced by the chair of the negotiating group on subsidies and countervailing duties, Cartland in 1990.

19. The Treaty of Paris, on coal and steel, included a supranational merger control instrument, in part, for political reasons. Steel was then a strategic industry and experience with the major German steel combines influenced the thinking behind this provision of supranational control.

20. See for example US International Trade Commission, *1992 The effects of Greater Economic Integration within the European Community on the United States* First follow-up report, March 1990, at Chapter 9.

²¹ According to the effects doctrine any restrictive measures that affect intra EU trade fall under EU competition rules, even when these action take place entirely outside the EU.

22. See for example Article 33 (EA 63) of the Interim Agreement with the CSFR *Official Journal* L 115 30 April 1992.

²³ See Estrin and Holmes 1998 on the role of competition policy in the Europe Agreements and EEA.

²⁴ Agreement between the Government of the United States of America and the Commission of the European Communities on the Application of Their Competition Laws (Washington, D.C., 23 September 1991; entry into force, 10 April 1995).

²⁵ For a comprehensive discussion of the elements of competition in the WTO rules see (OECD, 1998a).

²⁶ There is a significant literature on the pros and cons of the application of WTO dispute settlement to competition issues, which for reasons of space cannot be discussed here. (OECD, 1994)

²⁷ The OECD definition of hard-core cartels is agreements that fix prices, rig bids, allocate markets between suppliers and set output restrictions.

²⁸ See OECD *Draft Report on the nature and impact of hard-core cartels and the sanctions under national competition laws*, Paper for the Global Competition Forum, 2001 CCNM/GF/COMP(2001)3 2 October 2001.

²⁹ Charles James US Assistant Attorney General, Anti-trust Division, US Department of Justice before the OECD Global Forum for Competition October 2001 (www.usdoj.gov/atr/public)

³⁰ See also Hoekman 1996 for an early discussion of the issues.

³¹ The US Department of Justice has promoted the Global Competition Dialogue between competition authorities.

³² For an early debate on the issue from a legal perspective see Petersmann 1993 and from a trade perspective Blackhurst 1994.

³³ For a critical review of the benefits of including competition in the WTO from a practitioner perspective, see for example Marsden v 2003.

³⁴ See the Annual Reports of the Working Group WT/WGTCP/M 17-20

³⁵ See WTO (2002) Report of the Working Group on The Interaction between Trade and Competition Policy to the General Council WT/WGTCP/6

³⁶ OECD countries can of course make such requests within the OECD framework, but there do not seem to be many viable options for non-OECD countries.

³⁷ See for example Communication from the European Community and its Member States A Multilateral Framework Agreement on Competition Policy, submitted to the WGTCP, WT/WGTCP/W/152 25 September 2000 pg 6

³⁸ This would presumably entail an elaboration or interpretation of the existing provisions on competition in the TRIPs agreement.

³⁹ For example, in the debate on public procurement where the US argued for transparency rules to be subject to dispute settlement.

⁴⁰ See Communication from the European Community and its Member States op cit.

⁴¹ See for example *Report of a Group of Experts Competition Policy in the New Trade Order: strengthening international co-operation and rules*, European Commission, 1996 and European Commission proposal to the 133 Committee of the EU on modalities for negotiating competition policy in the WTO, Quoted in OECD supra.

⁴² OECD Secretariat Paper for the Global Competition Forum February 2002 *Experiences of OECD outreach and Members Technical Assistance Activities in the 1999-2000 period* CCNM/GF/COMP (2000)4 31 January 2002

⁴³ International Competition Network was established in 2002 as a result of a US initiative following the findings contained in the ICPAC Report released by the US Department of Justice in June 2000, which had called for a “global competition initiative”, with the idea that countries might be prepared to cooperate in meaningful ways but were not necessarily prepared to be legally bound under international law. The ICN is basically a network of competition authorities that exchange experience and knowledge on practical competition concerns, focusing on improving worldwide cooperation and enhancing convergence through dialogue. So far, the ICN has held four annual conferences (in 2002, 2003, 2004 and 2005), and its next conference will take place in Cape Town (South Africa) in 2006.

⁴⁴ It is worth mentioning that the two cases in which the US has been very active in pressing for multilateral rules have been those in which the EU has been relatively weak, namely investment and to some extent public procurement. In the two cases in which the EU has had a strong alternative to the US approach to rule-making, namely TBT and competition the US has shown much less interest in stronger multilateral rules.

Chapter Nine Conclusions

8.1 The importance of rule-making

Three of the policy areas covered by the case studies are what have been dubbed 'Singapore issues,' in other words topics placed on the WTO agenda at the 1996 Singapore ministerial meeting. The three issues concerned (transparency in public procurement, investment and competition) were subsequently dropped from the Doha Development Agenda at the time of the Cancun WTO ministerial meeting in 2003. What does this rejection of the three issues by the DDA mean?

This thesis is not about the Singapore issues or the pros and cons of including them on the DDA. It is about the role of RTAs in rule-making in trade and investment, and it has shown that for a range of policy areas, including in procurement, investment and competition, rule-making has been an enduring topic in the broad trade policy debate since the late 1940s if not before. What has changed has been the level at which rule-making has taken place. Indeed, as illustrated throughout the thesis, rule-making is a multi-level process. The exclusion of the Singapore issues from the DDA shows that the current multilateral agenda has modest objectives. Indeed, compared to the previous Uruguay Round, the DDA is unlikely to produce more than modest results all round not just in rule-making. The exclusion of the Singapore issues from the WTO agenda therefore means that rule-making on these and other policy issues will continue on other levels. This is what one would expect given the history of rule-making and it is indeed the reality as the case studies all show.

Rule-making will therefore continue to shape the trading system. In fact as tariffs and other immediate barriers to market access become relatively less important, rule-

making will assume central importance in the trading system unless there is a shift back towards overt protectionism at the border. Tariff and other market access preferences have a limited 'half life' and will be subject to preference erosion if the kind of progressive liberalization that has occurred over the past 40 years continues.¹ But are rules subject to the same process of erosion?

Rules embody preferences anchored in statutory measures, secondary instruments and regulatory practice that reflect a deep-seated consensus or at least a *modus operandi* in the markets concerned. When these preferences are included in regional, bilateral or plurilateral rules they may be less subject to erosion than the more transparent tariff preferences. Rule-making on these other levels is thus likely to have a more enduring and longer term impact on the trading system than tariff preferences. It is therefore important to know more about the role of RTAs (and bilateral agreements) in rule-making.

8.2 Rule-making is a multilevel process

The case studies support the thesis that rule-making is a multi-level process and always has been. In the case of TBT there were very general and largely ineffective rules at the multilateral level based on non-discrimination. The OECD discussed TBTs, but it was really at the regional level, and in particular the EU, that rules on TBTs were developed. These rules sought a more sophisticated middle ground between ineffective non-discrimination principles and harmonization. The approach developed, including mutual recognition and the use of agreed international standards to show compliance with regulations, was then adopted at the multilateral level in the WTO.

Public procurement was discussed in preparation for the Havana Charter of the ITO but rejected. Subsequent discussions in the GATT also led nowhere, so the issue was taken up at the plurilateral level in the OECD. The framework rules developed in the OECD were then transferred to the multilateral level in the GATT negotiations of the Tokyo Round, but faced difficulties at this level because of the desire to build reciprocity into the rules. In the 1980s the regional level took up the framework rules developed in the OECD and GATT and developed them further with respect to coverage and enforcement. These advances at the regional level were then incorporated into the plurilateral rules in the WTO.

Investment is probably the clearest case of an international regime being established as a result of a patchwork of bilateral, regional, plurilateral and multilateral rules. The repeated attempts to establish international investment rules failed in the 1930s and 40s. As a result the bilateral level was used for investment protection in the 1950s, and the plurilateral OECD level for investment liberalization in the 1960s and 1970s. The regional level in the shape of NAFTA then brought protection and liberalization together in a comprehensive investment agreement, although rule-making also continued on other levels. The comprehensive NAFTA model has subsequently found application in a network of FTAs.

In the case of competition the failure of the ITO also ultimately resulted in work being carried out at the plurilateral level in the OECD. The 'co-operation in enforcement approach' developed in the OECD then found application in a series of bilateral agreements. An alternative comprehensive model for competition rules was developed at the regional level in the EU, but this has not (yet) found widespread application outside

of the EU agreements with its immediate neighbours, despite the EU's effort to include competition in the more binding WTO framework. At the same time the 'soft' rules co-operation approach is finding application in various global dialogues on competition.

The interaction between levels of rule-making has not been a one way process. A typical sequence has been attempts at multilateral rules followed by plurilateral rules developed in the OECD that have then found application in the GATT/WTO before being further developed at the regional level. But it would be more accurate to say that the various levels are in a state of flux. It is not that rule-making in a particular policy area is assigned to a level and then remains there. The focus of rule-making can progress through the bilateral and plurilateral levels to the multilateral level and then 'regress' back to the regional or bilateral level.² Even stringent rules established at a multilateral level, such as the TRIPs and SPS rules in the Uruguay Round are subject to erosion as shifting preferences and interests exploit 'regulatory safeguard' provisions to promote regional preferences that are not easily accommodated under the multilateral rules. The historical evolution of rule-making suggests that there is no simple division of labour between levels. If there is a form of global subsidiarity it is rather more complex and includes the processes by which aspects of rule-making move between levels.

Given this state of flux it is still possible to identify some general trends that are relevant to the current debate. In the 1960s and 1970s the OECD played an important role in rule-making. It provided the forum for (relatively) like-minded negotiators to develop common approaches to rules and for agreeing on framework rules of a greater or lesser degree of detail. These framework rules were then incorporated into multilateral negotiations. This was the case for TBT and procurement in the 1970s and was also the

case for services, intellectual property and investment in the 1980s. The OECD continued to be the forum in the 1990s for investment and competition, but with less success.

Broadly speaking the regional level was more important in the 'second phase of regionalism' from the mid 1980s to the middle of the 1990s. This relative increase in importance went hand-in-hand with the comprehensive multilateral level negotiations during the Uruguay Round. These ongoing multilateral negotiations facilitated a synergy between the regional level negotiations, which in any case based their approach to rule-making on the framework rules developed in the OECD, and the multilateral level. This synergy existed because those negotiating regional agreements made considerable efforts to ensure that RTAs were consistent with the emerging multilateral rules.

After the end of the Uruguay Round there has been a shift towards a greater emphasis on bilateral agreements or FTAs that are in practice bilateral agreements. Indeed the vast majority of FTAs notified to the WTO since the end of the Uruguay Round have been bilateral agreements. Rule-making or at least discussion continues on other levels. For example, the OECD has continued to be the forum in which common approaches to competition policy have been developed. The WTO negotiations on services have a bearing on investment and competition, and regional initiatives such as the FTAA are still (just about) alive as are efforts to negotiate region-to-region agreements such as in the case of the EU. But with no comprehensive or ambitious work at the multilateral level on rules there has been no mutually reinforcing synergy between RTAs/FTAs and multilateral rule-making.

The reasons for the increased importance of regional agreements in rule-making are not the subject of this thesis and cannot be covered comprehensively, but it is possible

to indicate a number of reasons. First, there is the difficulty negotiating rule-making at the multilateral level due to the presence of a larger number of WTO members expecting to have a real say in the nature of the rules. The Single Undertaking approach to trade negotiations adopted in the Uruguay Round, means there has to be a much wider consensus on rules than before. During, previous rounds the variable geometry of the GATT in the shape of Part IV, the enabling clause and qualified MFN codes of the Tokyo Round had enabled framework rules to be adopted. The Single Undertaking also makes it difficult, if not impossible, to separate negotiations on rules from market access negotiations. Whilst multilateral rounds may be unavoidable for 'market access' issues, linking market access with rule-making has led to suboptimal results and should be reconsidered. This topic is picked up again in the discussion of prescription.

Second, the plurilateral level of rule-making, which was dominant in the period up to the 1990s has lost much of its viability. The OECD as the archetypal 'club model' can no longer develop approaches to rule-making and expect them to be taken up in multilateral negotiations in the way they were in the period up to the 1990s. Developing countries are no longer ready to accept the integration of framework rules developed in the OECD into the multilateral WTO. With weak plurilateral and multilateral rules, regional or bilateral routes to establishing rule-making becomes the only alternative, short of unilateral imposition of rules.

A possible third reason for the shift to regional and then bilateral/FTA levels is that the US now sees this level as more important. Although the US has always negotiated on multiple levels, it placed greater emphasis on the multilateral - or perhaps as a second best option - plurilateral levels through much of the post 1945 period. But

faced with competition from a viable alternative approach to rule-making in trade and investment in the shape of the EU³ and the difficulties reaching agreement in the WTO, the US has placed more emphasis on the bilateral approach since the late 1990s. The same argument can be made for the EU, although, with the exception of potential accession states, the EU has been less aggressive in pushing for a particular model of rule-making in bilateral FTAs or in its region-to-region negotiations. The EU policy on FTAs and RTAs appears to have been driven more by the timing of negotiations, which was largely determined by wider political events (e.g. the end of the Cold War) than any strategic view of the relative merits of different forums or levels.⁴

8.3 The impact of RTAs

Before discussing the impact of RTAs and FTAs it is important to be clear on what are the positive and negative effects. The analytical framework in chapter three provides the basis for making a qualitative judgment on this question.

8.3.1 What are positive and what negative effects of RTAs?

First of all, rule-making at the regional level will tend to have positive effects if the preference is limited and trade facilitation effects of the RTA outweigh trade restrictive effects. (see chapter two) Using the typology of the elements of rules set out in the analytical framework it is possible to provide a straight forward qualitative assessments of these effects for RTAs and FTAs in any policy area. A preference will be created when the *coverage* of regional rules exceeds that of the WTO (or other international rules).⁵ This can take the form of greater coverage of sectors, regulatory

entities or regulatory instruments. Such a preference will, however, be subject to erosion provided multilateral negotiations result in an extension of the multilateral coverage.

Transparency and co-operation provisions are least likely to represent a form of preference, but will facilitate trade and investment by promoting competition and regulatory best practice. Therefore rules that emphasis such procedural measures are likely to be positive. Transparency promotes better regulation by establishing clear non-discriminatory criteria for regulation and helping to ensure that regulators hold to these criteria. More objective, consistent regulatory practices then facilitate trade and investment because suppliers are more likely to seek to enter a market when the regulatory framework is predictable. The greater competition that ensues also helps to promote economic growth within the region, which, in turn has positive growth effects for third parties as well as the region concerned.

Equally, RTA rules that facilitate trade and investment by replacing divergent national rules, but do not set the common regulatory norms or standards at such a level as to restrict competition from third parties, will also be beneficial. Those that set high standards could on the contrary restrict trade and investment. As a general rule of thumb, RTAs in which *substantive provisions* are consistent with generally agreed international standards will pose no systemic threat, whereas RTAs that go significantly beyond the prevailing agreed rules pose more of a risk. The balance of benefits on common substantive rules must however, be assessed case by case since some common rules will be beneficial for all parties and some will favour certain parties (e.g. suppliers in developed economies) over others.

An assessment of the use of *regulatory safeguards* must also be undertaken on a case by case basis. The use of these instruments at a regional level can mean more open, liberal economies if the exceptions and exclusions from the rules are more tightly defined than at the multilateral level. However, looser disciplines at the regional level may result in the use of such safeguards to restrict trade or investment. The use of regulatory safeguards may also have a systemic effect if they provide scope for interpretations of rules at the regional level that diverge from the WTO interpretation.

Jurisprudence or precedents set in the *implementation* of RTA rules might thus take an RTA/FTA beyond generally agreed international norms (or the interpretation of equivalent rules in the WTO).

Regional rules that complement multilateral rules can be seen as positive. RTAs will therefore be positive if they implement multilaterally agreed principles, but do so more effectively. Often however, regional initiatives are likely to be developed alongside wider multilateral rules. Here they could be said to be complementary if there is synergy between the two levels of rule-making in which developments on one level enhance progress on the other level. On the other hand, RTAs/FTAs pose a systemic risk if they serve narrow vested interests by seeking to strengthen relative gains for one party over another rather than seek to establish an agreed framework of rules from which all can benefit.

In the past rule-making has been closely linked to market access and thus the interests of specific sector interests. For example, the TRIPs agreement clearly served a narrow set of interests and as a result has not achieved a sustainable balance between the interests of the owners intellectual property rights on the one hand, and those seeking

access to IP on the other, such as consumers of products or medicines. (Meir, 2006) Rule-making initiatives to curb subsidies and to promote liberalization of public procurement markets may also serve narrow sector interests if the aim is market access for specific suppliers rather than economic benefits for all parties. (see chapter five) The fact that vested interests captured multilateral rule-making in, for example, IPR and to a lesser extent public procurement, illustrates that the threat of such malign rule-making is not just one at the regional level.

Rule-making in RTAs/FTAs can also have negative systemic effects if it represents 'regulatory regionalism.' Regulatory regionalism occurs when regional or bilateral rules go beyond the existing agreed (WTO) rules, either in terms of substantive provisions or how the rules are interpreted. If the regional approaches to rule-making then diverge, RTAs could be used to promote the competing approaches. This is for example, the case with the European and US/North America approaches to rule-making in the field of SPS, where the EU and US (and Canada) are competing to establish a global norm for the regulation of biotechnology by having their respective approaches included in the FTAs (and other agreements such as the Bio-safety protocol) they negotiate. (Isaac, 2006) Regulatory regionalism may also take the form of divergent interpretations of the general principles or rules adopted in the WTO. This has indeed been the case with precaution in the SPS rules.

8.3.2 The impact of regional/bilateral agreements

Regional agreements had a broadly positive impact during the second phase of regionalism. After the mid 1990s, however, the position is less clear with some negative developments emerging.

This thesis confirms that regional agreements, during the period between the mid 1980s and mid 1990s, had on balance, a positive effect. In terms of the impact on third parties, regional agreements did not constitute much by way of a preference. National preferences were generally not replaced by regional preferences. Rules were mostly in line with existing WTO rules and when they did go beyond the WTO this was predominantly in terms of coverage, closer cooperation, enhanced transparency and 'due process' rather than substantive measures. (see also Sampson and Woolcock, 2003)

This finding is consistent with the view that deep integration will be less discriminatory, but at odds with the image of conflicting rules suggested by Bhagwati's spaghetti bowl analogy. Bhagwati's analogy, which has been picked up and accepted by many writers, (e.g. UNCTAD, 2004a) is in fact based on his assessment of preferential rules of origin. In this respect it is certainly appropriate. There is little doubt that divergent rules of origin, which filled the vacuum left by the absence of agreed international rules of origin, have created additional complications and costs for third parties.⁶

But the spaghetti bowl analogy does not necessarily apply to other areas of rule-making. The case studies in chapters four to seven show that in most cases there is not a tangle of different rules. Indeed, if there were to be a pasta analogy it would be one of 'lasagna' rather than spaghetti. In other words rule-making made up of layer upon layer of developments at different levels.

Comparing the 'second phase' of regionalism with the period after the end of the Uruguay Round one comes to a less positive or at least a more qualified judgment on the impact of RTAs/FTAs. Bilateral FTAs have become far more prevalent and these show signs of going beyond existing international rules in some areas of substantive rule-making. There have also been signs of active forum shopping in order to press narrow sector interests rather than use the regional or bilateral agreements in a path-finding role or as models for future multilateral approaches. In other words the synergy between the regional/bilateral level and the multilateral level has been weakened. (Woolcock, 2006) These findings on the impact of RTAs/FTAs in the 'second phase' and the post Uruguay Round phase can be illustrated by examples from the case studies.

The TBT case study in chapter four shows how regional initiatives, and in particular the EU's programme led to a rejuvenation of work on TBT rules at the international level. Regional measures led to a greater awareness of the importance of TBTs and hence to more resources being devoted to rule-making in this area. This in turn contributed to more capacity, not only to negotiate rules and international standards, but also to implement the rules. The EU activism also resulted in other countries devoting more resources to negotiating international rules so as to contain the emerging EU 'hegemony' in standards making and rule-making in TBTs in general.

The rules that emerged at the regional level led to significant improvements in transparency compared to the failing multilateral rules. More sophisticated approaches to tackling TBTs using mutual recognition and/or equivalence emerged to replace the ineffective non-discrimination based rules of the GATT. These more sophisticated approaches then found their way into the WTO rules. There were also explicit linkages

made between regional rule-making and international rules, such as in the case of EU level standards work being linked explicitly to the work in the ISO and IEC. As this involved cooperation between levels before regional level standards were adopted, it contributed to a positive synergy between the regional and international levels. Finally, the regional level measures facilitated trade by replacing multiple national technical regulations, standards and conformance assessment rules with common rules or avoiding the restrictive effect of such rules with mutual recognition.

This positive momentum in the TBT field was mostly driven by EU rule changes during the second half of the 1980s. After 1995 some of the positive impetus has gone, but equally neither regional nor bilateral rules are undermining the international approach significantly. Bilateral mutual recognition agreements have not proliferated. Some 30 have been agreed, but these have to date not yet created the kind of two tier system that some had feared. (Baldwin, 2000) The picture in SPS after the Uruguay Round agreement is rather different. Despite stringent multilateral rules on SPS measures there has been a trend towards regulatory regionalism with a clear divergence emerging between the EU and the North America on the interpretation of the WTO Agreements on SPS measures.

Chapter five shows that in the case of public procurement during the second phase of regionalism there was also a close synergy between the regional and in this case the plurilateral levels of rule-making in the GATT that led to the strengthened Government Purchasing Agreement (GPA) of 1994. The development of regional level rules enabled an increased coverage of the GPA. Regional initiatives also strengthened the transparency rules, something that in the case of PP makes a far more important

contribution to better regulatory practice than prohibitions of *de jure* preferences. The regional level rule-making in PP did not go beyond the existing rules with regard to substantive rules. For example, the framework rules set out in the GPA have been the basis for all the RTA rules in this field. But regional rule-making did strengthen enforcement procedures by introducing bid-challenge rules that were subsequently used in the GPA.

In the post 1994 period the tendency has been to use FTAs as a means of extending the number of countries that effectively comply with the GPA or GPA equivalent rules. The WTO negotiations of the 1990s failed to increase the number of signatories to the GPA. This was the one area in which there was no progress. But subsequently both the EU and the US have made compliance with GPA rules a condition of many FTAs. As a result countries that refused to sign the GPA have now agreed to comply with equivalent regional/bilateral rules. As the major impact of the GPA rules is to enhance transparency, this has not created significant new preferences, but promises to contribute to better procurement practices. This extension of rules through asymmetric bilateral FTAs is less than ideal, but at least the framework rules are based on plurilaterally agreed rules and not simply dictated by the mercantilist interests of the dominant 'hub.' Negotiations on coverage of procurement rules are, however, likely to be driven by reciprocity and/or mercantilist interests.

The investment case study discussed in chapter six does not support the case for synergy between the regional and multilateral levels, because there were no comprehensive negotiations on investment at the multilateral level during the second

phase. The analogous case of services, that has been discussed elsewhere, does however, show a close synergy. (Ullrich, 2006)

Regional rule-making, in particular in the form of NAFTA, led the WTO-plus rules during the second phase of regionalism. Coverage of the NAFTA was greater than the plurilateral OECD investment rules and the GATS, both of which used positive listing rather than the more liberal negative listing of NAFTA. NAFTA also introduced pre-investment national treatment to take the application of non-discrimination principles further. On substantive provisions the NAFTA created a comprehensive investment agreement including both liberalization and investment protection. NAFTA banned more performance requirements than the TRIMs, introduced *de facto* expropriation and investor-state dispute settlement in an FTA for the first time.

In the post Uruguay Round period FTAs have been used to extend the NAFTA regional model of a comprehensive investment agreement to more and more countries. This has been done through the US centred FTAs, but also through emulation of NAFTA by countries such as Mexico, Chile and Singapore in their south-south FTAs. In investment therefore, there has been little positive synergy between the regional/bilateral level and multilateral investment rules. The willingness of countries to sign up to FTAs with comprehensive investment rules appears to be based on a belief that such FTAs will help them attract investment in the short to medium term.

The competition case study discussed in chapter seven is also marked by an absence of any real multilateral level rule-making. The approach to dealing with international issues in competition, again developed within the OECD, was the 'co-operation-in-enforcement' model and was subsequently used in a range of bilateral

agreements. As with investment, lessons learned in the application of bilateral agreements were then fed back into the plurilateral rule-making process.

The regional development with most impact during the second phase of regionalism was the consolidation and extension of the EU's comprehensive model for competition policy. Unlike the TBT case, however, the EU model finds no application in multilateral rule-making.⁷ The one exception to this is in state subsidy rules, where there is clearly close synergy between the EU and enhanced WTO rules. The EU model has also been spontaneously emulated (i.e. without concluding any FTA or bilateral with the EU) in a range of other regions, but most of these are still at the early stages of development.

One of the main reasons for the lack of multilateral rules in competition has been the US preference for bilateral agreements between competition authorities based on the non-binding OECD co-operation-in-enforcement model. Little has changed in the post 1994 period. The US has continued to conclude bilateral agreements and the EU has unsuccessfully sought to promote the idea of competition rules at a multilateral level in the WTO. Perhaps the one development of note is the steady growth of voluntary co-operation in global dialogues.

The case studies therefore show evidence of a positive synergy between the regional and the multilateral levels during the second phase of regionalism, but the investment and competition cases show that there cannot of course be synergy when there are no serious multilateral negotiations. Other studies of SPS, services and intellectual property using the same approach tend to support the argument that there was synergy

during the second phase but less subsequently. (Isaac, 2006; Ullrich, 2006 and Pugatch, 2006)

8.3.3 Factors influencing the relationship between regional and multilateral rules

There are a number of features of the mid 1980s to mid 1990s period that contributed to this generally benign impact of RTAs in the field of rule-making.

First, it was a period shaped by a liberal paradigm. The general trend in national trade and investment policies was towards more liberalization. The paradigm was clearly one of progressive liberalization at the regional and multilateral level. Thus preferential agreements went hand-in-hand with multilateral liberalization. This can be contrasted with the inter-war period when regional preferential agreements were adopted against the background of growing protectionism. (see chapter two)

Second, the rule-making at the RTA and bilateral levels during the late 1980s and early 1990s could draw on a reservoir of norms, standards and negotiating processes developed in the OECD. In all the case studies the OECD was the forum in which initial framework rules were developed. As regional rules invariably took the OECD framework as a starting point, regional rules developed along similar lines so there was not much regulatory regionalism.

Third, the rules devised at a regional level were devised against the background of active negotiations in the GATT and consultations in the OECD on a wide range of rules. These multilateral and plurilateral negotiations acted as a real constraint on negotiators who went to considerable lengths to ensure that the regional rules were consistent with the emerging international framework. This was clearly shown in the cases of TBTs and

public procurement with respect to GATT rules. In the case of investment and competition it was the OECD that provided this kind of discipline.

Fourth, the second phase of regionalism was a period in which there was close cooperation between the EU and US, both in the OECD and the GATT. Indeed, the Uruguay Round was, like the previous Tokyo Round of the GATT, characterized by the central importance of the transatlantic negotiations. This was especially the case with regard to rule-making in which the US and EU were the main protagonists. During this period the US also saw RTAs as a prelude to wider multilateral agreements.

In the post Uruguay Round period it is necessary to qualify all of these features. Support for the liberal paradigm began to weaken as illustrated by the debate on the MAI, an agreement that practitioners had thought was the logical next step after the Uruguay Round. The failure of the MAI also illustrated the difficulty of using approaches to rule-making developed in the OECD as the basis for wider agreements. The failure to launch a comprehensive multilateral trade round as opposed to the more limited ambitions of the DDA, means that there are no ongoing negotiations in the WTO that can act as a constraint on the growth of regional or bilateral rule-making. Finally, US-EU cooperation is no longer sufficient in an increasingly multi-polar trading system. Even if it were there has been a weakening of transatlantic cooperation on rule-making as illustrated by the limited results coming out of the efforts in US-EU regulatory cooperation. There are also signs that the US is seeing FTAs as more of an alternative than a prelude to multilateral agreements and the EU is actively considering adopting a more active FTA strategy vis-s-vis Asia.

8.4 A comparison of the US and EU approaches to RTAs

There has been much general debate about the respective US and EU motives for seeking an RTA/FTA, but there has been much less discussion of the content of the agreements. This section first summarizes the debate on US and EU motivations and then considers whether there are any general differences in the content of the US and EU FTAs. The section argues that there are some general differences as well as detailed differences, either of which can create difficulties for multilateral rule-making.

8.4.1 EU policy on preferential agreements

The EU is by far the most active player in terms of preferential agreements and has for some time pursued a multi-level trade strategy. The EU currently differentiates between groups of trading partners. The first group comprises of the EU's immediate neighbours in eastern, central or southern Europe and the Mediterranean. With these partners EU policy is largely motivated by a desire to promote stronger political relations and to support the stable economic and thus political development of the countries concerned. The EU approach to these countries is that they should progressively adopt EU norms and rules as reflected in the *acquis communautaire*. Countries aspiring to EU membership are expected to comply with the full *acquis*, others such as the Euro-Med partners only elements of the *acquis* and even then provisions in the Association Agreements are very general and require decisions of the Association Councils to implement.

For more distant countries the EU pursues a declared policy of region-to-region agreements. Thus for example, the EU is negotiating with Mercosur rather than

individual Latin American countries, with the Gulf Cooperation Council and with the various Economic Partnership Agreements (EPAs) rather than individual African Caribbean and Pacific states. This region-to-region approach is motivated by a desire to promote regional integration as a model for economic prosperity and political stability. When it comes to negotiating regional-to-region agreements however, the EU has also sought to ensure equivalent access to the partner region. Because of the single European market and the fact that a good or service sold in one EU Member State can be sold throughout the whole EU, any product from a third country gains access to the whole EU market once it has entered the EU customs territory. The EU is therefore seeking equivalent access in the case of Mercosur. This, however, requires Mercosur to make rather more progress towards its own regional integration than it has to date. Slow progress on regional integration in the EU's partner region then becomes an impediment to negotiating FTAs.⁸ This is also already an issue in the EPAs, because some ACP regions such as ECOWAS have made little progress towards economic integration.

All EU preferential agreements do not, however, fall into the region-to-region category. The bilateral agreement with Mexico was negotiated in order to minimize the trade diversionary effects of NAFTA following a significant reduction in EU trade once NAFTA was agreed. (Reiter, 2003) The EU started negotiations with Chile at the same time as it did with Mercosur, because Chile had an association agreement with Mercosur. But the bilateral agreement with Chile progressed much faster than that with Mercosur. Competition with the US is also a factor in EU FTA strategy. If progress with Mercosur falls behind the negotiations on an FTAA, (which seems unlikely at present, 2006) there

could well be more pressure to negotiate bilaterally with Brazil and other Latin American countries.

There is therefore no one model for EU FTAs. The rules content has also varied from case to case. In general the EU has not succeeded in including in its bilateral FTAs significant WTO plus provisions on competition or investment. Although procurement has been included so that the EU partners in some FTAs have signed up to GPA type rules. Even core EU policy issues such as mutual recognition rules for TBTs have been left out of bilateral FTAs.

8.4.2 The US FTA strategy

The lack of uniformity in EU FTAs contrasts with the US. The US has pursued a multi-level trade policy since (at least) the beginning of the 1980s when it became disillusioned with the purely multilateral route. In the early 1980s there was also a significant element of unilateralism when the US sought, in effect, to impose its trade rules on its trading partners by threatening to deny market access to the US market if its trading partners did not oblige.

The US offered a free trade agreement to Central America as part of the Caribbean Basin Initiative in the early 1980s. It offered an FTA to Egypt and Israel in 1982 although only Israel accepted the offer. In 1988 the Omnibus Trade and Competitiveness Act provided negotiating authority for regional trade agreements as well as for the completion of the Uruguay Round negotiation. In 1986 the US initiated bilateral negotiations with Canada in part 'to show how' trade liberalization could be

achieve and provide a model for wider multilateral negotiations. In 1990 the US began negotiating the NAFTA with Mexico.

Since the early 2000s the multi-level trade strategy of the USA has been more clearly and forcefully articulated in the concept of 'competitive liberalization'. During the second phase of regionalism the US saw RTAs and FTAs as a means of promoting and helping to shape the multilateral agenda. Since the beginning of the 2000s FTAs appear to offer more of an alternative to multilateralism in which the NAFTA model is seen as the dominant approach.

8.4.3 Comparison of the general EU and US approaches

There are some general differences between the European and US approaches to rule-making in RTAs/FTAs, as well as some detailed, but important differences in each of the case studies. The EU appears to adopt a more comprehensive approach to rule-making with more extensive rules covering more aspects of policy, and the development and use of international standards in most policy areas. As noted above however, these only find partial application in the EU centred FTAs.

The US on the other hand, tends to favour an enforced non-discrimination approach consisting of framework rules backed up by extensive enforcement provisions that facilitate private access to judicial reviews. The stress on private access to reviews is illustrated in the bid challenge rule for public procurement first introduced in the CUSFTA and investor-state dispute settlement in NAFTA. But US-centred FTAs have more elaborate enforcement mechanisms in other areas as well. This of course is the approach used in the US for its domestic regulatory reviews and remedies.

8.4.4 The EU and US as selfish hegemons?

Whilst this general comparison of EU and US FTA policies provides some helpful insights, more important questions cannot be answered without looking at the detail of the FTAs. For example, it is not possible to say whether the EU and US are selfish hegemons unless one looks at the detail of the various FTA agreements.

Taking the case studies in turn the TBT case does not show much evidence of selfish hegemons. The EU has adopted a flexible approach to the treatment of TBTs in its FTAs and has not, for example, pressed for the extension of mutual recognition agreements. The US has not seen TBTs as a priority in its rule-making at any level and as a result the TBT provisions in US FTAs are very modest. This does not preclude the EU and US acting as selfish hegemons in the TBT field. For example, while the EU has not pressed the case for mutual recognition it still requires its trading partners to comply with EU regulatory norms or voluntary standards. The EU is also dominant in international standards making bodies such as the ISO and IEC, so the EU focus on agreed international standards is in practice heavily biased towards European interests. Agreed international standards are however, still better than the imposition of standards bilaterally. The fact that US has only skeletal rules on TBTs means that markets determine standards and thus the size of the US market will always mean that small or developing countries will always be obliged to comply with US industrial standards. In other words, the EU and US can shape standards regardless of what they include in FTAs.

In public procurement both the EU and US have used FTAs as a means of extending the number of countries that comply with GPA-style rules. In terms of rule-making this is still fairly benign because the rules these two regional hegemon are extending through FTAs have been agreed internationally, albeit at the plurilateral rather than the multilateral level. When it comes to market access issues or coverage, the EU and US use the asymmetric FTA negotiations to further their offensive interests in public procurement. But here there is little difference between the bilateral and plurilateral levels since the coverage of the GPA is also negotiated bilaterally. In other words, as with the TBT case, the use of FTAs to extend procurement rules have not made a major difference in terms of how the EU and US make use of their relative economic power in trade negotiations.

The investment case shows rather more clearly the use of sequential negotiations by the US to achieve its interests in investment rule-making. There appears to have been a strategy starting with the US model BIT in the early 1980s and progressing through bilateral, regional and plurilateral negotiations to establish *de facto* international investment rules based on the US model. Here therefore is evidence of a selfish hegemon using sequential negotiations to achieve its aims. In the case of the EU the absence of EC competence in investment and other factors has meant that investment has not (to date) figured in EU FTAs.

Finally, the case of competition is similar to that of TBTs in that the EU has a comprehensive 'domestic' model which it has been unable to 'export' while the US has not pressed competition/anti-trust in international rule-making. In its FTA policies the

EU has sought to include competition in its FTAs, but not at all aggressively. The US has actively avoided inclusion of rule-making on competition in its FTAs.

Taking the findings on FTA policy in general with the evidence from the case studies considered here and augmented with other analogous case studies (Ullrich, 2006; Pugatch, 2006 and Isaac, 2006) it is possible to argue that the US has been more ready to pursue selfish hegemon policies, especially after 2000 when its competitive liberalisation strategy led to an aggressive use of FTAs. In comparison the EU has been less aggressive and more flexible in its FTA negotiations and has therefore not sought to impose its own approach to rule-making on its FTA partners to the same degree. There are, however, policy areas in which the EU has more aggressive policies such as geographic indicators, where it is seeking to use FTAs as a means of achieving what it has been singularly unable to achieve multilaterally in the WTO.

8.4.5 Why have developing countries been ready to sign up to rule-making in FTAs?

The position of developing countries (DCs) in the case studies largely mirrors the discussion above. For example, in the case of TBTs, DCs are standards takers regardless of whether these are set unilaterally by the EU or US, in FTAs or in international standards bodies. So accepting provisions in FTAs that, for example, promote the use of international standards is not to the DCs disadvantage. In fact DCs have offensive interests in limiting the scope for the use of discretion by the EU or US when it comes to regulatory norms or voluntary standards and certainly have an interest in technical assistance to help them in certification and conformance testing. In any case neither the EU nor US has asked much of developing countries in terms of TBT in FTAs.

It is less easy to explain why DCs have been willing to sign up to FTA rules on procurement. One possible answer is that for the larger DCs/emerging markets much of the benefit will accrue to their own economies through increased competition resulting from better procurement practices. For the smaller DCs it is difficult to see what the benefit might be. For both it is possibly a trade off with the benefits of greater access to the large markets.

In investment DCs, and in particular small DCs, have been willing to sign up to investment rules in FTAs (with the US) because they have sought to gain a first mover advantage and attract FDI. Finally, the demands on DCs in terms of competition have been modest and seldom binding, so agreeing to these has not come at much of a cost in terms of compliance costs or lost policy autonomy.

8.5 The nature of policy making in rules

A number of other general comments can be made on the basis of the case studies that are relevant for trade policy. One of these is that precedent is important in shaping rules. Approaches to rule-making at one level tend to find application on other levels. The most obvious version of this is in the application of domestic rule-making to international agreements. Domestic regulatory policy is usually the product of many years of policy and practice and embodies deep seated preferences that balance liberalization and other legitimate policy objectives, such as consumer safety, environmental protection, or a desire to retain discretionary powers for government or regulators to pursue industrial or development policies. In the case of regional agreements, such as the EU in particular, the balance has to be found among all

participants before framework rules can be adopted. Once such a 'domestic' balance has been struck, there will be considerable resistance to reopening the deal so that approaches to international rule-making will tend to reflect the precedent set by such domestic rules.

The case studies suggest that precedent plays an important role at other levels of rule-making, not just the domestic-international interface. In all the cases considered OECD codes have played an important role in shaping the evolution of regional and multilateral rules. The USA proposals for public procurement in the Uruguay Round negotiations were, for example, taken almost word for word from the CUSFTA provisions. Likewise the pace of developments in the EU shaped its position in the multilateral negotiations. Clearly the causality of such links is important and is addressed below. But the point here is that decisions on the substance of rules are not just shaped by the relative balance of power of the parties, the lobbying of vested interests, or for that matter the institutional framework within which decisions are taken, although all of these will of course be important. They are also shaped by precedents set in previous agreements.⁹ Rational choice approaches to RTAs and FTAs therefore need to be augmented by an awareness of the influence of this interaction.

8.6 Policy prescription

What does this all mean in terms of policy? First RTAs/FTAs can be good or bad when it comes to rule-making, just as they can be good or bad, trade creating or trade diverting, in terms of tariff preferences. It all depends on the substance of the specific RTA/FTA and how it interacts with other levels of rule-making.

8.6.1 A practical approach to assessing the impact of rule-making in RTAs and FTAs

Second, it is possible to devise a set of general qualitative criteria for assessing the impact of rule-making based on the expected impact of regional or bilateral provisions in the different elements of rule-making. Based on such general qualitative criteria a simple traffic light system similar to that used for WTO Agreement on Subsidies and Countervailing Duties might be developed to provide an initial assessment of different elements of bilateral and regional rule-making measures. This practical approach is based on the assumption that unambiguous results from quantitative assessments of the impact of RTAs/FTAs in rule-making will not be forthcoming for some time.¹⁰ The application of such an approach would follow the time-honoured practice of first improving transparency. It must be assumed that strict WTO discipline of RTAs/FTAs, at least without any economic or legal criteria on which to base an interpretation of Art XXIV GATT, is not about to be accepted by WTO members. But progress has been possible in WTO discussions on transparency provisions for RTAs/FTAs. It would therefore seem a realistic aim to develop an enhanced transparency approach to RTAs/FTAs along the lines of that set out in table 8.1. Here it is only possible to provide a broad outline of the approach. More work will be needed to develop a workable set of criteria. The principle, however, would be to require closer scrutiny for those elements of RTAs/FTAs that are more likely to have negative effects on third countries or on the trading system. This would mean for example, notification of any substantive regulatory norm or standard that is not consistent with existing, agreed international norms or standards or notification of any regional interpretation of rules that could have wider implications or be at odds with the WTO interpretation of an equivalent

provision. In these cases notification of the measure would ideally be required to the WTO CRTA as it is proposed. For those elements of rule-making that can be expected to have positive effects, there would only be a need for periodic notification, i.e. when transparency rules are adopted and then at regular intervals depending on the importance of trade and investment covered by the agreement.

Chart 8.1 Simplified overview of criteria for enhanced WTO transparency rules for RTAs

Element of rule-making	Probable impact	Notification requirements	Amber = subject to scrutiny, Green = permitted Red = indicates need for work to ensure compatibility of RTA/FTA with international rules.
Coverage	Preference if coverage goes-beyond existing WTO coverage	Notification of WTO-plus coverage	Amber indicator
Non-discrimination	Preference if national treatment limited to signatories	Notification of <i>de jure</i> preferences	Green indicator
Transparency	Limited preference, promotes better regulation through clear objective criteria for regulation	Periodic notification only	Green indicator
Substantive rules	Can facilitate or restrict trade depending on the case	Notification of any substantive measure that is not consistent with existing relevant international agreements	Amber indicator, but red for measures that clash with existing WTO rules
Co-operation	Can channel more resources to cooperation than under multilateral rules	Only periodic notification only	Green light
Regulatory safeguard	Scope for re-regionalisation /re-nationalisation of regulatory policy	Notification of any interpretation of regional 'regulatory safeguard' that could undermine existing	Amber

	or use as protection.	WTO rules	
Enforcement	More rapid remedies	Notification of any interpretation that diverges or threatens to diverge from WTO interpretations	Amber

As noted above WTO-plus sector or entity *coverage* constitutes a form of preference that will be subject to erosion provided multilateral negotiations continue to increase the coverage. Notification of WTO-plus coverage would serve to flag up areas for negotiations to extend the coverage of other regional agreements or ideally multilateral level agreements.

Regional and bilateral agreements would have to be allowed to maintain preferences in the shape of not extending *de jure non-discrimination* to third parties otherwise preferential agreements would lose much of their substance.¹¹ But *de jure* preferences should still be subject to notification to the WTO, for example, if an RTA or FTA stipulates a price preference for public contracts. *De facto* preferences, i.e. preferences that result from the application of rules or laws are more important than *de jure* preferences, but notification of all *de facto* preferences is impracticable and would impose excessively high compliance costs. But *de facto* preferences in terms of substantive obligations that deviate from existing international rules should be notified as should interpretations of rules that diverge from established interpretations in the WTO or other bodies.

Transparency rules in RTAs/FTAs should be subject to only periodic notification as they seldom constitute a significant preference, tend to promote best regulatory practice and are unlikely to pose any systemic risk. As transparency rules constitute a significant share of RTA provisions this would reduce the notification requirements

considerably. Freeing RTA/FTAs from notification obligations in this area would also signal a permissive approach to preferential rules in these elements of rule-making.

Substantive provisions are much more complex. The proposal here is that all those substantive rules, standards or regulations that are compatible with existing international rules, would be assumed to be consistent with wider multilateral aims and not subject to closer scrutiny. As many substantive rules have been drawn up in forums other than the WTO, 'existing international rules' would have to be defined to include norms and standards agreed in bodies such as WIPO for IPR, the ISO for TBT, the Codex Alimentarius for SPS and the WTO plurilateral agreements, such as the GPA for procurement. Including plurilateral agreements under the definition of 'existing international rules' might be seen as second best option to multilaterally agreed rules, but the constraints on global rule-making mean that requiring global agreement (or multilateral agreement in the WTO) is likely to stymie multilateral rules with the result that there will be no discipline on regional and bilateral norms and standards.

Where an RTA or FTA goes beyond existing international rules to establish a regional or bilateral standard this poses more of a threat. Such standards may serve the mercantilist interests of selfish hegemonies or may constitute a form of regulatory regionalism. Any RTA/FTA measure that establishes such norms or standards should therefore be immediately notified to the WTO with the presumption that such measures are inconsistent with the maintenance of a wider multilateral order. In other words the burden of proof would have to be on the parties proposing the new rule or standard to show that they are not.

Co-operation provisions in RTAs do not constitute much of a preference and can often result in more effective promotion of good regulatory practice than is possible at the multilateral level. Inevitably, when dominant parties such as the US or EU provide technical assistance under co-operation arrangements they will be promoting their own approaches to regulation and standards. But if regional initiatives can help increase technical assistance there would seem to be no point in discouraging them.

Implementation of an RTA or FTA is not something that can be closely monitored at the multilateral level, but regional or bilateral interpretations of core rules may clash with the equivalent WTO interpretations. Regional or bilateral interpretations of principles such as proportionality or a 'regulatory safeguard' are also likely to set precedents for future trade and investment rules and should be notified. For example, an interpretation of the use of precaution in an SPS case at the regional or bilateral level could have a bearing on the future interpretation of the WTO rules and should be notified as it occurs. In cases of bilateral or regional rulings clashing with existing WTO interpretations there may well be scope for WTO members to bring the case under WTO dispute settlement, but this would not cover cases where the regional interpretation is WTO-plus. These cases should be brought to the attention of all WTO members.

Application of the traffic light system would mean, for example, that anything with a red light would be subject to immediate notification and close scrutiny at the WTO level. An amber light would mean perhaps notification only at regular intervals along the lines of the frequency of the Trade Policy Review Mechanism (TPRM) of the WTO. A green light would mean there would be perhaps only an obligation to notify such rules when they are introduced or modified.

There is also the issue of when notification should occur. Notification after the fact, as in the case of RTAs and FTAs under the existing WTO rules is likely to make effective scrutiny difficult, because once ratified agreements are unlikely to be revoked. A more ambitious policy prescription would therefore be to require prior notification of measures when these fall into the 'red indicator' category. This could involve linking the notification of such measures to the opening of negotiations on agreed international rules on the topic concerned. The regional measure would then be suspended for a specified period until the international negotiations had had an opportunity of finding agreed international rules. New regional or bilateral rules would not be blocked, but the WTO or other bodies would be given an opportunity of developing agreed multilateral rules. Of course the key issue here is who decides whether the measure concerned should have a red, amber or green light. Self notification alone by the parties is unlikely to be effective, as in the past with TBT type notification in the GATT, so there would need to be provision for cross notification by third parties.

Such an enhanced transparency system could be carried out along the lines of the Trade Policy Review Mechanism (TPRM) and would in effect bring all RTAs and FTAs into the remit of the TPRM. But limiting notification to those areas that pose a potential risk for third countries of the trading system such criteria could help to reduce the volume of work that has to be carried out in the Committee on Regional Trade Agreements and thus enable it to be more effective in addressing the more important areas. Non-participants in the FTAs would have an opportunity of commenting during the TPRM-type procedures. By highlighting areas where regional or bilateral rules are likely to constitute significant preferences or pose systemic risk (i.e. of regulatory regionalism or

developing rules that undermine existing agreed international rules) the system will have fulfilled its function. As with existing transparency provisions in the WTO such as the Trade Policy Review Mechanism (TPRM) there should be no direct link to dispute settlement.

The ideas set out above provide only the outline of such an enhanced notification procedure. More work would be needed. But it offers a means of applying the framework developed in the thesis to the policy environment.

8.6.2 Promoting forums that can build trust and thus consensus

There is a debate in trade policy on the relative merits of multilateral ‘rounds’ and continuous negotiation. Rounds are probably indispensable as long as market access negotiations are based on reciprocity. But there are a number of significant drawbacks in linking agreement on framework rules to reciprocity based negotiations.

The existing forums within which trade and investment rules are discussed are not appropriate for developing such framework agreements. For such framework agreements to be developed there is a need for negotiations to be based on detailed, impartial information and research that will enable rules to be developed that are balanced and sustainable. This is unlikely to be achieved when negotiations on rules are linked to mercantilist, market access negotiations. In the past the OECD has provided such an objective forum for developed countries. Despite its efforts to reach out to developing countries and its increased membership, the OECD is still not inclusive enough to make progress in the current climate in which more countries need to understand and support the rules developed.

The WTO discusses a range of rule-making issues, such as in the various Working Groups set up to discuss the Singapore issues between 1996 and 2003, but the nature of the WTO means that these are linked to reciprocity. The link is at least twofold. First, rules in the WTO have, in the past, been used as a means of market opening, so the expectation is that any proposal on rule-making is motivated by the offensive market access interests of the government making such proposals rather than the establishment of rules that will benefit all parties. The public procurement case has illustrated this very clearly, as has services. Secondly, multilateral negotiations have included broad trade-offs between framework rules and market access, most famously that between textiles and clothing liberalization and TRIPs in the Uruguay Round. Agreed rules for trade and investment will only function if their benefit is recognized by all countries. The TRIPs agreement shows how rules accepted reluctantly as part of a global package are unlikely to be sustainable.

UNCTAD could, of course, provide an inclusive forum to discuss framework rules and it has served this purpose to some extent in competition, for example. But UNCTAD is seen as a developing country forum, just as the OECD is seen as a developed country forum.

Regional or bilateral FTAs are not appropriate forums for negotiating framework rules, because they can be too easily exploited by selfish hegemony seeking to ensure that their trading partners adopt their own domestic rules regardless of the level of development or needs of their trading partner. Rule-making at a regional/bilateral level also runs the risk of regulatory regionalism in the longer term.

In the past close transatlantic co-operation has formed the basis of many approaches to rule-making, because of the central importance of the US and the EU in this field. Indeed, much of the work in the OECD had a strong transatlantic flavour. In the 1990s there were efforts to maintain and strengthen transatlantic regulatory co-operation through various bilateral channels, such as those serving the New Transatlantic Agenda (NTA) after 1995. Whilst some would like to preserve transatlantic co-operation, there are clear limits to how far this can provide the basis for international rules in the 21st century. Developing countries and especially the emerging markets are not going to accept the US and EU pre-cooking the rules, even if this were possible.

There is therefore a need for an organization, not just a forum for dialogue, in which the pros and cons of any given approach to rule-making can be discussed on the basis of objective research and with a view to ensuring that rules can benefit all countries. This organization would be plurilateral but inclusive, i.e. include all major countries and representation (perhaps at a regional level) of smaller developing countries. It would be something like the OECD in that the aim would be to develop agreed rules, not simply have a dialogue on voluntary guidelines. The aim of such an organization would be to develop general approaches to framework rules that can be applied in regional and multilateral level agreements or for that matter on a voluntary basis at a plurilateral level.

Finally, even if there were a body working on the development of framework rules, there would still be a need to determine the extent to which these should be applied in the WTO. Multilateral rounds of negotiation will still be needed to resolve market access issues. The underlying character of the trading system is based on reciprocity and this is unlikely to change in the short term. As rules and market access

cannot be separated in practice, one approach would be to have the framework rules developed in an organization as envisaged above but then have coverage determined in multilateral rounds. This approach has been used in the GATS approach to services and could be applied in other areas of rule-making.

Endnotes

¹ This is not to say that there are not tariff peaks, tariff escalation and rearguard actions by entrenched interests to retain tariff preferences.

² This appears to be happening in the SPS field (see Isaac, 2006) and intellectual property (TRIPs) field (see Pugatch, 2006)

³ It could be argued that the EU only really developed a viable alternative approach during the 1980s, before that the EU tended to react to US initiatives on rule-making. (Woolcock, 2005)

⁴ With an active debate on EU FTA policy, this may now (2006) be changing.

⁵ For simplicity the WTO has been used as a reference for multilateral rules, but in practice other global rules could be used as the reference.

⁶ Some recent comprehensive work on preferential rules of origin (Garay and De Lambaerde, 2006) suggests that in the medium to long term there may well be some consolidation of rules of origin around a number of major models. Not surprisingly these include the NAFTA and PanEuro models of preferential rules of origin. Consolidation is occurring as countries approximate to one or other major models. The negative effects of different rules of origin are also being reduced by the increased use of cummulation.

⁷ When one compares TBT with SPS or for that matter other policy areas such as intellectual property rights, there has been relatively limited progress towards binding multilateral rules. This may also be due to the low priority placed on international coordination in the TBT field. In other words one could conclude that the US has had more sway on the multilateral agenda than the EU, despite the EU's efforts for the past decade to promote a comprehensive multilateral agenda.

⁸ The EU's approach to it EuroMed Agreements did not initially reflect this approach. Bilateral Association agreements were negotiated with the North African partners that resulted in a hub and spoke type arrangement, because of the existing concentration of the Euro-Med partner countries' on the EU. To try and correct this the EU has sought to promote increased intra-regional trade around the Mediterranean by supporting the Agadir process and the introduction of cummulation in rules of origin. The EU is also about to launch a new 'open regional' approach to services in which all Euro-Med partners wishing to join the services FTA would be free to do so.

⁹ Previous agreements will of course reflect the relative balance of interests and lobbying from vested interests. In this sense when policy makers take an existing text from the shelf they are also basing their starting position on what was the balance of national interests in the previous negotiation.

¹⁰ This seems a fairly safe assumption given that empirical work on the impact on trade and investment of deeper integration and on the systemic effects of regional rule-making is very limited.

¹¹ Open regionalism defined as the extension of all commitments to third parties via MFN is of course an alternative here, but not one that appears likely to make much practical headway against the tide of regional and bilateral preferential agreements.

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