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Abstract

This paper explores how far free trade agreements (FTAs) have strengthened or weakened global governance of the trading system. We open with an analysis of the altered political and economic context within which countries have come, in recent years, to assign a new importance to regional and bilateral trade agreements in their trade policies. We then consider each of the main provisions included in FTAs and comment on how these may separately affect the management of trade relations. We conclude with some observations of the broader trends affecting global governance that are associated with the spread of trade agreements as a whole.

Key words: Global trading system; free trade agreements; WTO; management of trade relations

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Andrew G. Brown and Robert M. Stern

1. Introduction

In 1995 when the WTO was established, it seemed to be final confirmation of the success of a system that had managed multilateral trade relations since 1947. It provided an institutional framework within which governments were not only able to negotiate reductions in trade barriers but also to bind themselves to rules of conduct that, in principle, were both universal and non-discriminatory. About the same time, however, the new wave of regional and bilateral free trade agreements (FTAs) was beginning to gather strength. For some, this has emerged as a threat to the central role of the WTO as manager of the trading system and even to presage the fading of an era of multilateralism in trade relations. For others, it has been a call to revise long-held conceptions about the multilateral system and to embrace a more complex world composed of networks of multilateral, plurilateral, regional and bilateral arrangements. In this paper, we aim to contribute to this debate by exploring how far FTAs have strengthened or weakened global governance of the trading system.

For the most part, the contribution of economists to the debate has centered around the effects of preferential tariff regimes (including their rules of origin) on merchandise trade and trade relations. We think that the almost exclusive focus on tariff regimes is too narrow a prism. For one thing, we are skeptical of the practical significance of the tariff preferences that have been actually introduced in affecting trade

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flows. More important, the focus on tariff barriers leaves aside the other major aspects of trade relations that multilateral, plurilateral, regional and bilateral arrangements seek to address. Central to these arrangements is the removal of a host of non-tariff obstacles, found both at the border and in domestic regulations, through the adoption by governments of more convergent regulatory practices. In a world of deepening economic integration, the regulatory aspects of trade agreements have rapidly been assuming increasing importance. Indeed, the future progress of integration will be partly conditional on how successful governments are in making mutual accommodations in their domestic regulatory networks to facilitate flows of trade, investment, and technology.

We open with a brief analysis of the altered political and economic context within which countries have come, in recent years, to assign a new importance to regional and bilateral trade agreements in their trade policies. We then take up each of the main provisions included in FTAs and comment on how these may separately affect the management of trade relations.[1] If we had to start from scratch, this would be a formidable task indeed; but we are helped by a number of recent studies noted in the References that have explored the characteristics of recent FTAs, comparing and grouping them by their different features. In the final section, we conclude by identifying a few of the broader trends affecting global governance that are associated with the spread of trade agreements as a whole.

[1] Some trade agreements are component parts of broader agreements that address political and economic relations more generally; they are as much instruments of foreign policy as a means of regulating commercial relations. We confine our attention here to those provisions in the agreements that impinge directly on trade and investment flows.

2. Altered Context

For the best part of fifty years after WW2, international trade relations were largely managed by the multilateral system embodied in the General Agreement on Tariffs and Trade (GATT) and later incorporated into the WTO. Customs unions or FTAs were of importance for some regions or countries, but these were viewed as clearly subsidiary to the multilateral system. Nondiscrimination among nations, otherwise known as general most-favored-nation (MFN) treatment, was a cornerstone of the system. It kept at bay the deep-seated fear that, as in the interwar years, exclusionary trading blocs might again arise to restrict market access.

The postwar transformation in the economic relations of the countries that might formerly have dominated major trading blocs – the US, the larger European countries and Japan – greatly diminished that fear. As a group, these countries became quite closely integrated in manufacturing production and trade, in the service industries, in cross-border direct investment, and (as we have recently been made painfully aware) in finance. China, now another potential leader of an East Asian bloc, has also become heavily dependent on access to western markets. The multilateral, and largely nondiscriminatory, character of relations among these countries, moreover, has been institutionally embedded in their national laws and regulations in conformity with their obligations under the GATT/WTO agreements.

It was within this changed setting of diminished rivalry that, in the 1980s, a resurgence of interest in regional FTAs took place. The new focus was on the expansion of markets, of possibly promoting broader economic integrations and even – as had occurred in western Europe – of overcoming political antagonisms. Since the

agreements rigorously avoided any raising of trade barriers against third countries, they were not deemed protectionist, at least in intent. Moreover, though there certainly remained a residual fear of the emergence of possible trading blocs, that only acted as an additional stimulus to action. The passage of the Single European Act in 1986, for instance, and the later trade agreements of the EU with eastern European countries after the collapse of the Soviet Union were spurs to the signing of the US FTA with Canada and later, to the formation of NAFTA; and the US also began to entertain the dream of a Free Trade Area of the Americas (FTAA) while it established an Asia and Pacific Council as a precursor to another extensive free trade area.

Thus, in the new world of globalization and of increasing reliance on unrestricted private enterprise that the 1980s ushered in, the emphasis on nondiscrimination yielded to the search for ways to expand access to foreign markets. And it was but a small step to include bilateral agreements along with regional agreements as an effective instrument. These kinds of arrangements, moreover, had the advantage of not being dependent on the slow pace of multilateral trade negotiations, which were being made more intricate and less conclusive by the growing number and diversity of the participants. Further, particularly for the US as the leading economic and trading power, the interest in market access was moving beyond the reductions of barriers at the border to include access to service industries like telecommunications and finance as well as access for investment capital in general. Securing access to specific markets of interest was thus easier to realize through the negotiation of FTAs.

These shifts in attitude of the major trading powers, particularly of the US, interacted with equally complex but different changes affecting the trade policies of many

other countries, which were to become the demandeurs in regional or bilateral trade agreements. In the western hemisphere, for example, it was Canada that became the first country to approach the US with a proposal to negotiate an FTA. It was motivated in part by an immediate concern that the US was threatening to introduce new trade defense measures. More profound was the dissatisfaction with the growth performance of Canadian industry. The solution was partly seen in closer and more open trade links with the US to enhance competitiveness. Other countries, both in the developed and the developing worlds, were also embracing more open trade policies as part of their growth or development strategies. A few, such as Chile, Mexico, and Singapore, began to actively pursue the negotiation of FTAs as a route toward the realization of a universal free trade policy.

As more countries began to see advantage in widening their markets for exports through the negotiation of FTAs, this provided an additional incentive for others to follow suit. In accordance with the domino theory that Baldwin (2006) has so persuasively expounded, numerous countries feared that they faced possible costs to themselves in remaining aloof from these preferential arrangements.

While the new wave of regional and bilateral agreements has made for a more complex network of trade relations among countries, the WTO disciplines have nonetheless remained at the core of the global governance of trade relations. Most regional or bilateral agreements explicitly reaffirm their rights and obligations under the WTO, and the multilateral disciplines provide a basic framework around which these agreements are built. On certain major matters, such as the definition of those domestic subsidies that may be considered to be breaches of trade commitments, regional and

bilateral agreements have been unqualified in their acceptance of the WTO discipline. It is with the other provisions, and their deviations from the WTO, that we are mainly concerned with in what follows.

3. Contents of Regional and Bilateral Agreements[2]

We first take up those provisions like tariffs and services regulations that are very largely concerned with market access, and we thereafter discuss those other provisions like customs procedures and standards that are more in the nature of supporting rules. There is, however, no sharp line of distinction between the various provisions since the supporting rules may also affect market access. The final provisions that we review – competition policy, and labor and environmental standards – are those that lie largely or wholly outside the WTO body of agreements.

a) Tariffs and Rules of Origin

The most serious objection to FTAs is the preferential treatment that they introduce, most obviously in tariff regimes. While MFN treatment has been seen as a cornerstone of the multilateral trading system, partners in regional or bilateral trade agreements deliberately set such treatment aside. However, the de facto importance of their preferential arrangements is probably a good deal less than might be expected from the proliferation of these agreements. It is unfortunate that the proportion of world trade actually conducted on preferential terms under these agreements is difficult to determine. For example, a World Bank (2005) report estimated the proportion of world trade conducted among countries that were partners in regional or bilateral trade agreements

[2] An especially useful source of information on preferential agreements is Chauffour and Maur (2011).

was around one-third in 2002, and the number of agreements has increased appreciably since that date. However, for reasons noted in the World Bank report and elaborated upon below, that estimate grossly overstates the likely volume of trade conducted on preferential terms. Thus, for example, exclusion of the intra-trade of the EU alone reduces the 2002 figure from one-third to one-fifth.[3]

Moreover, there are several reasons for skepticism about the practical significance of the preferential arrangements. For one thing, although a large number of agreements have been signed, these have not always fully specified their programs for tariff reduction or elimination, or they have envisaged implementation spread out over long periods. Broadly, with some notable exceptions, it is in agreements to which developed countries are partners that the tariff reductions and eliminations have been more firmly implemented. However, the developed countries had already brought down their MFN tariffs to very low levels. Thus, duties are, in fact, zero on a quarter to two-fifths of their imports, and the duties on the remaining products average about 4 per cent (WTO Annual Report, 2003). In the FTAs to which the developed countries are parties, preferential tariffs on imports into their markets thus have limited value. Indeed, for exporters, rates of duty are often too low to make it worthwhile to conform to the process necessary to qualify for the preferential rate. In this connection, Whalley (2008) noted an official Canadian finding (Government of Canada, 2005) that perhaps as much as 70 percent of its bilateral trade with the United States under NAFTA that was eligible for preferential

[3] Technically, the World Bank analysis includes all customs unions and FTAs that members have notified to the WTO under GATT Article XXIV. This includes the EU. But it makes little sense to include the EU in the present context of a discussion of how the proliferation of regional or bilateral trading arrangements is affecting the management of the global trading system. The EU has been in the process of evolution over the last 50 years and, compared with other such arrangements, is now a closely integrated economic entity. A test of the difference is that it acts as such in trade negotiations.

rates actually took place at MFN rates. Baldwin (2006) likewise noted that the utilization rate in the ASEAN FTA was very low, perhaps below 10 percent.[4] The point is that where preferential margins are small, the certification process itself can incur costs for the exporter that outweigh the benefit.[5] The greater blame for the relatively low utilization rates, however, is usually assigned to the production conditions that exporters have to meet in order to comply with the rules of origin spelled out in the agreements. Rules of origin in the agreements of developed countries are generally product-specific and can run into several hundred pages of conditions.[6] Thus, the modest reductions in tariffs that these countries have been able to offer are partly offset by their tight rules of origin. Indeed, in developed countries FTAs with developing countries, it has usually been the latter that have made the more significant tariff cuts (and rules of origin in the FTAs of developing countries appear, in the main, to be simpler and less protective).

Another restriction on the scope of regional and bilateral FTAs is that, as in multilateral trade negotiations, they invariably exclude some products from the liberalization of trade barriers.[7] The most common exclusions are agricultural commodities. While many FTAs have taken the liberalization of agricultural trade in

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[4] Relatively low utilization rates have also been found among developing countries participating in the General System of Preferences (Brown and Stern, 2007).

[5] Plummer (2007) has noted that the cost has been estimated at 3-5 per cent of export value.

[6] The rules of origin are often complex. Brenton and Manchin (2003) noted that in the EU's bilateral agreements, the basic rule is that the product has to undergo changes at the 4-digit level of the Harmonized System (HS) of tariff classification. However, for many products, it is not this rule that applies; instead, the products have to undergo specified technical changes. Value added is another criterion and, although it is infrequently used, the relatively high figure is indicative of how restrictive rules of origin can be. In the EU, the necessary domestic value added is about 60 per cent (McQueen, 2002). In NAFTA, the local content requirement for cars imported from Mexico to the US is 62.5 per cent. An exception to the usually complex rules of origin in developed countries is the New-Zealand-Singapore agreement in which the rules are based on tariff transformation or a simple 40 percent value added (Plummer, 2007).

[7] Article XXIV of GATT requires that, to qualify as a free trade area, "substantially all the trade" in products should be covered. While many interpret this as 95 per cent of bilateral trade flows, the EU, for instance, sees this as 90 percent.

specific products beyond that achieved in multilateral negotiations, the range of experience has been wide and most exclude some sensitive products. Unsurprisingly, the excluded products in FTAs are the same sensitive products identified in multilateral trade negotiations.

While the proportion of world trade conducted at preferential tariff rates is a good deal less than might be imagined, it is nonetheless significant and has been growing. The harmful spillover effects of preferences on third countries are a valid source of concern in the management of international trade relations. Once again, however, we must caution that the adverse consequences are less than what the prevalence of FTAs might lead one to suppose. Thus, third countries have frequently responded with their own measures to counter the threat or actuality of trade diversion. A common response has been to negotiate a parallel agreement in order to preserve access to the trading partner's market on equal terms. This, in good part, accounts for the network of FTAs that links so many countries – and it should also be remembered that the process of negotiating these reactive agreements results in further trade liberalization. Another response to the threat or actuality of trade diversion has sometimes been to lessen the diversion through the lowering of MFN tariffs.[8]

It is not only preferential tariffs, however, that may cause trade diversion. Restrictive rules of origin can be similar in effect. Since the rules of origin in FTAs generally permit only bilateral accumulation,[9] the source of inputs required for the

[8] For example, Tovias (1999) has noted that after Israel had signed trade agreements with both the US and the EU, it found that because its preferential margins were relatively large, the cost (before duty) of imported consumer goods, which had come mostly from Asian countries, rose significantly. The response of the government was to lower MFN tariffs.

[9] Bilateral accumulation allows the inputs originating in each partner country to be counted as though they originated in the other.

production of exported products from one trading partner may shift from a third country to the other trading partner in order to qualify for preferential treatment even though the production costs of the latter are higher. This kind of problem can arise in acute form when a major trading country has FTAs with several other countries so that the relationship takes on a hub-and-spoke form. It is particularly harmful to trade in a world where the fragmentation of production processes means that the different phases of production can be most economically located in several countries. If the rules of origin do not allow for the inclusion of imports from other countries with FTAs, they impede the locational fragmentation of production. Eastern European countries in FTAs with the EU experienced this problem. It was only after several years that the EU finally reformed its rules of origin to permit diagonal cumulation among itself and its trading partners. [10] Baldwin (2006) has pointed out that the motive for reform was the trend toward outsourcing among EU firms. Formerly protected from the competition of free trade partners by the rules of origin, EU firms later found that the same rules prevented them from exploiting the advantage of "unbundling" their production among several cheaper locations. Baldwin also noted that among the East Asian countries, where the dispersion of fragmented production processes accounts in no small part for the rapid growth of regional intra-trade, there was no network of FTAs to impede the outsourcing process. What did happen was that competition among countries in the region, to make themselves attractive sites for outsourced activity, led to the reduction or elimination of tariffs on the inputs to be further processed.

[10] Diagonal cumulation means that the input originating from any countries in a common trading zone is allowed to be used for production of the ultimate product, where more than two countries are party to a single agreement or several countries are incorporated to each other with similar agreements.

What can we conclude from this thumbnail review of tariffs and rules of origin in regional and bilateral trade agreements? Baldwin and Venables (1997) observed some time ago that, "despite some theoretical ambiguities, regional integration agreements seem to have generated welfare gains for the participants, with small, but possibly negative spillovers on to the rest of the world." The same appears to hold broadly true of bilateral agreements. What generates conflict between the multilateral system and these preferential agreements is not the trade liberalization that occurs but is rather the instances of trade diversion. However, as noted, countries have often responded to the threat of diversion with their own offsetting countermeasures. But this is not to deny that trade diversion exists and can be very damaging for individual firms or industries in particular instances. More might be done therefore to lessen the possible conflict on this score between the multilateral system and FTAs. As other have suggested, assessments of the effects of proposed FTAs on third countries might point to some accommodations that could be made, for instance, by means of some reduction by the free trade partner of tariffs that provoke the diversion.[11] Much the same holds true of rules of origin.[12]

b) Services

While a General Agreement on Trade in Services (GATS) was successfully negotiated during the Uruguay Round, progress at the multilateral level in enlarging market access for services was decidedly limited. That was doubtless in part because of

[11] In 2006, as part of the Doha Round, the Negotiating Group on Rules formally approved a new WTO transparency mechanism for regional trade agreements. The Committee on Regional Trade Agreements will conduct reviews of any notified regional trade agreement on the basis of a factual presentation by the WTO Secretariat. This is an opportunity for some analysis of the consequences of an agreement for third countries.

[12] See Baldwin (2006) for a detailed discussion of the possible role of the WTO in lessening the distortions caused by rules of origin.

the reluctance of countries to open their markets to foreign competition, but it also owes something to the complexity of negotiating reforms in the service industries multilaterally. The markets for the numerous kinds of services that can be traded not only differ from each other in their characteristics; they are also subject to national laws and regulations that often vary substantially among countries in their content. There is much less scope for the more straightforward kind of across-the-board reciprocal reductions in barriers that have been so successful in lowering tariffs on goods at the multilateral level. Moreover, under the GATS, countries take a "positive list" approach to the liberalization of services, meaning that they indicate their willingness to negotiate reductions in barriers only on those services included in the list. This restricts the possibilities for the negotiation of reciprocal reductions within the service sector as a whole.

Greater progress has been made through FTAs in improving foreign access to domestic markets for services. Roy et al. (2008) found that, overall, commitments in FTAs went significantly beyond GATS offers in terms of sectoral coverage and levels of commitment for both Mode 1 (cross-border) and Mode 3 (foreign direct investment) type services. The liberalization has been particularly evident among countries – most notably, the US and its bilateral trading partners – that have taken a "negative list" approach, meaning that they have included all services except those specifically named. They have been successful in improving access to key sectors such as telecommunications and financial services, and they have also been able to agree on the binding of existing access to many sectors, thus providing a basis for future liberalization. FTAs have also enabled exporters to focus their lobbying activities on the particular countries and sectors in which they are most interested (Hoekman, 2008). Further, it may

well be that FTAs, being limited to so few negotiating partners, provide an easier framework within which the countries can find ways of accommodating their differences in the aims and purposes of their regulations relating to specific services. It has to be added, however, that another reason derives from the large asymmetries in power between partners in some FTAs. The weaker partners are subject to greater bargaining pressures than at the multilateral level.

It has to be assumed that, at least in principle, the improvements in market access gained through FTAs would accord preferential status to the service providers from the trading partners; and this is a possible disadvantage. First movers in liberalization may be reluctant to see their benefits extended to the firms of other countries. However, little is known empirically about such possible effects of preferences. It may be that, after agreeing to bilateral reductions in regulatory barriers, countries begin to apply the reformed regulations to firms from other trading partners. Rules of origin, moreover, for services in FTAs may also be problematic, lessening the effectiveness of any stated preferences.[13]

c) Government Procurement

For a number of countries, greater access to the government procurement market has been an important aim in negotiating regional or bilateral agreements. For those that are already signatories to the plurilateral WTO Agreement on Government Procurement, the FTAs serve to enhance transparency in requirements relating to tendering and the reward of contracts. For countries that are not signatories to the Agreement (which

[13] For further discussion, see Fink and Molineuvo (2008) and Roy et al. (2008).

provides for nondiscrimination and national treatment), the FTAs open up markets on a strictly preferential basis.

Many FTAs, however, contain no provisions at all relating to the opening up of this market. Numerous countries, especially emerging countries, lean toward the protection of their government procurement market, partly because it remains an important instrument for assisting in the development of indigenous enterprises and, sometimes, also because it may be a fruitful source of rent-seeking activity. Even among developed countries, the reciprocal nature of any agreement may deter trading partners from pressing for greater openness.[14]

In brief, while most countries have been reluctant to liberalize their government procurement markets either multilaterally or bilaterally, some have negotiated FTAs that have served to reinforce the WTO Agreement and only a few have done so preferentially.

d) Investment

The major instruments regulating commercial relations with regard to investment have been the bilateral investment treaties (BITs) drawn up between countries and, more recently, the international investment agreements (IIAs) incorporated into FTAs. This network of treaties and agreements, while certainly a component in the global governance of international commercial relations, stands quite apart from the WTO disciplines.

There has been a very substantial upsurge in the negotiation of BITs since the early 1990s and, more recently, with the proliferation of FTAs, of IIAs. It is noteworthy,

[14] For instance, perhaps because of the difficulty of obtaining the agreement of all the member governments, the EU has not sought extensive provisions in the agreements to which it is a signatory.

moreover, that quite a number of emerging countries, some of which are now home to world-class multinational corporations and/ or have firms managing international production across the borders of several neighboring states, have negotiated BITs or IIAs with other poor countries as well as with the rich countries.

BITs and IIAs overshadow the principal WTO agreements addressing investment, namely, the Trade Related Investment Measures Agreement (TRIMS) and the GATS. TRIMS is confined to prohibiting the application of certain performance measures to foreign direct investment (FDI). The GATS is broader in that it addresses the issue of right of establishment, that is, market access for foreign investments that relate to services. By contrast, BITs have taken up more fundamental matters relating to the security of foreign investments, such as their standard of treatment, financial transfers, expropriation and compensation, key personnel and dispute settlement. Some of the IIAs embodied in FTAs – those following the NAFTA model – have gone much further. They have addressed questions of entry and performance requirements as well as of the security of investments. They have sought, in other words, to establish national treatment for foreign investments at both the pre-establishment and post-establishment stages, at least in most sectors. Such conditions differentiate these FTAs markedly from the WTO disciplines as vehicles for liberalizing investment flows.

Many countries, however, have legitimate concerns in acting as hosts to foreign investment. Unlike the NAFTA model agreements, most FTAs reserve to the host country the general right to regulate the entry of foreign investment. In other words, for most or all direct investments, national treatment is withheld at the pre-establishment stage. While well aware of the direct benefits as well as the spillover benefits of foreign

firms, host countries may fear that foreign firms could crowd out smaller and currently less efficient domestic enterprises and, especially in the public utilities sector, can establish entrenched monopolistic positions. What additionally affects attitudes in many countries is the emotional baggage that they have carried over from the colonial past when foreign investments were perceived – rightly or wrongly – as exploitative consequences of political domination.[15]

Most countries may also be cautious about the extent to which BITs or IIAs could encroach upon their regulatory autonomy. These investment agreements generally provide that individual foreign enterprises can take legal action against states in the event that the terms of the agreements are breached. By invoking the expropriation clauses in these agreements, a number of foreign-owned companies have sued host governments on the grounds that the action of these governments have had the effect of directly or indirectly expropriating foreign assets, even if only in some partial way. Such a broad interpretation could place serious constraints on the freedom of host governments to pursue certain policies such as those affecting the environment or the health of the population.[16]

A further concern relates to the definition of investment employed in the BITs or IIAs. In the NAFTA model agreements, for instance, investment has been defined very broadly to include not only capital associated with FDI but also portfolio investment and even intangible assets like intellectual property. This can assume critical importance if or

[15] When the prime minister of India, Manmohan Singh, was finance minister, he said that India was "not yet ready for right of establishment. You have to remember our history as a colony. The East India Company came here as a trader and ended up owning the country." (*The Economist*, 10/3/98).

[16] It appears, however, that in some new or renewed agreements, host governments have made efforts to ensure that their freedom to determine social or environmental polices is no longer so constrained.

when host countries are faced with currency crises. For example, in the Asian financial crisis, it was the volatility of portfolio investment that aggravated the instability while the flow of FDI remained relatively steady.

Because of the asymmetries of power, the bilateral agreements – BITs and IIAs - have not protected weaker countries from being obliged to accept undesired conditions. Nor have they have been vehicles for advancing the principle of nondiscrimination. On the other hand, they have done much to provide an environment favorable to foreign investment; and their bilateral nature may also allow signatories the flexibility to design agreements that suit their particular aims and circumstances.

e) Intellectual Property Rights

Efforts to promote the international harmonization of intellectual property rights have a long history that dates back to the late 19th century. Agreement on a common, internationally recognized set of rules was successfully negotiated only during the Uruguay Round; and the incorporation of these rules into the WTO made non-compliance subject to the WTO system of trade sanctions.

Most FTAs have done little more than recognize their obligations under the WTO Intellectual Property Agreement (TRIPS). They have accordingly neither advanced nor impeded the multilateral discipline. The major exceptions have been those agreements to which the US is a signatory. In one respect, these latter agreements have probably contributed to improving the implementation of the TRIPS Agreement. That is, they have included specific obligations relating to the administration and enforcement of domestic intellectual property laws. However, the agreements have also included restrictions on the flexibilities, such as the use of compulsory licensing, that are open to countries in the

application of TRIPS; and they have added new restrictions.[17] In contrast, many poorer countries have wanted to retain the flexibilities built into the TRIPS Agreement, especially in the case of pharmaceuticals.

f) Customs Procedures

Unpredictable or cumbersome customs procedures are well known as a source of cost and delay in trade flows. Progress toward the international standardization of some aspects of customs procedures has been made through the WTO Agreement on Customs Valuation as well as through the work of the World Customs Organization (WCO) in defining best practices. In the reform and improvement of these procedures, regional and bilateral trade agreements appear to have played a positive role. These agreements have proposed cooperation between the parties to simplify and harmonize customs procedures – as, for instance, in some cases through the introduction of a single administrative form for customs clearance. Some have also envisaged cooperation in preventing breaches of customs laws and regulations. Agreements between developed and developing countries – like those between the EU and Mediterranean countries – have also provided for technical assistance to improve and modernize customs procedures. These kinds of actions taken under FTAs can only have positive spillover effects on the trade of third countries.

[17] The US Trade Act of 2002 stated that the objective of the US is to further promote adequate and effective protection of intellectual property rights, in part through "ensuring that the provisions of any multilateral or bilateral agreement governing intellectual property rights that is entered into by the United States reflect a standard of protection similar to that found in United States law."

g) Standards

Governments everywhere promulgate regulations whose intent is the protection of consumer safety and the environment, the health of human, animal and plant life, and the prevention of deceptive practices. The diverse standards set by individual countries, however, may also impede trade unnecessarily or be misused as a hidden form of protection. The Agreements on Technical Barriers to Trade (TBT) and on Sanitary and Phytosanitary Measures (SPS) of the WTO aim to lessen, or remove, such impediments. They do so by encouraging the adoption of international standards, the harmonization of national standards, or the mutual recognition of like standards. They also encourage the accreditation of agencies located in partner countries that engage in testing and certification procedures. The provisions of FTAs do not conflict with these multilateral aims but, on the contrary, may serve to further them.

On TBTs, virtually all trade agreements include some provisions. Most frequently, they confine themselves to reaffirming their rights and obligations under the WTO TBT Agreement. Many also establish joint committees to further cooperation in lessening these technical barriers. At a minimum, these committees can enhance the flow of information. They can also be more actively used to identify impediments that could readily be removed.

In some regional agreements, participants have given their cooperation considerably more concrete expression. Members have sought to introduce common standards for specific products. Harmonization of detailed national specifications, however, is not easy since it means overcoming resistance to changes in long accustomed practices where the benefits accruing from the changes may not be apparent to many

firms in the affected industries. Thus, it was after many years of such attempted harmonization that the EU – a path breaker in this context – was persuaded to take the alternative approach in which members accord mutual recognition to each other's regulations and procedures.

In some bilateral agreements, the parties have likewise set out quite detailed and extensive arrangements for lessening TBTs. They have sought, where possible, to align their regulations with international standards or they have agreed to engage in mutual recognition of each other's standards. Probably still more important in facilitating the flow of trade has been the agreement of parties to accept each other's conformity-assessment procedures and to accredit the certifying bodies in each other's territories. Obviously, this kind of cooperation can prove most feasible when the parties perceive that the underlying aims of each other's regulations are very much the same and when there is a sufficient level of mutual trust in each other's inspection, testing, and accreditation procedures.

In regard to SPS measures, the WTO Agreement is rigorous in defining the standards that national regulations must meet in order to qualify as legitimate constraints on trade. The Agreement, in effect, introduced a science-based standard for assessing national regulations; if the regulations cannot be shown to be scientifically justifiable, they cannot be invoked to impede imports.

Not all countries, however, have been equally enthusiastic in their embrace of the SPS Agreement, and their FTAs express a more qualified acceptance of its principles. Most conspicuously, the EU has taken the view that the science-based rationale of the

rules in the Agreement should yield, in some circumstances, to a broader social rationale, a view that has not been shared by the US.[18]

Some have expressed the concern that, through the multiplication of FTAs, the difference in approach between the US and the EU may lead to "regulatory regionalism". This concern has some validity though the root cause lies not in the multiplication of FTAs but in the inability to resolve differences at the international level about what the standards and procedures should be. With the accumulation of scientific evidence, it may well be that these differences will be bridged over time.

Though it may be confined to a relatively small number of countries, the work carried out under the auspices of regional and bilateral agreements evidently contributes toward improving the implementation of the WTO Agreements. It would be a mistake, however, to evaluate such work in isolation. The work carried out under regional or bilateral agreements is part of a larger endeavor. There is a substantial international network of agencies, both official and private, that seek to define technical standards in specific sectors or activities; and many countries have mutual recognition agreements relating to regulations affecting specific products or services. However, a major limitation of these varied activities is that they have been conducted largely by OECD countries. A more inclusive approach is needed.

h) Trade Remedy Measures

Trade remedy measures receive limited attention in the majority of FTAs. Quite a number make no mention at all of these measures. Of the agreements that do address the

[18] The disputes between the EU and the US on hormone-fed beef and on GMOs that have been taken to the WTO Dispute Settlement Body were outcomes of this difference in approach.

topic, almost all reaffirm their rights and obligations under the WTO agreements, and the few that elaborate on these rights and obligations mostly do so within the terms of these agreements. [19]

Thus, FTAs appear to contribute little or nothing to bettering the global management of trade-remedy measures. For example, as others have pointed out, the conditions in Article XIX of GATT and the WTO Safeguard Agreement are so phrased that they give rise to considerable uncertainty in their application.[20] According to the conditions, the import surges justifying the unilateral introduction of protective measures should arise from "unforeseeable developments," should cause "serious injury" to the industry and should be identifiable as the source of the injury. There is room for wide differences in the interpretation of these conditions, and FTAs offer no clarification.[21] Again, the WTO Anti-Dumping Agreement leaves wide discretion to the individual member countries in the procedures they follow and the criteria they apply, in imposing anti-dumping duties. In FTAs, only a few tighten the conditions under which such action may be taken.[22]

The treatment of countervailing duties in FTAs stands in interesting contrast to the other trade remedies. The WTO Subsidies and Countervailing Measures Agreement

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[19] For an extensive analysis of trade remedy measures in regional and bilateral agreements, see Teh et al. (2007).

[20] For a critique of the language of the GATT and WTO rules and the uncertainties to which they give rise, see Sykes (2003). For a summary in the context of Dispute Settlement Body rulings, see Brown and Stern (2009).

[21] In NAFTA and other trade agreements to which the US is a signatory, a further element of arbitrariness is that participants may be exempted from any restrictions that they place on imports from all other sources. This does not appear to comply with GATT/WTO rules, which call for nondiscriminatory application of the measures.

[22] One significant exception is the agreement between Australia and New Zealand. In a 1990 protocol to the agreement, these countries chose to recognize that the maintenance of anti-dumping provisions was inconsistent with the realization of free trade between them, and that thereafter, any allegations of predatory pricing practices would be considered under the competition laws of the two countries.

provides a full definition of what constitutes actionable subsidies, and it lays out procedures for assessing the duties. The discipline is clear and virtually no FTAs include any qualification to its terms.

i) Dispute Settlement

FTAs generally spell out a process for dispute settlement, although in some cases, it is no more than an undertaking to hold consultations on any disagreement. In most agreements, however, a formally complete process is laid out very much along the same lines as in the WTO. Parties to a dispute usually have the option of taking any dispute to the WTO or to the body established under the regional or bilateral trade agreement.[23] This is interesting since it implies that parties believe that their agreements are consistent with their rights and obligations under the WTO. There should, in principle, be no conflict between the different dispute settlement bodies, although different tribunals may, of course, make different judgments.

j) Competition Policy

Some FTAs have gone beyond the WTO disciplines to address other issues that also affect commercial relations among countries. One such issue is competition policy.[24] Cross-border disputes about competition policy have repeatedly surfaced in relations between the EU, Japan, and the US. These are likely to multiply in the future, particularly as emerging countries, having dismantled state controls and embraced some

[23] In NAFTA, disputes on certain issues – such as those concerning SPS measures – can be settled only by the partner countries.

[24] In international trade relations, competition policy is often loosely understood to include governmental measures that impede the competition of foreign enterprises. Thus, they can include governmental regulations that prevent the operation of foreign enterprises in, say, the banking or airline sectors. We are concerned here only with the anti-competitive conduct of firms in the private sector.

version of the market system, increasingly feel the need to develop their own internal competition policies.

Competition policy – understood as policy relating to firms in the private sector – may affect commercial relations among countries in several ways. [25] In the context of FTAs, however, it is first and foremost in relation to market access that questions of competition policy may arise. Competition laws, or their absence, may result in the apparent inability of foreign competitors to gain market access, undermining the benefit expected from the negotiation of reductions in trade barriers.[26] A second major source of possible conflict is disagreement over the propriety of competition rulings that affect a country's multinational corporations operating in another's jurisdiction. [27]

For FTAs to make a contribution toward the resolution of such issues, some convergence in the design and enforcement of national competition laws is needed. But this is hard to realize. While we can say at a high level of generality that countries' competition laws generally share the common aims of promoting efficiency and fairness, individual countries interpret these concepts differently in the light of their own particular objectives and norms. (Graham and Richardson, 1997) Moreover, we should recall that there is not a settled and unchanging body of economic doctrine about what constitutes anti-competitive behavior in all circumstances. What happens in practice is that national

[25] Tartullo (2000) provides a lucid exposition on the several ways in which cross-border conflicts may arise between national competition policies.

[26] This, for example, was the substance of several complaints that the US brought against Japan in the 1980s and 1990s.

[27] The US and the EU, for example, have had disagreements about proposed mergers of major aircraft and pharmaceutical companies, holding different views on how the mergers might affect competition in their markets.

laws are expressed in broad conceptual terms, leaving the enforcing agencies to interpret and apply them in the specific circumstances of each case.

FTAs bear out the difficulty of seeking the convergence or harmonization of national competition laws. Many agreements make no reference to the issue at all, but of those that do, the substance relating to competition policy proper – the laws concerning the conduct of firms in the private sector – is almost always limited to general statements of purpose or principle. [28] They affirm their intent to pursue competition polices that will realize such broad aims as the promotion of efficiency and consumer welfare, or the protection of the benefits of trade liberalization measures. It is made clear, however, that this is to be accomplished through the enforcement of the national competition laws of each country.

Some FTAs contain another provision that contributes more positively to the lessening of possible cross-border conflicts over competition issues. Accepting that national laws differ, they have looked to promote cooperation in the enforcement of these laws. Cooperation between the enforcing agencies can over time not only promote a better mutual understanding of national laws and enforcement procedures, but can also facilitate the exchange of information on the conduct of businesses alleged to be engaging in anti-competitive practices. This encourages adoption of the legal concept of comity which, in the present context, means that each party's competition agency undertakes to carry out investigations of firms operating within its jurisdiction when their

[28] In some FTAs, most notably those to which the US is a signatory, a major part of the chapter on competition policy is devoted to the conduct of state monopolies or state-owned enterprises. The primary stipulation is that in so far as these monopolies or enterprises are granted powers affecting other firms, such as the issue of licenses, these powers should be exercised in a nondiscriminatory way. While a legitimate concern, this falls into the broader category of government obstacles to open competition and goes beyond our more limited definition of competition policy.

conduct allegedly harms the interest of the other party. Of course, commitments to such mutual assistance are not conditional on the negotiation of FTAs. Several OECD countries, in fact, have bilateral arrangements that extend cooperation on procedural matters to include the reciprocity implied in the principle of comity.

Bilateral or regional trade agreements cannot address all the competition issues that arise in international commercial relations. Egregious anti-competitive practices of international cartels are a case in point. A broader approach, such as that pursued by the Competition Law and Policy Committee of the OECD, or by UNCTAD, has to be taken.[29] What we need to note in the present context is the very modest contribution that FTAs have made, or are likely to make, in lessening conflicts over competition policies. Closer cooperation among national competition agencies, however, is worthwhile, particularly to assist each other in the enforcement of their own laws.

k) Labor Standards

Some developed countries, most notably the US and the EU, have insisted on the inclusion of clauses on labor standards in the FTAs to which they are parties. They have been acting partly in response to general concerns about human rights and partly to allay fears that competition from poorer countries may be unfair because of exploitative working conditions.

From the viewpoint of the advocates of labor standards, the advantage of their inclusion in FTAs is that they can be tied to trade sanctions in some form. For instance, in

[29] For a discussion of proposals along these lines, see Tartullo (2000, pp 499-503). See also Graham and Richardson (1997, Ch. 17) for a more ambitious set of proposals. McGinnis (2003) sets out a modest proposal for the inclusion in the WTO of an explicit commitment to apply competition laws in a non-discriminatory way to foreign firms. The ability to invoke the WTO dispute settlement machinery would be cases in which market access was at issue.

several agreements to which the US is a partner, breaches of standards can attract monetary penalties. However, the effectiveness of such arrangements is open to doubt. It is noteworthy that, under the post-NAFTA trade agreements signed by the US, no labor dispute has reached the Office of the US Trade Representative (USTR). One disincentive is that, because of disparities between the labor standards as stated in the agreements and the domestic labor laws of the US, any actions by the USTR could expose a number of these laws to legal challenge. (Bolle, 2008).

As we have discussed elsewhere (Brown and Stern, 2008), the inclusion of labor standards in trade agreements raises some major concerns. Many countries with low labor costs fear that such provisions may be abused for protectionist purposes. It is, moreover, very difficult to arrive at unambiguous definitions of labor standards that are mutually acceptable and sufficiently specific for dispute-settlement purposes. Though agreed international labor conventions may be taken as a guide, these are expressed in broad terms and leave much to interpretation by national courts and labor tribunals. It is thus not surprising that trade agreements have tended to confine themselves to a requirement that trading partners enforce their own national labor laws. Further, there are grounds for skepticism about the effectiveness of trade or monetary penalties as means of bringing about improvements in domestic standards. Improvements in labors standards are closely bound up with developments that are essentially domestic, namely, rising levels of living and the associated changes in social norms. To many, the moral suasion exercised through the ILO and other channels appears a more effective external influence than penalties embodied in trade agreements.

l) Environmental Standards

There are a large number of environmental agreements dealing with specific environmental matters. Some of these provide for the use of trade measures, such as import bans on hazardous materials, in implementing the agreements. The WTO Committee on Trade and the Environment also has, as a standing item on its agenda, the study of the relations between environmental agreements and the WTO disciplines. However, apart from these modest links, environmental agreements and the multilateral trading system stand apart from each other as separate endeavors. It is equally the case that, in regional and bilateral trade agreements, the inclusion of environmental provisions is the exception rather than the rule. Many agreements make no mention at all of environmental matters. It is only in agreements to which the US is a party that trading partners accept a decided obligation to abide by specified environmental standards, facing possible trade penalties in the event of failure to comply.

The environmental provisions in US trade agreements are modeled after the North American Agreement on Environmental Cooperation (NAAEC) that the US negotiated with Canada and Mexico after NAFTA had been signed. The essence of the provisions of the NAAEC and of subsequent bilateral trade agreements has been, not the setting of common or minimal standards for the participating countries, but a requirement that the parties enforce their own existing environmental laws. They have not differed in intent from the agreements or understandings on environmental cooperation that the US has negotiated, quite separately from trade agreements, with a number of other countries on a broad range of environmental issues. The innovative element in including these provisions in trade agreements is the incorporation of procedures that ostensibly allow for

countries to be called to account in the event that they appear to be failing in enforcing their own laws. Further, if a country does not mend its ways, it may be required to pay a monetary assessment or even – as a last resort – to face the withdrawal of a trade benefit.

4. Concluding Observations: Some Broader Prospects

When we consider the likely part played by FTAs in future global governance, we should bear in mind two major changes that are taking place in international trade relations. First, the WTO is losing its central role as the prime mover in the liberalization of border barriers to trade. In the earlier decades after WW2, the core of trade liberalization was the reciprocal tariff reductions negotiated among the industrial countries in GATT on the basis of general MFN treatment. In the last two decades, however, the greater part of the liberalization of border barriers has taken place unilaterally – mostly by developing countries – while the main interest of the developed countries has shifted to the part played by domestic regulations in impeding integration of markets for goods, services and investment. As a consequence, the critical importance of multilateral negotiations in lowering trade barriers has been receding. Second, we are moving away from a world in which the US has acted as the sole dominant power, interacting mainly with the EU countries in formulating international trade policies. Both the US and the EU are now increasingly required to share the management of the multilateral system with emerging market and developing countries, particularly with Brazil, China, and India. In brief, so long as globalization moves forward, the WTO is likely to retain its significance, though less as a body focused on trade liberalization and more as the multilateral institution responsible for defining and overseeing compliance with global norms, principles and rules of trade conduct. Extension of its disciplines,

however, will be more constrained by the diverse interests of a wider and more disparate group of countries.

We cannot say whether, in the aftermath of the recent recession and financial crisis, regional and bilateral trade agreements will continue to multiply or how far existing agreements will be strengthened. In particular, there is some concern, as expressed, for example, in Aggarwal and Evenett (2010), about the introduction of "behind-the-border" barriers to deal with the effects of the recession, currency imbalance, and exchange-rate management. Nonetheless, it seems quite likely that regional and bilateral of agreements will gradually play an increasing role in the global governance of commercial relations. We see two reasons for optimism about their future interaction with the multilateral system established under the auspices of the WTO, and we see one reason for pessimism.

a) Diminishing Tariff Preferences

In the matter of market access, the formation of regional or bilateral trade agreements has been a deliberate act of divergence from a multilateral system that is based on non-discrimination. What can be said of these agreements, however, is that none have raised their general MFN tariff barriers against third countries. In thus conforming to GATT Article XXIV, they have lessened the fear that mutually exclusive trading blocs might emerge. In fact, because the long term trend since WW2 has been toward the progressive lowering of MFN tariffs, tariff preferences have slowly diminished.

What can we expect over the next ten to twenty years? So long as the decline in US political hegemony and the emergence of a multi-polar world does not result in its

political fragmentation into hostile blocs, it is likely that economic and technological forces will persist in making for closer, global economic integration. So, provided that trade measures do not become more widespread and severe because of domestic economic problems and a failure in the exchange-rate and payments system to adjust to changing circumstances, the trend toward lowering trade barriers is unlikely to be halted.

Certainly, the pace of liberalization may well in any event be slower than in the last twenty years. With the industrial countries having less to offer in the way of reductions in trade barriers that they are willing to put on the bargaining table, multilateral trade negotiations offer diminishing returns in the field of trade liberalization. The world will rely still more on unilateral reductions of trade barriers to decide the pace of liberalization. This implies a slower rate that will not please the committed free traders, but it has the benefit that countries will decide how far and how fast to open their markets on the basis of their own policy preferences.

There is, then, a reasonable, if fairly distant, prospect that the network of tariff preferences and other preferential barriers arising from FTAs will gradually fade in importance. It is quite conceivable that, if the many regional or bilateral agreements now envisaged actually bring most tariffs to zero, this could advance the world toward multilateral free trade in numerous products. The developed countries already have zero tariffs on many products and if agreements in the developing world eliminated tariffs on their intra-trade in similar products, multilateral agreements establishing free trade in particular sub-sectors might become feasible. The agreements would be based not on reciprocal bargaining but on the recognition of collective interest. They could be modeled on the International Technology Agreement to which countries voluntarily

became signatories and which came into effect only when the total number of signatories accounted for 90 per cent of world trade.

b) Regulatory Cooperation

To a major degree, expanding commercial relations now depend upon the forging of agreements that lessen the regulatory impediments to external trade that many domestic regulations, unintentionally or not, give rise to. This has motivated the search for some convergence in national standards and procedures. The common international rules of the WTO and the network of mutual recognition agreements among individual countries are practical instruments of these endeavors.

These, however, are not isolated activities. Convergence in the rules and procedures affecting commercial relations among countries rests upon the growing international infrastructure of cooperation that exists among national regulatory agencies and among numerous private and semi-private bodies like scientific, professional or industry groups that are concerned with common standards and procedures. Many have formal organizations at the international level where information is exchanged and discussed and where shared standards or procedures are enunciated or best practices defined. An instance is the Codex Alimentarius Commission serviced by the FAO/WHO that defines health and safety standards affecting human, animal and plant well being, and we have briefly mentioned the World Customs Organization's work relating to customs procedures as well as the less formal consultations among national competition agencies in implementing competition laws. There are a great many more such endeavors. Without such an infrastructure, both formal and informal, it would be much less feasible for governments to reach agreement on broad rules in the WTO that require

countries to conform to shared standards and procedures. In this sense, it is misleading to view governance by the WTO of the multilateral trading system solely as a hierarchical arrangement in which a higher central body defines rules of conduct that are thereafter passed down for enforcement by the individual member countries. The process has to be preceded by the emergence of some consensus on what the rules should be; and that depends on an extensive exchange of information, on analysis and on discussion among specialized national agencies. Regional and bilateral trade agreements can pay a positive role in this process by promoting cooperation among the regulatory agencies and raising their levels of mutual trust in each other's practices.

Some may argue that, because of such cooperative measures, firms in member countries of regional or bilateral agreements are likely to enjoy an advantage over competing firms from third countries. Their trading costs may be lowered by streamlined procedures, and they may face fewer regulatory hurdles in introducing new products. This could be seen as a violation of the principle of non-discrimination. There is, however, nothing necessarily exclusive about their preferential status; other countries could arrange for equivalent treatment. Indeed, we could expect competition to result in the more general adoption of better practices.

c) WTO-plus Provisions

The most controversial aspect of some regional or bilateral agreements is that they include provisions that extend beyond the range of WTO disciplines. Proponents of these WTO-plus agreements often defend them on the grounds that they are vehicles for making innovations in the management of multilateral trade relations. This may be true of some provisions. Trade agreements may not only clarify, or facilitate, implementation of

WTO disciplines; they may also point the way toward an extension of these disciplines. We have noted earlier, for instance, how the inclusion of competition policy in some agreements may contribute toward greater collaboration among national competition agencies and to a consequent lessening of certain trade conflicts. However, the most striking feature of one group of bilateral trade agreements – those between large rich countries and small poor countries - is the great asymmetry in bargaining power between the parties to the agreements, and this shows up in the inclusion of provisions in their agreements that would not be acceptable among countries less unevenly balanced in power.

The US has been the worst offender on this score. We have noted several instances in which the inclusion of WTO-plus provisions has no explanation other than such asymmetry of power. In the provisions relating to investment capital, for instance, the US has insisted that portfolio investment be freely transferable even in circumstances of currency or financial crisis, virtually prohibiting the possible use of temporary capital controls or other restrictive measures. In view of the vulnerability of developing countries to externally generated instability, this appears to subsume the public interest of weaker trading partners to the private interest of US financial concerns. Likewise, some provisions relating to IP have placed restrictions on the manufacture of generic drugs by poor countries that are noticeably more limiting than those stipulated in the WTO discipline. Again, the bilateral agreements to which the US is a party include provisions on labor and environmental standards that place intrusive obligations on trading partners.

These kinds of additional provisions can be sincerely (if self-righteously) advanced on the grounds that, despite the objections of trading partners, they are not

merely self interested but also work for the good of the trading partner, at least in the long run. But the economic reasoning that supports this line of argument is always open to challenge, and the imposition of such provisions is not in any case the action of a just nation. Provisions should not be imposed on weaker trading partners that they – and other disinterested observers – perceive to be unfair. To use bilateral agreements in this way weakens international confidence in the commitment of powerful nations to multilateral disciplines based on consensus.

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