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Nr. 36/1

Peter Balastèr, Chantal Moser
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Sur la voie du bilatéralisme: enjeux et conséquences (volume 1)

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Préface

Le Secrétariat d'Etat à l'économie (SECO) a confié six études à des chercheurs en politique économique extérieure, avec pour objectif d'examiner la stratégie des concurrents de la Suisse en matière d'accords de libre-échange et d'évaluer le risque de discrimination qu'elle encourt avec l'accélération de la conclusion de ce type d'accords. Les études ont été conçues de manière à d'abord donner un aperçu horizontal des différents réseaux d'accords de libre-échange, puis d'associer une région géographique à une catégorie économique particulière : L'UE et les biens agricoles, la zone Euro-Med et les textiles, l'Asie et les services et investissements, l'Amérique latine et les biens manufacturiers. Les travaux de recherche ont été effectués durant l'année 2007 par des économistes en Suisse et à l'étranger. Les résultats de leurs recherches font l'objet des deux volumes de la présente publication.

Vorwort

Das Staatsekretariat für Wirtschaft (SECO) hat sechs Studien an Forschungsstellen vergeben, die sich mit aussenwirtschaftlichen Fragen befassen. Ziel der Studien war es, die Strategien der mit der Schweiz bezüglich Freihandelsabkommen konkurrierenden Länder zu untersuchen und das Diskriminierungsrisiko abzuschätzen, das mit der Zunahme dieser Art von Abkommen einhergeht. Die Studien geben einerseits einen Überblick der verschiedenen Freihandelsnetze, andererseits werden einzelne geografische Regionen mit verschiedenen Kategorien von wirtschaftlichen Leistungen in Verbindung gebracht: mit der EU Agrargüter, mit der Euro-Med-Zone Textilien, mit Asien Dienstleistungen sowie Investitionen; und schliesslich mit Lateinamerika Industrieerzeugnisse. Die Forschungsarbeiten wurden von Ökonomen in der Schweiz und im Ausland im Jahr 2007 durchgeführt. Die Resultate der Forschungen werden in den vorliegenden zwei Bänden vorgestellt.

Note des éditeurs : Sur la voie du bilatéralisme – enjeux et conséquences

L'Organisation mondiale du commerce (OMC) estime que près de 400 accords commerciaux régionaux (ACR[1]) seront en vigueur d'ici à 2010. Son directeur général, Pascal Lamy, a récemment affirmé que la prolifération d'ACR est « source de préoccupation »[2]. La multiplication d'accords qui se chevauchent suscite des inquiétudes quant à leurs effets sur les relations commerciales basées sur le multilatéralisme. Pourtant, le régionalisme n'est pas près de disparaître, d'autant plus que les négociations commerciales multilatérales se trouvent toujours dans l'impasse. Que signifie cette évolution du système commercial international pour une économie aussi intégrée que la Suisse ? Les études du SECO permettent de mieux comprendre les enjeux et les conséquences de l'effervescence du régionalisme.

La conclusion d'accords de libre-échange sur un plan régional n'est pas un phénomène nouveau. En 1960 déjà, la Suisse figurait parmi les membres fondateurs d'un accord commercial régional (ACR), à savoir l'Association européenne de libre-échange. Ce qui est nouveau, c'est l'effervescence avec laquelle les accords commerciaux préférentiels se sont multipliés ces dernières années. A une exception près, tous les pays membres de l'OMC sont partie d'au moins un ACR. La Suisse n'est pas restée en marge de cette dynamique bi- ou plurilatérale : en 2007, elle aura mené six négociations en parallèle, visant à obtenir un accord de libre-échange avec le Canada, la Thaïlande, le Conseil de coopération du Golfe arabe, le Japon, la Colombie et le Pérou.

Depuis les années 1990, la Suisse s'est engagée à assurer à ses entreprises des conditions d'accès au marché au moins équivalentes à celles dont bénéficient leurs concurrents européens, en mettant d'abord l'accent sur la conclusion d'accords de libre-échange avec les pays d'Europe centrale et orientale, puis en étendant progressivement son réseau d'accords au bassin méditerranéen. Plus récemment, la Suisse a cependant pris les devants par rapport à l'Union européenne (UE), en concluant des accords avec des partenaires commerciaux du monde entier, reflétant une nouvelle dimension dans les rapports économiques internationaux.

L'évolution du régionalisme a été particulièrement vigoureuse ces dix dernières années et ne semble pas ralentir, comme en témoigne la multiplication des accords entre des pays asiatiques, qui auparavant n'avaient pas d'arrangements préférentiels. On estime que les ACR couvrent aujourd'hui plus de la moitié du commerce mondial. Ces initiatives régionales ont été perçues tantôt comme une menace, tantôt comme complémentaires au cadre multilatéral. Les études du SECO n'ont pas pour objectif d'alimenter davantage ce débat. Au contraire, en admettant que la

[1] Les « accords commerciaux régionaux » englobent, selon la terminologie de l'OMC, également les accords de libre-échange bi- ou plurilatéraux conclus entre des pays ou des groupes de pays qui n'appartiennent pas à la même région.
[2] Discours prononcé lors de l'ouverture de la conférence intitulée "Multilatéraliser le régionalisme", 10 septembre 2007, Genève. (http://www.wto.org/french/news_f/sppl_f/sppl67_f.htm)

conclusion d'accords commerciaux préférentiels est devenu une constante dans le système commercial international, ses implications doivent être examinées avec attention.

L'avantage de la flexibilité

L'attractivité du bilatéralisme s'explique essentiellement par la flexibilité que permettent les négociations bi- ou plurilatérales : flexibilité au niveau du choix et du nombre de partenaires de négociation et flexibilité au niveau du contenu des accords. Il est évident que mener des négociations entre un nombre limité de partenaires homogènes est plus facile que de négocier à l'OMC entre 151 pays aux intérêts divergents. Néanmoins, cette flexibilité dans le choix des partenaires ravive la question des rapports de force entre partenaires économiques de taille différente. Lier les intérêts économiques aux considérations politiques peut devenir problématique pour les petits pays qui ne disposent pas du même pouvoir de négociation que les grands blocs économiques.[3]

Dans ce contexte, l'étude de Ken Heydon et Steve Woolcock (voir Heydon/Woolcock 2007, vol. 1, p.13ss) identifie les considérations stratégiques qui sous-tendent la politique commerciale de trois grandes puissances économiques, à savoir les Etats-Unis, l'Union européenne et le Japon, et de deux petites entités économiques fortement intégrées dans le commerce mondial : les pays de l'AELE et Singapour. Ils examinent ensuite les dispositions des accords qui ont été conclus, en évaluant leur signification en termes d'accès au marché et d'ouverture.

Bien que par définition, un accord commercial préférentiel déroge au principe fondamental de non-discrimination sur lequel est construit le système commercial multilatéral, il est prévu que les pays membres de l'OMC peuvent conclure de tels accords, à condition qu'ils respectent les règles énoncées à l'art. XXIV du GATT, à l'art. V du GATS ou prévues par la clause dite d'habilitation[4]. Parmi ces règles figure l'obligation d'éliminer des droits de douanes et autres réglementations restrictives pour « l'essentiel » des échanges commerciaux. Cette formulation assez vague confère une certaine marge de manœuvre aux négociateurs permettant d'accommoder les sensibilités des uns et des autres.

Un domaine sensible : l'agriculture

Sur ce dernier point, l'agriculture est un secteur particulièrement sensible dans les négociations commerciales internationales. L'étude de Jean-Christophe Bureau (voir Bureau/Jean 2007, vol. 2, p. 13ss) montre que la politique commerciale de l'UE a été marquée durant plusieurs années par trois priorités qui ne mettaient pas les relations bilatérales au centre de sa stratégie

[3] Selon certains observateurs, le manque de progrès des négociations d'un accord de libre-échange entre la Nouvelle Zélande et les Etats-Unis serait dû en partie à la décision néo-zélandaise de 1985 d'interdire l'accès de ses ports aux navires à propulsion nucléaire et, plus récemment, à sa décision de ne pas soutenir l'intervention américaine en Irak en 2003.

[4] Cette clause permet aux pays développés d'accorder un traitement plus favorable aux pays en développement, tels que le prévoit par exemple le Système généralisé de préférences (SGP).

commerciale. Outre la voie multilatérale, l'UE s'est efforcée de renforcer ses relations commerciales avec ses voisins immédiats, soit pour des objectifs de stabilité politique, soit en vue d'une future intégration dans l'UE. La troisième priorité consistait en une politique de préférence vis-à-vis des pays en développement. Ce n'est que récemment que l'UE s'est mise à conclure des accords de libre-échange à vocation purement économique. L'étude de Bureau montre que, dans le domaine agricole, les accords signés par l'UE n'apportent que des avantages limités aux pays partenaires, comparés à ceux dont ils bénéficiaient déjà sous le Système généralisé de préférence. Contrairement aux accords du cycle de l'Uruguay du GATT, signés en 1994 à Marrakech, les accords préférentiels ne semblent pas avoir influencé l'évolution de la politique agricole commune de l'UE.

L'étude de Sébastien Jean prolonge celle de Bureau dans la mesure où elle quantifie les effets des préférences tarifaires et se réfère aussi à la Suisse (voir Jean/Bureau 2007, vol. 2, p. 151ss). Comparée à l'UE, la Suisse a davantage tendance à exclure de ses accords de libre-échange les produits considérés comme sensibles. Par contre, les réductions des droits de douane accordées sont proportionnellement plus importantes, le niveau initial étant généralement plus élevé[5]. Pour plusieurs pays partenaires, les estimations quantitatives révèlent des effets plutôt modestes de la libéralisation du commerce dans le secteur agricole. Des effets plus importants sont observés lorsque le secteur agricole est désagrégé en catégories de produits. Les estimations empiriques sont néanmoins rendues difficiles par la présence d'instruments commerciaux tels que les contingents tarifaires ou un système de prix d'entrée, ainsi que par le manque de recul temporaire des données eu égard à la mise en œuvre relativement récente de la plupart de ces accords.

Effets sur les pays tiers

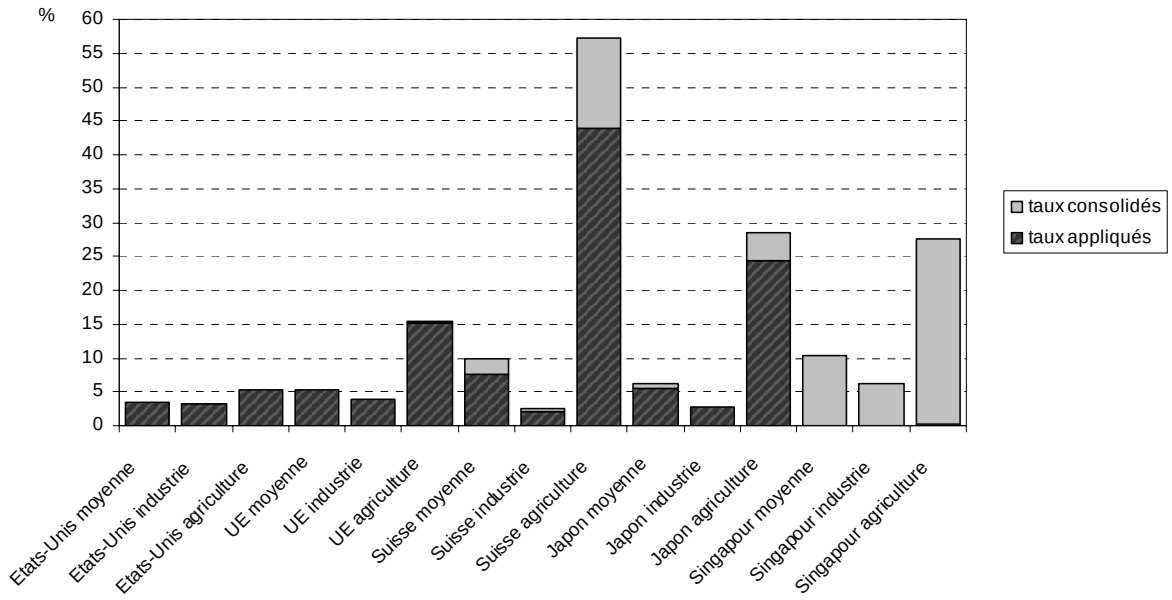
Les effets des accords commerciaux préférentiels sont étroitement liés à non seulement l'accès au marché effectif octroyé par les accords (importance de la marge préférentielle), mais également à la capacité du partenaire de saisir de nouvelles opportunités d'exportation. L'ampleur de la marge préférentielle dépend bien sûr du niveau des droits de douane accordés sur la base de clause de la nation la plus favorisée (NPF). Le graphique 1 montre qu'il existe des variations importantes entre les pays examinés, en particulier entre les produits agricoles et industriels.

L'effervescence du bilatéralisme soulève la question des conséquences sur la compétitivité des pays tiers. En 1950 déjà, Jacob Viner identifiait deux effets distincts d'un accord commercial préférentiel : il y a création de commerce lorsque l'élimination (ou réduction) tarifaire permet d'importer des produits moins chers du pays partenaire ; et il y a déviation du commerce lorsque

[5] Il faut néanmoins souligner que les comparaisons tarifaires entre la Suisse et l'UE sont incertaines en raison des problèmes méthodologiques liés au calcul d'équivalents ad valorem.

ces importations s'effectuent au détriment du pays tiers qui, s'il bénéficiait de préférences similaires, serait à l'origine des importations les plus avantageuses.

Graphique 1: Taux ad valorem consolidés et appliqués[6] pour la Suisse en comparaison internationale



Les taux consolidés correspondent aux engagements d'un pays à l'OMC de ne pas relever un droit de douane au-dessus d'un niveau convenu (consolidé). Les taux appliqués sont les droits ad valorem (en pourcentage du prix) effectivement perçus sur les importations. Bien que la moyenne simple des taux consolidés de Singapour dépasse 10%, les taux effectivement appliqués par ce pays sont nuls. (Source : WTO tariff database, 2006)

En se concentrant sur un secteur extrêmement concurrentiel, Olivier Cadot (voir Cadot et al. 2007, vol. 2, p. 205ss) utilise deux types de modèles économiques afin d'évaluer les effets de la libéralisation du commerce de la zone Euro-Med dans le secteur du textile et habillement. Il conclut que pour la Suisse, les risques de déviation du commerce existent mais sont limités, et que d'autres facteurs (tels que le PIB, le taux de change réel, la qualité des infrastructures, etc.) expliquent généralement de manière plus significative l'évolution des échanges. Outre l'aspect tarifaire, l'étude de Cadot s'intéresse plus particulièrement aux effets des règles d'origine. Celles-ci visent à assurer que le produit importé sous un régime préférentiel provient effectivement du pays auquel la préférence tarifaire a été accordée. Mais elles sont définies selon différents critères et de manière non harmonisée. Dès lors, la prolifération des accords

[6] Un nombre important de partenaires commerciaux sont des pays en développement qui profitent de droits de douane réduits ou nuls par rapport aux taux NPF, en vertu des systèmes généralisés de préférences. La base de données de l'OMC ne contient pas les droits préférentiels plus bas accordés au titre d'accords de libre-échange ou de programmes préférentiels en faveur des pays en développement.

commerciaux préférentiels a donné lieu à un enchevêtrement de règles complexes ressemblant ainsi à un « spaghetti bowl », selon l'expression consacrée de Jagdish Baghwati.[7]

Le textile est un secteur qui se prête bien pour l'étude de la problématique des déviations du commerce, puisqu'il est caractérisé par des chaînes d'approvisionnement transfrontalières – du fil au vêtement en passant par le tissu – qui se retrouvent également dans les statistiques. Les différentes étapes de cette chaîne de création de valeur ajoutée se déroulent en général dans différents pays, par exemple au Nord et au Sud de la Méditerranée. En se concentrant sur le secteur textile et habillement en Afrique du Nord, l'étude de Cadot montre de manière empirique que les règles d'origine contraignantes réduisent de façon statistiquement significative les avantages des préférences tarifaires octroyées à des pays comme la Tunisie et le Maroc. Les contraintes des règles d'origine empêchent la fragmentation optimale de la chaîne de production.

L'étude rédigée par des collaborateurs de la Banque interaméricaine de développement (voir Estevadeordal et al. 2007, vol. 2, p. 329ss) renverse la perspective Nord-Sud de Heydon et Woolcock en se concentrant sur l'Amérique latine et en identifiant les déterminants des importations à de cette région ces quinze dernières années. Le facteur déterminant est sans conteste l'essor rapide des pays dynamiques d'Asie – de la Chine en particulier –, à quoi s'ajoute l'instabilité macro-économique des grands pays latino-américains comme deuxième facteur explicatif de l'évolution des importations. La Suisse – et l'Europe en général – ont perdu des parts de marché comme exportateurs. Il est encore trop tôt pour déterminer dans quelle mesure les accords de libre-échange conclus dans la région parviendront à faire progresser le commerce entre partenaires commerciaux parties à ces accords au détriment d'autres sources d'approvisionnement. Cependant, les auteurs sont d'avis que les facteurs structurels (composition du commerce selon les pays d'origine et les catégories de bien commune à l'Amérique latine) expliquent davantage l'évolution des échanges que les facteurs politiques, y compris la politique commerciale.

Services et investissements

Au-delà des questions tarifaires et des règles d'origine, de plus en plus d'accords commerciaux préférentiels sont qualifiés de « deuxième génération », c'est-à-dire qu'ils visent aussi à réduire les barrières non tarifaires et qu'ils couvrent les domaines des services et des investissements. L'étude de Pierre Sauvé (voir Sauvé et al. 2007, vol. 1, p. 183ss) quitte donc le domaine du commerce des marchandises pour s'intéresser aux services et aux investissements directs étrangers. En se concentrant sur le bloc asiatique, Sauvé constate d'abord que l'intégration des pays asiatiques dans l'économie mondiale a été déterminée essentiellement par les forces de marché, en particulier par l'investissement direct étranger et par le commerce intra-industriel

[7] Baghwati, Jagdish (2002). *Free Trade Today*.Princeton University Press: Princeton, New Jersey.

qu'il a suscité. Il semble que les accords de libre-échange et d'investissement n'aient joué qu'un rôle limité dans l'ouverture progressive de la région.

Il n'en reste pas moins que toute libéralisation préférentielle comporte un risque inhérent de discrimination à l'égard des pays tiers. Pour les services, il semble toutefois que ce risque soit plus limité que pour les marchandises, du fait que les obstacles au commerce se trouvent moins à la frontière (tarifs ou quotas) qu'au niveau des réglementations internes. Or, une fois qu'un secteur est réglementé de façon plus libérale, l'ouverture bénéficie généralement à l'ensemble des partenaires commerciaux. En outre, les accords commerciaux préférentiels conclus par les pays asiatiques comprennent des règles d'origine liées aux investissements dans les services qui sont relativement peu restrictives, en permettant à une entreprise étrangère implantée dans le pays partie à l'accord de bénéficier des mêmes préférences que les entreprises locales. En conséquence, une entreprise suisse qui entretient un volume substantiel d'opérations commerciales dans un « hub » tel que Singapour peut également profiter de l'ouverture des marchés en Asie. Cependant, des règles d'origine libérales contenues dans les accords des concurrents de la Suisse ne remplacent pas le besoin de sécurité juridique qu'assurent les accords de libre-échange conclus par la Suisse.

Le phénomène du régionalisme va se poursuivre

Il ressort des études présentées ici que les craintes de déviation du commerce traditionnellement exprimées en rapport avec l'effervescence du bilatéralisme doivent être nuancées. En tous les cas, le phénomène du régionalisme va se poursuivre et dès lors mérite que des travaux de recherche empiriques y soient consacrés. Il faut néanmoins rappeler que les régimes préférentiels n'existent que parce que les droits de douane accordés sur la base de clause de la nation la plus favorisée (NPF) ne sont pas à zéro. Par conséquent, l'intérêt pour le bilatéralisme – et les risques qu'il comporte – diminuent substantiellement avec une conclusion couronnée de succès du cycle de Doha.

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LSE Enterprise

The Evolution of Free Trade Agreements negotiated by the United States, European Union, EFTA, Japan and Singapore: strategies, content and comparisons

Ken Heydon and Steve Woolcock

London School of Economics and Political Science

Final Report

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1.0 EXECUTIVE SUMMARY

1.1 Effects of FTAs on Trade and Investment

Notwithstanding the problems of data availability and interpretation, there seems to be evidence of a linkage between trade and investment flows and the *implementation* of FTAs to which the United States and, to a lesser extent, the EU are a party. There may also be a linkage between trade and investment activity and the *announcement* of FTA negotiations, though this is much harder to substantiate.

Unlike the US and EU experience, Japan's FTAs appear to have had a negligible effect on flows of trade and investment, though the relative newness of Japan's agreements, and associated data limitations, mean, however, that any observations at this stage can only be tentative. Similar considerations apply in the case of Singapore.

There seem to be few discernible trends in EFTA trade and investment with individual FTA partners. Moreover, such trade, in total, represents a relatively small percentage of EFTA exports and imports, since the bulk of EFTA's external trade is with the EU, whose trade relationships are covered by the EEA Agreement in the case of Norway, Island and Liechtenstein and by the 1972 Free trade agreement in the case of Switzerland. There are nevertheless observations that can be made in respect of EFTA FTAs, which may also have wider significance.

- Overall, EFTA trade with FTA partners rose 8.1 percent between 1992 and 2002, compared with only 0.7 percent with the rest of the world.

- Within this trade, EFTA imports of goods increased more than EFTA exports, because of the asymmetric liberalisation provisions of the agreements.

- Even where aggregate trade with a partner did not increase, trade in products that were subject to significant liberalisation increased. For example, while Swiss trade with Mexico relative to the rest of the world fell from 2002 to 2005, exports of pharmaceuticals and watches, each subject to tariff dismantling, grew strongly.

This observation about trade between Switzerland and Mexico in watches and pharmaceuticals highlights the importance of product specificity in seeking to identify trends related to FTA activity. It had been hoped in the course of this study to relate the work on tariff dismantling and other trade facilitating measures to the assessment of trade effects, i.e, is there a correlation between barrier reduction for particular products and the observed trade in those products? This, however, did not prove possible in the circumstances. Reliance has therefore been placed on primary analysis of trade data, together with a review of the literature.

Overall, the findings of *ex post* studies produce a fairly mixed picture, indicating that some RTAs boosted intra-block trade significantly, while others did not. There is some evidence that external trade is smaller than it might otherwise have been in at least some of the blocks, but the picture is mixed enough that it is not possible to conclude whether trade diversion has been a major problem. In addition, these studies do not reach any definitive answer on the welfare impact of RTAs. Most of the studies using growth regressions suggest that RTAs have had little impact on economic growth. Broadly, the conclusions from *ex ante* studies are

also that there has been evidence of weak trade diversion, but that the recent wave of regionalism has been trade-creating on a net basis and welfare-improving for member countries

Again micro analysis of the data tends to produce more conclusive results. A study of the effects of investment provisions in FTAs finds that the entry into force of an FTA with substantive investment provisions is associated with a 60 percent increase in FDI flows between the parties and a 20 percent increase in trade.

Finally, studies of preference erosion as a result of multilateral liberalisation tend to find that while preferential exports decline as a consequence of erosion, new opportunities from MFN tariff liberalisation more than offset the negative effects for all but a handful of countries.

1.2 Trends in the Growth and Development of Preferential Trade Agreements

It is not an exaggeration to describe recent growth in preferential trade agreements as a proliferation. As of December 2006, 367 FTAs had been notified to the WTO. Of these, no less than 55 were notified in the period January 2005 to December 2006.[1] The annual average number of notifications since the WTO was established has been 20, compared with an annual average of less than three during the four and a half decades of the GATT. Within the last five years, the share of world trade accounted for by FTAs has risen from some 40 percent to over half. Behind these numbers, some clear trends are apparent:

- For most countries, FTAs have become the centrepiece of their trade policy and the principal focus of their trade officials' attention.

- FTAs are showing an increased degree of sophistication in the range of issues they address. Many of the newer agreements cover trade in services and include provisions dealing with technical barriers to trade, sanitary and phytosanitary measures, investment, competition policy, government procurement and intellectual property rights.

- A clear preference for free trade agreements, as opposed to customs unions, is apparent. Among projected agreements, 92 percent are planned as free trade areas, 7 percent as partial scope agreements, and only 1 percent as customs unions.

- There is a pronounced increase in the number of North-South FTAs, which now represent the main cluster of agreements. In these reciprocity features as a shaping factor in negotiations, although there are some examples of asymmetric measures benefiting developing country partners in FTAs. On the one hand, comprehensive coverage goes hand in hand with high expectations with regard to reciprocity (i.e. the US 'gold standard' for FTAs), on the other hand, more flexibility means more partial agreements (i.e. Singapore, Japan and to a less degree the EU and EFTA).

- In parallel with the increase in North-South agreements there is a trend towards more cross-regional FTAs. While only 12 percent of FTAs notified and in force are cross-

[1] There are also a large number of South – South FTAs adopted under the enabling clause that are not notified to the WTO. These clearly also add to the complex network of agreements.

regional, the number rises to 43 percent for agreements signed or under negotiation, and to 52 percent for those at the proposal stage.

- Finally, an increasing number of FTAs are being concluded on a bilateral basis. Bilateral agreements account for 80 percent of all agreements notified and in force; 94 percent of those signed or under negotiation; and 100 percent of those at the proposal stage.

1.2.1 Motivations

Together, these trends point to some broad observations about the underlying motivations for entering FTAs.

- the desire for speed and flexibility favours free trade agreements over customs unions and bilateral over plurilateral agreements;

- there is nevertheless a concern to conclude agreements that are ambitious in both the scope of issues covered and in the sharing of liberalisation commitments among the Parties.

- the proliferation of bilateral cross-regional agreements may even be weakening regional integration and diluting intra-regional trade patterns;

- enhanced market access is the overarching motivation even though there continue to be multiple motivations behind FTAs including political and strategic aims;

- finally, FTAs feed upon one another in that a desire to neutralise the real or potential trade diversionary effects of other FTAs has given momentum to the current proliferation of agreements.

1.2.2 Trends in Specific Policy Areas

Beyond these broad observations, the present study has also identified a number of issue-specific trends, some of which await confirmation.

- There is a clear trend towards the elimination of all industrial ***tariffs*** within the FTAs, either immediately or after a fairly short transition by all the 'core entities', and with a few exceptions by their FTA partners. But large parts of agriculture are excluded from tariff and other liberalisation in the non-US FTAs.

- Two rather contradictory trends characterise ***rules of origin***. On the one hand the recent FTAs are consolidating the NAFTA and PanEuro approaches as the two dominant 'poles' for framework rules. These constitute complex rules of origin. So increased influence of these two poles means a greater complexity in rules of origin. This study confirms that more complex and thus more restrictive rules of origin tend to be used as political economy tools to ease the pressure on sensitive sectors as tariffs protection is removed. They are also more restrictive the higher the gap between the preferential and MFN tariff. On the other hand, there appears to be a trend towards simpler rules of origin for developing country partners in FTAs.

- Trade liberalisation has historically always been accompanied by some form of 'safeguard' measure, broadly defined. The recent FTAs are no exception. Nevertheless, while all the FTAs include provision for ***commercial instruments***, such as anti-dumping and safeguard measures, the objective of deeper integration appears to have resulted in some forgoing, or limiting the scope of contingency measures.

- Recent FTAs conform to the framework of and principles set out in the WTO provisions on ***SPS and TBT*** but then go beyond these to adoption more detailed procedural and institutional arrangements to implement these principles.

- In ***government procurement*** the FTAs are bringing about a wider application of the Government Purchasing Agreement (GPA) framework to more and more countries as the core entities include GPA-equivalent provisions in most of the FTAs they conclude. All FTAs conform to the (plurilateral) GPA principles, but coverage can be GPA – plus (or minus) depending on reciprocity-based bilateral negotiations.

- There is a use of hybrid listing formula in ***services*** in North-South RTAs, in other words negative listing combined with positive listing in sectors where there are strong regulatory sensitivities. The FTAs include;
  - more provisions on the competition policy dimension of service delivery, in part perhaps as compensation for the absence of competition policy from the Doha Development Agenda;
  - the right of non-establishment (i.e, no local presence requirement) to facilitate cross-border trade via e-commerce;
  - but a possibly reduced focus on regulatory harmonisation, as bilateral FTAs often involve countries that are widely separated both geographically and economically.
  - sector and modal coverage that carves out the same sectors (such as health, education and audio-visual) as in the GATS, but there has been modest progress in mode 4 liberalisation, as the facilitation of service-provider-mobility at the regional or bilateral level is seen to be less threatening than a possible multilateral commitment.

- FTAs - with a question mark for the EU - increasingly incorporate ***investment.*** This trend might be expected to continue as long as investment remains outside the scope of multilateral negotiations, but precisely because investment has been taken out of the DDA, public opinion in both developed and developing countries will come to question the inclusion of comprehensive investment provisions in RTAs. The jury is out on this, and for the moment the benefits that FTAs can bring to a more coherent approach to the promotion and protection of investment is likely to prevail.

- For ***intellectual property*** recent FTAs have been TRIPS-Plus in areas ranging from the extension of patent and copyright terms, to the protection of undisclosed information. These TRIPS-Plus provisions have been largely limited to the FTAs negotiated by the United States, although the European Union has used FTAs to eliminate the exceptions for GI protection allowed in TRIPS. EFTA's FTAs extend the protection for industrial designs. For the most part, agreements negotiated by Japan do not address IPR issues in a way that go beyond TRIPS.

1.3 The Policies of the Core Entities

1.3.1 The United States

Since the current Bush Administration took office, a total of 18 countries or groups of countries have participated in FTA negotiations with the United States, ranging over nations as diverse as Australia, Oman, Morocco, Colombia and Korea. The United States has a wide range of motivations for pursuing these agreements. The relative importance of these motivations differs from one branch of government to another.

The focus on the *foreign policy impact* of preferential deals will be sharper in the Office of the President than in Congress. In writing to the Democratic leadership of Congress on completion of the bilateral agreement with Korea, President Bush said the deal would 'further enhance the strong US-Korea partnership, which has served as a force for stability and prosperity in Asia'. USTR did not shy from the strategic link, saying that 'this FTA will strengthen the more than 50-year-old alliance… and will underscore the substantial US engagement in and commitment to East Asia [and] promote strong economic relations with the region'. Washington's view that KORUS assures the United States' continued clout in the area can also be seen as implying a restraint on China, as well as on the idea of an East Asian preferential block, first espoused by former Malaysian Prime Minister Mahathir and now characterised as ASEAN plus 3 (China, Japan and Korea).

On the other hand, concerns about incorporating into FTAs provisions dealing with *public health, the environment and core labour standards* are more pronounced in Congress than in the Administration, as was witnessed in the 10 May 2007 agreement reached between the White House and the Hill.

There is, however, one underlying objective that seems to be shared equally by Congress and the Administration and that is the desire to use FTAs as a lever for improved *market access* for the goods and services produced and exported by the United States. The following US motivations discussed in this study all relate, directly or indirectly, to this key objective: a concern not to be left out of preferential arrangements; dissatisfaction with progress in the multilateral trading system and a weakened US commitment to that system, rationalised through the concept of 'competitive liberalisation'; a desire to take opportunities for deeper integration; and the wish to advance trade-related issues and so avoid unfair competition in international trade.

The US has therefore placed FTAs at the centre of its trade policy in a fashion that has not been seen since 1947, although this should be seen as a relative shift towards bilateral and regional agreements which have been in the background of US trade policy for many years and at least since the early 1980s.

The US approach to the content of FTAs is uniform. In other words the US starts with a standard agenda (based on versions of the NAFTA). In pursuit of its market access aims it also has high expectations in terms of coverage, the 'gold standard'. As a result reciprocal market access drives the process and there is little scope for asymmetry of commitments. The US commitment to reciprocity was very clearly demonstrated in the, now abandoned, negotiations with the members of the Southern African Customs Union (SACU). SACU concerns that it lacked the institutional capacities to meet US expectations were met with the response that ways should be explored to strengthen the trade and investment relationship in the hope that SACU 'could undertake the obligations of a US-style FTA in the future.' On the

other hand, this tough approach appears to have been more successful in ensuring comprehensive coverage than the more 'flexible' approach of the Europeans, Japanese and Singapore. The political economy problems of selling comprehensive coverage to the domestic constituencies is addressed by: excluding a few difficult sectors, focussing on a narrow range of selected partners, avoiding MFN commitments and therefore free riding by third parties, including something on labour and environment as well as, of course securing reciprocity from partners.

The US has been significantly WTO – plus in a number of priority policy areas. On the central issue of tariffs the US 'gold standard' takes the form of almost 100 percent tariff elimination of US tariffs. This is certainly the case for industrial products and is very nearly the case for agricultural products, where there remain some tariff quotas. The standard appears to have slipped however, in the FTAs with Korea and Australia. In return the US has expected and got more or less complete elimination of all tariff lines by its FTA partners. The use of the fairly complex NAFTA list of rules of origin does however take some of the gilt off the standard. This has provided some consolation for hard pressed sectors such as textiles and clothing, where rules of origin are restrictive and thus limit preference utilization by the US's FTA partners.

Services, intellectual property and investment are three areas of deeper integration in which the US FTAs are also significantly WTO - plus. US agreements tend to go beyond the GATS in rule-making in both financial services and telecommunication services. The provision in US agreements – pioneered in NAFTA - that prohibits local presence requirements goes beyond the criteria defined in Article 27 of the GATS on market access. In terms of sector coverage the US has sought and obtained GATS – plus coverage in its FTAs. Though the relative impact of negative and positive listing needs to be assessed with care, if it is agreed that a negative-list approach tends to promote greater transparency, then consistent US support for this approach can be seen as a commitment to ambitious services liberalisation. In investment the 'gold standard' equates to the comprehensive investment provisions of the NAFTA that the US has obtained in almost all its FTAs, including those with developing as well as emerging market countries. Most recently, the investment provisions in KORUS will ensure that US investors in Korea have the same rights and enjoy an equal footing with Korean investors. The US has also been the driving force behind TRIPs – plus provisions in intellectual property rights in FTAs, that have, for example, progressively extended the 50-year term of copyright protection required by TRIPS and the minimum term of trademark protection from 7 to 10 years as well as eliminated the 'innocent infringement' clause in TRIPS that precludes penalties for 'unknown violation'.

In the area of government procurement the US has, like the other core entities, used FTAs to extend the number of its trading partners that effectively comply with GPA type rules. In this sense the US has pushed for WTO – plus provisions. But in some agreements the coverage of US purchasing entities is considerably below what it has agreed to with some of its GPA partners. Here the concern for reciprocity has meant WTO – minus commitments on the part of the US.

In some areas the US FTAs have remained WTO consistent. This is generally the case for commercial instruments, although the US FTAs have consistently applied time limitations on the use of safeguard action that are tighter than those found in the WTO, with no reapplication possible on the same product. Additionally, the US-Chile FTA provides that on the termination of a safeguard, the rate of duty shall not be higher than the rate that would have

been in effect one year after the initiation of the measure according to the agreed tariff schedule.

In policy areas of lower priority one finds much less drive for progress. This is for example, the case for TBT and SPS measures, where the US is content to rely on the existing WTO agreements. For TBT provisions in FTAs the US has preferred the use of equivalence over standards harmonisation. Commonly within the US FTAs Parties need to give an explanation when not applying the principle of equivalence to the regulations of other Parties, hence going beyond WTO rules. Although there is encouragement for mutual recognition of test results, the US FTAs reflect a preference for a light institutional framework using 'TBT coordinators' in preference to joint committees.

Finally, as a result of the agreement reached on 10 May 2007 between the US Administration and the Congress, parties to US FTAs will henceforth be asked to enforce worker protection as set out in the ILO's 1998 *Declaration on Fundamental Principles and Rights at Work*, and to implement seven Multilateral Environment Agreements, including the Montreal Protocol on Ozone Depleting Substances and the Convention on Trade in Endangered Species.

US FTA policy therefore aims for a WTO-plus commitment from its FTA partners and generally gets it. This leaves little scope for asymmetry. There is perhaps a slight trend towards an increase in WTO - plus provisions, but the main distinguishing feature of US FTAs it is their uniformity. Whether the WTO – plus provisions, including those on core labour standards, constitute a building block for wider multilateral agreements or a stumbling block by seeking to provide an alternative to multilateralism is not the question addressed in this study. But there is clearly an important interaction between the bilateral FTAs and what happens at a multilateral level that needs more study.

The expiry of fast-track negotiating authority at the end of June 2007 raises some uncertainty about US FTA policy. It can be expected, however, that bi-partisan support for improved market access through bilateral deals, together with heightened opportunities to address environmental, labour and public health concerns in FTAs, foreign policy considerations, along with a fear of being left out as other countries sign FTAs, will ensure that the United States continues to seek opportunities for preferential arrangements.

1.3.2 The European Union

In contrast to the US FTA policies the EU approach to FTAs has been characterised by differentiation and flexibility, and by relatively modest results. The EU has differentiated between its FTA partners. Near neighbours and potential accession states were expected to sign up to the full *acquis.* EuroMed partners, with which FTAs were motivated by a desire to promote economic and thus political stability in an otherwise volatile region on the EU's doorstep, were offered free trade in industrial products, but with exclusions for sensitive agricultural products. The EU has also tended to have a stronger institutional framework for its FTAs than the US and has provided more financial assistance. The FTAs under negotiation with the ACP states are driven by development objectives, which ultimately presumes flexibility to accommodate the needs of the countries concerned. Finally, there are the FTAs with emerging markets (and developed economies such as Korea), including the proposed FTAs with ASEAN and India that are motivated by commercial interests and a desire to match what the US or other countries have already achieved through FTAs.

In concrete terms this flexibility finds expression in the EU's coverage of tariffs in FTAs. Compared to the US the EU excludes relatively more agricultural tariff lines, although it approaches 100 percent coverage of industrial products. Even for agriculture coverage varies from FTA partner to FTA partner and reflects the potential competition for EU agriculture. As a result it is not possible to identify any trend over time. In services the EU uses a positive list approach that provides 'flexibility' to exclude sensitive sectors for both itself and its trading partners. Thus the greater flexibility of EU FTA policy means there is more scope for asymmetric provisions favouring the EU's developing country FTA partners. But on some occasions it is the EU that is 'benefiting' from the asymmetry, such as in agricultural tariff elimination in the EU – Chile agreement.

Another characteristic of EU FTA policy is a desire to use existing, agreed international standards. This contrasts with the US antipathy towards agreed, international standards as being too rigid and overtly centralising and regulatory in nature. The EU's 'domestic' experience with non-tariff barriers and the emphasis placed on the need for comprehensive provisions on TBTs means that it takes efforts in this field, including the promotion of agreed international standards through cooperation in FTAs, more seriously than the US. The EU also tends to stress compliance with existing standards of protection for intellectual property rights in its FTA provisions on IPR, rather then pressing for TRIPs plus provisions. In these respects the EU's FTA provisions are in line with agreed international norms. But there are important exceptions. In the field of SPS measures the EU favours SPS-minus rules in the sense that it wants an interpretation of precaution that allows for social as well as science-based risk assessment and risk management. In the IPR field the EU is seeking to use FTAs to promote its case for TRIPs - plus protection for geographic indicators (GIs). In both these areas domestic policy developments have had a direct bearing on the content of the EU's FTAs. The aim in agriculture policies to promote higher value-added agricultural products as part of the CAP reform favours protection for GI. The desire for the use of the precautionary principle in food safety has been brought about by the BSE and other food safety crises.

On the Singapore issues (investment, competition, public procurement and trade facilitation) the EU has also shown 'flexibility' in the FTAs it has negotiated to date. There is little or nothing on investment in the EU's FTAs, except for EU – Chile, but even this is well short of the NAFTA model. There are proposals for a minimum platform for investment provisions in EU FTAs, but these stop short of the comprehensive US rules on investment. It seems unlikely that the EU will resolve all the competence issues that have inhibited the inclusion of comprehensive investment provisions in its FTAs. As a result the EU seems likely to pursue a slow progressive approach to investment in its FTAs. To date the EU Member States have negotiated bilateral investment treaties for investment protection and there have been no EU level investment protection agreements, for which there is a demand from the EU's FTA partners. Competition and procurement have found their way into the EU's FTAs, but again the EU is flexible in pressing its aims. For example, the EU has only one brief article on procurement with its EuroMed partners that simply sets the aim of liberalising public procurement. In contrast the US 'gold standard' applies the full GPA framework in its FTA with Morocco. There is a similar picture in competition, although here the EU has got somewhat more in terms of provisions aimed at the progressive adoption of EC norms and rules for the EuroMed partners and fairly ambitious provisions in the EU – Chile (and EU South Africa) agreements that include positive comity in cooperation between competition authorities. The test for the EU on the Singapore issues will be ASEAN and especially India.

The positive side of the EU's flexibility is that there has been scope for asymmetric provisions favouring developing country FTA partners. For example, on industrial tariffs the EuroMed partners have the ability to reintroduce tariffs as part of infant industry strategies. Positive listing for services leaves scope for developing countries to pace liberalisation as they wish and the EU has accepted general aims in the Singapore topics rather then forcing developing countries to adopt fully fledged agreements. Finally, the EU has been relatively generous in its trade related technical assistance measures, which might be seen as a form of asymmetry.

The trend however, appears to be towards a more aggressive and ambitious FTA strategy on the part of the EU. The current negotiations with Korea will provide a test for the EU's determination to establish a new higher standard for its FTAs. The EU – Chile FTAs was seen as the standard when it was negotiated. The aim with Korea is to bring about a step change to a higher level. Should the EU succeed in this, the test will then be whether it can negotiate equally ambitious FTAs with India and ASEAN? The expectation must be that flexibility will again prevail with the result that the scope of any EU – India or EU – ASEAN agreements will be rather more modest.

1.3.3 EFTA

EFTA's FTA policy shares many of the features of the EU policy. But there are also some important differences. EFTA's pragmatic approach to FTAs differs from the EU in that it reflects EFTA's character as a trade driven association. EU FTA policy is, like all the core entities considered, shaped by commercial interests, but EU policy is also shaped by strategic, political and developmental objectives. This appears to be less the case for EFTA, where commercial considerations are the predominant facto. For example, whilst the EU's agreements with the EuroMed and ACP states are motivated by security and development motivations and a desire to promote regional integration in the Mediterranean and the various African regions concerned, EFTAs agreements with the EuroMed are shaped by a desire to match EU agreements. EFTA policy is neither shaped by a legacy of colonialism nor the Lome and Cotonou agreements. As a result the only agreement EFTA has with sub-Saharan Africa is with SACU, which was primarily motivated by commercial interests. But this is not to say that the EFTA states do not support a wider mediterranean free trade area and thus the Barcelona Process in order to promote economic and political development in the region. Equally, the EFTA states see development objectives in the agreements they sign with other developing countries, such as with SACU.

EFTA's third-country trade policy since 1990 has had three phases. The first phase focussed on free trade in industrial goods with the Central and Eastern European Countries and was guided by a desire to re-establish pan-European ties. The second phase, from 1995, expanded EFTA's FTA network to the southern and eastern rim of the Mediterranean, as part of the pursuit of a Euro-med free trade area. In the third phase, EFTA went global.

In the first two phases of EFTA shadowed the EU developments. This is illustrated by the agreements with the Central and East European countries (CEECs) after 1991 and the EuroMed agreements after 1995. A central motivation here was to ensure that EFTA's interests were not undermined by the EU agreements. In the third phase EFTA's FTA policy was also shaped by developments elsewhere. Thus FTAs negotiated with Chile and Mexico reflected a desire to match what the EU and the US were doing in terms of preferential

agreements. But EFTA then moved ahead of the EU through negotiations with Canada, Singapore, Korea and SACU.

This shift to a more activist policy was motivated by a pragmatic desire to strengthen EFTAs commercial position in sectors in which it has a comparative advantage, such as services, investment and research intensive activities (IPR). EFTA's FTAs reveal fairly strong WTO-plus provisions in services, investment and intellectual property. In services EFTA has seen FTAs as a means of moving ahead with service liberalisation that has remained static since the conclusion of the Uruguay Round. For economies in which services account for 70 percent of GDP this is seen as inadequate. In investment some EFTA FTAs have been more ambitious than the EU's although not as comprehensive as the NAFTA model used by the US. Recent FTAs, such as with Singapore have included pre-investment national treatment (the right of establishment) and investor-state dispute settlement provisions. Like the EU, EFTA states retain bilateral investment treaties that cover investment protection. In intellectual property rights, some EFTA states have been rather more offensive than the EU in seeking to use FTAs as a means of ensuring the effective compliance with agreed international standards for the protection of intellectual property rights by their trading partners.

EFTA is also like the EU (and Japan) in that its trade policy is influenced by a defensive position on agriculture. This has resulted in the effective exclusion of sensitive agricultural products from liberalisation in the FTAs. The position varies from EFTA state to EFTA state, with Norway insisting on some of the most protectionist provisions of all the core entities considered.[2] This clearly influences EFTAs ability to get what it wants in other areas of policy in which it has more offensive interests. As for all FTA signatories, potential welfare gains from preferential deals are reduced to the extent that coverage is less than comprehensive.

In the remaining areas of policy EFTA's revealed preferences broadly line up with those of the EU. In TBT and SPS EFTA's approach is more or less the same as that of the EU. This should come as no surprise as the EFTA states have always participated in European standards making (in bodies such as CEN and CENELEC) that has shaped parts of the EU *acquis.* In SPS the EFTA states share the same domestic pressures as the EU for higher food safety standards and better animal rights as an integrated approach to food production and consumption. If anything the EFTA states appear to be even more cautious than the EU when including provisions on TBT and especially SPS rules in FTAs. This is probably in part due to a wish to retain as much discretion as possible in the sensitive area of SPS measures, which may argue against codifying how the WTO principles should be applied in FTAs. In rules of origin EFTA uses the PanEuro model and as a result benefits from diagonal cumulation with the EU. It therefore uses the same rules list as the EU in its preferential agreements with third parties. Here EFTA has also been out ahead of the EU in introducing a simplified system of rules of origin for developing countries, something the EU is only now considering. EFTA also shares the EU preferences in the area of public procurement, competition and commercial instruments.

A feature of EFTA's FTAs is that flexibility permits the inclusion of asymmetric provisions. In this respect, EFTA's agreement with SACU is in stark contrast to the now abandoned, negotiations between SACU and the United States.

[2] The EFTA states negotiate separate bilateral agreements on agriculture.

1.3.4 Japan

Japan has been a latecomer to bilateral FTAs, with only three Agreements having entered into force (Mexico, Malaysia, and Singapore). Twelve other agreements are in varying stages of ratification, negotiation or exploration. Final agreement documents have been published for Mexico, Malaysia, Singapore and the Philippines, and conclusion of a deal with Indonesia is imminent.

As for the EU and the United States, foreign policy considerations loom large for Japan as a motivation for, somewhat belatedly, pursuing preferential deals – not least the dominant and growing role of China. This is seen most clearly in Japan's advocacy of the Comprehensive Economic Partnership in East Asia (CEPEA), an FTA covering ASEAN+6 (Australia, China, India, Japan, Korea and New Zealand). This proposal is widely considered to be a counter proposal to that of China for an East Asia Free Trade Agreement covering ASEAN+3 (China, Japan and Korea). By extending the range of the grouping to include Australia, India and New Zealand, Japan would draw in important food and raw material suppliers, a pervasive concern for Japan, but would also dilute the influence of China, not least through the presence of India. Widening the net even further, Japan has also expressed support for the Free Trade Area of the Asia Pacific, a US proposal that would see APEC converted into a preferential arrangement. Japan is thus drawn in opposing directions: the pursuit of closer Asian integration with neighbours and key trading partners, in part in recognition of regional vulnerability exposed by the 1997-98 Asian financial crisis; and the widening of formal economic linkages beyond the East Asian region in order to pursue broader economic, foreign policy and strategic interests.

In the case of the US it was concluded that while foreign policy considerations are important, concern about improved market access was the most widely-held and strongly advanced motivation for the pursuit of FTAs. In the case of Japan the situation is less clear. As with the US, Japanese motivations based on the fear of being left out, dissatisfaction with the progress in the WTO and maximising opportunities for deeper integration all have an important market access dimension. METI has vaunted the Japan-Mexico EPA on the grounds that 'Mexico will become increasingly attractive as a base not only for exporting to the North American market, but also to Latin America as well'.[3] And the Gaimusho has said of the Japan-Malaysia EPA that it 'provides a framework for expansion and liberalisation of bilateral trade and investment'. A primary aim of the FTA under negotiation with Switzerland will be to increase Japanese exports of electronic goods, while also strengthening the protection of intellectual property rights. However, compared with the US, Japan has been less successful in implementing FTAs that reflect a high level of ambition, albeit with exceptions, to improve market access.

It might be concluded that for Japan, like the United States, improved market access is a key objective, but that the power of vested interests has so far constrained the realisation of the objective to a greater extent than it has in the US. It has thus been said that Japan's ability to embark on a bold and strategic economic policy is undermined by its own domestic policy making dynamics. The demonstration of this, it is suggested, is the success of the agricultural and labour lobbies in avoiding substantial liberalisation commitments and in compromising

[3] The complex rules of origin that apply in NAFTA may present a barrier to entry into the US market for Japanese investment in Mexico, especially in the sectors such as automobiles and textiles in which NAFTA rules of origin are especially restrictive.

the quality of Japanese FTAs. The problem is compounded by coordination arrangements within the Japanese bureaucracy.

A related question concerns the apparent lack of a blueprint for Japan's FTAs: there is a mixture of positive and negative listing from one agreement to another; there is no consistent treatment of domestic tariff schedules; and rules of origin are similarly varied. This might reflect a deliberate flexibility on Japan's part, so that agreements can respond to particular circumstances and differing wishes of Japan's partners. It might equally, however, reflect again domestic political constraints. Only with the conclusion of more agreements is the picture likely to become clearer.

1.3.5 Singapore

Like Japan, Singapore drew lessons from the experience of the Asian financial crisis. Unlike Japan, however, it has a clear strategy for its FTAs.

Singapore is perhaps the leading exponent of an activist and strategic FTA policy. Building on the experience of trade and deeper integration agreements in ASEAN, APEC and of course the WTO, Singapore has pursued a strategy of using FTAs to consolidate its role as a 'hub' in the Asian region. Indeed, one could say that the agreements with countries in many continents appear to have the aim of extending Singapore's role as a hub for investment and trading. With the domestic institutional and human capital resources it has, Singapore appears to be seeking to attract international investors and companies to establish global headquarters in Singapore. By concluding sophisticated agreements covering trade and investment, Singapore can offer access to a range of markets in all continents, not just ASEAN.

This is reflected in the content of Singapore's trade agreements. It offers a 'gold standard' in terms of zero tariffs, comprehensive investment provisions, TRIPs - plus provisions on IPR and 'European-standard' provisions on TBT, SPS and public procurement. Singapore gets rather less from its FTA partners however. This is clearly due to its limited negotiating leverage as a small, liberal trader. In some sectors, such as agriculture, Singapore also has no real offensive interest. One is therefore left with the impression that Singapore adopts a very pragmatic approach to FTAs.

In terms of tariffs, Singapore binds 100 percent zero tariffs in its FTAs, but has been fairly unsuccessful in getting anywhere near this level of liberalisation from its partners. Japan excluded more or less all its agricultural tariff lines from liberalisation. India offered only 25 percent of all tariff lines for full tariff liberalisation. This pattern runs through all the Singapore FTAs**.**

2.0 INTRODUCTION

2.1 GOALS AND METHODOLOGY

The terms of reference of the study provide that it be organised in two parts. The **first part** will consider the pattern of trade and investment between the EU, EFTA/CH, the USA, Japan and Singapore, henceforth the core entities, on the one hand, and their existing and envisaged FTA partners in Asia, North Africa, the Gulf States and Latin America on the other.[4]

The approach to this phase involved the following:

- **(a)** Collection of trade and investment data for the five 'core entities' and each of the target regions respectively.
- **(b)** Collection of material and identification of websites and other sources of information on the content of the FTAs between the 'core entities' and the target regions.
- **(c)** Gathering of material on the general policy statements of the 'core entities' with regard to FTA policies.
- **(d)** An initial assessment of the data, including in particular whether there is any correlation between the pattern of trade and investment and FTAs. In this we looked at years leading up to the conclusion of any given FTA as well as the years following, in order to assess any anticipatory effects as well as increased flows, such as investment in anticipation of the liberalisation.

The approach taken was a 'vertical study' of each of the 'core entities'. In other words we looked at the trade and investment patterns for each core entity in its relations with selected FTA partners in each of the target regions. We focused particularly on the following:

[4] There is a general debate on the right terminology. Free Trade Agreements are not used by some authors on the grounds that many FTAs are not in fact very 'free'. Sometimes Regional Trade Agreements is used as a generic term to cover what are in fact bilateral agreements. Other authors prefer the term Preferential Trade Agreements because this accurately describes most agreements that do not include general MFN clauses and because it expresses a degree of negativity. In this report we shall use the term Free Trade Agreement as the generic term for the agreements concluded between the 'core entities' covered in the study. This does not imply that they are always free or liberal in nature.

Table 1 FTAs covered by the study

	USA	EU	JAPAN	EFTA	SINGAPORE
Latin America	**Chile 01.01.2004** **Mexico (NAFTA) 1994** *Peru (Andean)*	**Chile 01.02.2003** **Mexico 01.07.2000** *Peru (CAN)*	**Mexico 01.04.2005** *Chile*	**Chile 01.12.2004** **Mexico 01.07.2001** *Peru* *Colombia*	*Mexico* *Peru*
Asia	**Singapore 01.01.2004** *Malaysia* *Korea*	*Malaysia and Singapore(ASEAN)* *Korea* *India*	**Singapore 30.11.2002** **Malaysia 13.07.2006** *Korea* *India*	**Singapore 01.01.2003** **Korea 01.09.2006** *Thailand*	**Japan 30.11.2002** **India 01.08.2005** *Korea*
North Africa	**Morocco 01.01.2006**	**Egypt 31.12.2003** **Morocco 01.03.2000**		**Morocco 01.12.1999** **Egypt 01.08.2007**	*Egypt*
Gulf	**Bahrain 01.08.2006** *Oman*	*GCC*	*GCC*	*GCC*	*Qatar*

Compiled by the authors based on information from government websites

Bold indicates agreements have been concluded. Date indicates entry into force.
Italic indicates agreements under negotiation at the time the research began.

The main challenge with this phase of the research was the search for any link between the trade and investment data and the negotiation of FTAs. We addressed this issue in some detail and came to the tentative conclusions described below. Rather than spend more time at an early stage on this attempt to find a link we chose to move ahead with phase two with the aim of trying to highlight areas of liberalisation resulting from FTAs. Should any further research be envisaged, it would be possible to return to the trade data and see if there have been any effects in the specific sectors.

The terms of reference provide that the **second part** of the study 'will consider the general question of whether there is a general over-arching strategy in the use of FTAs and the more specific concrete question of how the parties concerned use FTAs in any given policy area'. The policy areas are identified as including: tariffs, rules of origin, SPS and TBT provisions, government procurement, commercial defence, services, investment and intellectual property rights. It was subsequently agreed to also include provisions dealing with the environment and core labour standards.

The approach to this phase involved, for each of the policy areas identified, an analysis of the texts of the agreements, or negotiating texts where appropriate,[5] in order to address the following questions.

(a) In which areas do the FTAs go beyond existing WTO coverage of commitments?

(b) What, if any, has been the evolution over time of the specific provisions in FTAs. In other words, does the content of FTAs show how the 'core entities' policies are evolving over time (i.e. revealed preferences in FTA policy)?

(c) What are the differences in the substance of the FTAs between core entities; i.e. are there general differences between the FTAs negotiated by the US and the other core entities?

(d) To what extent do RTAs have asymmetric provisions? (Such as longer transition periods or different, more lenient rules for less developed FTA partners).

(e) What are the links if any between domestic policies (of the core entities) and the content of the FTAs?

The work load varied considerably between policy areas:

- In assessing the level and structure of tariff preferences in the FTAs it was necessary to work through the tariff information provided in each FTA agreement. We did not find any existing studies that were adequate or up to date in this area. In view of the budget constraints we opted to build up a picture of tariff preferences in the FTAs by looking at information of tariff liberalisation provided in the agreements. The coverage of tariff liberalisation is indicated by the percentage of tariff lines at an eight digit HS level that are (i) zero (either on entry into force of the agreement or after a transition period), (ii) partially liberalised, or (iii) excluded from liberalisation. This method of assessing tariff liberalisation has been used in previous WTO studies. (WTO, 2002) See tables 2 to 5 for summary results of this work. The lack of existing suitable data meant a considerable effort was involved in generating this data. The full results of the work are provided in the annexes 3.1.1 to 3.1.7, which are annexed in the form of excel files.

- Similar difficulties were encountered with rules of origin. Here it was necessary to limit analysis to the framework rules for preferential rules of origin, although the detailed rules were assessed for a number of 'sensitive' sectors.

- With regard to services, another policy issue that involved studying schedules, there are more recent studies available that provided helpful data.

- Coverage of investment provisions was however, again less straight forward because of the patchwork of international agreements dealing with investment and the diversity of approaches adopted, including within the WTO.

[5] Given the resources available and uncertainties surrounding the negotiating texts in current negotiations, detailed analysis was limited to the texts of FTAs that had already been agreed at the time the research began in late 2006.

- The work on the other policy areas was more straightforward and it was possible to establish the degree to which the FTAs are WTO plus and to make comparisons across agreements. Details of the FTA provisions for the various core entities are equally provided in excel files referred to in the relevant sections, because of their volume and are provided as an electronic attachment to this report.

On the basis of this (vertical) analysis of the selected policy issues, an analysis was then undertaken of the overall (horizontal) FTA strategies of the core entities.

Both phases of the study were augmented by reference to secondary material (see Bibliography).

2.2 RECENT TRENDS IN FTAs[6]

2.2.1 The Growth

It is not an exaggeration to describe recent growth in preferential trade agreements as a proliferation. As of December 2006, 367 FTAs had been notified to the WTO. Of these, no less than 55 were notified in the period January 2005 to December 2006. The annual average number of notifications since the WTO was established has been 20, compared with an annual average of less than three during the four and a half decades of the GATT.

Two clarifications are in order. First, the number of notifications does not correspond to the number of FTAs actually in force. There were 214 FTAs notified and in force as at the end of 2006. However, if all agreements currently in the pipeline come to fruition then by 2010, it is estimated that there will be close to 400 FTAs in force in the global trading system. Second, the number of agreements in force does not in itself indicate their impact on world trade – many of them may be quite small. But here again the trend is clear; within the last five years, the share of world trade accounted for FTAs has risen from some 40 percent to over half.[7]

2.2.2 Tendencies

Behind these numbers, some clear trends are apparent:

- For most countries, FTAs have become the centrepiece of their trade policy and the principal focus of their trade officials' attention.

- In recognition of this increased importance, attempts are being made to improve the monitoring of FTAs within the WTO. (WTO, 2006) A new Transparency Mechanism has been introduced, under which the Committee on Regional Trade Agreements has so far (June 2007) examined FTAs between Thailand and Australia, Thailand and New Zealand, and Armenia and Moldova.

[6] This section draws particularly on Fiorentino et al (2007), WTO Discussion Paper No. 12 "*The Changing Landscape of Regional Trade Agreements*: 2006 Update", 2007.

[7] This is not the same as saying that over half of trade is preferential trade. It has been argued that only some 15% of trade is actually preferential, if one accounts for tariff lines already at zero or less and 5% 'covered' by preferential agreements. (World Bank, 2005)

- FTAs are showing an increased degree of sophistication in the range of issues they address. Many of the newer agreements cover trade in services and include provisions dealing with investment, competition policy, government procurement and intellectual property rights.

- A clear preference for Free Trade Agreements, as opposed to Customs Unions, is apparent. Among projected agreements, 92 percent are planned as Free Trade Areas, 7 percent as partial scope agreements, and only 1 percent as CUs.

- There is a pronounced increase in the number of North-South FTAs, which now represent the main cluster of agreements.

- The trend towards North-South agreements is being accompanied by a commitment to the principal of reciprocity by all parties, developing as well as developed. Where asymmetric liberalisation commitments are present, these seem to be more common in South-South than in North-South agreements (Heydon, 2007).

- In parallel with the increase in North-South agreements is a trend towards cross-regional FTAs. While only 12 percent of FTAs notified and in force are cross-regional, the number rises to 43 percent for agreements signed or under negotiation, and to 52 percent for those at the proposal stage.

- Finally, an increasing number of FTAs are being concluded on a bilateral basis. Bilateral agreements account for 80 percent of all FTAs notified and in force; 94 percent of those signed or under negotiation; and 100 percent of those at the proposal stage.

Together, these trends point to some broad observations about the underlying motivations for entering into preferential arrangements. First, there is clearly a pursuit of speed and flexibility. The predominance of FTAs rather than CUs, and of bilaterals rather than plurilaterals is testimony to this. Second, there is nevertheless a concern to conclude agreements that are ambitious in both the scope of issues covered and in the sharing of liberalisation commitments among the Parties. Third, there appears to be a relative decline in the goal of *regional* integration. Indeed, as pointed out recently by the WTO Secretariat, the proliferation of cross-regional agreements may even be weakening regional integration and diluting intra-regional trade patterns. (Fiorentino et al. 2006) Finally, drawing together all of these elements, there seems to be an overarching concern to use FTAs to enhance market access, both more speedily and more comprehensively: by range of issue, by geographic coverage and by the sharing of commitments.

2.3 EFFECTS ON TRADE AND INVESTMENT

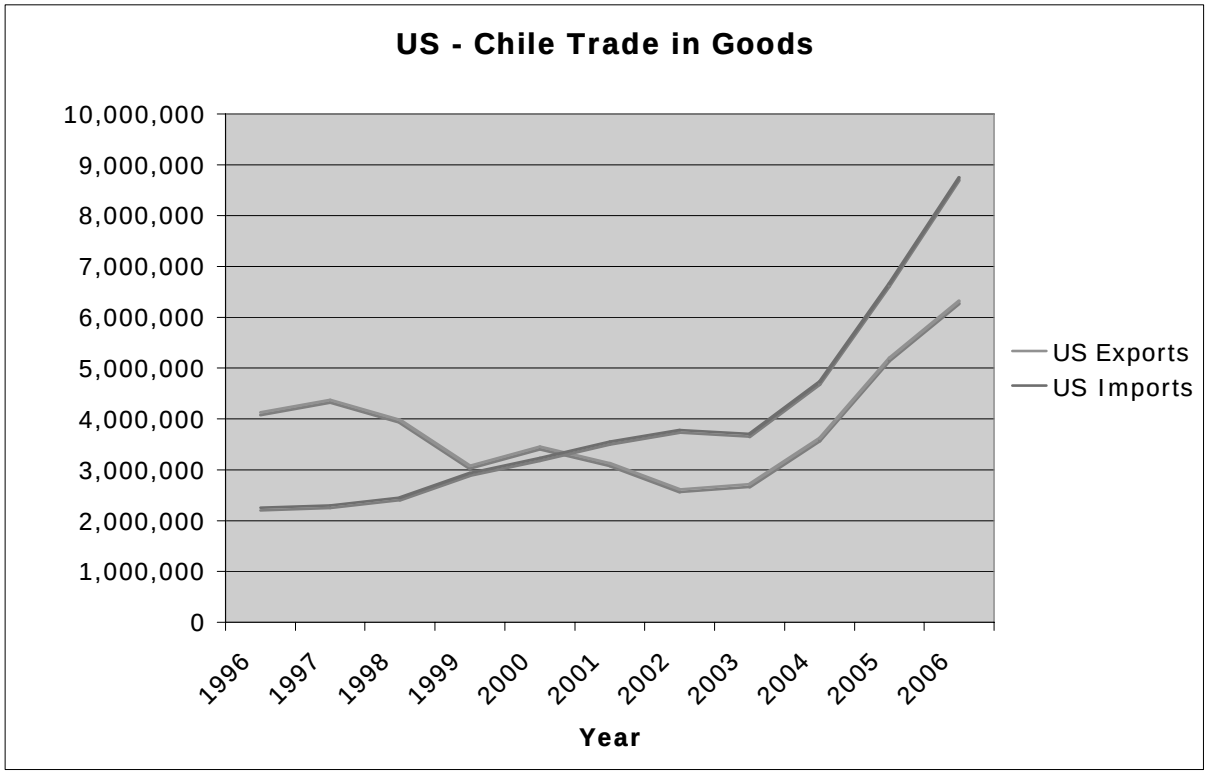
2.3.1 Evidence from the Study

United States

Notwithstanding the problems of data availability and interpretation, there seems to be evidence of a linkage between trade and investment flows and the *implementation* of FTAs. On the basis of data over time and of flows expressed in real terms as a percentage of total (global) activity, such an apparent linkage is seen, for example, in:

- the movement of US goods trade with Chile. US exports and imports with Chile grew 133 percent and 135 percent respectively in the three years following the implementation of the US-Chile FTA. As a percentage of US totals, US exports to Chile grew by 63 percent and imports by 62 percent (see graph).

Chart 1 Trade in goods between the US and Chile ($US 1000)

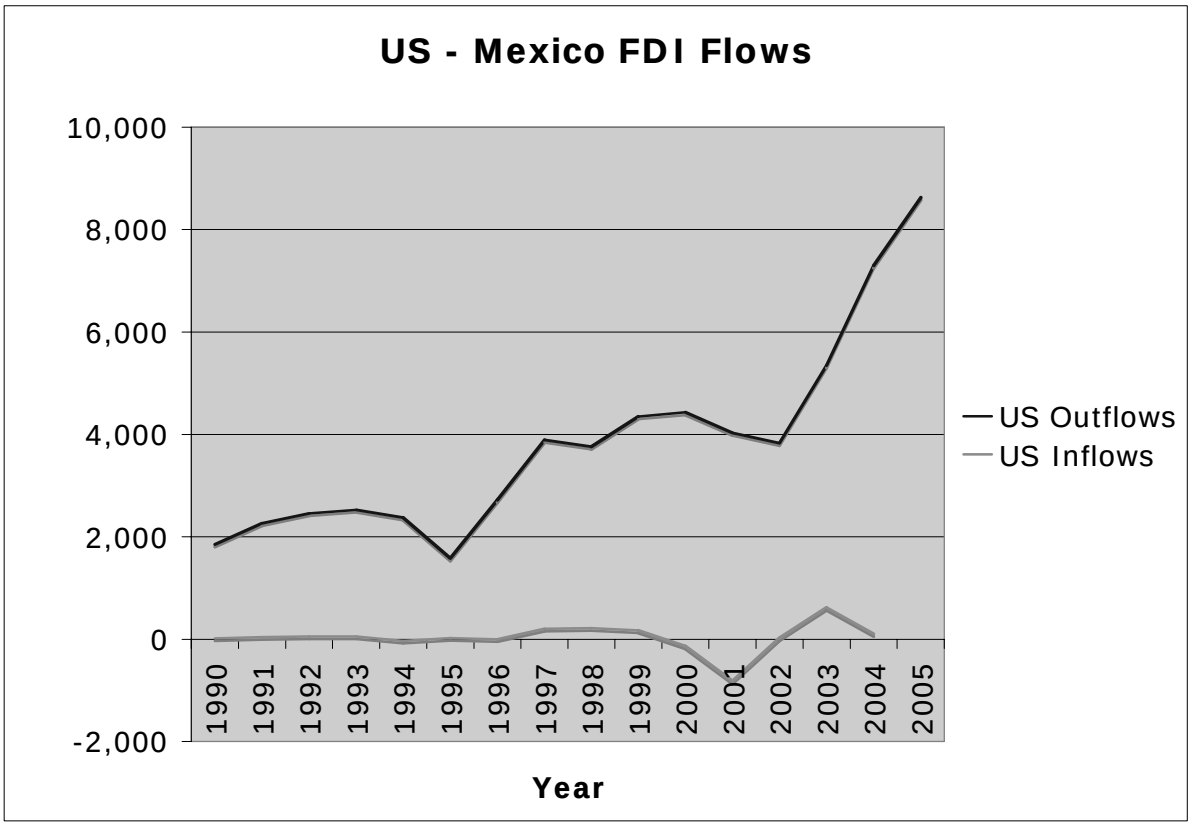


Compiled by the authors from data from the Bureau of Economic Analysis, US Department of Commerce.

- US services exports to Mexico grew 137 percent in the ten years following the implementation of NAFTA in 1994. This followed two years of declining exports prior to the FTA. When calculated as a percentage of total US exports, service exports to Mexico increased by 34 percent during this period.

- US FDI outflows to Mexico have increased 263 percent since implementation of NAFTA. As a percentage of total US outflows, FDI to Mexico has increased by 10 percent over the past ten years (see graph).

Chart 2 US – Mexico investment flows ($US million)



Compiled by the authors using data from the Bureau of Economic Analysis, US Department of Commerce.

There may also be a linkage between trade and investment activity and the *announcement* of FTA negotiations, though this is much harder to substantiate. Investment activity could increase, on the part of efficiency-seeking investors, in anticipation of improved resource allocation flowing from freer trade. Trade flows themselves might increase as a result of the increased legal certainty of the trading regime that an FTA would bring, and through greater market awareness generated by the announcement of negotiations. Against this, however, some traders might defer action until a more liberal regime is established. Following the announcement of intent to negotiate an FTA with Oman in November 2004, US exports and imports have grown 142 percent and 115 percent respectively in two years. As a percentage of total US trade, exports to Oman grew by 92 percent and imports by 71 percent.

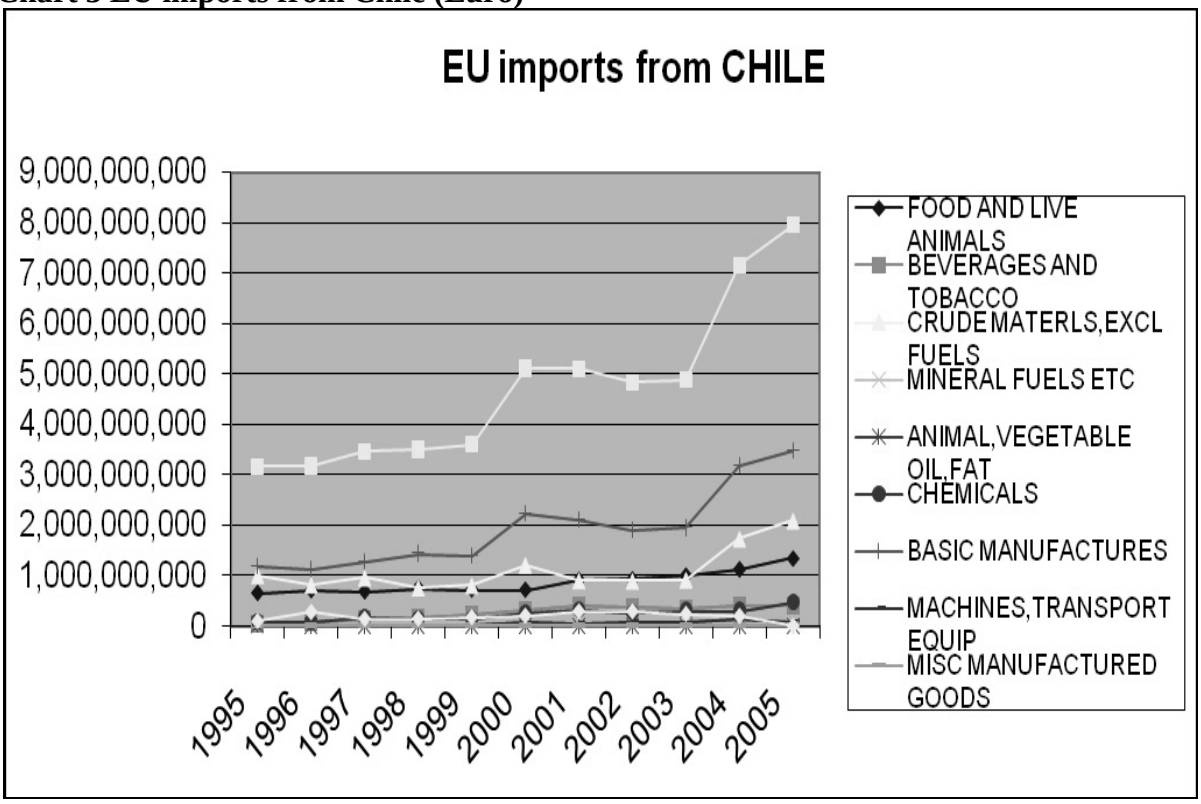
EU

As with the US, but perhaps less markedly, there can be a presumption of linkage associated with FTA *implementation*. On the basis of data over time and flows expressed in relative terms, this could be reflected, for example, in:

- EU goods trade with Mexico
- Chilean goods exports to the EU (see graph below)
- EU services exports to Chile, and

There may also be linkage associated with the announcement of negotiations, for example, as seen in two-way FDI flows between the EU and Egypt, but again, this is much harder to substantiate.

Chart 3 EU imports from Chile (Euro)



Source: Compiled by the authors using Eurostat data

EFTA

There seem to be few discernible trends in EFTA trade and investment with individual FTA partners. Moreover, such trade, in total, represents a relatively small percentage of EFTA exports and imports (about 14 percent of trade in goods outside the EU). There are nevertheless observations that can be made in respect of EFTA FTAs, which may also have wider significance.

- Overall, EFTA trade with FTA partners rose 8.1 percent between 1992 and 2002, compared with only 0.7 percent with the rest of the world.

- Within this trade, EFTA imports of goods increased more than EFTA exports, because of the asymmetric liberalisation provisions of the agreements

- And even where aggregate trade with a partner did not increase, trade in products that were subject to significant liberalisation did increase. For example, while Swiss trade with Mexico relative to the rest of the world fell from 2002 to 2005, exports of pharmaceuticals and watches, each subject to tariff dismantling, grew strongly.

Japan
Unlike US and EU experience, Japan's FTAs appear to have had a negligible effect on flows of trade and investment, the possible exceptions being Japanese exports to Mexico, which rose 53 percent in real terms between 2004 and 2006, and Singapore's FDI in Japan. Nor is there a discernible pattern in trade and investment in anticipation of FTAs.

The relative newness of Japan's FTAs, and associated data limitations, mean, however, that any observations, at this stage can only be tentative.

Singapore
There appear to be no discernible trends in Singapore data, though the limited number of agreements and their relative newness makes any observation very difficult.

The observation about trade between Switzerland and Mexico in watches and pharmaceuticals highlights the importance of product specificity in seeking to identify trends related to FTA activity. It had been hoped in the course of this study to relate the work (see below) on tariff dismantling to the assessment of trade effects, i.e. to assess whether there is a correlation between barrier reduction for particular products and the observed trade in those products? This, however, is a highly labour and time-intensive activity and it did not prove possible within the time and budget limitations of the study. Reliance has therefore been placed on the preceding observations, together with a review of the literature, as discussed below.

2.3.2 A Review of the Literature[8]

Some Theory
The theory of FTAs dates from Viner (1950), who identified trade-creating and trade-diverting effects resulting from FTA formation. If partner country production displaces higher cost domestic production then there is trade creation. However, if partner country production displaces lower cost imports from the rest of the world then there is trade diversion. This analysis falls within the theory of 'second best' welfare economics. As long as some distortions remain within the economy, it is not necessarily true that removing partial distortions (via an FTA) is welfare-improving.

Researchers have identified three conditions under which FTAs are more likely to be welfare-enhancing:

- Meade (1955) showed that the higher pre-arrangement MFN tariffs, the higher the pressure for trade diversion following formation of the FTA. Conversely, when the external barriers of a regional arrangement are low, the potential for trade diversion is low because lower external tariffs provide less scope for the displacement of imports from third countries. An important policy implication of this observation is that ongoing reduction of MFN tariffs in the framework of the WTO plays an important role in containing the distortionary effects of preferential trade arrangements.[9]

[8] This section draws in particular on Geloso Grosso (2001), *Regional Integration: Observed Trade and Other Economic Effects*, OECD, October 2001

[9] A recent study finds that the average applied industrial tariff among Parties to existing bilateral agreements of Singapore (at 4.8 percent) is significantly lower than that for US bilaterals (7.5), which in turn is lower than that for EU (9.2) and Japanese (10.0) bilaterals, (Messerlin, 2007).

- Lipsey (1957) pointed out that opportunities for trade creation are enhanced and risks of trade diversion reduced where an FTA groups countries that are already major trading partners. This is because before the introduction of preferences, trade flows are consistent with least-cost sourcing, reducing the likelihood that the removal of trade barriers will lead to trade diversion from third country least-cost suppliers. Summers (1991), using similar reasoning, developed the "natural trading block" argument.

- Corden (1972), by bringing scale economies into the theory of FTAs, demonstrated that trade preferences and resulting shifts in demand in favour of intra-regional trade enable firms to achieve greater economies of scale and lower output prices as they capture larger markets for their products, domestically and overseas. Consistent with this observation is the principle that gains from FTAs will be greater to the extent that product coverage is comprehensive, covering (in terms of GATT Article 24) substantially all the trade.

Measurement Techniques

Two principal techniques of empirical measurement are available, each with their own strengths and weaknesses.

- *Ex post studies*, which seek to measure trade creation and diversion by taking actual statistical data of intra-regional trade flows and controlling for factors influencing trade (like geographic size and distance). The standard way to control for other effects is via an econometric model, usually a gravity model or a growth regression. The limitations of such approaches are that they are static, cannot capture the interplay of variables, do not establish causality (in the case of regressions), and (Lucas 1976) are of limited use for policy evaluation because policy changes themselves change the model.

- *Ex ante studies*, which use computable general equilibrium (CGE) models to allow for the interaction of variables. Such studies take their parameters from econometric analysis, together with estimates that are chosen so that the model fits exactly the data for a chosen base year. The drawback of such models is that they are not usually fitted to the data as precisely as in econometric models and are not subject to statistical testing.

Tentative Conclusions

Geloso Grosso (2001) draws the following conclusions from the literature:

- Overall, the findings of *ex post* studies produce a fairly mixed picture, indicating that some FTAs boosted intra-block trade significantly, while others did not. There is some evidence that external trade is smaller than it might otherwise have been in at least some of the blocks, but the picture is mixed enough that it is not possible to conclude whether trade diversion has been a major problem. In addition, these studies do not reach any definitive answer on the welfare impact of FTAs. Most of the studies using growth regressions suggest that FTAs have had little impact on economic growth.

- Broadly, the conclusions from *ex ante* studies are also that there has been evidence of weak trade diversion, but that the recent wave of regionalism has been trade-creating on a net basis and welfare-improving for member countries. However, the variation in simulated economic gains is wide, depending on the model used. In models assuming

perfect competition, the combined effect of trade diversion and trade creation typically gives very small welfare gains. However, CGE models of imperfect competition with increasing returns to scale (cf, Corden) suggest that the pro-competitive effects of FTAs might be more significant for OECD countries than for developing countries. These models increase the estimated gains considerably for the EU and NAFTA.

More recent literature is broadly consistent with these tentative findings.

- In an econometric model of NAFTA, Waldrich (2003) finds, as does the present study (see above), a clear positive effect of NAFTA on FDI in Mexico. He estimates that between 1994-1998, US and Canadian FDI to Mexico would have been around 42 percent lower without NAFTA. Moreover, he finds that the positive effect comes almost exclusively from increased investment from the United States and Canada, rather than from other countries wishing to access the NAFTA market. The World Bank (2003), using a gravity model of NAFTA, find that Mexican exports and imports would have been 25-30 percent and 50 percent lower, respectively, without NAFTA. While most research shows no significant trade diversion, one study (Fukao, Okubo and Stern, 2003) finds, at a disaggregated level, trade diversion in the textile and apparel sector.

- In an ex-ante model of EU-Chile, Francois, McQueen and Wignaraja (2005) estimate a 5 percent increase in Chile's exports to the EU as a result of the agreement. This is also consistent with the tentative findings of the present study (see above). An ex-ante model of US-Chile by the IMF finds that, consistent with the present study, Chilean exports of processed crops, textiles and clothing would receive a boost, with small welfare gains. The modest welfare gains are attributed to trade diversion as machinery and equipment-based manufactures from the United States replace lower cost imports mainly from the European Union (Hilaire and Yang, 2003). Another ex-ante study of US-Chile, by the US International Trade Commission, finds that the most important benefits are related not to reciprocal tariff elimination but to non-tariff provisions. A study for the Swiss Government of a possible US-Switzerland FTA (Hufbauer and Baldwin, 2006) found that in a static CGE framework trade flows between the two countries would increase by 20 percent, but that this increase would lead to negligible changes in US and Swiss GDP levels. The study also drew on dynamic analysis, reflecting improved production methods, exit of less efficient firms and scale and network economies. Under this dynamic analysis, it was found that annual GDP gains to each partner could be of the order of $1.1 billion, amounting to a permanent gain – level effect – for Switzerland of some 0.5 percent of GDP. Importantly, in both the static and dynamic analysis it is assumed that trade coverage of the FTA is comprehensive. The importance of comprehensive coverage is highlighted in one study which finds that if agriculture is not covered Chile suffers a welfare loss in US-Chile, the benefit of US-CAFTA is significantly reduced and, in US-Australia, a negligible welfare loss for Australia turns into a significant one (Hilaire and Yang).

One important issue that has been the subject of recent (ex-ante) analysis is that of **preference erosion**. As noted above, lower MFN tariffs will help reduce the risks of trade diversion. But, as the other side of the coin, lower MFN tariffs will also reduce preference margins. Hence the fear that FTAs will create vested interests, among preference beneficiaries, against multilateral reform. However, while particular sectors may suffer from preference erosion, this does not necessarily mean that there will be losses economy-wide. Indeed, a range of

studies find that for all but a handful of countries the gains from across-the-board MFN tariff reduction more than offset any losses arising from the erosion of preferences. One particular study (OECD 2004) postulates a 50 percent reduction in ad valorem tariffs across all regions and examines the net effects on welfare after allowing for the erosion of preferences (not just from RTAs, but from preferential arrangements such as the African Growth and Opportunities Act). The study finds that while preferential exports decrease as a consequence of erosion, new opportunities from MFN tariff reductions offset the negative effect for all but five countries. For those particular countries – Colombia, Madagascar, Mozambique, Tanzania and Uganda - special efforts and assistance are required to help diversify exports. But for the vast majority of countries, the lesson is clear – concerns about preference erosion, including from FTAs, are not a valid basis for avoiding commitment to multilateral trade liberalisation.

A Note of Caution

Before concluding this section, a cautionary note is in order. It is prompted by a particular study, (Krueger, 1999), which finds that there had indeed been increased trade between Mexico and her NAFTA partners, but that these increases owed more to other factors than to NAFTA. Among those factors, one can count the devaluation of the *peso* during the Mexican financial crisis, strong growth in the United States, and Mexico's reform of investment regulations in 1989. Indeed, even the most sophisticated modelling techniques are hard pressed to totally isolate the effects of an FTA from the other factors that determine flows of trade and investment. One way of addressing this problem is to narrow the focus of analysis. An example of such an approach is described in the following section.

2.3.3 The Effects of Investment Provisions on Trade and Investment Flows[10]

A recent study conducted at the OECD, using a gravity model, reaches conclusions that are broadly consistent with the above findings in respect of *ex post* models, but with somewhat greater specificity as the study is focused exclusively on the effects of investment provisions in FTAs.

Some Theory

On the one hand, the removal of trade barriers between countries can lower intra-regional FDI when investment is mainly market-seeking or tariff-jumping. On the other hand, efficiency-seeking investment may increase because freer trade of goods and services enables companies with low fixed costs to localise their activity in different countries and then trade intermediate inputs. In this case, investment complements trade.

Measurement Techniques

The approach taken in the OECD study is to: (1) classify provisions in the (24) North-South FTAs selected as containing substantive investment-related rules; (2) create an index of the extensiveness of those provisions; and (3) use the index to perform a quantitative analysis, via a gravity model, of the impact of the investment provisions on patterns of trade and investment.

Compilation of the index is based on six broad categories of provisions:

- Right of establishment and non-discrimination in the pre-establishment phase

[10] This section draws on Miroudot and Lesher, *Analysis of the Impact of Investment Provisions in Regional Trade Agreements* OECD March 2006

- Non-discrimination for post-establishment
- Investment in services (NT and MFN)
- Investment regulation and protection
- Dispute settlement
- Investment promotion and cooperation

Tentative Results

The study finds that investment provisions are positively associated with trade and investment flows, and that they matter more for FDI flows than for trade flows. It is estimated that the entry into force of an FTA with substantive investment provisions is associated with a 60 percent increase in FDI flows between the Parties and a 20 percent increase in exports.

The positive (albeit modest) relationship observed between the extensiveness of investment provisions and trade flows is found to be in line with the literature, and indicates that trade and investment are complements rather than substitutes, reflecting more efficiency-seeking than market-seeking FDI.

The results for trade and investment creation and diversion were found to be somewhat mixed. There is evidence of trade creation and diversion for both the Reporter and Partner countries, but the pattern does not hold completely across the dataset. The results for investment are more ambiguous than those for trade, as most of the FTA-specific variables are not 'significant'. It might be tentatively concluded that the apparently large FDI stimulus, combined with limited evidence of investment diversion, suggests that the higher FDI flows are additional rather than displacing.

The study finds an insignificant result for the variable that represents the existence of a bilateral investment treaty (BIT) between the country pairs. This led the authors to conclude that either substantive investment provisions in FTAs impact trade and investment more profoundly, or that the combination of substantive investment provisions and provisions liberalising other parts of the economy come together to more significantly impact trade and investment flows.

3.0 THE NATURE AND SCOPE OF FTA PROVISIONS

3.1 TARIFF PREFERENCES

Tariffs are the first issue to be considered when assessing the scope and depth of any FTA and thus the degree of preference. Tariff preferences are of course WTO – plus in the sense that they are reduced below the level of the MFN bound rate in the WTO. Article XXIV of the GATT requires FTAs to cover 'substantially all trade (SAT)'. This is based on the view, which was articulated as early as the League of Nations discussions on the topic, that complete coverage is better because it means that the parties to an FTA do not exclude sensitive or difficult sectors from tariff liberalisation and thus helps to contain discrimination. There remains no agreement in the WTO's Committee on Regional Trade Agreements (CRTAs) on the definition of SAT. Suggestions range between 80 percent and 100 percent of all trade, with developing countries seeking more flexibility. The first question to address is therefore what the coverage of tariff liberalisation is for the 'core entities'.[11]

A second question is what trends, if any, can be identified in the coverage of tariff preferences? For example, are recent FTAs extending the sector coverage of the preferential agreements? Is the structure of tariff liberalisation pursued by the core entities the same for all the FTAs they negotiate, or does it vary from case to case? A trend towards greater coverage could be seen as FTAs being building blocks for future liberalisation. Varying structures of liberalisation and overlapping FTAs would make for greater complexity exacerbating the 'spaghetti bowl' or 'noodle bowl' of preferences feared by some authors. (Bhagwati, 1991)

As there are more and more north – south FTAs and developing countries are pressing for greater flexibility in the application of GATT Art XXIV, how do the FTAs negotiated accommodate countries at different levels of development? Is there asymmetric tariff liberalisation favouring the less developed partners in agreements? Finally, how do the approaches to tariff preference of the 'core entities' compare?

Availability of Information

Although tariff barriers are generally seen as being the more transparent form of protection compared to non-tariff or regulatory barriers, providing an answer to the questions above is far from straightforward. Assessing the degree of preference requires a detailed comparison of applied or multilaterally bound tariffs on a line by line basis with the preferential tariff. This was beyond the scope of the current study. The approach adopted was to consider the preferential tariffs of the core entities as set out in the various texts of the FTA agreements. This still requires a time consuming process of identifying which tariff lines are liberalised by any agreement, which are excluded and which are subject to partial liberalisation or tariff rate quotas (TRQs). Unfortunately the information provided by the various parties is not standardised, making the scope and sector coverage of agreements often opaque.[12] There is

[11] There is no consensus on the merits of greater coverage of tariff preferences. Some argue that greater coverage will mean more and more sectors come to accept liberalisation and liberalisation at the regional or bilateral level can clear the way for future multilateral liberalisation. (Summers, 1991) Others argue that by establishing preferences simply creates an incentive to resist multilateral tariff liberalisation.

[12] The WTO has recently started producing Factual Statements of the FTAs notified to the CRTAs. These follow the agreement on a Transparency Mechanism for Regional Trade Agreement (WT/L/671) adopted in December 2006. These should prove helpful as a source of comparable data, but only a few studies had been produced by the time this study was completed. Five factual statements were discussed in May covering Thailand – Australia; Thailand – New Zealand; SDAC; and Armenia – Moldova. These provide some data on the coverage of preferential tariff liberalisation, so further studies will shed light on other FTAs in due course.

also no consensus on the measure for coverage and depth of tariff preferences in FTAs. For example, should coverage be determined by the number of tariff lines for which tariffs are reduced to zero as a result of an FTA, or should the measure be the percentage of trade at zero tariffs? (WTO, 2002; pg2) The different methods produce different results. What account should be made of reduced tariffs or the use of tariff rate quotas?

The approach adopted in this study has been to measure the percentage of tariff lines covered on the basis of the texts of the agreements at the HS 8 digit level. This approach is broadly in line with previous WTO work (WTO, 2002) and thus facilitates some comparison, but proved to be so time consuming that the number of FTAs studied in depth had to be rather more limited than we would have wished. This approach does not take account of the trade between the parties in each sector, so that removal of tariffs has equal weight regardless of the volume of trade in the product concerned. Methods of measurement that take account of trade will, on the other hand tend to overstate the importance of lines where tariffs are not in place or not restrictive.

The study assessed 13 selected FTAs, with the position for each party being studied. In other words the coverage by the EU of imports from Chile and Chile's coverage for imports from the EU. In each case tariff lines (at the HS 8 level) for fully liberalised products, for excluded products and for partially liberalised products were identified. In addition to the new research carried out for this study we have also drawn on existing work, such as that by the WTO in 2002 which adopted a similar approach, in order to give a somewhat wider picture

Summary of Findings on Tariffs
The findings for this detailed work on tariffs for the FTAs considered is broadly in line with equivalent although older studies.

- There is a clear trend towards the elimination of all industrial tariffs, either immediately or after a fairly short transition (i.e. 6 years) by all the core entities. There remain some exceptions however, and in some cases protection is provided in the form of longer transition periods. Many of the 'core entities' FTA partners are also liberalising industrial products. In other words free trade in industrial goods appears to be accepted as the norm among the major players in FTAs.

- There is some asymmetry favouring developing country FTA partners of the core entities, this takes the form of accepting the exclusion of more tariff lines, longer transition periods and in some cases scope to reintroduce tariffs in certain circumstances.

- The position in agriculture is, however, different. There is no trend here. Some core entities (USA and Singapore) are moving towards nearly complete coverage of agriculture as well as industrial products, but others (EU, EFTA and Japan) excluding large parts of agriculture from tariff and other liberalisation.

- Trends in the scope and depth of tariff liberalisation are not easy to identify as the coverage tends to vary according to the potential of the FTA partners as a competitor. There are some indications of greater coverage of tariff lines in FTAs, but this must be seen as a tentative conclusion requiring more work.

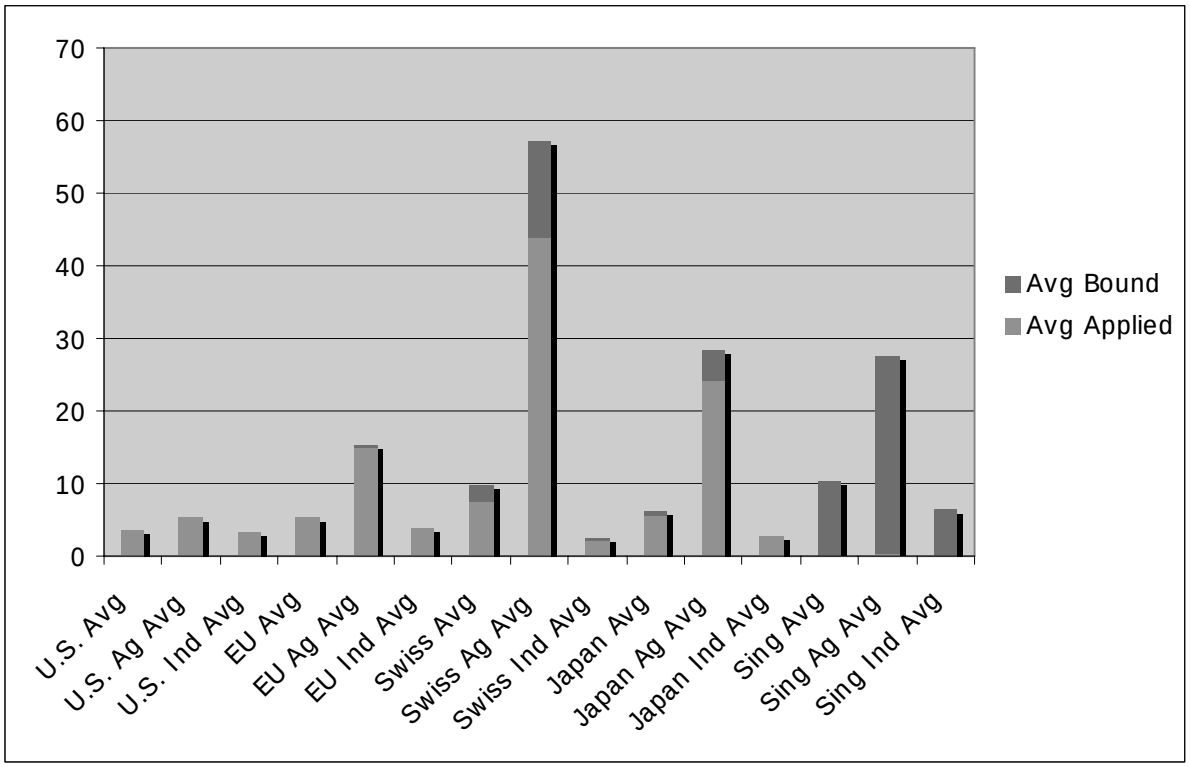
- The distinctions between the core entities are more clear cut. In the FTAs studied the US liberalisation covers more tariff lines and in many cases is close to 100 percent, but uses longer transition periods (up to 18 years) when it wants to provide some degree of continued protection. At the same time the US expects its FTA partners to do the same, which by and large they have. As a result there is little asymmetry favouring the US's FTA partners. The EU and EFTA have similar approaches in that they have close to 100 percent coverage of industrial tariffs, but exclude large parts of agriculture from coverage, EFTA somewhat more so than the EU.[13] On the other hand, the EU and EFTA have accepted more asymmetry in industrial tariff liberalization, allowing developing countries a good deal of flexibility in their sensitive sectors. But there is also asymmetry favouring the EU, such as through longer transition periods for some agricultural sectors. Singapore combines the US and European approaches in that it offers 100 percent liberalisation (or binding tariff elimination since it already has zero applied rates in most cases), but accepts considerable flexibility on the part of its FTA partners. This is illustrated in the case of the Singapore – India agreement, in which Singapore accepted the exclusion of nearly 75 percent of India's tariff lines. Japan, has tended to exclude rather more industrial tariff lines than the other core entities along with many agricultural products, but its recent FTAs appear to suggest a move towards greater coverage.

3.1.1 The United States

The United States maintains a relatively low level of MFN tariffs; in 2005, the average U.S. bound and applied tariff rate was 3.5 percent,[14] and approximately 31 percent of American tariff lines receive duty-free treatment.[15] According to a 2006 WTO estimate, two percent of American tariff lines are covered by tariff rate quotas[16]. Industries with the highest level of tariff protection include dairy (10.5 percent), canned tuna (11.6 percent), apparel (11.1 percent), and footwear and leather products (10.7 percent). Tobacco, sugar, beef, peanuts and cotton have also traditionally been protected.[17] See chart 4.

[13] In order to reduce the work load this study has used Swiss tariff schedules as a proxy for EFTA as a whole.
[14] WTO Statistics Database, 2007, www.stat.wto.org
[15] Based on lines identified as already receiving duty-free treatment in the U.S.-Chile FTA
[16] WTO Trade Policy Review 2006, WT/TPR/S/160, p. viii
[17] Rates are ad valorem equivalents as calculated by the ITC, from *The Economic Effects of Significant U.S. Import Restraints*, USITC Publication 3701, p. xvii

Chart 4 Existing MFN tariff rates (percentage) for the 'core entities' for agricultural and industrial products



Source: complied by the authors from WTO data

American FTAs are characterized by fairly consistently comprehensive liberalization of tariff lines by both parties. In the four agreements closely analysed in this study, 100 percent of tariff lines in the American schedule were liberalised entirely by the end of the transition period. While two to three percent of American lines were subject to tariff rate quotas, all such quotas were eliminated by the end of the transition period. American agreements are thus highly WTO-plus with regards American tariff elimination, albeit from a low initial level of tariff protection.

In the FTA with Chile, the U.S. also made use of reference prices and quantities for a small number of U.S. tariff lines (0.5 percent of the American schedule) as a trigger for safeguard measures. All such measures were forbidden after a transition period.

Table 2 The coverage (in percentage) of HS 8 tariff lines for imports into the United States from various FTA partners

	All Products				Agriculture				Industrial Products			
FTA Partner	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part.**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**
*Israel (1985)	**n.a**	**n.a**	**100**	**n.a**	**n.a**	**n.a**	**98**	**n.a**	**0**	**0**	**100**	**n.a**
*Canada (1988)	**n.a.**	**n.a.**	**100**	**n.a.**	**n.a.**	**n.a.**	**98**	**n.a.**	**n.a.**	**n.a.**	**100**	**n.a.**
*Mexico (NAFTA 1993)	**n.a**	**n.a**	**90**	**n.a**	**n.a.**	**n.a.**	**87**	**n.a.**	**n.a**	**n.a**	**91**	**n.a.**
Chile	**0**	**0**	**100**	**1.8**	**0**	**0**	**100**	**10**	**0**	**0**	**100**	**0.05**
Morocco	**0**	**0**	**100**	**3**	**0**	**0**	**100**	**11**	**0**	**0**	**100**	**1.6**
Singapore	**0**	**0**	**100**	**1.8**	**0**	**0**	**100**	**10**	**0**	**0**	**100**	**0.1**
Bahrain	**0**	**0**	**100**	**1.8**	**0**	**0**	**100**	**10**	**0**	**0**	**100**	**0.1**

Source: compiled by the authors from data taken from each of the FTAs

***** figures from WTO 2002; Annex 2

Ex = number of tariff lines excluded from liberalisation;
Part = number of tariff lines partially excluded;
Full = number of tariff lines fully included (i.e. liberalised)
TRQs = tariff lines subject to tariff rate quotas or other quotas

See annexes 3.1.1 to 3.1.7 for details of the various tariff schedules in the FTAs studied

The US 'gold standard' thus brings the US well within the current range of definitions of SAT and explains why the US is pressing for 100 percent or near full coverage. However, not all U.S. FTAs have been as strictly liberalising as the four agreements analysed in this study. Agreements with countries of higher levels of development have notably included carve-outs on both sides of the agreements. The US-Israel agreement of 1985, for example, allowed both sides to retain import bans, quotas and fees to protect sensitive agricultural sub sectors. The agreement also explicitly allowed for infant industry protection within a transition period, and balance of payments-related protection for limited periods.

More recently, the US-Australia FTA (2004) allowed the U.S. to maintain duties after the transition period on sensitive American agricultural tariff lines. Duties will remain on some U.S. beef, dairy, cotton, peanut and horticultural product tariff lines. The U.S. also placed tariff-rate quotas on some dairy products, which will increase indefinitely by a fixed percentage but will not be removed completely. Australian agricultural tariffs, on the other hand, were fully liberalized.

On ratification, the U.S.-Korea FTA will also include important exclusions. The Korean side has excluded some lines completely—including rice and rice-related lines—and will maintain quotas on dairy, honey, potatoes, oranges, and soybeans. In contrast to the U.S.-Australia agreement, the U.S. appears to be more consistently liberal on both industrial and agricultural goods in this agreement.

The United States affords protection for its sensitive domestic sectors by providing long transition periods for tariff and quota elimination, sometimes as long as 12 years (Chile FTA) or 18 years (Morocco FTA). Sectors consistently receiving the longest transition periods are predominantly agricultural (including beef, various dairy lines, sugar, tobacco, peanuts, wine, and cotton), but may also include industrial lines (as with quotas for tires, copper, and some chinaware in the Morocco agreement). The percentage of lines in the agreements with long transition times was relatively small: at least 79 percent of American tariff lines were liberalized immediately in each of the agreements, and at least 92 percent of lines were liberalized within 6 years.

The four US FTAs closely scrutinised in the study are also characterized by comprehensive tariff elimination by trade partners and asymmetry in tariff reductions favouring the US's FTA partners is either zero or very nearly so. American FTA partners generally did not make more extensive use of long transition times than the U.S., and partners introduced fewer tariff rate quotas as a percentage of tariff lines in all of the studied agreements.

The exception in the studied agreements was Morocco, where a modest 0.4 percent of Moroccan tariff lines either maintained quotas at the end of the transition period or did not completely liberalize tariffs. Approximately 34 percent of Moroccan lines had transition times of over 8 years—a significantly greater figure than for the American schedule—and transition times of 18, 19 and 25 years were allowed in a limited number of cases.

The United States' FTA tariff schedules are presented as comprehensive lists, specifying line-by-line tariff treatment in both countries' schedules. The U.S. used the same format for all of the studied agreements, and designated tariff rate quotas for similar sectors. Southern trade partners conformed to the American style of tariff schedules in all of the agreements analysed.

3.1.2 The European Union

The European Union binds 100 percent of tariff lines in the WTO at an average bound (and applied) MFN tariff of 5.4 percent. The EU maintains a high level of tariff protection on agricultural goods, for which the average MFN applied tariff, is 15.4 percent.[18] Among the most supported and protected sectors are beef, sheep, goats, poultry, dairy, rice, barley, various fruits and vegetables, rice sugar, wine and tobacco.[19]

Free trade agreements of the EU are open with respect to industrial goods and defensive on agricultural goods. The agreements typically use a short negative list for industrial goods in the EU schedule, excluding less than one percent of tariff lines. By contrast, large parts of the EU agricultural schedule are excluded from reduction or liberalization, allowing for the protection of key CAP products such as beef, poultry, dairy, olive oil, rice barley, wheat, rye, sugar and wine.

[18] WTO Statistics Database, www.stat.wto.org
[19] WTO Trade Policy Review 2007, WT/TPR/S/177, pp. 88-92

Table 3 The coverage (in percentage) of HS 8 tariff lines for imports into the European Union from various FTA partners

	All Products			Agriculture			Industrial Products		
FTA partner	**Ex**	**Part**	**Full**	**Ex.**	**Part**	**Full**	**Ex.**	**Part**	**Full**
South Africa (1995)*			55%			27%			61%
Morocco (2000)	15	4	81	63	16	21	0.1	0.2	99.6
Chile (2003)	6	4	90	25	17	58	0.3	0	99.7

Source: compiled by the authors from data taken from the text of each FTA covered

***** figures from WTO 2002; annex 2

Ex = number of tariff lines excluded
Part = number of tariff lines partially excluded
Full = number of tariff lines fully included

See annexes 3.1.8 to 3.1.11 for the details of tariff structures in EU FTAs.

Asymmetry in EU agreements differs for the industrial and agricultural sections of the partners' tariff schedules. While tariff line coverage is symmetrical for industrial goods, partner countries are typically allowed a long transition periods; Morocco, Chile, Tunisia and Egypt were allowed maximum transitions of between 12 and 15 years. EU agreements also allow Southern partners to take safeguard measures on industrial goods to protect 'infant industries' and industries facing 'difficulties (that) produce major social problems,' though all such measures are time-limited and may not continue after the transition period. Neither long transition periods nor explicit safeguard clauses are extended to the EU on industrial goods.

On agriculture, by contrast, the EU's Southern partner does not typically receive more lenient treatment. The right to convene discussions of sensitive agricultural sectors is extended to both parties, as are agricultural transition periods. While the agreement with Morocco was largely symmetrical, the agreement with Chile appears generally favourable to the EU: Chile liberalized a far greater proportion of its schedule in its FTA, and the EU enjoyed longer transition periods for its fishery goods. The picture on agricultural asymmetry is thus mixed, but shows no clear tendency for lenience for Southern trade partners.

In terms of tariff structure EU association agreements have are largely consistent. Industrial goods are treated in a simple, straightforward manner for the EU schedule. Agricultural lines, for both the EU and its partners have more extensive and varied treatment in Annexes, including tariff rate quotas, exclusions, and stipulations for future negotiations. There is however, a variation between the EU FTA agreements in their differing use of positive, negative and comprehensive lists. The agreements with Chile, Egypt, Morocco, and Tunisia varied on this point without a clear trend. In the investigated agreements, negative and comprehensive treatment resulted in more liberal regimes than positive lists.

3.1.3 EFTA

With average applied MFN tariffs ranging between 7.6 and 8.6 percent, the EFTA countries individually maintain higher average tariffs than any of the other core entities. The countries also bind their tariffs at relatively high rates, introducing greater uncertainty into their tariff regimes; Norway and Iceland bind their rates at averages that are respectively 12.3 and 15.8 percent higher than the applied average.[20] The average bound and applied agricultural rates of the EFTA countries are far greater than any of the other core entities. All EFTA members maintain average applied rates of over 40 percent, and Norway and Iceland each bind their agricultural lines at an average of greater than 109 percent.[21] See Chart 4 for Swiss data.

The EFTA countries enter into trade agreements as a group but negotiate agricultural schedules independently, and do so for primary agricultural products on a bilateral basis. As a result, while industrial treatment is shared by all of the EFTA countries and their partners, the agricultural tariff coverage varies by EFTA member. This study has analyzed the agreements from the perspective of Switzerland, and data in the annex 3.1.12 - 13 represent the Swiss commitments and schedules.[22]

Like the FTAs of the European Union and Japan, EFTA agreements are liberal on industrial goods and defensive on agricultural goods. Industrial tariffs are eliminated with a short positive list of excluded goods; in the investigated agreements, those lists included dairy-related products and animal feeds. With large portions of the agricultural schedules excluded entirely (see Table 4), EFTA agreements afford extensive protection for sensitive agricultural products, including beef, dairy, cereals, milling products, animal and vegetable fats and oils, sugar products, cocoa products, and others. There does not appear to be a trend towards greater liberalisation.

[20] The somewhat higher figure for EFTA than for the EU or US is due to the higher tariffs for sensitive agricultural products.
[21] All EFTA figures from WTO Statistics Database, www.stat.wto.org
[22] Due to time and budgetary constraints detailed work on other EFTA states was not possible.

Table 4 The coverage (in percentage) of HS 8 tariff lines for imports into EFTA (Switzerland was taken as a proxy for EFTA)

	All Sectors				Agricultural Products				Industrial Products			
FTA partner	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**
* Israel	n.a.	n.a.	79	n.a	n.a	n.a.	23	0	0	0	100	
Morocco (1999)	18	4	78	0	62	15	23	0	0.0	0.2	99.8	0.0
Chile (2004)	17	5	78	0	48	18	34	0	5	0	95	0

Source: compiled by the authors from data taken from the text of each FTA covered

***** figures from WTO 2002; Annex 2

Ex = number of tariff lines excluded
Part = number of tariff lines partially excluded
Full = number of tariff lines fully included
TRQs = tariff lines subject to tariff rate quotas or other quotas

See annexes 3.1.12 and 3.1.13 for detailed examples of EFTA tariff structures in FTAs. Switzerland was taken as a proxy for EFTA.

As in EU agreements, partner countries are allowed the extensive use of longer transition times for the elimination of industrial goods, a consistent source of asymmetry favouring Southern partners. That said tariff line coverage for both industrial and agricultural goods was highly symmetrical. The extensive treatment of agricultural lines by both parties in EFTA agreements means that the agricultural agreements do not afford significantly greater lenience for Southern partners.

Because EFTA executes free trade agreements as a group, but does not present a common tariff schedule to its partners, EFTA agreements take on a fragmented character. While treatment of industrial lines in EFTA agreements is similar to other core entities, even here the excluded lines for EFTA are broken out by member country.

Within the common free trade agreement, all partners to the agreement provide a Protocol detailing positive-list treatment of processed agricultural goods. In parallel to the main agreement, each of the EFTA member countries then executes a bilateral agreement with the partner country on primary agricultural goods. Treatment of tariff lines varies between and within the agricultural annexes, and includes ad valorem tariff elimination, specific duty elimination, EU-compatible treatment, currency-denominated tariff reductions, and deductions from the existing MFN level.

Beyond the pattern of tariff coverage that EFTA agreements share with EU agreements (a comparison of the EFTA and EU agreements with Morocco shows a remarkable similarity in the percentage of tariff lines covered and excluded), there are also some explicit ways in which EFTA has linked its agreements to those of the EU. In the Morocco agreement, both EFTA and Morocco agreed to designate a positive list of processed agricultural lines for which treatment would be no less favourable than that afforded to the EU. EFTA made the same designation for a positive list of processed agricultural products in the agreement with Chile.

While some EFTA agreements featured variations on the structure described the overall structure described above was broadly consistent in the investigated agreements.

3.1.4 Japan

Japan binds 99.6 percent of tariff lines in the WTO at an average rate of 6.1 percent and has an applied MFN average tariff of 5.6 percent.[23] a higher applied average than the U.S., EU or Singapore. While agriculture accounts for only 1.1 percent of Japanese GDP,[24] Japan has been defensive in its approach to agricultural tariff liberalization. The average applied rate for agricultural products of 24.3 percent contrasts sharply with an average rate of 2.8 percent for industrial goods.[25]

Japan provides high tariff protection for dairy, vegetables, milling industry products, sugar products, and footwear, and often uses large non-ad valorem tariffs to do so. Japan also maintains tariff rate quotas on dairy, rice, barley, wheat, silk-related products, and edible fats and starches, often with peak duties on out-of-quota rates.[26]

In contrast to the consistent treatment of the domestic tariff schedule by the United States and Singapore, the Japanese treatment of the domestic schedules has varied. The two FTAs closely analyzed in this study illustrate a significant contrast. In the 2002 Japan-Singapore FTA—Japan's first—Japan took a highly defensive, positive-list approach. Japan excluded 81.5 percent of its agricultural schedule (over 1600 lines), and excluded 7.2 percent of industrial lines; only India could claim to be more defensive on either agricultural or industrial goods in any of the studied agreements.

Moreover, of the relatively few Japanese agricultural lines that were included in the agreement for duty-free treatment, 97.5 percent had already been bound at zero in the Uruguay Round, rendering the agricultural schedule largely meaningless. Where Japan maintained its most significant tariff protection, the FTA did not go beyond Japan's WTO commitments.

The Japan-Chile FTA, released in March of 2007, presents a somewhat different picture. Japan agreed to a comprehensive list with Chile that liberalized 32 percent more of the total Japanese agricultural schedule than the Singapore agreement, and went beyond Japan's duty-free commitments in the WTO. Moreover, with 98.3 percent of industrial lines liberalized, it provided significantly more duty-free treatment than the Singapore agreement.

[23] WTO Statistics Database, www.stat.wto.org
[24] WTO Trade Policy Review 2002, WT/TPR/S/107, p. 55
[25] WTO Statistics Database, www.stat.wto.org
[26] WTO Trade Policy Review 2002, WT/TPR/S/107, pp. 55-56

Table 5 The coverage (in percentage) of HS 8 tariff lines for imports into Japan from selected FTA partners

	All Products				Agriculture and Fishery				Industrial Products			
FTA partner	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**
Singapore (2002)	24	0	74	0	82	0	18	0	7	0	93	0
Chile (2007)	12	0.5	88	0.5	48	2	50	2	2	0	98	0

Source: compiled by the authors from data taken from the text of each FTA covered

Ex = number of tariff lines excluded
Part = number of tariff lines partially excluded
Full = number of tariff lines fully included
TRQs = tariff lines subject to tariff rate quotas or other quotas

See annex 3.1.15 to 16 for examples of Japanese FTA tariff structures.

Despite this dynamic shift following the agreement with Singapore, Japanese agreements as a whole remain relatively defensive. Both of the investigated agreements exclude over half of the agricultural schedule, and the industrial schedules are more restrictive than any of the other core entities. The excluded agricultural lines cover beef, dairy, fish, rice, wheat, barley, sugar products, and numerous other sensitive industries. Japan has also made increasing use of longer transition times for sensitive sectors, as noted in greater detail below.

Due to Japan's relative defensiveness, Japan's FTA partners were more liberal in agricultural and industrial goods, and used fewer quotas (where quotas were used) than Japan. Singapore and Chile respectively liberalized 26 percent and 7 percent more of their domestic schedules. While the longer transition periods used in more recent Japanese agreements have often been extended to both parties, the asymmetry in the most recent agreement with Thailand allowed Japan the longer maximum transition period (16 years, versus 11 years for Thailand). The existing asymmetry in Japanese agreements thus provides greater lenience for Japan than for its partners.

There have also been changes in the structure of agreements used by Japan. The 2002 Japan-Singapore agreement used an all-or-nothing approach, where lines were either liberalized immediately or excluded entirely (only ten lines in the entire Japanese schedule were liberalized over a transition period, and that period was capped at six years). There were no tariff rate quotas.

With the 2005 agreement with Mexico, Japan shifted to a comprehensive list approach, and extended transition times to as long as 11 years; more recent agreements with Malaysia, Chile and Thailand include transitions of 16 years. The Mexico FTA also introduced tariff rate quotas for the first time. The former extensive and cumbersome list of varied quota and tariff treatments in the Mexico agreement was consolidated into a shorter, clearer, and more uniform list of tariff rate quotas by the 2007 agreements with Chile and Thailand.

Beginning with the 2006 FTA with Malaysia, Japan also excluded a portion of tariff lines for future negotiations (often with a time limit for negotiation), a feature that has now become

standard in Japanese FTAs. The recent Japanese agreements with Malaysia, Thailand and Chile now share a largely standardized format.

3.1.5 Singapore

While the simple average of Singapore's bound WTO tariff is 10.4 percent,[27] Singapore's applied tariff schedule is almost entirely duty-free, see chart 4. Singapore maintains tariffs on only 6 tariff lines (covering beer and samsu) out of over 10,000 total lines. Despite its liberal applied tariff regime, Singapore has only bound 69.2 percent of tariff lines in the WTO, a practice that Singapore's authorities have indicated has been maintained in part for negotiating purposes.[28]

Singapore's FTAs are characterized by complete and immediate liberalization of all of Singapore's tariff lines, usually executed in a single sentence. In the sense that the agreements bind Singapore's tariffs at the applied rate of zero, and in the sense that they bind *all* of Singapore's tariff lines (i.e., the remaining 30.8 percent), the agreements are WTO-plus. In practice, however, they have little or no affect on the customs rates being applied at Singapore's ports, which continue to be duty-free.

Table 6 The coverage (in percentage) of HS 8 tariff lines for imports into Singapore

	All Products				**Agriculture and Fish**				**Industrial Products**			
FTA partner	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**	**Ex**	**Part**	**Full**	**TRQs**
India (2005)	0	0	100	0	0	0	100	0	0	0	100	0
Japan (2002)	0	0	100	0	0	0	100	0	0	0	100	0
USA (2004)	0	0	100	0	0	0	100	0	0	0	100	0

Source: compiled by the authors from data taken from the text of each FTA covered

Ex = number of tariff lines excluded
Part = number of tariff lines partially excluded
Full = number of tariff lines fully included
TRQs = tariff lines subject to tariff rate quotas or other quotas

See annex 3.1.14 for an example of Singapore tariff structures in FTAs.

Perhaps as a result of the fact that Singapore has little to offer in the way of tariff elimination, Singapore's FTA partners do not appear to deviate from their usual tariff elimination preferences. The United States pursued complete elimination of tariffs, Japan liberalized industrial lines (7 percent of tariff lines excluded) but remained defensive on agriculture (81 percent excluded from liberalisation), and India remained highly defensive in both agriculture and industrial goods agreeing to fully liberalise only 12 percent of agricultural and fishery tariff lines and only 25 percent of industrial tariff lines. The level of asymmetry thus varied widely depending on the FTA partner.

[27] WTO Statistics Database, www.stat.wto.org
[28] WTO Trade Policy Review 2004, WT/TPR/S/130, p. 30

In the studied agreements, Singapore allowed partners to pursue their preferred style of tariff elimination schedules. As a result, there is little continuity in the structure of agreements, with some comprehensive, some negative-list and some positive-list treatment by FTA partners. Treatment of transition periods was similarly varied.

3.1.6 Conclusions on tariffs

Comparing the core entities' FTA policies on tariff preferences the US 'gold standard' liberalisation covers more tariff lines and in many cases is close to 100 percent, but uses longer transition periods (up to 18 years) when it wants to provide some degree of continued protection. At the same time the US expects its FTA partners to do the same, which by and large they have. As a result there is little asymmetry favouring the US's FTA partners. However, the more recent Australia and Korea FTAs, although not be covered comprehensively in this study, appear to include rather more exclusions.

The EU and EFTA have similar approaches in that they have close to 100 percent coverage of industrial tariffs, but exclude large parts of agriculture, EFTA somewhat more so than the EU.[29] On the other hand, the EU and EFTA have accepted more asymmetry in industrial tariff liberalisation allowing developing countries a good deal of flexibility in their sensitive sectors. But there is also asymmetry favouring the EU, such as through longer transition periods for some agricultural sectors.

Singapore combines the US and European approaches in that it offers 100 percent liberalisation, but tolerates the exclusion of sensitive sectors on the part of its FTA partners, possibly due to a lack of negotiating leverage, an absence of offensive interest on the part of Singapore or a desire to press ahead with the FTA for other reasons. This is illustrated in the case of the Singapore – India agreement, in which Singapore accepted the exclusion of nearly 75 percent of India's tariff lines.

Japan, has tended to exclude rather more industrial tariff lines than the other core entities along with many agricultural products, but its recent FTA appear to suggest a more towards greater coverage. The link to domestic policies in tariffs can be seen most clearly in the continued defence of agriculture by limited market access provisions in Europe and Japan.

3.2 RULES OF ORIGIN

3.2.1 Introduction

Preferential rules of origin (RoO) are used to determine which suppliers or producers should benefit from any preference granted by an FTA. They therefore constitute an integral part of all FTAs. With no agreed international rules of origin, at least for preferential RoO, each country has more or less a free hand to determine the rules they wish. As a result there has been a proliferation of different rules producing the famous 'spaghetti bowl' effect. In order to facilitate a comparison between the various approaches of the core entities it is helpful to distinguish between what might be called framework provisions on RoO and the detailed sector by sector or even product by product 'rules' for determining origin. The table below sets out a typology of rules of origin.

[29] In order to reduce the work load this study has used Swiss tariff schedules as a proxy for EFTA as a whole.

Table 7 Typology of rules of origin

Typology of RoOs (Kyoto Convention)

Coverage	Primary criterion	Secondary criterion	Tertiary criterion	Prohibitive	Liberalizing
Product-specifc	Wholly obtained/produced			x	
	Substantial Transformation	Change in tariff classification (CT)	Chapter (HS-2) (CTC)	2	
			Heading (HS-4) (CTH)	1	
			Sub-heading (HS-6) (CTS)		1
			Item (HS-8-10) (CTI)		2
		Exception attached to particular CT (ECT)		x	
		Value Content (VC)	Domestic/Regional Value Content (RVC) (min%)		
			Import Content (MC) (max%)		
			Value of Parts (max%)		
		Technical Requiorements (TR)		x	
Regime-wide	De minimis rule (max%)				x
	Roll-up/Absorption Principle				x
	Cumulation	Bilateral			1
		Diagonal			2
		Full			3
	Drawback Provision			x	
Administration	Certification	Private self-certification			x
		Public (government sponsored)		x	

source: Garay and Lombaerde (Dec 2004)

The broad principles for determining rules of origin are that products are either wholly obtained (in other words originate entirely from the exporting country) or undergo substantial transformation in the exporting country in order to benefit from a preference. Over the years 'substantial transformation' is a principle that has been defined in different ways and there are competing claims as to the best criteria. A change of tariff heading (CTH) is argued as being simple and clear cut, but this is not necessarily the case. Detailed annexes to FTAs can define rules of origin on the basis of 6 digit tariff headings or even higher, thus adding to complexity. Using the lower digit tariff changes, i.e. at HS 2 or 4 can require significant transformation hence resulting in the rules being relatively more restrictive. It is also argued that value content (VC) is the most straight forward approach. This means that a set percentage of value content must originate in the exporting country. The level can be set at anything from 25 to 70 percent. Whilst simple on paper this method requires an audit trail in order to calculate the value content resulting from work in the country claiming the preference and as a result can be costly to apply and thus equally represent a restriction to trade. Less costly to apply is perhaps the technical requirement criterion (TR), which requires a specific production process to be carried out in the exporting country. Whilst it is easier to show origin, such a criterion requires investment in specific productive capacity in the exporting country and can therefore lead to the preferential agreement having a more distorting effect on investment and trade. With no consensus on the best approach there has been a variation across FTAs and even across different sectors and products within FTAs, thus creating the spaghetti bowl effect.

Compliance with any of the various RoO can constitute an important cost and can approach the cost of the MFN tariff producers would have to pay in the absence of a preference, so that utilization of the preference is reduced. For example, a study by Herrin estimated that for firms wishing to take advantage of preferences under the EFTA-EC FTAs, the administrative and technical work needed to achieve compliance with the rules of origin added around 5 percent to production costs. Where there are tariff peaks, such as in textiles and clothing, however, this option can be prohibitive so rules of origin can have a considerable effect.

Textiles and clothing is also characterised by more complex RoO than normal (such as sequential changes of tariff headings from yarn to thread, thread to cloth and cloth to clothing) that have been used to provide strong incentives for preferential suppliers to use yarns and fibres from the hub country – even if sourcing from this location is more expensive/ less efficient.

Framework provisions also include the *de minimis* rules and cumulation. *De minimis* excludes a set percentage of the value of a product from the calculation of origin and thus eases the restrictiveness of origin rules. Cumulation allows products originating in a third country (C) to be further processed or combined with products in a preferential country (B) so that the combined product then qualifies for a (tariff) preference in the importing country (A). Bilateral or diagonal cumulation can facilitate intra-regional trade. Bilateral cumulation operates between two countries where an FTA contains a provision allowing them to cumulate origin. This is the basic type of cumulation and is common to all origin arrangements. Only originating products or materials can benefit from it. Diagonal cumulation (as in the EuroMed agreements) operates between more than two countries provided they have FTAs containing identical origin rules and provision for cumulation between them. As with bilateral cumulation, only originating products or materials can benefit from diagonal cumulation. Full cumulation dispenses with this requirement so that all goods, including those that originate outside of any preferential agreement can be included in a product, provided all working or processing required to confer origin status is carried out in the exporting country (B).

One final framework issue is that of the method for certification of rules of origin. Here the options are private self-certification or public/government sponsored. It is generally assumed that public/government sponsored certification is more time consuming than private self-certification.

3.2.2 Comparison of Approaches

As there are no agreed detailed RoO for preferential agreements the focus of this section will be on a comparison of the various approaches. Rather than a ‘spaghetti bowl’ of different rules, there are in fact three dominant models for rules of origin; the NAFTA model, the PanEuro model and what has been called the Asia/Indian Ocean model. The NAFTA model is used by the US in its FTAs and has also found fairly wide general application in the western hemisphere. The PanEuro approach has emerged from the standardisation of the various rules of origin used by the EU in its preferential agreements and is used by the EU and EFTA in their FTAs. Both the NAFTA and PanEuro approaches are complex, making use of a range of different criteria (see table 8 below). As a result they are seen to be the more ‘restrictive’ of trade than simpler systems. The Asian/Indian Ocean is used by Japan, Singapore as well as most developing countries in its more simple formats. This approach makes extensive use of value content.

Table 8 Comprehensive regime typology for rules of origin

Regimes	Selectivity	CTC	CTH	CTS	CTI	ECT	VC	TR	Application	Admin	Cum	De Minimis
Pan Euro	SS		x				X+	x	EU and EFTA Agreements	Pub or Priv	Bilat Diag	10%
NAFTA	SS	x	x	x	x	x	X++	x	US FTAs and those western hemisphere	Priv	Bilat	7%
USA-Bahrain/Jordan/ Morocco	AB	v	v			v	X+++	x		Priv	Bilat	10%
Asian	AB		v				X+++			Pub	Bilat.	10%
Japan-Mexico	SS	x	x			x	X++	v		Pub	Bilat	10%
Japan-Malaysia	SS	x	x			x	X++++	v		Pub	Bilat	10%
Singapore-Korea	SS	x	x			x	X+++++	v		Pub	Bilat	10%
Singapore-Jordan	AB						X++++++	x		Pub	Bilat	10%

CTC change of tariff heading at HS 2 level
CTH change at HS 4 level
CTI change at HS 6 level
CTS change at HS 8 level
ECT exceptions for particular products

SS = sector specific
AB = across the board
x =used extensively
v = less used
X+ = MC 30-50%, ex works
X++ = RVC 50-60% (60 FOB, 50 cost prod.)
X+++ = MC 30-70%; RVC 25-35%
X++++ = RVC 45-55%
X+++++ = RVC 45-55%
X++++++ = RVC 35%
Pub = certification predominantly by customs/public bodies
Priv = certification by private agents including exporter
Cum = cumulation (**bilat**=bilateral; **diag**=diagonal; **f**=full)
De Min = de minimis rule

Source: Garay and Lombaerde, Dec 2004. Based on Estevadeordal and Suominen (2003a)
See annex 3.2.1 to 3.2.5 for more details on the various rules of origin regimes.

3.2.3 NAFTA

The NAFTA contains some of the most complex RoO. As the chart above shows this uses the full range of criteria. Some 70 percent of products use multiple criteria (families) for defining origin. Change of tariff heading at HS 4 level is used for 45 percent of all products, but in only 17 percent of products is CHT the only criteria. In 17 percent there is one other criterion and in 7 percent even two other criteria. The more restrictive change of tariff heading at the 2 digit level (CHC) criterion is used in 42 percent of cases (for 25 percent of products by itself). The HS 8 level is used for change of tariff rules in just 6 percent of cases. Value content (of 50 or 60 percent) is used in 30 percent of cases and technical requirements in 43 percent of cases. There are also specific RoO for sensitive products such as textiles and clothing in particular. Here NAFTA uses the infamous yard forward rule mentioned above, which in effect provides a captive market for US producers of textiles. (Cadot, 2004)

The NAFTA approach as used by the US provides for a 7 percent *de minimis* rule, bilateral cumulation and roll up and duty drawback is precluded five years after the agreement. Duty drawback exclusion is considered trade restrictive because exporters are prevented from recouping tariffs paid for foreign materials that are subsequently used in products being exported to the partner country. Rules of origin are issued through self certification by producers or exporters.

The US approach to RoO with Bahrain is simpler in that it makes use of a 35 percent VC rule for most products. For developing countries the costs of complying with such a rule may still be significant, but the RoO are not based on complex combinations of rules. The exception is again sensitive products, such as textiles and clothing where the yarn forward rule is again applied. As Bahrain has little domestic production of yarn or cloth this means almost all the cloth is purchased in the US. In the case of Bahrain there is a Tariff Preference Level (TPL) which in effect excludes a specified volume of cloth from the yarn forward RoO, thus providing some limited flexibility. See annex 3.2.4 for details of the detailed rules of origin for sensitive sectors in a range of FTAs.

The approach to RoO in the US – Jordan and US – Morocco agreements is essentially the same as for US Bahrain with a 35 percent value content, but specific rules for sensitive sectors such as textiles and clothing. In the case of Morocco the TPL has to be phased out after 10 years so that it appears to be even more restrictive than US Bahrain. The scale of the TPL is in any case limited and is equivalent to only about 1 percent of the US exports of cloth and yarn to Morocco.

The NAFTA administrative approach uses self-certification by exporting countries. Certificates of origin are issued directly by producers or exporters (private law). If there are questions as to the validity of the certificate than partner officials (private sector) can make inspections in the host country. The NAFTA Certificate of Origin for a product is valid for a whole year, which facilitates trade and reduces transaction costs and is considered to be a much simpler and more efficient approach than other models.

3.2.4 The EU and EFTA

The PanEuro approach dates from 1997 when the EU standardised the rules used for its various preferential agreements with the EEA, Switzerland and the accession states in central and Eastern Europe. In 2003 it was agreed to apply the PanEuro approach to the whole of the

Euro-Med region in an attempt to promote intra-regional trade. The PanEuro approach forms the basis of the EU's RoO in its subsequent FTAs.

While harmonised across the various EU (and EFTA) agreements the PanEuro system is still complex. In 60 percent of cases it uses CTH (HS 4 level change of tariff heading) but in 25 percent percent of cases there is also a value content criterion. Some 20 percent of products require technical requirements. As in NAFTA, the restrictiveness of certain rules of origin criteria is mitigated by an either/or option. This means that exporters can choose between two different criteria to confer origin status.

The PanEuro framework provides for a 10 percent *de minimis* rule, but there are exclusions to this in particular for textiles and clothing. Full cumulation applies to the EEA. Bilateral cumulation and diagonal cumulation are also applied. With diagonal cumulation products from, for example, Morocco can count products originating in Algeria or Tunisia when origin rules are applied. This is intended to assist in promoting intra regional trade between the EU's Euro-Med partners. This still requires all the countries to prove originating status using the PanEuro rules.

There are two options for administration of RoO under the PanEuro system. Certificates of origin can be issued by a competent agency (e.g. chamber of commerce) or by an invoice declaration for approved exporters with a recognized record of good administration. But the importer is liable for any false declaration or incorrect certification and must pay the full tariff unless any irregularity is corrected within 30 days.

The specific agreements considered in the study all illustrate the progressive application of the PanEuro model to EU FTAs. This holds for the EU – Mexico agreement as for the EuroMed agreements. There are however, exceptions to this pattern in the sensitive sectors such as textiles in trade with Mexico where two alternative approaches to rules of origin are applicable.

In terms of future agreements the European Commission is in the middle of a reform of preferential rules of origin with the aim of simplifying them for developing countries. The proposals envisage a move to a purely value content (VC) approach based on ex factor prices rather than the more costly to administer net production cost basis and supported only by a list of insufficient working or processing operations. (European Commission 2005) The level of value content is still to be set, but the European Commission has proposed 45 percent for the GSP and 35 percent for the Everything But Arms programme for least developed countries. Estimates by the Commission puts the existing rules at the equivalent of 60 percent of value content. The Economic Partnership Agreements (EPAs) will continue to use the RoO as defined in Cotonou, due to the lack of time, but the Commission paper envisages that these will also convert to a pure value content system. If these reforms are introduced it will mean the EU maintaining two regimes, the PanEuro regime and the more simple regime for developing countries.

The EFTA FTAs largely follow the PanEuro model in RoO. This is the case for the European region and for the EuroMed. The framework provisions for EFTA- Mexico and EFTA Korea are also more or less the same as the PanEuro approach, but with a number of specific changes. First, the EFTA states negotiate agriculture (HS Chapters 1-24) separately and thus determine their own rules of origin for these sectors. For the most part the restrictive wholly obtained rule is applied. For Chapter 82-92 that were negotiated by EFTA as a group there are

also complex rules of origin, suggesting a restrictive use of RoO. For the other chapters the EFTA offers a choice between CTH and VC (at 50 percent) for the EFTA Mexico and EFTA Korea FTAs. One area in which the EFTA FTAs are simpler than the PanEuro model is that outside of the EuroMed region EFTA importing authorities accept exporter declarations rather than using the Euro.1 procedure.

3.2.5 Japan

In general, Japan Economic Partnership Agreements usually combine a CTH and a value content test in RoO for processed and manufactured goods. Value content differs according to the partner (RVC 50 percent for Mexico and RVC 60 percent for Singapore in most chapters). The nature and thus restrictiveness of the RoO appear to depend on the economic capabilities of the partner. For example, Chapter 24 (tobacco) of the Japan-Mexico FTA specifies a 70 percent RVC and does not allow cumulation - a result of pressure from domestic lobbying interests – compared to 60 percent RCV and cumulation with Singapore. Chapter 86 (transport equipment) specifies CTH plus a 65 percent RCV for road vehicles in the Japan-Mexico FTA, but only a CTH rule for Singapore. Clothing (Ch 61-62), however, is more restrictive in the Singapore agreement as it requires a CTH + 60 percent RVC, as opposed to only CTH with Mexico. Japan does not provide for alternative (either/or) methods for proving origin.

Japan tends to use official administrative procedures meaning that an exporter can only validate a consignment once it has been approved by the relevant governmental authority, which tends to add to costs. In the Japan – Mexico FTA certificates of origin have to be issued by the competent governmental authority or its designees in the exporting country. If there is doubt as to the accuracy of the origin claim the importing authority may request a verification visit to the exporting country. This is similar to the NAFTA model (verification visits – although they are conducted privately), whereas the Pan-Euro model does not allow for such verification visits.

3.2.6 Singapore

In general, the Singapore RoO regimes differ dramatically across Singaporean PTAs with very comprehensive (almost 300 pages) of product specific rules with the USA (NAFTA rules), more simple and flexible RoO with Asian partners (making greater use of VC) and Pan-Euro type rules with the EFTA States (mainly specifying maximum non-originating content rules and TR rules with CTH). VC rules vary across agreements: 45 percent or 35 percent for USA, 35 percent for Jordan, 45 percent in general for Asian partners, and 50 percent VC maximum with EFTA.

Singapore is an example of a country that has very diffuse RoOs with virtually no RoO harmonization, even with Australia and New Zealand. This could increase costs of compliance for exporters/importers. For example, the Singapore – Korea FTA uses RVC (regional value content) of approximately 45-55 percent for selected sectors (55 percent for Chapters 38, 60-62, 84-87). The TR rule is used only under Chapters 60-62. There is a special consideration for outward processing, important in the case of Singapore, provided that the MC of the good does not exceed 40 percent; the RVC is at least 45 percent.

Administratively, Certificates of Origin are public. This means that when claiming preference tariff treatment, an importer of a product has to produce a Certificate of Origin issued by the exporting Customs Authority to prove origin.

The Asian approach initially used by Japan and Singapore was characterised by a relatively simple across the board criterion, usually a value content criterion, although the value content criterion tends to be rather higher than the NAFTA and PanEuro levels. See table 8. This is the approach that also tends to be applied by most developing countries. However, recent FTAs concluded by Japan and Singapore suggest that as trade agreements become more complex so do the rules of origin.

In terms of framework rules the Asian model tends not to provide for de minimis and customs authorities tend to require a certificate of origin issued by the customs authority of the exporting country. This is less flexible than the approach used by the PaEuro and especially the NAFTA models.

3.2.7 Conclusions

There are three main models for rules of origin, the NAFTA model, the PanEuro model and a more diffuse Asian model. The NAFTA and PanEuro models are both complex regimes that make use of all the main criteria for determining rules, so that rules vary from product to product. With the harmonisation of the EU rules there is at least now generally uniformity across the various agreements. Singapore and to a lesser degree Japan still have different rules of origin for different FTAs, even if the basis for the Asian model for RoO is on paper more straightforward in that it is based on value content.

In addition each of the main ‘core entities’ have varied their approach to rules of origin in order to address criticism from developing countries concerning the complexity of the rules. Thus the US uses a simple value content approach to RoO in its FTAs with Morocco and other developing countries, but still retains the protection afforded to sensitive sectors, such as textiles by requiring more detailed rules. The EU is also considering introducing simplified value content rules for its preferential agreements with developing countries.

The expectation must therefore be that there will be a form of two tier system in which FTAs involving relatively developed economies will make use of the NAFTA, PanEuro or Asian models while FTAs involving developing countries will use a simplified value content based system of rules of origin.

Rules of origin have clearly been shaped by protectionist interest that have sought to ensure that increased import competition due to tariff liberalisation has been qualified by complex rules of origin in the case of preferential tariff reductions. In some cases one could argue that rules of origin are even used as a means of creating artificial benefits for producers by establishing what are effectively captive markets. Textiles is probably the best example of this.

3.3 COMMERCIAL INSTRUMENTS

3.3.1 Introduction

This section examines the treatment in FTAs of commercial instruments: safeguards, anti-dumping measures, state-aids, and subsidies and countervailing measures. In the trading system more broadly, the tightening in the Uruguay Round of provisions relating to the use of safeguards has led to fears that anti-dumping would become the trade remedy of choice. This makes the treatment of anti-dumping in FTAs of particular interest.

Competition policy is closely associated with trade remedies insofar as some parties to preferential agreements have agreed to forgo anti-dumping action against each other and rather rely on competition policy to monitor and discipline dumping. Similarly, there is scope for agreement on anti-subsidy rules in the framework of competition policy as an alternative to countervailing duties. It is appropriate to recall, therefore, that there are broadly two approaches to competition policy in regional trade agreements: those that contain general obligations to take action against anti-competitive business conduct (for example, a requirement to adopt a domestic competition law without setting out the specific provisions the law should contain) and those that call for more explicit coordination of specific competition standards and rules. As a general rule, most of the agreements containing substantive provisions addressing anti-competitive behaviour have been concluded by the EU. On the other hand, agreements that focus more on general obligations have been concluded in the Americas, or involve a North or South American Party (Solano and Sennekamp, 2006).

3.3.2 United States

US agreements tend to have tighter disciplines on the use of safeguard measures (SGM) than are found in the WTO. Whereas the WTO limits the use of SGM to 4 years (8-10 years for developing countries), in US agreements the limit ranges from 2 years (US-Singapore, 2003; US-Peru, 2005; US-Oman, 2006) to 3 years (NAFTA, 1994; US-Chile, 2003; US-Morocco, 2006; US-Bahrain, 2006), with no re-application possible on the same product. The US-Chile agreement also provides that on the termination of the safeguard, the rate of duty shall not be higher than the rate that would have been in effect one year after the initiation of the measure according to the agreed tariff schedule. US-Peru provides that tariff rate quotas or quantitative restrictions are not considered as permissible safeguard measures.

A number of US agreements also include provisions relating to competition policy (US-Singapore, US-Chile, US-Peru). Though it cannot be assumed that this is a precursor to the elimination of anti-dumping action between the signatories. And the more recent agreements with Morocco, Bahrain and Oman do not include competition provisions.

In NAFTA, each party reserves the right to apply its anti-dumping law and countervailing duty law to goods imported from the territory of any other party. Art. 1904 provides each party with the right to replace judicial review of final anti-dumping or countervailing duty determinations by a bi-national panel review. As to global safeguard action, Art.802 establishes that when a country that is a party to NAFTA takes a safeguard action, its NAFTA partners shall be excluded from the action, except where their exports of the good in question (a) account for ‘a substantial share’ of imports (among the top 5 suppliers) and (b) contribute importantly to a serious injury or threat thereof. Art.1501, 1502 and 1503 only state the

importance of cooperation and coordination among competent authorities to further effective competition law enforcement.

NAFTA's subsidies disciplines correspond to those of the WTO, with the exception of export subsidies in the agricultural sector. Members may adopt or maintain an export subsidy for an agricultural product exported to another member where there is an express agreement with the importing country.

3.3.3 European Union

In EU-Mexico, SGM are limited to 1 and a maximum of 3 years, no reapplication is possible on the same product and compensation for SGM needs to be offered prior to its adoption. The agreement with Chile states that the WTO Agreement on Safeguards is applicable between the parties but that the provisions only apply when a party has a substantial interest as an exporter of the product concerned (the party must be among the five largest suppliers of the imported product during the most recent 3 year period). In EU-Egypt, tariff rate quotas and quantitative restrictions are excluded as permissible safeguard measures.

All the EU agreements examined contain provisions on competition policy, though again without any presumption that this will facilitate the elimination of anti-dumping action among the parties. In the case of the EU-Morocco agreement, explicit reference is made to core EU legislation dealing with competition and state aid. The direct reference to EU law signifies that Morocco will import EU law where it concerns competition or state aid that could touch upon trade with the EU, in a timeframe of 5 years after the agreement entered into force.

3.3.4 EFTA

All of the EFTA agreements examined provide for a limited period for the application of SGM of one year with a maximum of 3. EFTA-Morocco excludes tariff rate quotas and quantitative restrictions as permissible safeguards. In EFTA-Mexico and EFTA-Singapore compensation for SGM needs to be offered prior to its adoption. In EFTA-Korea no reapplication of SGM on the same product is possible, and in EFTA-Chile and EFTA-Singapore, reapplication is not possible for 5 years. In EFTA-Korea (2006), the parties are to review the bilateral safeguard mechanism to determine whether it is still needed.

All the EFTA agreements examined contain provisions dealing with competition policy, and the three more recent agreements (with Singapore, Chile and Korea) all foresee the abolition of anti-dumping measures between the parties.

3.3.5 Japan

In all of the Japanese agreements examined, SGM have a limited duration: 1 and a maximum of 3 years in Japan-Singapore; 3 and a maximum of 4 years in Japan Mexico; and 4 and a maximum of 5 years in Japan-Malaysia. In the agreements with Malaysia and Singapore, tariff rate quotas and quantitative restrictions are not considered permissible safeguard measures. Japan-Mexico and Japan-Malaysia provide for the phasing out of SGM within 10 years, and the parties are allowed 60 days of consultation before the adoption of SGM, compared with 30 days in the WTO. All three agreements include provisions on competition policy.

3.3.6 Singapore

In Singapore-Korea, SGM are limited to 2 years and a maximum of 4. In Singapore-Jordan, tariff rate quotas and quantitative restrictions are not permissible safeguards, SGM may not be reapplied on the same product and the phasing out of SGM is envisaged within 15 years.

Both agreements contain provisions on competition policy and more precise criteria for the application of anti-dumping action than are found in the WTO; when anti-dumping margins are established on the weighted average basis, all individual margins, whether positive or negative, should be counted towards the average (Art. 6.2.3(a)). This contrasts with the practice of many countries in the WTO, including the United States, of 'zeroing'(ie, excluding cases where the domestic price is lower than the export price) a practice which has recently been the subject of dispute settlement. On 9 January, 2007, the WTO Appellate Body ruled that the US methodology of zeroing for calculating anti-dumping duties, which had been challenged by Japan, was incompatible with multilateral trade rules.

In this section, the provision which foresees the substitution of anti-dumping action with the application of competition policy has been characterised as WTO-plus. This provision, however, is an illustration of the point that "WTO-plus" does not necessarily mean "better". The practice of partners to a preferential agreement undertaking not to anti-dump one another when they continue to take anti-dumping action against third parties is arguably discriminatory, even though, within the preferential agreement resort to trade remedies has been disciplined.

3.3.7 Conclusions

Asymmetric Provisions: EU agreements provide two examples of asymmetric treatment in favour of the less advanced party. In EU-Egypt, the competition provisions are less stringent for Egypt, with a longer transition period. In EU-Morocco, it is provided that in the transition period during which state aid is phased out, Morocco will be treated in the same way as those areas of the Community identified as suffering economic hardship. Hence the agreement allows for aid, during the transition period, to promote the economic development of areas where the standard of living is abnormally low. De facto, most state aid in Morocco is therefore deemed compatible with the agreement. There are similar provisions in all the EuroMed agreements. Notwithstanding these provisions, it cannot be concluded that asymmetric treatment is an unvarying feature of EU agreements: as noted, provisions limiting the use of SGM are tougher than in the WTO, and in the agreement with Morocco, that country is required to adopt EU competition policy.

In EFTA-Morocco, under Art. 21, Morocco may apply increased customs duties to protect its infant industries, or certain sectors undergoing restructuring or facing serious difficulties, particularly where these difficulties produce important social problems. This is similar to the EU agreement and appears to be general for the EuroMed partners of the EU and EFTA]

No significant asymmetric provisions relating to trade remedies have been identified in the agreements of the United States, Japan or Singapore.

Policy Trends: Provisions in FTAs dealing with trade remedies reflect two potential tendencies (OECD, 2003). On the one hand, border barriers between parties have been reduced below MFN levels, which could give rise to fears of an increased resort to

contingency measures. At the same time, the objective of deeper integration may obviate the need or lead members to forgo, or limit the scope of, contingency measures. On the basis of the present study, the latter trend seems to have prevailed. The agreements examined commonly provide for stricter provisions (limiting the use of contingency measures) than those provided for under the WTO rules.

On the basis of the observations in this present study, two trends might be expected to develop:

- Greater resort to competition policy provisions, assuming this remains outside the ambit of the DDA, including, in some cases, to address concerns about dumping.

- Adoption of an approach to 'averaging out' in anti-dumping actions similar to that of Singapore, in light of the recent DSM finding in the WTO.

One pointer to possible future trends may come from negotiations between the EU and Korea. Seoul has asked the EU, in the framework of the RTA, to ease anti-dumping rules and to reduce countervailing duties (*Bridges*, Vol.11, Number 17). This of course will only be a pointer if the EU responds. A major aim of Canada in NAFTA was to ease administrative protection measures on the part of the US, but that did not lead anywhere.

Links to Domestic Policies: The clearest link to domestic policy arises in the case of the EU and the requirement in the agreement with Morocco that – consistent with the pursuit of policy harmonisation - Morocco should comply with EU competition law and practice.

Differences in Approaches: There are no major differences in the approach of the Core Entities. On the contrary, there is a considerable degree of similarity in approach and a tendency for countries to copy from each other – notably, Japan and Singapore from the US and EFTA from the EU.

- US FTAs show a clear tendency to a blueprint application. The agreements with Oman, Bahrain and Morocco are very similar in their provisions. The same is true of US-Peru and US-Chile.

- The EU-Morocco demonstrates the EU's ambition to spread its 'normative' influence by the way in which competition is treated. This, however, is not a constant tendency in EU agreements.

- EFTA is distinguished from the other Core Entities by providing for the replacement of anti-dumping action with competition policy.

- While Singapore is differentiated by the approach to AD reform, this is again not a constant tendency.

3.4 TECHNICAL BARRIERS TO TRADE AND SANITARY AND PHYTOSANTITARY MEASURES

3.4.1 Introduction

The TBT and SPS provisions of the FTAs studied are not significantly WTO – plus. In almost all cases the FTAs reaffirm the existing WTO obligations under the TBT and SPS Agreements negotiated during the Uruguay Round. See the provisions on TBTs and SPS in the excel spread sheets annexes 3.4.1 to 3.4.10. Although remaining within the letter - and in most cases the spirit - of the WTO agreements many of the FTAs elaborate on the TBT and SPS provisions, such as in the area of more explicit transparency provisions and more detail on how principles set out in the WTO agreements, such as mutual recognition, equivalence and harmonisation of international standards, should be applied. This is also the case with regard to the co-operation measures in the various FTAs, which are often more extensive than is possible within the WTO. There are also bilateral or regional institutions established that promote cooperation, implementation and provide a venue for conciliation and dispute settlement.

The general trend is for all FTAs to include provisions on TBT and SPS and for these to become more comprehensive and sophisticated,[30] but that these are only WTO plus in terms of pushing forward faster with the application of the approach envisaged in the WTO. The WTO TBT and SPS agreements do, however, leave a good deal of scope for divergent approaches. For example, the WTO TBT Agreement envisages the use of international standards, mutual recognition and equivalence. This reflects a lack of fundamental consensus on how to address TBTs as is shown in the divergence between, for example the North American and the European approaches (see below). Equally, the SPS agreement is being interpreted by the US and EU rather differently on issues such as the use of precaution. Thus the FTAs, whilst reaffirming the rights and obligations of parties under the WTO agreements do reflect rather different views on how these should be interpreted and applied. This is good in the sense that the WTO rules are broad enough to encompass these variations, but the down side is that differences in application can, over time, result in divergence. Having said this the FTAs negotiated by the core entities included in the study are complementary to the aims of the WTO in facilitating trade by containing or removing TBTs and ensuring SPS measures are not unjustified restrictions to trade.

Asymmetry measures in the TBT and SPS field take the form of technical co-operation and assistance. The trend towards more sophisticated provisions implies greater capacity and compliance costs for developing countries. The core entities considered therefore all provide technical assistance, including financial support to help developing country FTA partners meet the requirements in terms of compliance with standards and technical regulation, testing and certification. The study did not find any cases of the acceptance of lower standards being incorporated into the FTAs themselves.

The link between domestic policy and FTAs goes both ways. On the one hand, consumer pressure for higher standards of – in particular food – safety has been a major factor driving the greater sophistication of TBT and SPS agreements. On the other hand, FTAs have

[30] Only FTAs with the Gulf of Middle Eastern states tend to exclude TBT and SPS measures. For example, the EU – GCC agreement has nothing on TBT, nor do US and Singaporian agreements with Jordan. This contrasts with Israel which has fairly highly developed provisions in its FTAs. This suggests that inclusion of TBT and SPS rules and their degree of sophistication correlates with the degree of development. (OECD, 2007)

probably contributed to the development of greater sophistication and better regulatory practices at the national level. This occurs as countries recognize the need for more domestic capacity in standards and conformance assessment in order to ensure access to export markets. The technical assistance measures offered by FTAs has also directly contributed to increase capacity.

As noted above virtually all the FTAs considered reaffirm conformance with the WTO rules. This is consistent with findings of other studies.[31] But there are clearly differences between the core entities on which of the various options available under the WTO rules is the preferred approach. The EU and also to a very large extent EFTA, place rather more emphasis on the use of agreed international standards, with centralised systems of accreditation for conformance assistance in order to facilitate mutual recognition (of conformance assessment) and relatively elaborate institutional arrangements to promote cooperation and deal with disputes. The US stresses the more general use of equivalence (unilateral recognition rather than mutual agreements) with safeguards to inhibit the use of the discretion not to recognize equivalence. For example, regulators must say why if they do not recognize equivalence. Rather than sophisticated institutional rules, the US emphasizes the rights of legal persons from FTA partners to be involved in national standards setting or regulatory processes and the use of individual 'coordinators' to deal with dispute rather than committees.

Japan and Singapore appear to follow a pragmatic line of offering a range of options in their FTAs. Again it is a question of emphasis here between the more institutional approach of the Europeans and the more organic approach envisaged by the Americans. Japan tends to be rather closer to the US approach, in that its FTAs adopt the equivalence concept with competent bodies in the importing country being required to state why they have not accepted equivalence. But both Japan and Singapore have sophisticated and centralised domestic systems that promote agreed international standards and verification and monitoring of conformance assessment. In the case of Singaporian FTAs the level of sophistication varies with the level of development of the partner country but is also in part a pragmatic desire to offer its FTA partners the option of the institutional or organic approach.[32]

3.4.2 Technical Barriers to Trade

This section discusses the various policies of the core entities in a little more detail. See annexes 3.4.1 to 3.4.5 for a graphical comparison of the various TBT provisions.

3.4.2.1 The United States

The US FTAs include provisions that reaffirm the parties' rights under the TBT agreement (e.g Art 903 NAFTA) including therefore the national treatment provisions for technical regulations and conformance assessment. In terms of coverage US FTAs tend to focus on mandatory regulations at the level of the (federal) government. Voluntary standards-making is seen as something for the market and compliance with TBT rules at sub-central/federal government level is based on best endeavours.

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[31] See for example, for TBT rules OECD *Bilateral and regional trade agreements: an analysis of provisions regarding technical barriers to trade* TAD/TC/WP(2007)12 and Piermartini R. and Budetta, M. *A Mapping of regional rules on technical barriers to trade*, preliminary draft for the Inter-American Development Bank and World Bank Meeting in Washington DC 26-27 July 2006

[32] Chile is an analogous case in that it includes harmonisation to international standards, mutual recognition and equivalence in the TBT rules it has agreed with the EU and US.

In terms of transparency US FTAs require the parties to provide prior notification of any new regulatory measure.[33] As the US has only a weak central standards making system in ANSI, the range of private standards making bodies are not bound to such transparency rules (unless they have signed the Code of Conduct in of the WTO TBT Agreement). US FTAs provide that (legal) persons should be treated no less favourably than nationals when it comes to consultation in regulatory and standards making. This goes beyond the WTO's TBT requirements and was included in NAFTA and confirmed in US-Chile and US-Morocco agreements.

In terms of 'substantive measures' the US FTAs oblige parties to use international standards (Art 905 of NAFTA) (again this is unlikely to apply to private standards bodies), but like the WTO TBT text NAFTA provides considerable scope not to adopt such standards, if these are seen to be ineffective or inappropriate. Given the general antipathy towards agreed international standards on the part of the US, such measures cannot be expected to result in much pressure for more effective international standards.

The US emphasizes what might be called an 'organic' approach to TBTs. The aim is for exports from one party to be treated as *equivalent* by the competent bodies in the importing country. (Art 906.4 of NAFTA for example). The competent body in the importing country retains discretion to reject equivalence, but must then explain why. The approach to conformance assessment (Art 906.6 NAFTA) also applies the same approach. This approach is organic in that the expectation is that equivalence will be achieved through the general application of best practice and dialogue without significant institutional provisions. The US expects its FTA partners to follow a similar approach, as illustrated by the US-Chile (and US-Singapore agreements). As a result Chile and Singapore have included the option of equivalence in their other agreements, such as the Trans-Pacific Strategic Economic Partnership agreement of November 2006. [34]

Taking a broader view the US does not preclude mutual recognition or regional harmonisation of standards. It has been supportive of the mutual recognition framework in APEC, which has resulted in a number of sector agreements and NAFTA set up a number of sector standardisation committees. Equally the US, or the relevant professional bodies, has signed a range of mutual recognition agreements in specific sectors, including six with the EU (although only three were implemented) and MRAs on wine with Chile, Australia and New Zealand (agreement on mutual acceptance of oenological practices, 2003).

The US FTAs include provision for co-operation, technical assistance and information exchange on TBT issues. As with the other core entities this benefits the less developed partner, but also provides a means of promoting ones own standards. The US generally spends less on such support than the EU or Japan (only $3.4m between 2001 and 2005 compared to $29 m for the EU and $9.6m for Japan).[35] Generally speaking the US FTAs have weaker bilateral institutional machinery for cooperation than the EU or other core entities. In recent

[33] In line with the TBT agreement this is only binding for the Federal Government, the US is obliged to make 'best endeavours' to ensure that state level government conform. In general only mandatory regulations are covered under the WTO. The various private standards making bodies are not bound to provide such notice.
[34] The EU – Chile agreement provides a choice between mutual recognition and equivalence as the means of addressing TBTs.
[35] http://tcbdb.wto.org cited in OECD 2007 pg 20

FTAs there has been a shift towards establishing 'TBT coordinators' (e.g US Morocco Art 7.7 and Annex 7a and the same articles in US-Bahrain) in each of the parties to deal with disputes, rather than establishing joint committees. This reflects a preference for a lighter institutional framework compared to the EU, for example, which generally establishes a specific Joint Committee for TBT (and SPS) in addition to any general Association Council.

3.4.2.2 The European Union

Whilst the internal EU regime for TBT covers all levels of government, its FTAs tend to be equivalent with WTO coverage and thus limited to central government. The EU FTAs also reaffirm rights and obligations under the TBT agreement. In terms of transparency the EU FTAs are consistent with the TBT agreement.

On substantive measures the EU has been rather unambitious in its FTAs compared to the comprehensive approach to TBTs adopted within the EU. In FTAs with its near neighbours in North Africa the EU has been content with a general objective of harmonisation to the European standards and practice. This is set out in a short statement of aims that will require considerable time and effort to achieve. (Art 40 EU – Morocco 1996) When the circumstances are right this would lead to mutual recognition agreements (Art 40 (2) EU – Morocco). The EU is seeking to negotiation a recognition agreement with Morocco for industrial products (in the first instance electrical goods, machinery and construction equipment). Given the level of development of such countries it will be some time before circumstances are right for extensive MRAs.

More surprisingly perhaps is the relative weakness of the TBT provisions in the EU – Chile agreement, which is in other respects seen to be a 'model' for future EU FTAs. This offers little more than a menu of various possible approaches, including the promotion of regional and international standards, mutual recognition and equivalence. (Art 87 EU – Chile) The general lack of provisions in the FTA has however not stopped the EU negotiating a mutual recognition agreement with Chile on wines in 2003.

The EU promotes technical cooperation in the field of TBT issues. Indeed, the impact of FTAs in the field of TBTs will largely depend on how the various special joint committees that are established work. For example, the Special Committee on Technical Regulations, Standards and Conformance Assessment set up with Chile (Art 88) has the task of developing a work programme for the TBT field. With ASEAN the EU has negotiated TREATI, which has as one of its central features cooperation in the development of TBT and SPS measures.

Finally, the EU approach to enforcement has been to use the joint committees for TBT measures for consultation and conciliation.

3.4.2.3 EFTA

The EFTA approach to TBTs has been very similar to that of the EU. Like the EU and other FTAs the EFTA agreements reaffirm the rights and obligations under the TBT Agreement (eg Art 2.8 EFTA Korea). The more developed status of Korea provided scope for more specific aims of promoting mutual recognition of products tested by conformance assessment bodies that have been accredited in accordance with the relevant guidelines of the International Standards Organisation (ISO) and the International Electrotechnical Commission (IEC).

3.4.2.4 Japan

The Japan – Malaysia FTA provides an illustration of the Japanese approach to TBT provisions in FTAs. Again this reaffirms the rights and obligations of the parties under the existing WTO TBT Agreement (Articles 59-67). There then follow a number of options for dealing with TBTs including the use of equivalence, harmonization and/or mutual recognition. Equivalence as applied here is very similar to the US usage, with importing regulators obliged to explain when they do not accept equivalence. Mutual recognition is a general aim with either party able to initiate negotiation of specific (sector by sector) mutual recognition agreement. A subcommittee is established to promote the application of the TBT provisions and the various forms of cooperation envisaged that include exchanges of experts, promotion of strengthened capacity in certification and testing etc. The Japan-Malaysia agreement like other Japanese FTAs excludes TBT provisions from the bilateral dispute settlement provisions.

3.4.2.5 Singapore

All the FTAs concluded by Singapore include provisions on TBT, with the exception of Singapore Jordan. Singapore is also actively engaged in TBT work in ASEAN, APEC and TREATI. In almost all respects the Singaporian domestic institutional capacity in terms of standards making, certification, accreditation and the ability to negotiate TBT provisions matches that of the OECD countries.

As with the other core entities Singapore's FTAs reaffirm TBT rules and generally provide effective transparency measures that contribute to the effective application of the WTO rules on transparency.

On substance Singaporian FTAs and its engagement in regional arrangements cover the whole range of policy options. For example, ASEAN as well as the bilateral agreements with New Zealand, Korea and the TPSEPA all stress the need for the use of harmonised international standards. Within AFTA (ASEAN) Singapore is involved in an approach that focuses on harmonisation of essential safety requirements, that is initially focusing on electrical equipment cosmetics, pharmaceutical products and foods. This approach emulates the EU approach. Within APEC it is involved in negotiating MRAs, and has even negotiated one MRA with India. In its FTA with Korea, Singapore has negotiated provisions on regulations, verification and monitoring of conformance assessment that represent a fairly centralised approach. On the other hand the FTA with the US adopts the more organic approach based on equivalence.

In terms of co-operation Singapore with its strong domestic capacity provides technical assistance to the more developing members of ASEAN through the ASEAN Consultative Committee on Standards and Quality and is active in APEC. Enforcement of the TBT provisions tends to be through bilateral committees for TBT. In the case of ASEAN these exist at a sector level. In the FTA with the US there is no separate committee for TBT, but a 'coordinator' in each party to resolve disputes following the US approach.

In short Singapore appears to be able and willing to gear the structure of its TBT provisions to the desires and requirements of its FTA partner. In the case of Korea and ASEAN there are quite centralised provisions, whereas with the US it has accommodated the more organic approach of the USA.

3.4.3 Sanitary and Phytosanitary Measures

3.4.3.1 Introduction

The approach to sanitary and phytosanitary measures in FTAs is broadly similar to that adopted in the TBT provisions of such agreements. For the most part the FTAs refer to the existing WTO SPS Agreement of 1994 and reaffirm the rights and obligations of the parties under this agreement. The 1994 SPS Agreement constitutes an attempt to strike a balance between the right to protect human, animal and plant health on the one hand, and a desire to facilitate trade in food and animal and plant products on the other. Thus the SPS Agreement grants rights to take action to protect health and food safety but only when these are necessary and when the measures are supported by scientific evidence (Art 5.7 SPS). Precautionary measures are possible when the scientific evidence is not available, but only on a temporary basis until the parties can gather the requisite scientific evidence. Under the SPS agreement there is a presumption that risk assessment and risk management should be science based.

In recent years public opinion in some regions and in particular within Europe, has shifted against a purely science based approach following the failures of science-based regulation in the BSE and various other cases. This has led to pressure for the use of the precautionary principle in the application of SPS measures and other regulation. For a graphical presentation of the SPS provisions in the various FTAs, including indications of where they are WTO plus (or SPS minus) see annexes 3.4.6 to 3.4.12.

3.4.3.2 The United States

The NAFTA was finalized one year before the SPS Agreement. Therefore, there is no mention of the WTO SPS Agreement in the NAFTA. In fact, the WTO SPS Agreement is said to be more stringent than Chapter 7 of NAFTA. However, the SPS provisions in both the WTO and NAFTA are generally similar.

In all TBT and SPS provisions NAFTA transparency measures require the parties to notify any new or revised regulation 60 days in advance and to provide an opportunity for the parties to commenting on such regulations. (Art 718 and 719 NAFTA) To facilitate trade, countries are encouraged to use relevant international standards and work towards harmonization - that is, the adoption of common SPS measures. To promote harmonization, the agreements cite, as sources of scientific expertise and globally recognized standards, international bodies such as the Codex Alimentarius Commission, which deals with food safety issues; the International Office of Epizootics (IOE), for animal health and diseases; and the International Plant Protection Convention (IPPC), for plant health. However, Article 713(2) states that a measure that ‘results in a level of SPS protection different from that which would be achieved by a measure based on a relevant international standard, guideline or recommendation shall not for that reason alone be presumed to be inconsistent with this section.’

The requirement to use agree international standards is further weakened by provisions that allow each country to decide its own ‘appropriate level of protection’ of human, animal, or plant life or health. Such measures - which can be more stringent than other countries' and differ from international benchmarks - are acceptable as long as they are based on scientific principles and risk assessment, applied consistently to all countries, and not used as disguised

trade barriers. This provides for considerable national policy autonomy, but is firmly based on scientific risk assessment.

To reconcile these two potentially divergent aspects NAFTA, like the SPS Agreement stresses the benefit of equivalence (Art 714 NAFTA). In other words parties are to recognize the other's products as equivalent to their standards. NAFTA therefore set a precedent for the SPS Agreement in its use of equivalence, but there is not much detail on how this should work in practice. Nor does SPS appear to be a priority issue included the US 'gold standard' for FTAs. See table 9.

Table 9 Provisions concerning SPS measures within RTAs

Provisions Concerning SPS measures within RTAs

Agreement	Harmonization	Equivalence	Mutual Recognition	Technical Cooperation/Assistance
APEC	N/A	N/A	Yes	Yes
Asean-China	NP	NP	NP	Further negotiations
Canada-Chile	NP	NP	NP	NP
EU-SA	Yes	NP	NP	Yes
Eu-Tunisia	Yes	NP	Yes	Yes
EFTA-Turkey	NP	NP	NP	NP
NAFTA	No	Yes	No	Yes
EU	Yes	Yes	NP	Yes
Japan-Singapore	NP	NP	NP	NP
US-Chile	No	NP	NP	Institutional
US-Australia	No	NP	NP	Institutional
EU-Mexico	NP	Yes	NP	Yes
US-Morocco	NP	NP	NP	Yes (non-commital and mild)
US-Bahrain	NP	NP	NP	NP
Japan-Mexico	NP	NP	NP	Yes
Japan-Malaysia	NP	NP	NP	Yes
Singapore-Korea	NP	NP	NP	NP
Singapore-Jordan	NP	NP	NP	NP

NP - no provision found
Institutional - signifies the establishment of a committee or institution dedicated to SPS matters

Source: authors based on the texts of the agreements.

NAFTA supports the principle of regionalization, in other words the differentiation between regions in the exporting country so that any restrictions on exports from the country can be limited to the affected region, thus mitigating the effects of any health controls on trade.

Finally, NAFTA established a specific Committee on Sanitary and Phytosanitary measures to oversee the implementation of the agreement and envisages cooperation.

The US agreements with developing countries such as Morocco and Bahrain do not have extensive SPS rules. The US – Morocco Agreement provides for a Joint Committee on SPS Measures, but apart from this is content to reiterate the parties' rights and obligations under the WTO SPS Agreement.

3.4.3.3 European Union

The EUs provisions on SPS fall into three broad categories. There are the agreements with near neighbours and potential accession states, which take over the entire *acquis communautaire* and thus in effect assume the same rules as the EU. For countries such as Turkey or potential accession states in the Balkans the agreements with the EU assume the progressive adoption of EU rules and standards for all issues including SPS. A second group of countries includes the EuroMed partners with which the FTAs tend to simply restate the

parties obligations under the WTO SPS Agreement and set out a general objective of promoting the approximation or harmonisation of SPS standards, but without any specific binding obligations or details of how this should be achieved. The aim of harmonisation of SPS standards is included in Art 46 of the EU – Israel agreement; Art 51f for EU – Lebanon, Art 58 for EU – Algeria and Art 40 EU – Morocco (see Annex 3.7) All the EU bilateral agreements include provisions on cooperation in a wide range of policy areas and generally include SPS policy and standards as an area for cooperation and technical assistance. For example, Art 71 for the EU – Jordan agreement. In the case of EU – Israel the more developed national procedures in Israel mean there has been scope for rather more closer cooperation. FTAs with other developing countries, such as the ACP states are likely to take a similar form. The only agreement with a Sub-Saharan African country was the Trade Development and Cooperation Agreement (TDCA) with South Africa which simply included general references to the desire to cooperate in the SPS field to promote a harmonisation of SPS standards and rules in conformance with existing WTO obligations. (Art 61 TDCA).

The third category of FTAs is with major emerging markets or developed markets outside of Europe, such as the agreements with Mexico, Chile and the potential agreements with ASEAN, India and Korea. The agreements negotiated with Mexico and especially Chile include some WTO plus provisions in the SPS field, especially with regard to process. Table 10 sets out these in a simple tabular form.

Table 10 SPS Provisions in existing EU FTAs

WTO consistent rules	**Euro-Med**	**TDCA**	**EU - Mexico**	**EU - Chile**
Reaffirmation of WTO SPS obligations	yes	yes	yes	yes
General cooperation in SPS	yes	yes	yes	yes
Harmonization of SPS standards as an objective	yes	yes	yes	yes
General exception possible similar to GATT Art XX	yes	yes	yes	yes
Provision for specific technical assistance in the SPS field				yes
Procedural WTO – plus measures				
Establishment of a joint committee on SPS			yes	yes
Detailed rules for determining equivalence				yes
Guidelines for conducting verifications, checking imports and certification of testing				yes
Schedules for reporting and consultation				yes
Specific rules on import administration				yes
Requirement to exchange information				yes
Provisional approval of certain establishments				yes

The most important SPS provisions in the EU – Mexico agreement can be found in Article 20 of the supplement to the EU – Mexico Agreement resulting from a decision of the EU/Mexico Joint Council 2/2000 of March 2000. This reaffirms the SPS Agreement but establishes a WTO-plus Special Committee on SPS matters to progressively develop cooperation in the SPS field. The pace with which more developed procedural measures are introduced in Mexico will therefore be dependent on the work of this Special Committee. It is possible that more advanced provisions for Chile, see below, will provide a precedent for the EU's approach to this work.

In general terms the EU – Chile FTA is seen as a model for future EU FTA agreements. [36] The SPS provisions in the EU- Chile agreement are also the most developed and are therefore likely to provide a precedent for future FTAs. The *aims* of the EU –Chile SPS Agreement are set out in Article 89 (2) of the agreement. Details are however, included in Annex IV to the agreement. A special Joint Management Committee is established to develop work on SPS measures. There are also twelve appendices detailing specific procedures and definitions with a view to:

[36] The EU has not in fact made use of a model FTA in the way the United States has used NAFTA as a model FTA for all the subsequent agreements it has negotiated. The EU FTAs are by comparison not uniform in structure and appear to be shaped more by the specific conditions in each bilateral relation.

- ensuring full transparency of SPS provisions (to enable each party to comply with the detailed SPS rules and procedures);

- establishing the mechanism for recognising equivalence (Art 6 and 7 of annex IV)(that would enable the importing party to recognise animal and plant products as satisfying the importing parties rules);

- applying the principle of regionalisation (Art 6b of annex IV) (that allows exporting parties to show that specified regions are free of pests and thus facilitate trade);

- promote the application of the WTO SPS agreement;

- facilitate trade (such as through building confidence on verification and control applying FAO standards) (Art 10 Annex IV) and;

- improve cooperation and consultation.

The EU Chile agreement does not appear to cover genetically modified crops (due to the sensitivity of this issue). On the other hand there is no specific reference to science-based approaches. One innovation however, in the EU Chile agreement is inclusion of a specific reference to animal welfare standards in article 1 of the Annex IV. The aim being to develop common approaches to the treatment of animals and compliance with OIE standards falling within the scope of this Agreement'.

3.4.3.4 EFTA

EFTA has relied on reiterating the rights and obligations of the parties under the WTO SPS Agreement. This is done through a single article (EFTA-Mexico FTA Article 9) (EFTA-Korea FTA Article 2.7). However, each agreement goes nominally beyond the WTO by stipulating that the Parties shall exchange names and addresses of contact points with SPS expertise in order to facilitate technical consultations and the exchange of information.

3.4.3.5 Japan

The SPS measures in Japan – Mexico reflect those typically incorporated within Japanese FTAs (Section 2 – Articles 12-15). These include explicit reference to the reaffirmation of rights and obligations of the WTO SPS Agreement, enquiry points, institutional cooperation via a subcommittee, and non-application of dispute settlement procedures. On this later point the SPS approach is the same as for TBT provisions.

A sub-committee on SPS measures is established with the mandate to ensure, inter alia, information exchange, notification, science-based consultation to identify and address specific issues that may arise from the application of SPS measures with the objective of obtaining mutually acceptable solutions, technical cooperation and cooperation in international fora. The subcommittee may, if necessary, establish ad hoc technical advisory groups to provide technical information and advice on specific issues.

The wording of the Japan – Malaysia FTA (Chapter 6, articles 68-72) is identical to the Japan-Mexico FTA with the one important addition of technical assistance. Here it states that

both parties, through the subcommittee, shall cooperate in the areas of SPS measures including capacity building, technical assistance, and exchange of experts subject to the availability of appropriated funds and the applicable laws and regulations of each country.

3.4.3.6 Singapore

According to Chapter 7, Article 7.1 (SPS Measures), of the Singapore – Korea FTA both Parties reaffirm their rights and obligations under the WTO SPS Agreement. Other than reiterating provisions found in the WTO SPS Agreement, such as non-discrimination and the use of scientific principles, this agreement provides for consultation and exchange of information between the Parties on SPS matters and obliges the parties to respond to queries on SPS matters within a reasonable time. Enquiry points are also established.

There is nothing in the Singapore Jordan FTA on SPS measures.

3.4.4 Conclusion on TBT and SPS

In the case of both TBT and SPS measures all FTAs reaffirm the parties' obligations and commitments under the respective WTO agreements. The FTAs reiterate the principles set out in the WTO agreements, such as transparency and notification of new technical regulations or SPS measures and endorse the use of international standards, mutual recognition and equivalence as well as cooperation in specialist committees. The WTO – plus nature of some the FTAs negotiated by the core entities rests therefore in how these various principles and instruments are applied. Preempting the discussion below about differences in approach between the core entities, one could argue that the WTO agreements offer a menu of possible approaches for dealing with TBT/SPS issues because there is no agreement between the main protagonists on what the rules should be.

The WTO – plus nature of the FTAs is illustrated, for example, in the Annex IV provisions of the EU – Chile FTA. This provides a detailed text on how equivalence, regionalization etc should be implemented in practice. This and other FTAs are therefore within the letter of the WTO text but hold out the promise of more effective implementation of the principles. Much the same can be said for the use of mutual recognition in TBT. This is envisaged in the WTO TBT Agreement, so promoting mutual recognition (of conformance assessment) is within the letter of the WTO rules. But mutual recognition agreements are clearly WTO plus in that they provide preferential benefits for parties signing up to them that are not available to general WTO members.

Another area in which the FTAs go beyond the WTO in TBT/SPS is in the establishment of specialist joint committee to oversee the implementation and application of the agreements. The establishment of specialist committees for SPS measures is widely used for SPS, but rather less than complete for TBT. These specialist committees have the job of promoting the implementation of the principles and instruments envisaged in the agreements, but also promote cooperation and provide a forum for addressing disputes. It is noteworthy that there have been very few WTO dispute settlement cases in TBT/SPS between signatories to FTAs. In the case of north-south FTAs, where the agreements are generally much less detailed, joint committees provide a channel for cooperation and provision of technical assistance.

At first glance the approaches of the 'core entities' to TBT/SPS measures in FTAs appear to be very similar, namely the use of the existing WTO approach through reference to the WTO

agreements.[37] As noted above however, the WTO agreements provide a menu of options. They urge the use of agreed international standards, while at the same time provide an opt-out for parties that do not wish to be tied to such standards. They encourage the use of mutual recognition (of test results), but also offer 'equivalence' as an alternative. Much therefore turns on how the WTO – plus procedural measures mentioned above are used to apply these different principles.

The EU and EFTA tend to use a comprehensive approach to addressing TBT and SPS. The texts of the provisions are more extensive in an effort to ensure that essential safety rules are really equivalent. This can then facilitate mutual recognition, trade and market access. The EU and EFTA also place more emphasis - and devote more resources to developing - agreed international standards. The US approach as reflected in its FTAs, places less emphasis on - and devotes less resources - to agreed international standards and prefers a less detailed approach that envisages a kind of organic emergence of compatibility or equivalence. Japan and Singapore tend to be more supportive of agreed international standards and some of the FTAs they have negotiated, such as Singapore – Korea and the TPSEPA suggest a more comprehensive approach to TBT and SPS measures.

In the texts of the FTAs there is little evidence of the difference between North America and other agricultural exporting countries and the Europeans over risk assessment in agricultural bio-technology. All the FTAs commit the parties to the WTO SPS agreement, which is rather more science-based than the EU would like. The EU has not pressed for or not been able to get explicit reference to the precautionary principle in its FTAs. Its FTA partners, such as Mexico and Chile would be unlikely to agree to this given that they are being asked to adopt a rigorously science-based approach in their agreements with the USA. The divergence between Europe and the US on this issue may however, emerge over time if the respective EU and US FTAs diverge in how they implement the SPS rules.

The trend in treatment of TBT/SPS issues in FTAs suggests that these will remain an important element in trade relations and that FTAs will include more comprehensive provisions to deal with such non-tariff barriers. As most of the FTAs have not been established long, it is not yet possible to come to any firm view on how the various core entities are implementing the principles the FTAs share with the WTO agreements. This will require a study of the detailed functioning of the FTAs and the work of the various specialist joint committees that was beyond the reach of this study.

The policy approaches to TBT/SPS of the core entities have clearly been shaped by their domestic policies and institutional capacities. This largely explains the more comprehensive EU and EFTA approaches and the more skeletal US approach. Japan and Singapore also have well developed, centralized institutions dealing with TBT/SPS issues and have therefore been ready to negotiate fairly comprehensive agreements. In terms of the impact of FTAs on domestic policies, the obligations in the FTAs tend to commit the parties to more intensive cooperation then the WTO agreements. In this sense they are more constraining on domestic policy autonomy. At the same time the FTA provisions on TBT/SPS tend to be more soft law than binding hard law.

[37] For those familiar with differences over the use of precaution in SPS agreements this statement may seem odd. But the precaution issue illustrates how different interpretations of a principle included in trade agreements can result in major trade disputes. Assessments of the text of agreements may therefore come to the conclusion that they appear very similar, but the devil is of course in the detail of how they are applied.

3.5 PUBLIC PROCUREMENT

3.5.1 Introduction

When considering the provisions on public procurement in the FTAs negotiated by the core entities it is helpful to distinguish between the *framework* agreements and the schedules specifying *coverage*. In most cases the FTAs of all the core entities use the plurilateral Government Purchasing Agreement (GPA) of 1994 for framework rules. This means that the provisions in the FTAs on transparency of public procurement (laws and individual contracts); contract award procedures (open, selective and negotiated), selection criteria (lowest costs or the economically most advantageous bids); and compliance (bid challenge) are as set out in the GPA. (see annexes 3.5.1 to 3.5.6 for a breakdown of the FTA provisions for the FTAs negotiated by the core entities and where these are GPA/WTO plus) The widespread use of the GPA as the framework means that there is a very large measure of consistency across all the core entities.

The second element of all procurement provisions is the *coverage*. This is set out in schedules of purchasing entities covered by the various agreements in category I (central government), category II (sub-central government) and category III (public enterprises and other purchasing entities). Here one finds a variation across the core entities in their FTAs depending largely on the FTA partner and (as in the case of the GPA schedules) determined by reciprocity calculations. Coverage is also determined by the thresholds for coverage set to capture the most economically significant public contracts while minimizing the compliance costs for all purchasing entities. Broadly speaking the thresholds are the same as those used in the GPA. In short the main variation across the FTAs and core entities lies in the coverage of purchasing entities. Here there are some important differences that may be critical in specific sectors.

The trend in procurement is therefore the progressive application of the GPA framework to more and more countries as the core entities include GPA equivalent provisions on procurement in most of the FTAs they conclude.

The only real exception to this trend is that not all the core entities have sought GPA like rules with developing countries. This does not really amount to asymmetric provisions favouring the developing countries as the weaker provisions on procurement provide no rights for developing country exporters to the developed country markets. However, a form of *de facto* asymmetry exists in that the transparency rules in the GPA framework rules ensure that information on procurement procedures and specific contracts of the developed countries are put in the public domain and are thus open to all potential suppliers including developing countries.

3.5.2 WTO-Plus

The 1994 GPA was one of the few plurilateral agreements of the Uruguay Round. It was signed by a limited number of developed OECD countries and a few developed emerging markets including Singapore. Thus all the core entities have signed the GPA. The FTAs concluded with non-signatories to the GPA are thus ‘WTO plus’ in the sense that they extend coverage of the WTO’s GPA agreement to more countries. The FTAs negotiated with Chile for example, effectively extend the reach of the GPA framework rules to a country that had strongly opposed the GPA when it was negotiated in 1994.

The procurement rules in some of the FTAs are WTO/GPA minus. For example, FTAs with developing countries often include only a short article setting out progressive liberalization of public procurement as an aim. These are far short of the fairly lengthy and complex provisions included in the GPA framework type agreements.

3.5.3 The United States

The US FTA provisions in procurement are WTO – plus in the sense that the US has included GPA type provisions in the FTAs it has concluded with emerging markets (Mexico and Chile) as well as a string of developing countries (Peru, Morocco, Bahrain, Oman etc). The NAFTA agreement with Mexico was negotiated before the 1994 GPA and as a result has somewhat less coverage. For example, NAFTA does not include any category II entities (state or provincial government purchasing, which is probably worth more than the federal government purchasing in each of the three countries). NAFTA also includes only 53 central government entities compared to the 79 listed in category I in the GPA.

The 2003 US-Singapore FTA was in contrast more or less identical to the GPA coverage. [38] Both the US and Singapore were signatories to the GPA, so the FTA in effect had no impact in this policy area.

The US – Chile FTA (2003) on the other hand extended the GPA to Chile[39] and was as such GPA-plus. The thresholds for category I and II purchasing were also set somewhat lower in the US – Chile FTA than in the GPA thus opening rather more of the respective purchasing markets to competition.

The US – Peru FTA (2005) extended the GPA regime to another new country and is therefore WTO/GPA plus. The full GPA framework was applied in the US – Peru FTA even though Peru is a developing country. But the entity coverage offered by the US was GPA – minus, with only 7 entities in category I (compared to 78 federal agencies in the GPA) and 9 in category II (compared to 37 states in the GPA) covered. The US also excluded purchasing by US ports from category III. The thresholds for Peru were also a little higher than the GPA thus providing some form of asymmetry, but not significantly.

In the US – Morocco FTA (2006) the US also sought the full application of the GPA framework agreement for this developing country. As for US – Peru, the coverage of entities offered by the US was less than the GPA. Although category I coverage was equivalent to the GPA, only 23 US states were covered under category II compared to the 37 in the GPA. Purchasing by US ports was again excluded.

The FTAs with Bahrain and Oman (2006) also provided for the full application of the GPA framework. In these two cases however there was no coverage of category II (state purchasing) at all the US.

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[38] Entity coverage of the GPA is negotiated on a bilateral basis.

[39] In a US – Chile FTA of course an agreement on public procurement establishes a preference for the US and Chilean exporters to each others markets. In reality however, the degree of preference is not very great. Much of the GPA framework rules concerns promoting transparency and best practice in public procurement. If national purchasing is carried out in a transparent fashion following best regulatory practices there is unlikely to be discrimination between different suppliers, let alone between different foreign supplies. In other words the same purchasing procedures are often used regardless of the origin of the bid.

Finally, the US – Korea FTA involves two signatories to the GPA so the FTA made no substantive difference to the procurement sector.

To sum up, the US FTAs have been WTO/GPA plus in the sense that they have extended the rules on public procurement to a number of the US's FTA partners. They have also been WTO/GPA plus in the sense that some of the thresholds have been (marginally) lower than those in the GPA. But the US has offered less entity coverage than in the GPA with some FTA partners on reciprocity grounds and has thus been GPA – minus in this sense.

3.5.4 The European Union and EFTA

The EU has also adopted the GPA framework rules for all its FTAs with emerging markets, but has less extensive rules for FTAs with developing economies. In this sense it might be said that the EU is rather less WTO/GPA plus than the US. The EU – Mexico FTA (2000) is NAFTA and GPA consistent. It was NAFTA consistent because Mexico has used the NAFTA text and coverage on procurement, which although similar to the GPA is not the same. Indeed, Mexico is not a signatory of the GPA. The FTA is GPA consistent in that the EU uses both the GPA framework and schedules.

The EU – Morocco FTA has only one short article (Art 41) that sets out the aim of progressive liberalisation of procurement markets. This will have no effect until the EU – Morocco Association Council takes specific action to add some flesh to the provisions. This approach to developing countries was established with the Trade Development and Cooperation Agreement (TDCA) between the EU and South Africa negotiated in 1995. The same is true for the EU – Egypt Euromed Association agreement of 2003 which has just the one short article (Art 38) setting out liberalisation as an objective.

The EU – Chile FTA (2003) on the other hand applies the full GPA framework to the procurement practices of the two parties. Coverage is somewhat GPA – minus however, in that the EU others fewer category III (public enterprises and utilities) entities than under the GPA.

There is little difference between the EU and EFTA positions on public procurement in their FTAs. The EFTA agreements negotiated with Mexico and Chile are the same as the EU agreements. In the case of Chile the EFTA parties exclude electricity entities from its list for category three. EFTA agreements with developing countries such as Morocco have, like the EU, simply included one short article (Art 15 in the case of Morocco) that sets out the aim of progressive liberalisation. EFTA has also negotiated FTAs with Korea (2006) and Singapore (2003). As both these countries are signatories to the GPA there is simply a reference to the obligations of the parties under the GPA.

3.5.5 Japan and Singapore

Both Japan and Singapore are signatories to the GPA. Japan has followed the same pattern as the EU and EFTA in its FTA with Mexico. In other words Japan has used the GPA framework rules and offered the same coverage as for the GPA and Mexico has used the NAFTA text. This has clearly been done with the intention of avoiding Mexico having to implement two slightly different provisions in its national law.

In the FTA between Japan and Singapore there is simply reference to the GPA obligations in terms of procedures, compliance, bid challenge etc. But the two agreed to somewhat lower thresholds than those in the GPA, so the agreement could be said to be slightly GPA plus. The same is true for the Singapore – Korea FTA agreed in 2006.

When it comes to agreements with less developed countries Japan accepted the FTA with Malaysia (2006) without any reference at all to public procurement. In the case of Singapore's agreement with Jordan provisions on procurement were left out pending Jordan's negotiation of accession to the GPA. So both Japan and Singapore appear to be rather more flexible in leaving procurement off the agenda of FTAs than the EU or EFTA that seek some inclusion, or the US which seeks a full GPA equivalent approach.

3.5.6 Conclusions

In terms of WTO plus therefore, the FTAs are GPA plus in the sense that they extend the application of the GPA framework rules to more countries. The degree of GPA plus measures varies across agreements because the coverage of purchasing entities is based on the same reciprocal negotiations that determined the coverage for GPA signatories.

These schedules provide scope for asymmetry in the sense that developing or emerging market signatories could include fewer purchasing entities in their schedules than the developed countries. But in practice the developed parties to the FTAs have also varied the coverage of their schedules to satisfy reciprocity objectives. This appears to be particularly the case with the USA. The US has however, used some general asymmetry provisions in the NAFTA which allowed transitional measures for Mexico such as exclusion of PEMEX (8-years transition period), and a general 'set-aside' for Mexican suppliers of around US$ 1 billion up to 2003. (Mexican purchasers could prefer domestic suppliers up to $ 1 bn) Mexico was also permitted local content requirements of 40 percent for labour-intensive contracts and 25 percent for capital-intensive contracts. The agreements with Oman and Bahrain also allow 2 year transition periods for the two countries to implement the agreement and set slightly higher thresholds. Following the precedent set with NAFTA the EFTA and EU agreements with Mexico also offered Mexico the same asymmetrical benefits, as did the Japan – Mexico agreement. Otherwise there appear to be no current specific asymmetric benefits for developing countries that sign up to procurement provisions in FTAs. The EU did offer asymmetric access to the Single European Market to the accession states under the Europe Agreements in the early 1990s.

One distinction between the 'core entities' is that while the US tends to expect all its FTA partners to adopt the full GPA framework, the EU, EFTA and Japan have accepted simple short provisions aiming at the progressive liberalisation of procurement markets with their developing country FTA partners. The test for the EU will come with India and ASEAN. The EU FTA with Chile included full GPA provisions but not the TDCA with South Africa. The question is will the EU be able to include the GPA framework in its Asian FTAs?[40] In terms of coverage the US tends to lower its thresholds in its FTAs compared to the GPA, but excludes certain entities and/or federal states. The coverage largely depends on the partner country (US-Peru FTA very restrained coverage, US-Chile larger coverage). For US

[40] The EU – Korea FTA does not raise much of a challenge as both are signatories to the GPA. India has resisted inclusion of procurement in the WTO negotiations and the indications are that it will resist its inclusion in an FTA with the EU.

Morocco, US-Bahrain and US-Oman, the US used a blueprint on PP framework rules even if the schedules differed EU coverage on the other hand appears to be more uniform, perhaps as a function of the internal liberalisation within the EU and perhaps somewhat less emphasis on reciprocity.

Finally, there appear to be close links between the PP provisions negotiated in international agreements and domestic policies. This holds for the EU where limited progress in intra EU negotiations held back the plurilateral negotiations on the GPA.[41] With reference to FTAs, agreement to GPA-like rules in an FTA generally requires the introduction of new legislation and administrative measures in countries that bring about more transparent procurement practices and thus tend to drive out discriminatory practices and corruption in contract award procedures, so that there are quite important implications for domestic policies. The evidence from quantitative studies of the impact of rules on procurement is that these changes in domestic policy tend to favour competition within the national market rather than increased cross border provision. (Evenett and Hoekman, 2005)

3.6 SERVICES

3.6.1 Introduction

The growth in the number, and pattern, of FTAs including provisions dealing with services (and investment) mirrors that of FTAs more generally. Since 1994, some 180 regional agreements combining investment and trade in services rules have come into existence, compared with only 38 in the previous forty years. Over 40 percent of the cumulative total has come into existence since 2000, involving countries and regions increasingly further apart and more diversified in levels of development. The most active countries have been identified as Mexico, Chile, Singapore, the United States, Australia and New Zealand, with EFTA, the EU and ASEAN standing out as the most active regional groupings (Houde, 2007). The growth in the focus on services in FTAs is also a reflection of the importance of services trade for each of the Core Entities (see table 11)

3.6.2 United States

NAFTA: The services provisions of NAFTA go further and deeper than the GATS with respect to both substantive measures and sectoral coverage. Sector coverage is based on a negative list approach, whereby everything is liberalised unless explicitly excluded, compared with the positive list (or bottom-up) approach of the GATS. The negative list approach is generally regarded as being more transparent than positive listing and as affirming an up-front commitment by signatories to an over-arching set of general obligations. This approach, pioneered by the US, Canada and Mexico, has since been spread by Mexico in the agreements it has signed in Central and South America.

The implementation of services provisions in NAFTA is also GATS-plus by virtue of procedural provisions that facilitate continuous consultation and review in various trilateral commissions and working groups. These procedural aspects of NAFTA have helped establish the integrity of the regulatory process in the countries concerned, and in Mexico in particular.

[41] The EU could not agree that EU rules on procurement should cover the utilities because these were privately owned in some member states and publicly owned in others.

NAFTA was a pioneer in seeking to complement disciplines on cross-border trade in services (modes 1 and 2 of the GATS) with a more comprehensive set of parallel disciplines on investment (mode 3) and the temporary movement of business people (mode 4).

NAFTA was also a pioneer in providing for the right of non-establishment (i.e., no local presence requirement as a pre-condition to supply a service) as a means of encouraging greater volumes of cross-border trade in services. This right, for which no GATS equivalent exists, may prove particularly well suited to promoting electronic commerce (Sauve in OECD 2003).

Table 11: Trade in Services of the Core Entities with the Rest of the World, 2005 [1]

	Total services			**Transportation**			**Travel**		
	Net	**Credit**	**Debit**	**Net**	**Credit**	**Debit**	**Net**	**Credit**	**Debit**
EU-25 [2]	90,646.2	1,172,434.3	1,081,788.1	19,945.2	258,075.9	238,130.6	-3,782.3	289,173.9	292,956.2
US	62,207.9	376,786.5	314,578.6	-24,998.0	63,175.0	88,173.0	28,253.6	102,014.6	73,761.0
Japan	-23,968.9	110,302.3	134,271.2	-4,555.5	35,789.1	40,344.6	-25,094.8	12,439.0	37,533.8
Singapore [3,4]	-2,876.0	51,200.0	54,076.0	-	-	-	-	-	-
Switzerland	23,750.9	47,110.5	23,359.5	1,485.0	4,358.7	2,873.7	1,737.0	11,040.4	9,303.4
	Communication			**Construction**			**Insurance**		
	Net	**Credit**	**Debit**	**Net**	**Credit**	**Debit**	**Net**	**Credit**	**Debit**
EU-25	225.2	29,293.9	29,068.7	7,258.6	25,787.2	18,528.6	-2,429.9	24,018.9	26,448.8
US	-258.6	5,033.1	5,291.7	170.0	423.0	253.0	-21,652.4	6,831.3	28,483.7
Japan	-222.3	395.6	617.0	2,449.7	7,228.4	4,777.8	-1,061.5	868.3	1,929.8
Switzerland	205.4	1,156.0	950.5	-	-	-	4,267.0	4,534.3	267.3
	Financial services			**Computer and related services**			**Royalties and license fees**		
	Net	**Credit**	**Debit**	**Net**	**Credit**	**Debit**	**Net**	**Credit**	**Debit**
EU-25	48,512.2	94,699.8	46,187.5	28,196.6	59,416.0	31,219.5	-14,155.0	47,344.9	61,500.0
US	21,732.0	34,081.0	12,349.0	-730.0	8,239.0	8,969.0	32,909.0	57,410.0	24,501.0
Japan	2,366.2	5,070.9	2,704.6	-1,315.6	1,126.9	2,442.4	2,984.1	17,618.7	14,633.7
Switzerland	9,396.0	10,420.5	1,024.5	-	-	-	-	-	-
	Other Business services			**Government services (n.i.e.)**					
	Net	**Credit**	**Debit**	**Net**	**Credit**	**Debit**			
EU-25	15,816.1	301,548.7	285,732.6	-1,170.7	21,203.6	22,374.4			
US	27,927.2	66,237.1	38,309.9	-10,639.9	22,767.4	33,407.3			
Japan	824.7	27,347.6	26,522.9	671.4	2,320.9	1,649.5			
Switzerland	5,581.5	14,285.2	8,703.7	1,161.0	1,310.3	149.4			

Source: OECD Database

1 In Millions of US dollars
2 EU-25 trade includes both intra and extra EU trade
3 Total commercial services for Singapore not including government services
4 Data for Singapore based on WTO Statistical Database and available only for total trade.

A Sectoral Focus: This section will examine the sectoral dimension of WTO-plus in US agreements. All US agreements, apart from the FTA with Jordan, advance on rule-making in financial services and telecommunications. In financial services US FTAs advance on transparency measures, availability of insurance services, senior management and Board of Directors (mode 4) requirements, dispute settlement procedures, as well as providing for detailed extension of the MFN clause to prudential recognition. It should be noted however, that market access is provided only with regard to financial institutions, excluding, for example, insurance agents, (thus, limiting the scope of the FTA), and new financial services are defined differently than in the Understanding. With regard to telecommunication services, the FTAs exclude cable and broadcast distribution of radio and television programming, but expand on access and usage of public telecommunication transport networks and services, interconnection with suppliers of public telecommunication services, submarine cable landing stations, universal service, licensing processes, scarce resources, enforcement, dispute settlement issues, independent regulation and privatisation, as well as several other issues. Another GATS-Plus provision is the introduction, definition and incorporation of express delivery services. In general, US FTAs in services exclude from their overall scope air transport services, government procurement, governmental services, subsidies, nationals seeking employment in the territory of the other party, as well as certain elements concerning investment.

The United States' FTAs also tend to advance on transparency issues and provide greater elaboration than found in the GATS. Mutual recognition issues – of particular importance for the (mode 4) movement of natural persons - also constitute GATS-Plus elements, though no advancement is made on domestic regulation. On mutual recognition, US agreements provide criteria for professional services, and encourage temporary licensing (such as in CAFTA-DR). The FTAs with Chile and with Korea liberalise legal consultancy services and provide a framework granting temporary licensing for engineers. Movement of natural persons is furthered beyond the GATS in the agreement with, for example, Chile and Singapore. These FTAs provide a chapter on the temporary entry of business persons, which sets principles and obligations concerning the provision of information, transparency rules, dispute settlement, as well as rules for the entry of business visitors, traders and investors, intra-corporate transferees, and professionals. The agreements also go on to define minimum education requirements and alternative credentials in several professions. Lastly, the United States has committed to accept quotas of 1,400 and 5,400 business entry applications, respectively, in Chile and Singapore.

Competition rules constitute another development in the US FTAs and the agreements include specific rules concerning anti-competitive behaviour and major and dominant suppliers in the field of telecommunication, competitive safeguards, unbundling of network elements and more.

3.6.3 European Union

EU-Mexico: All four modes of supply and all sectors are included in EU-Mexico, except for the usual exclusions (audio-visual, air transport and maritime cabotage). The agreement establishes a standstill clause, locking in the existing access that has in practice already been granted to EU companies. Insofar as Mexico's domestic liberalisation is more comprehensive than the country's commitments under the GATS or NAFTA, which tends to be the case, the standstill clause therefore provides even more favourable treatment (de jure not de facto) for

EU service providers (Reiter in Sampson and Woolcock, 2003). EU-Mexico uses a positive-list approach, apart from financial services which is negative list.

The services chapter of EU-Mexico provides for measures to be taken, within three years of entry into force of the agreement, with a view to additional liberalisation (Article 7). This clause foreshadows the elimination of substantially all remaining discrimination with maximum transition periods of 10 years. The services chapter also calls for the negotiation of MRAs, particularly for the movement of natural persons, no later than three years after entry into force.

Finally, a Committee on financial services is established which will negotiate further opening should either Mexico or the EU agree to further liberalisation with another Party. In other words, if NAFTA's coverage of financial services is increased the European Union has the right to seek equivalent access.

Euro-Med Agreements: The Euro-Med Agreements are WTO-plus in services to the extent that for Mediterranean countries that are not Members of the WTO and therefore not signatories to the GATS, a basic framework agreement similar to that of the GATS is established.

The EU Neighbourhood Policy (ENP) sets the basis for future FTAs in services with Mediterranean non-Members Partners and will upgrade the current provisions on services found in the Association Agreements (AAs). The EU-Moroccan Action Plan (AP) calls for opening of negotiations on a FTA in services, as well as exchange of information with a view to regulatory convergence with the EU, capacity building, and e-commerce development. Specific actions in the field of financial services are aimed at upgrading Morocco's regulatory system in line with that of the EU and with international standards. Other specific measures to introduce greater competition in the Moroccan service sector include assessments of liberalisation of airport ground handling services and sea-ports and liberalisation of telecommunication services. It is not clear though, whether reference to opening to competition is also an opening to foreign competition. The AP with Israel proposes three complementary avenues for integration and enhancement of trade in services: (I) liberalisation of trade in services – the establishment of a FTA in services, cooperation on policy and regulatory issues in the field of services and cooperation on e-commerce issues, with an emphasis on a Mutual Recognition Agreement (MRA) for digital signatures; (II) financial services – the possibility of Israel's participation in the EU Single Market for financial services, as well as closer cooperation on regulation, supervision and financial stability, with the aim of gradual convergence of the prudential regulatory and supervisory framework; (III) movement of natural persons through advancement on mutual recognition of professional services. The possibility of Israel's participation in the SEM for financial services (the only ENP country currently offered this possibility) is a development, which if implemented would probably lead to greater liberalisation measures in this field than achieved by any FTA ("A stake in the Internal Market").

It should be noted, however, that the EU approach to trade in services with the Southern members of the ENP is based on the Euro-Mediterranean regional approach. Accordingly, liberalisation of trade in services is to be based on a framework protocol, which is very similar to the provisions of the GATS. This protocol will provide the framework for individual FTAs with the EU, which will be based on a regional MFN clause and will in future allow for a regional Euro-Mediterranean FTA. One important advancement beyond the

GATS in this protocol is the provision on progressive integration of services markets through alignment of partner countries to EU legislation when they sign an FTA and agreements on financial services.

A Sectoral Focus: This section examines in more detail the sectoral aspect of WTO-plus in two EU agreements; EU-Chile and EU-Mexico. Both agreements advance beyond the GATS in their provisions on financial services, telecommunication services and maritime transport. In financial services, they incorporate and move beyond elements of the WTO Understanding on Financial Services, further elaborate on measures such as transparency and new financial services, prohibit key personnel requirements, provide disciplines on dispute settlement and more. The provisions on maritime transport services extend to include door-to-door and inter-modal transportation. They also provide for national treatment in relation to commercial presence, but, as noted above, exclude cabotage from the agreement. The FTA with Chile introduces measures in telecommunication services that include independent regulators, specific transparency measures and non-discrimination in the application of scarce resources (like frequencies and numbers), interconnection issues and more.

Domestic regulation is treated in the same manner as in the GATS. Nevertheless, concerning mutual recognition, the FTA with Mexico, contains a soft commitment to negotiate mutual recognition agreements within 3 years. The agreement with Chile advances on the GATS in respect of movement of natural persons by providing for a specific review of rules in this area, including a change of the definition of a natural person.

Specific rules concerning anti-competitive behaviour and major and dominant suppliers in the field of telecommunication services exist in all FTAs with telecommunication provisions. This agreement with Chile also includes a new provision on the promotion of E-Commerce.

3.6.4 EFTA

Agreements signed by EFTA are mainly of a positive listing nature. However, the FTA with Mexico is a negative-list agreement. While GATS-Plus provisions differ between the agreements, all FTAs contain commitments to eliminate further trade discrimination within given time frames (for example, 10 years with Mexico and Singapore).

From a sector-specific perspective, most of the agreements provide for new commitments on rules in financial services and telecommunication services. In financial services, GATS-Plus provisions apply to extensions of measures found in the Understanding on Financial Services (such as in respect of national treatment), senior management and Board of Directors requirements, further elaboration of prudential carve-outs, incorporation of transparency rules set by international organisations, such as the Bank for International Settlements. In telecommunication services the agreements with Chile, South Korea and Singapore expand the GATS framework to include new definitions, licensing procedures, treatment of scare resources, minimum interconnection obligations and interconnection with dominant suppliers, independent regulation, universal service, as well as dispute settlement issues. The agreement with Mexico is noteworthy in including commitments and understandings on maritime transport services.[42] Air transport services are excluded from all agreements.

[42] In the GATS, Mexico, Liechtenstein, Norway and Iceland have not listed any commitments on maritime transport. Switzerland have two sectors committed

On domestic regulation, two FTAs go beyond the GATS. The agreement with Mexico treats regulation as a general non-trade barrier to trade in services, beyond bounded sectors as defined by the GATS. The agreement with Singapore is slightly GATS- plus by also applying international standards. Mutual recognition is an area advanced by almost all FTAs, which commit to a time frame for the development of mutual recognition procedures and agreements on qualifications, requirements, licences and other regulations. The FTA with Singapore contains a specific (mode 4) commitment to develop mutual recognition disciplines for engineering services.

Although competition elements, like monopolies or exclusive suppliers, are either treated as in the GATS, or not mentioned, most agreements provide for specific rules concerning anti-competitive behaviour and major and dominant suppliers in the field of telecommunication services.

In terms of new provisions which do not exist in the GATS, the agreement with Mexico provides for a standstill on new discriminatory measures, as well as another standstill in financial services.

3.6.5 Japan

Japan's FTAs are of mixed nature. Its FTAs in Latin America follow either a hybrid approach consisting of an overall negative-listing framework, with positive-listing in financial services (Chile) or a negative-list approach (Mexico). The agreements in South-East Asia adhere to a positive-list formula.

On a sector-specific basis, all FTAs, excluding that with Thailand, mildly advance on financial services rules, notably in the sense that they provide for rules on dispute settlement and incorporate provisions from the Understanding on Financial Services. The treatment of new financial services is more restrictive than in the Understanding. Progress on rules in telecommunication services is found only in the agreement with Singapore, where the FTA goes beyond the Annex on Telecommunications and expands on scope and definitions, interconnection issues including their dispute settlement, independent regulation, universal service and scare resources. All FTAs exclude air transport services, government services, maritime cabotage, subsidies and government procurement. Some FTAs also specifically exclude the other party's nationals seeking employment.

The agreement with Thailand slightly progresses on domestic regulation by including provisions in sectors where no specific commitments were undertaken. Mutual recognition is advanced with Singapore, but only to the degree that a designated committee is tasked to develop rules in this area, and recognition of professional qualification is mentioned as a possibility. Excluding Malaysia, Japan's FTAs go beyond GATS provisions on the movement of natural persons. A specific chapter addresses the entry and temporary stay of nationals for business purposes. This chapter provides principles, definitions, means of information-exchange, dispute settlement. It also defines categories for business purposes, *viz* intra-corporate transferees, investors, and nationals of a party who engage in professional business activities on the basis of a personal contact with a public or private organisation in the other party. Japan's agreement with the Philippines, which advances the most on the movement of natural persons, contains provisions designed to promote the movement of nurses from the Philippines to Japan. Under the agreement, Japan has agreed to accept 400-500 nurses and care-givers annually (*Bridges Weekly Trade News* 21 September 2006). The FTA with

Singapore also extends its scope to non-party juridical persons who have constituted in one of the parties, so long as they are genuinely engaged in this member (not to override the FTA by a non-member).

GATS-Plus rules on competition are found in the agreement with Singapore in addressing anti-competitive behaviour in the telecommunication sector, and providing for competitive safeguards.

3.6.6 Singapore

Singapore has three FTAs with non-Core Entities, South Korea, Australia and Jordan,[43] that are of all types: positive listing, negative listing and hybrid. While the FTAs with South Korea and Australia advance beyond the GATS in several ways, the agreement with Jordan is not GATS-Plus in any respect. FTA negotiations are currently under way with China and Canada. The FTA with China has been substantially concluded and will provide greater market access. The FTA with Canada has been under negotiation since 2001 and is projected to be completed this year.

The FTAs with South Korea and Australia advance beyond the GATS in financial services and telecommunication services. The South Korea FTA also includes progress on maritime services. The financial services framework includes services as well as investment, and further develops the GATS in transparency rules and definitions. It also has WTO-Plus provisions on dispute settlement and incorporates several provisions from the Understanding on Financial Services. While financial services are treated under a negative list in the FTA with Australia, they are positively-listed in the FTA with South Korea. The chapters on telecommunication services exclude from their scope cable and broadcast distribution of radio and television programming, while providing new measures and rules that extend beyond the GATS. These rules include definitions, transparency disciplines, access and usage of public telecommunications transport networks and services, independent regulation, universal service, licensing processes, treatment of scarce resources, enforcement and dispute settlement. In maritime transport, the FTA with South Korea provides a list of sectors where additional commitments are taken. Overall, government services, transportation and non-transportation services, investment, subsidies and government procurement are excluded from the scope of the FTA.

GATS-Plus provisions on mutual recognition in the South Korean FTA provide for criteria in the development of professional standards, and also encourage temporary licensing of professional services. Furthermore, with regard to professional engineers, South Korea committed to recognise 2 Singapore universities, while Singapore committed to recognise 20 South Korean universities. The chapter in the FTAs on the movement and temporary entry of business persons goes beyond the GATS framework on the movement of natural persons. It lists general principles and obligations for common disciplines, grants temporary entry, and deals with information provision and dispute settlement. Furthermore, it grants specific commitments on temporary entry categories of business visitors, traders and investors, intra-corporate transferees, as well as specifying durations of stay. The FTA with Australia also defines service sellers and short-term services suppliers for the purpose of movement of natural persons. It also prohibits labour market testing on those persons permitted to move under the agreement.

[43] This section will not review Singapore's FTAs with the Core Entities which are covered in other sections.

Competition rules further develop the GATS framework in telecommunication services. These rules include specific disciplines concerning anti-competitive behaviour and major and dominant suppliers.

General Observations: Designating services provisions as being WTO-plus requires considerable care. This is nowhere more evident than in respect of positive and negative listing. While it is generally accepted that negative listing is usually associated with increased transparency and greater liberalisation than positive listing, this says nothing about causality. It may simply be that countries that are prepared to open up significantly are more likely to use a negative list. Nor is the balance of advantage always clear cut. This is nicely illustrated by Japan's agreements (Fink and Molinuevo, 2007). Positive listing (as in Japan-Malaysia) can offer advantages, like status quo bindings, usually ascribed only to negative listing. While negative listing (as in Japan-Mexico) can bring disadvantages, like effectively denying application of the agreement to future service activities, usually ascribed only to positive listing. The implications of the form of listing for asymmetric integration, as discussed in the section below, introduces a further nuance into this particular debate.

An assessment of the extent to which FTAs go beyond the GATS should, ideally, involve measurement of the depth of commitments based on estimated tariff-equivalents. Such a measurement remains technically difficult. It has not been undertaken here and is not readily available in the literature on regional agreements. However, an assessment has been made recently of the incidence of new and improved services commitments in East Asian FTAs (Fink and Molinuevo), which has enabled the following broad conclusions to be reached about two of our Core Entities.

- Singapore, and to a lesser extent Japan, have made extensive use of FTAs to subscribe to greater openness in services. Singapore stands out with 86 percent of sub-sectors and modes showing improved or new commitments across its 11 FTAs. The corresponding figure for Japan is 71 percent (less than Korea, at 76 percent).

- The main value added of Singapore's FTAs is the widening of GATS commitments to cover additional sub-sectors. With the exception of the US-Singapore agreement there are few improvements relative to existing GATS entries, though Singapore's GATS commitment is already relatively liberal.

- Japan's FTAs offer value added relative to the GATS in a large number of sub-sectors and modes, though the depth of FTA liberalisation is sometimes modest. This partly reflects the already liberal commitments of Japan under the GATS. New FTA commitments cover, in particular, certain professional services.

A common feature of most of the FTAs examined is the extent to which the agreements advance beyond the GATS in financial and telecommunication services. This contrasts with an earlier finding (OECD, 2003) that progress in these infrastructure services was more likely in a multilateral setting, where critical mass is more present. It may in fact be the case that, in a form of reverse engineering, progress in the GATS has provided a stimulus to liberalisation at the regional level.

On a somewhat related point, it might also be observed that while there is clear evidence of FTAs going beyond the GATS, there is a tendency for sectors that are difficult to liberalise

multilaterally to be equally problematic at the regional level. In the recently concluded Korea-US agreement (KORUS), for example, while Korea has agreed to open up accounting, legal and broadcasting services, it will not open the education and health sectors.

3.6.7 Conclusions

Asymmetric Provisions: It is often observed that the positive list-hybrid approach of the GATS contains built-in Special and Differential Treatment (SDT) in that countries are able to determine the level of liberalisation with which they are comfortable. It might also be observed that regional agreements with positive listing are more amenable to asymmetric commitments, geared to the levels of development of the participating parties. A positive list of sectors together with the possibility of binding above status quo might thus enable governments to tailor their commitments to meet regulatory concerns. It is noteworthy that three East Asian negative list FTAs have fully or partially reverted to a positive list in scheduling commitments for financial services, a sector where regulatory concerns about foreign participation are often acute (Fink and Molinuevo).

Policy Trends: On the basis of observations emerging from this study, the following trends might be expected to become more pronounced within regional agreements:

- Greater use, particularly in North-South FTAs, of a hybrid listing-formula, whereby, overall negative listing is combined with positive listing in sectors where there are strong regulatory sensitivities.

- Greater focus on the competition policy dimension of service provision, though in the case of the US on a very selective basis, as compensation for the absence of competition policy from the Doha Development Agenda.

- A growing disparity between the treatment of those sectors subject to liberalisation commitments and those (such as health, education and audio-visual) which in regional accords, no less than in multilateral negotiations, tend to exclude.

- In those sectors which are subject to liberalisation commitments, a consolidation of WTO-plus elements relating to domestic regulation, whether through greater transparency (seen for example in US agreements), standstill provisions (in some EU FTAs), or the inclusion of sectors where no GATS commitments have been made (as in some Japanese agreements).

- Modest progress, as witnessed above, in tackling mode 4 liberalisation, as the facilitation of service-provider-mobility at the regional or bilateral level is seen to be less threatening than a possible multilateral commitment.

- An increasing tendency to provide for the right of non-establishment (ie, no local presence requirement) in order to facilitate cross-border trade via e-commerce. Such a provision is a common feature of agreements featuring generic investment disciplines.

- Insofar as preferential agreements are increasingly bilateral, often involving countries that are widely separated both geographically and economically, the pursuit of regulatory harmonisation and ‘legislative alignment’ (see under EU, above) may become less

pronounced (apart from in certain agreements to which the United States or the EU are a Party). Where countries are economically and socially disparate, the conditions for regulatory harmonisation may be less than optimal (see work undertaken at the World Bank to establish criteria for 'optimum regional harmonisation areas', Mattoo and Fink, 2002).

Links to Domestic Policy: The pursuit of services liberalisation at the regional level reflects domestic priorities both in terms of sectors chosen for market opening – as was the case with Japan in seeking an external stimulus to domestic reform of financial services – and in sectors shielded from opening – as is the case with maritime cabotage services in the United States, and elsewhere.

Liberalisation of particular sectors or modes can also reflect particular domestic preoccupations. The agreement of Japan in the recent accord with the Philippines to allow greater access of Filipino nurses into Japan reflects concerns arising from Japan being one of the world's most rapidly aging societies.

At a broader level, services liberalisation is being carried out in all of the Core Entities in recognition of the dominant and growing role of the service economy and of the benefits to be derived, via both exports and imports, of greater market opening. The focus on infrastructure services, as highlighted in this study, is a clear manifestation of this linkage.

Finally, it should be noted that the policy approximation fostered by some FTAs can have important implications for domestic policy in the less developed partner countries. The tendency for the regulatory norms of the United States and the European Union to become, by virtue of the economic size of these entities, the required standard (de facto and de jure for EU accession states) means that care is needed in ensuring that regulatory practices are appropriate for the level of development of partners. This is not a feature exclusive to services but it is of particular relevance in this sector. Moreover, notwithstanding the tendency for US and EU regulatory standards to become the de facto norm in bilateral agreements to which they are a Party, the proliferation of FTAs nevertheless means a proliferation of standards. This has been identified as a particular challenge for developing countries (see OECD, 2005).

Differences in Approaches: It should first be acknowledged that the similarities between the approaches of the Core Entities to services liberalisation at the regional level are as pronounced as the differences. Most importantly, they share to a very large extent the same sectoral and modal sensitivities. Moreover, the different agreements to which the Core Entities are a party are by no means identical, depending as they do on the partner(s) in question.

Nevertheless, some broad characteristics, and differences, can be identified:

- Singapore, in keeping with its generally liberal approach to trade policy, is at the liberalising end of the reform spectrum in its regional agreements.

- The United States too seeks ambitious outcomes, as reflected in its use of negative listing, though this, as we have seen, needs careful interpretation. And the United States is relatively cautious with respect to provisions on competition policy. In the area of investment, as will be noted elsewhere, US-style agreements (including NAFTA) tend to go beyond issues relating to the right of establishment (the principal

focus of EU-style agreements) by building on the investment treatment and protection principles of bilateral investment treaties.

- The EU is distinguished by its pursuit of regulatory harmonisation. In the area of competition policy, as will be noted elsewhere, agreements to which the EU is a party tend to include coordination of specific competition rules and standards, in contrast with US-style agreements (including NAFTA) which tend to contain only general obligations to take action against anti-competitive behaviour without setting out specific standards or provisions. EU agreements (and those of EFTA) also tend to be distinguished from those of the United States by the use of positive (or hybrid) listing. It may be that positive listing helps facilitate internal coordination within a trading block.

- And Japan tends to be distinguished by the intended use of regional initiatives to stimulate domestic reform efforts. Japan's agreements often share characteristics of those negotiated by the US. Thus the investment chapter of the Japan-Singapore EPA has provisions similar to those found in NAFTA, and like NAFTA includes investor-state provisions. The Japan-Singapore disciplines, however, are weaker than those found in NAFTA and do not apply in full to investment in services (Sauve, 2002). And the more recent Japan-Philippines FTA runs against the Japanese trend of including investor-state provisions because of Manila's concerns about the costs of international arbitration (Bridges Weekly, 21 September 2006). Japan's strategy with respect to positive and negative listing is not clear and the choice may reflect the preferences of Japans' partners as much as those of Japan.

3.7 INVESTMENT

3.7.1 Introduction

International rules and provisions on investment have not followed a consistent development, and are the result of a patchwork of multi-level international investment agreements. These agreements range from bilateral investment treaties (BITs), to regional and bilateral trade agreements, OECD codes and decisions, as well as multilateral rules under the WTO and UN non-binding codes (Reiter 2006). This summary will focus on the treatment of trade-related investment provisions in FTAs by the Core Entities, and will thus concentrate on bilateral trade agreements, leaving other levels of rule-making in investment out of its scope. For the sake of coherence and clarity regarding the relationship with the international trading system, this introduction will also briefly describe rule-making within the WTO.

Rules on investment and trade are among the current contentious areas of the WTO and are opposed by many countries, notably in the developing world. However, despite this resistance, which led to the withdrawal of the Singapore Issues from the current trade round, trade-related investment measures proliferate in FTAs formed by many countries, including the Core Entities, as well as some of those countries which oppose their adoption at the multilateral level. The inclusion of investment provisions in FTAs – arising in part, perhaps, from the greater flexibility of commitments in bilateral accords - highlights the possibility that FTAs can complement the WTO framework.

As a consequence of the reluctance to negotiate a multilateral trade and investment agreement, rule-making on investment in the WTO is rather limited and patchy to the extent that the relationship between trade and investment is on the one hand, not comprehensively covered, and on the other hand, spread over various agreements. Investments are covered in the GATS in so far as they constitute a part of mode 3 (commercial presence), but can also be relevant under mode 1 (cross-border supply) through provisions for non-establishment. The GATS applies the Most Favoured Nation (MFN) principle to all services, and thus also to investments in services that fall within the scope of the agreement. Furthermore, the National Treatment (NT) principle applies to those services where commitments have been undertaken in the schedules of specific commitments. The Agreement on Trade-related Investment Measures (TRIMs) relates only to trade in goods. It prohibits quantitative restrictions and measures which are inconsistent with national treatment. It also provides an illustrative list which mainly deals with local content and trade balancing requirements. The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) indirectly relates to investment, in so far as it covers intellectual property, an intangible asset that constitutes a significant part of many investments. The Agreement on Subsidies and Countervailing (SCM) measures addresses investment insofar as it prohibits subsidies and similar measures, which are a practice of states in providing incentives to local and foreign investment. Table 12 summarises the treatment of investment in WTO agreements.[44]

Table 12 WTO Provisions on Investment

Agreement	Coverage	Important Rules
GATS	Services	MFN, NT in modes 1, 3
TRIMs	Goods	NT, prohibition of quantitative restrictions
TRIPS	Intellectual property	MFN, NT, other provisions
SCM	Goods	Prohibition of subsidies and countervailing measures

Almost all the FTAs reviewed in this project include investment provisions, which can be grouped under six issue areas: provisions related to establishment and non establishment in sectors other than services, provisions dealing with non-discrimination in non-services sectors, the treatment of investment in services, investment regulation and protection, dispute settlement and investment promotion and cooperation (Miroudot and Lesher, 2006). The following sections will analyse investment provisions covered in the FTAs of the Core Entities based on the above taxonomy. It will then reflect over the trends across time in this field, and the strategies applied by each Core Entity.

3.7.2 United States

In the OECD ranking of RTAs according to the extensiveness of their investment provisions, NAFTA is placed high. The agreement is WTO-plus in many respects. NAFTA defines "investment" in broad terms. It provides (Chapter 11) for both national and MFN treatment for investment from all NAFTA signatories as well as investments from non-partner countries that are located within the NAFTA territory. National and MFN treatment applies equally to both pre- and post-establishment phases of an investment project, and Chapter 11 requires that members provide the better of national or MFN treatment. Chapter 11 also states that

[44] The Agreement on Government Procurement is not covered here, although it relates to investment as well.

members must provide “fair and equitable” treatment. NAFTA contains provisions which prohibit various types of performance requirements, such as import, export and domestic content targets, as well as obligations to transfer technology, many of which go beyond those found in the Agreement on Trade-related Investment Measures (TRIMS). NAFTA was one of the first RTAs to provide for investor-state dispute resolution; it also contains provisions for state-to-state dispute settlement. Overall, NAFTA – together with Canada-Chile and Mexico-Japan – is found to have the most extensive package of provisions on investment regulation and protection. NAFTA is commonly considered to have established a “model” approach to the treatment of investment in FTAs (see table below).

Liberalisation of non-services sectors is implemented according to the NAFTA model in the United States’ FTAs with Chile (2004), Morocco (2006) and CAFTA (2006). The FTA with Oman (2006) contains national treatment but does not extend the MFN clause. Investment in services is most commonly covered in the services section, although in some agreements (Chile, CAFTA) it is explicitly covered within the investment chapter. Regardless of whether investment in services is treated in the services or investment sections, all FTAs adopt MFN and national treatment on investment and apply a negative-listing approach. The only exception to this rule is the FTA with Jordan (2001), which uses positive-listing. The FTAs with Jordan and Bahrain liberalise investment in services but do not apply to non-services liberalisation. The relatively old agreement with Israel (1985) does not include any provisions on investment. Regulation and protection of investment in US FTAs is substantial to the extent that the agreements include provisions on the prohibition of performance requirements that go beyond those required in the TRIMs agreement. They also provide for the free transfer of funds, the temporary movement of key personnel, provisions on expropriation and specifically address the issue of fair and equitable treatment for investment. As in the modalities of liberalisation, the FTA with Jordan differs from the general trend as it does not include any of these measures, with the exclusion of the temporary entry and stay of key personnel. This last measure is also absent from the FTA with Morocco.

Dispute settlement is addressed in most FTAs in the same manner. State-state disputes are settled on an ad-hoc basis of consultation and arbitration. Investor-state disputes are to be resolved either through ad-hoc arbitration or by permanent arbitration through the ICSID.

Assessing the WTO-plus character of US FTAs is made difficult by the fact that while NAFTA, as well as US-Chile and US-Singapore are ranked high, another agreement, US-Jordan, is not. It has been suggested (Miroudot and Lesher) that the absence of pre-establishment provisions in US-Jordan arises because the agreement is focused on investment promotion and co-operation rather than on investment liberalisation.

In concluding, it might be observed that US investment provisions in its FTAs are linked closely with its broader foreign policy and economic goals. The United States has used FTAs to promote US investment abroad, as well as economic reforms. It puts considerable emphasis in its FTAs on securing access and protection for its investors in its partners’ markets. For this reason, the United States pursues the extension of the NAFTA model to other countries in its FTAs. Similarly, investor-state dispute settlement provisions seek to safeguard US investors’ interests abroad. Even so, the US itself is willing to deviate from its model, as in the case of the US – Australia FTA, that does not include investor-state dispute settlement provisions, probably for fear of legal challenges.

Table 13 The NAFTA model of investment agreement[i]

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
	Negative lists tailored to the country concerned	Negative list	Negative list	Negative list
Principles	Pre and post investment national treatment and MFN	Pre and post investment national treatment 11.2 MFN 11.3	Pre and post investment national treatment and MFN	Pre and post investmen 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 rules				
Liberalisation	General ban on performance requirements	7 performance requirements banned	As in NAFTA	As in NAFTA
	Fair and equitable treatment	Ban on linking incentives to performance requirements		
		Fair and equitable treatment		
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 in NAFTA	As in NAFTA
	General exemptions for security etc			
Enforcement Dispute settlement	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

3.7.3 European Union

The *Treaty Establishing the European Community* (1957) was among the early efforts at introducing rules on investment at the regional level; it emphasised the issues of establishment and the free movement of capital (OECD, 2003). In 1992, an article was added to the EC Treaty prohibiting restrictions on the movement of capital between member States and between member States and third countries.

Agreements involving countries that have historically restricted capital movements have also tended to emphasise establishment and capital movement issues. For example, the Europe Agreements, concluded in the early and mid-1990s between the European community and Central and eastern European Countries, also focus primarily on establishment issues by providing for national treatment with regard to the establishment and operation of companies and nationals.

The EU-Chile FTA contains a number of WTO-plus features. The chapter on investment in goods provides pre-establishment national treatment, together with an undertaking to review the legal framework for investment in both Chile and EU Member States by March 2008. The services chapter covers establishment with respect to Mode 3. Several sectors are nevertheless excluded from the ambit of the agreement, including audiovisual, maritime cabotage, air transport and government procurement. It has been observed that EU-Chile is the first FTA in which the European Union has included rules on the establishment of investments with a non-EU-accession country and that, in this respect, it could represent a new EU model agreement in respect of investment. It might also be observed that EU-Chile can be distinguished from the NAFTA model in that it makes reference to existing obligations under OECD codes, and might be regarded as representing a progressive, or gradual, approach to investment rules.

Table 14 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 transparenc 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 OECD codes on restrictive business practices	None
Regulatory safeguards	Exclusion of sensitive sectors	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

Whether or not EU-Chile represents a new departure will depend on the evolution of the relationship between the Commission and the member States.[45] On the basis of an agreement forged, under Swedish EU presidency, between Sweden and France (representing the two poles of opinion) EU-Chile, unlike EU-Mexico, came to have meaningful commitments on pre-establishment. But post-establishment investment protection and enforcement through investor-state dispute settlement were once more left aside, with a reference to BITs between individual member states and Chile. In short, the Commission had to stay in line with the distribution of competence within the European Union, and was not given any mandate to negotiate provisions on protection similar to those found in BITs.

It is therefore not assured that the achievement of including pre-establishment commitments can be consolidated, and perhaps extended to post-establishment provisions. In the meantime, the Euro-Med agreements and the Cotonou Agreement between the EU and the African, Caribbean and Pacific (ACP) Countries, instead of directly incorporating the full range of investment provisions typically found in bilateral investment treaties, provide for the conclusion of such treaties between the parties. It has thus been concluded (Reiter) that in a post-NAFTA world and compared to many other countries, including some more advanced developing countries, the European Union's treatment of investment in RTAs remains fairly limited in scope.

State-investor dispute settlement mechanisms are not included in any of the EU FTAs examined. State-state dispute settlement is solved either through consultations (all agreements) or through the establishment of political bodies (Morocco, Jordan, Israel).

3.7.4 EFTA

EFTA agreements are widely dispersed within the OECD ranking of investment provisions, with EFTA-Singapore highly ranked, EFTA-Mexico somewhat less so, and EFTA-Chile towards the end of the scale.

Consistent with this finding, EFTA's FTAs that provide for a general evolution of investment measures. Neither of EFTA's agreements with its Mediterranean partners, Morocco (2002) and Israel (1993), contains provisions on investment. The declaration with the GCC (2000) has no concrete provisions on investment. And the FTA with SACU (2002) deals only partially with investment promotion and cooperation.

Surprisingly, the FTA with Mexico (2001) is rather limited and mainly deals with liberalisation and protection of certain payments and transfers related to foreign direct investment, as well as investment promotion. It has no provisions on the right of establishment or non-establishment with regard to non-services sectors. Investment promotion and cooperation is confined to information enhancing mechanisms, cooperation procedures and harmonisation of rules. The review clause foresees the possibility of future liberalisation within three years of entry into force. Investment is addressed in the services section covering national treatment and MFN on establishment and pre-establishment with negative-list schedules. Quite in contrast the EFTA – Chile FTA (2004) contains national treatment on establishment with pre-establishment covered on a negative-listing basis. Non-discrimination is not included for non-services sectors. The services section covers investment with national treatment and MFN, providing for market access, using positive-lists. The FTA also contains

[45] The following observations draw on Reiter in Woolcock (2006).

provisions which prohibit ownership requirements and allows for the free transfer of fees, but is silent on expropriation, which is an important provisions recurring in many FTAs. There is no investor-state mechanism. And investment promotion or cooperation mechanisms are absent from the agreement.

In contrast to those agreements, the FTAs with East Asian countries, Korea (2006) and Singapore (2003) are further developed. [46] Liberalisation of investment is quite extensive in the case of Korea, and the FTA provides for both MFN and national treatment for establishment (investment provisions are covered in a separate agreement to the FTA), and pre-establishment on a negative-list basis. Investment in services sectors is treated through the same instrument, however, limited through positive-lists. The FTA provides for provisions on free transfer of funds, expropriation and the temporary entry of key personnel as part of the investment regulatory setting. State-state dispute settlement is carried out though consultation and ad-hoc arbitration, while state-investor dispute settlement in investment is subject to both an independent international arbitrator and the ICSID. Investment promotion and cooperation mechanisms are not provided for in the FTA.

EFTA countries have tended to follow the EU in their FTAs and investment provisions for many years. However, as can be noted from their FTAs with Korea and Chile, this has changed in recent years, and EFTA has gone beyond the EU with relation to its investment provisions. This is to some extent a result of an amendment to the EFTA convention, adopted in 2001, which led to the internal adoption of key NAFTA provisions, that later on facilitated more advanced FTAs with third countries.

3.7.5 Japan

As noted earlier, Mexico-Japan is ranked among the agreements having the most extensive package of provisions dealing with investment regulation and protection. It is ranked high in the OECD listing, as is Japan-Singapore.

Japan's agreements with Mexico (2005), Malaysia (2006), Philippines (2006) and Chile (2007) all follow a negative-listing approach for pre-establishment, with MFN and national treatment provisions on establishment for non-services sectors. The FTA with Thailand (2007) is an exception, which follows a positive-listing approach to pre-establishment. Investment provisions in services are addressed in the FTAs within the services sections. In these chapters, MFN and national treatment are accorded, and limitations and commitments are provided in positive-listing. The FTA with Mexico is an exception, and applies a negative-list approach, following the NAFTA model. Furthermore, liberalisation of investment in services is covered in this FTA in the investment chapter.

All of Japan's FTAs, surveyed here, include provisions which prohibit performance requirements. However these provisions extend beyond the TRIMs only in the case of the Philippines, Mexico and Chile. While prohibition of ownership requirement is specifically prohibited solely in the case of Mexico, all of the FTAs include measures on the freedom of transfer of fees, expropriation and guarantee the temporary entry or stay of key personnel.

[46] The FTA with Singapore will be analysed later. An FTA containing investment provisions is currently being negotiated with Thailand.

Dispute settlements are treated through ad-hoc consultations and arbitration with regard to state-state disputes. Investor-state disputes are resolved through international arbitration or referral to the ICSID.

The framework for investment promotion and cooperation does not include measures dealing with harmonisation of legislation and rules or lock-in prospects for future liberalisation. However, investment promotion provisions are included in the Mexican and Malaysian FTAs. In addition, these two FTAs also include also mechanisms for cooperation in investment.

3.7.6 Singapore

The investment provisions in FTAs to which Singapore is a party tend to be ranked relatively high.

The New Zealand-Singapore FTA is found to be among the most extensive in terms of investment liberalisation, with pre- and post-establishment national treatment of goods and services (Miroudot and Lesher). The absence of an MFN clause in the services chapter causes the agreement to be ranked a little behind NAFTA. Provisions on investment regulation and protection are also absent, though, interestingly, they are included in more recent Singapore FTAs with the United States and Japan.

Singapore's FTAs tend to follow the NAFTA model. Investment in services though is covered in a more varied way. The FTAs with the US and with Korea (2006) address investment in services within the investment chapter. Other agreements, with Japan (2002), Australia (2003), EFTA and Jordan (2005) include investment within the services section. National treatment is always granted, yet MFN is extended only in the case of FTAs with EFTA and the US. The FTAs with Korea, Australia and the US use a negative-list approach, while other agreements follow positive-listing.

Provisions on the prohibition of performance requirements are absent from the FTAs with Australia and EFTA. These provisions extend beyond those in the TRIMs, with the exception of the FTA with Jordan. The agreement with Australia includes a specific prohibition on ownership requirements. The free transfer of funds, which is common to almost any FTA with investment provisions, is not prescribed in the FTA with Korea. Temporary stay or entry of key personnel, fair and equitable treatment, as well as expropriation measures are addressed in all agreements.

Dispute settlement is addressed in a similar manner across the FTAs. For state-state disputes, the FTAs provide for ad-hoc consultation and arbitration. Investor-state disputes are to be resolved through either the ICSID or international and independent arbitration.

In principle, Singapore's investment provisions do not address investment promotion, cooperation, harmonisation of rules and legislation or future liberalisation. However, investment promotion measures are provided for in the FTA with Japan and Jordan. Furthermore, cooperation in investment mechanisms is addressed in the FTA with Japan.

Following the Asian financial crisis, Singapore decided to accelerate its liberalisation processes beyond the ASEAN Investment Area (AIA). Although a part of ASEAN, it considered the grouping's processes to be slow, in particular with regard to consensus building concerning trade agreements with third countries. Singapore's active bilateral trade

policy following the Asian financial crisis prioritises its main trading partners, as well as trying to achieve a first mover advantage with countries that are not yet linked with South East Asia and are interested in becoming so. Singapore's strategy in investment is based on a small and open economy perception aimed at attracting inward investment, and its FTA investment rules put an emphasis on the benefits of foreign-owned investment. Its conclusion of FTAs with Egypt and Jordan was motivated by the goal of inducing investors in third countries to channel their investments in Jordan and Egypt via subsidiaries to be established in Singapore, rather than in places such as the US or the EU.

3.7.7 Conclusions

Asymmetric Provisions: It has been found that, compared with the GATS, there is a tendency towards bilateral reciprocity in investment provisions in FTAs, particularly in agreements between developed countries and developing countries that have made fewer commitments under the GATS (Houde, 2007).

In short, very little evidence has been found of asymmetry in provisions dealing with investment. And where there is evidence it needs to be treated with care. It may even be that where there is asymmetric treatment, it could be interpreted as favouring the developed partner. For example, in EU-Jordan, EU foreign direct investment gets both Most-Favoured-Nation treatment and National Treatment in Jordan, while Jordanian investment in the EU receives only MFN. This raises the question, however, as to whether in talking about asymmetric treatment it is necessary to distinguish between the legal provisions and the economic effects of such treatment. In this particular case, asymmetric *legal provision*s, which give better treatment to EU investment in Jordan than to Jordanian investment in Europe, may, because of the benefits of inwards FDI, in fact serve the *economic interests* of Jordan. Because in this case, Jordan stands to "gain more by giving more", this in turn raises the broader question, beyond the scope of this study, of whether asymmetric treatment that serves to limit liberalisation commitments actually promotes national self interest (Heydon, 2007).

Policy Trends: In the course of preparing this study, the trend has become apparent (Miroudot and Lesher) that investment, which has traditionally been covered in BITs, is increasingly – with a question mark for the EU - being incorporated into FTAS. All North-South FTAs with investment provisions have been signed within roughly the last ten years, starting with NAFTA in 1994. As long as investment remains outside the scope of the DDA, this trend might be expected to continue. The counter-argument to this, however, is that precisely because investment has been taken out of the Doha Development Agenda, public opinion in both developed and developing countries will come to question the inclusion of comprehensive investment provisions in FTAs. Parts of civil society in the EU have already voiced concerns that economic partnership agreement (EPA) negotiations aim to establish rules in areas that have been taken off the agenda in the WTO. In Canada and the United States, the number of politically sensitive investor-state disputes, and the associated fines imposed upon governments, could generate a public backlash against ambitious investment provisions in FTAs (Reiter). The jury is out on this, and for the moment the benefits which FTAs can bring to a more coherent approach to the promotion and protection of investment is likely to prevail.

Links to Domestic Policies: The tensions just discussed between, on the one hand, fostering and protecting investment, and on the other, preserving governments' right to regulate are a

clear manifestation of the link to domestic policy. This is reflected, for all of the Core Entities, in the way in which FTA provisions seek, on the one hand, to foster the growth of FDI and its attendant benefits while at the same time excluding sectors, such as audio-visual or coastal shipping, where domestic sensitivities remain high.

Differences in Approaches: A recurring theme of this section has been the variety of ways in which Core Entities deal with investment in their own agreements. Such differences may in fact be as great as the differences between the entities. Nevertheless, some distinctions among the Core might be suggested:

- A distinguishing feature of the investment provisions of the United States, and her NAFTA partners, is the relative emphasis placed on investment regulation and protection. The three agreements found to have the most extensive provisions in this area all involve NAFTA Parties.

- A distinction might also be drawn between the NAFTA practice of combining all investment provisions (goods and services) in one chapter, with cross border services in another chapter, and the preference of the EU to have separate chapters for provisions dealing with, respectively, goods and services. A recent study by the OECD (Houde, 2007) finds that in terms of investment protection, the configuration of the chapters within FTAs is not the determining factor, but rather the scope and coverage of the investment protection provisions themselves.

- A distinction can also be drawn between those agreements which tend to use a negative-list approach and those employing a positive list. The former are essentially NAFTA-inspired and include US-Mexico, US-Morocco, and Japan-Mexico. The latter are GATS-based and include EU-Chile, EFTA-Singapore and Japan-Singapore. As with the services discussion earlier, however, care is needed in drawing implications for the liberalisation potential of these two approaches. While negative listing is seen as being relatively comprehensive and transparent, and positive listing as flexible and progressive, both approaches in the area of investment in FTAs are found to be WTO-plus. And elements of flexibility can be introduced into negative listing, just as positive listing can be made more transparent (Houde).

- The tendency to cover investment provisions in side-BITs would also seem to be a distinguishing feature of EU – or more precisely, EU member States' - practice.

- A difference is also evident between the United States and the European Union in terms of resort to sequential negotiations at different levels or forums (Woolcock 2006). The United States first forged progress through linking the investment protection principles of bilateral investment treaties with the plurilateral rules developed at the OECD. The resulting model was then applied at the regional level in the CUSFTA and perfected in NAFTA, before efforts were made to have the model adopted at the plurilateral level in the MAI negotiations. When the MAI failed, the United States opted to promote the NAFTA model in regional agreements, rather than in the multilateral setting of the WTO, because of developing country opposition to high-standard rules. In contrast, the EU has made less use of such sequential negotiations and has not used RTAs to promote a coherent model for investment rules. As seen above, this is largely because of "domestic" factors related to which level of

policy making in the EU – the Commission or the member states – has competence over investment in international negotiations.

3.8 INTELLECTUAL PROPERTY

Many of the recent bilateral free trade agreements (FTA) implemented by the United States (US), European Union (EU), Singapore, Japan, and the European Free Trade Association (EFTA) include provisions on intellectual property rights (IPR) that go beyond the requirements of the Agreement of Trade-Related Aspects of Intellectual Property Rights (TRIPS). However, with few exceptions, the majority of these 'TRIPS-plus' provisions are to be found in the FTAs of the United States and the European Union. Many of the FTAs negotiated by Japan and Singapore do not even include sections concerning IPR. Furthermore, the FTAs of the US are significantly more 'TRIPS-plus' than those being negotiated by the EU, which tend to narrowly focus on the protection of European geographic indicators (GI), see table 15 for an overview. The FTAs negotiated by the United States contain extensive 'TRIPS-plus' requirements for copyrights, trademarks, patents, civil and criminal proceedings, as well as border measures and are the most comprehensive IPR agreements contained in FTAs.

Table 15 TRIPS-Plus Provisions in Free Trade Agreements

	US	EU	EFTA	Japan	Singapore
Copyrights	X	*			
Trademarks	X	*			
Patents	X	*	X		
Data Exclusivity	X		X		
Geographic Indicators		X			
Industrial Design			X		
Satellite Signals	X				
Rights Management Information	X				
Internet Domains	X				
Civil Proceedings	X				
Border Measures	X				
Criminal Proceedings	X				

X = findings from the current study
***** =observations from Pugatch (2006)

For a detailed break down of the IPR provisions in the FTAs of the core entities see annexes 3.8.1 to 3.8.6.

3.8.1 The United States

This study focuses on US FTAs with Mexico (NAFTA), Singapore, Chile, Morocco, Bahrain, Peru, and Oman. Any reference to 'all US FTAs' should be considered limited to the agreements included in this study. The FTAs negotiated by the United States include many 'TRIPS-plus' provisions for the following[47]:

Copyrights:
US FTAs have extended the minimum term of protection for copyrights from the 50-year term established by TRIPS. Although NAFTA required only 50 years of protection, subsequent agreements with Singapore, Chile, Morocco, Bahrain and Peru have all extended this term to a minimum of 70 years.[48] The most recent US FTA, signed by President Bush in late 2006, extends the period of protection, when not calculated on the life of a person, to an astounding 95 years.[49] US FTAs also provide rules and penalties for the circumvention of technological protection measures (TPM).

Related Rights:
US FTAs are also TRIPS-Plus in their obligations concerning rights management information and the protection of satellite signals and Internet domain names.[50]

Trademarks:
All US FTA reviewed, from NAFTA to Oman, extend the term of protection for trademarks from the 7 years established in TRIPS to a minimum of 10 years. US FTAs also strengthen the protection of well-known marks, and eliminate a loophole in TRIPS that allowed countries to require that the generic name of a pharmaceutical product be displayed larger than the trademark name (Article 20 of TRIPS).[51] US FTA also provide detailed provisions for the creation of an efficient and transparent trademark registration process, which includes electronic applications, refusals of protection to be written and reasoned, and the opportunity for interested parties to contest decisions.[52]

Geographic Indicators:
US FTA are not TRIPS-Plus in their provisions for GI, in fact, they may be 'TRIPS-minus'.[53] US FTAs seek to protect GI through incorporating them into trademark systems, whereas TRIPS established GI as a potentially separate IPR from trademarks. In this sense, US FTAs provide protection for GI for all goods and services, as long as they are protected as trademarks, whereas EU FTAs only provide protection for listed GI for wines and spirits.[54]

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[47] The foundation for this analysis comes from: Pugatch, Meir Perez. "The international regulations of IPRs in a TRIPs and TRIPs-plus world" in *Trade and Investment Rule-making* edited by Stephen Woolcock. United Nations University Press, Tokyo, 2006 and Roffe, Pedro. *Bilateral Agreements and a TRIPs-plus World: the Chile-US Free Trade Agreement.* TRIPS Issues Paper 4, Quaker International Affairs Programme. Ottawa, 2004.
[48] US-Singapore 16.4:4, US-Chile 17.5:4, US-Morocco 15.5:5, US-Bahrain 14.4:4, and US-Peru 16.5:5
[49] US-Oman 15.4:4
[50] Article 15.4 and 15.8 of US-Bahrain deal with Internet domain names and satellite signals, respectively. The provisions are identical in other US FTAs.
[51] Article 15.2:3 of US-Morocco offers a good example of this provision, which is nearly identical in all US FTAs.
[52] Articles 14.2:7 to 14.2:9 of US-Bahrain offer a good example of the standard system of registration.
[53] Vivas-Eugui, David and Christophe Spennemann, 28. UNCTAD/ICTSD Project on Intellectual Property and Sustainable Development, Costa Rica, 10 - 12 May 2006. UNCTAD/ICTSD.
[54] For differing approached to GI in US FTA, see US-Peru 16.3 and US-Bahrain 14.2.

Patents:
US FTAs are TRIPS-Plus in three important ways.

- Every US FTA since Singapore has carefully prohibited the 'bolar provisions' that allow for the use of technology from a patented pharmaceutical to aide in the production of generic versions – the use of such bolar provisions to produce generic drugs has been ruled consistent with TRIPS obligations.[55]

- US FTAs require the extension of the term of patent protection if the life of the patent has been curtailed due to delays in patent registration or authorisation.[56]

- Some US FTAs prohibit the parallel importation of pharmaceutical products – a practice allowed under the international exhaustion provisions of TRIPS.[57]

Data Exclusivity:
US FTAs have all been used to clarify the vague terminology of Article 39 of TRIPS, which merely stated that protection of undisclosed data for the approval of pharmaceutical products or agricultural chemicals should be protected. After NAFTA required a period of protection of 5 years for such data, all subsequent US FTAs have required 5 years of protection for such data concerning pharmaceutical products and 10 years for agricultural chemicals.[58]

Civil Proceedings:
US FTAs contain careful legal wording in order to better define TRIPS provisions that were left vague and difficult to enforce. For instance, US FTAs attempt to preclude the possibility of 'innocent infringement' by excluding the TRIPS wording that punishable infringement must be done 'knowingly, or with reasonable ground to know'. In contrast, US FTAs simply state that 'in judicial proceeding, the judicial authorities shall have the authority to order the infringer to pay the right holder'[59], without any qualifications as to what type of infringement occurred.

TRIPS-Plus provision also includes:

- The option for pre-established damages to paid to rights holders, in excess of losses, in order to provide a deterrent for future infringement.[60]

- The destruction of infringing goods in civil proceedings, despite the domestic law of most countries only allowing such action in criminal proceedings.[61]

- The extension of civil proceedings to *all* IPR, not just those mentioned in the agreement.

[55] See, for example, US-Bahrain 14.8:5, US-Morocco 15.9:6, or US-Peru 16.9:5 for identical provisions.
[56] The definition of an 'unreasonable delay' differs from agreement to agreement. For variation see US-Peru 16.9:6 (a) and US-Morocco 15.9:7.
[57] US-Singapore 16.7:2 and US-Morocco 15.9:4.
[58] See, for example, US-Morocco 15.10 or US-Peru 16.10.
[59] See, for example, US-Singapore 16.9:8 or US-Morocco 15.11:5.
[60] See, for example, US-Bahrain 14.10:7 or US-Oman 15.10:7, which establishes a maximum penalty of three times the assessed injury.
[61] See, for example, US-Chile 17.11:12 (a) or US-Oman 15.10:10 (a).

- The destruction of any materials used in the infringement – whereas TRIPS holds that materials can only be destroyed if the 'predominate use' is for infringement.[62]

- The provision that sanctions be applied to any party of the proceedings who does not protect confidential information.[63]

- The provision that government experts who must be paid by the litigation shall not be prohibitively expensive.[64]

Border Measures:
Since the implementation of TRIPS, US FTAS have progressively tightened the requirements on border control. Although TRIPS only requires *ex officio* action for the importation of infringing goods, the FTA with Singapore requires such action for the importation and exportation of infringing goods, as well as cooperation for infringing goods found in transit. All subsequent agreements have explicitly required *ex officio* action for infringing goods imported, exported, and in transit.[65]

Criminal Proceedings:
The most notable provisions in US FTAs include:
- The right of authorities to initiate legal action without the need of private complaint.[66]
- Forfeiture of assets traceable to the infringing activity.[67]
- The need for criminal proceedings in the absence of wilful wrongdoing.[68]

Trends:
US FTAs follow a standard approach that is nearly verbatim in most agreements. Although NAFTA does go beyond TRIPS is some important ways, their contemporaneous negotiation led to many similarities. However, US FTAs after NAFTA have all followed a very similar format and often include entire identical sections. In this way, most US FTAs are equally 'TRIPS-plus', although there are a few notable exceptions:

- The extension of copyright protection, not based on the life of a person, from 50 years in NAFTA, to 70 years in FTAs with Singapore, Chile, Morocco, Bahrain, and Peru, and 95 years with Oman.

- The civil proceedings provision of sanctions against parties not protecting confidential information is only found in late FTAs such as with Bahrain, Peru, and Oman.

- The increase of border measures from NAFTA's requirement of *ex officio* action for imported infringing goods[69], to Singapore's requirement for such action on imports and exports, to the subsequent requirement in all following FTAs of *ex officio* action for infringing goods imported, exported, or in transit.

[62] Compare TRIPS Article 46 to US-Oman 15.10:10 (b).
[63] See US-Morocco 15.11:12 (b), US-Bahrain 14.10:12, and US-Oman 15.10:12 (b).
[64] See US-Bahrain 14.10:16, US-Peru 16.11:17, and US-Oman 15.10:16.
[65] Compare US-Singapore 16.9:19 and, for example, US-Peru 16.11:23.
[66] See, for example, US-Peru 16.11:27 (d).
[67] See, for example, US-Bahrain 14.10.27 (b).
[68] See, for example, US-Bahrain 14.10:28.
[69] NAFTA Article 1718:1

- The requirement of criminal proceedings for infringing activity, even in the absence of wilful wrongdoing for trafficking in counterfeit labels for computer programs, motion pictures, and other audiovisual works.

Domestic Linkages:
The United States can most clearly be seen to be advocating domestic type regulations in the field of geographic indicators and trademarks. Although TRIPS provides for geographic indicators to be protected as a separate type of IPR, US FTAs have attempted to classify GI as types of trademarks. The US conception of GI is based on a common law system, or private law conception, which grants trademark protection to persons of corporations. Other countries, especially the EU, can be seen to advocate a public law conception of protection for GI, which are technically owned by the state, rather than a person.[70] By including GI in the trademark sections of many FTAs, the US has attempted to spread its domestic conception of GI and trademarks abroad.

Asymmetrical Preference and Transitional Periods:
All US FTAs allow for certain transitional periods in order to ratify certain international conventions and agreements. Transition periods are also often allowed for enforcement, criminal proceedings, electronic applications for trademarks, the extension of patent terms, border measures, and civil proceedings, as well as other regulations. However, the transitional period allowed for each country appears to vary in ways that are beyond the scope of this analysis.[71] It is worth noting, however, that there is not a single instance of a transitional period allowed for the US, as TRIP-Plus regulations in US FTAs appear to be an extension of US domestic law.

3.8.2 The European Union

This summary focuses on the EU agreements with Mexico, Chile, Egypt, and Korea – the only agreements included in this study for which the EU has published a report including IPR provisions. Although the EU agreements may be TRIPS-Plus in their requirement for all parties to accede to several international conventions, the focus of the EU agreements is clearly on the protection of Geographic Indicators for EU Wine and Spirits[72]. However, the protection of Wines and Spirits is not always sought as part of Association Agreements. Although the Agreements for the Protection of Wine and Spirits is included in an Annex of the agreement with Chile, the Agreement for the Protection of Spirit Drinks with Mexico is a separate document.

Geographic Indicators: The EU has used bilateral free trade agreements to protect its interest in international protection for GI. Specifically, the EU has used such agreements to eliminate the exceptions granted in Article 24 of TRIPS, which allows for the continued use of GIs that had been used in good faith for a period of time before TRIPS.

[70] Vivas-Eugui, David and Christophe Spennemann, UNCTAD/ICTSD Project on Intellectual Property and Sustainable Development, Costa Rica, 10 - 12 May 2006. UNCTAD/ICTSD.
[71] See NAFTA 1701.3 and 1718.14, US-Singapore 16.10, US-Chile 17.12, US-Morocco 15.12, US-Bahrain 14.11, and US-Peru Annex 16.1.
[72] This analysis is heavily based on: Vivas-Eugui, David and Christophe Spennemann, UNCTAD/ICTSD Project on Intellectual Property and Sustainable Development, Costa Rica, 10 - 12 May 2006. UNCTAD/ICTSD.

Level and Means of Protection: Both the Spirits Agreement with Mexico and the Wine and Spirits Agreements with Chile stipulate that the use of GI must follow the laws and regulations of the party in which the GI originates.[73] This requires Mexico and Chile to respect EU laws concerning GI.

Automatic Protection for GI: Both the Spirits Agreement with Mexico and the Wine and Spirits Agreements with Chile require 'reciprocal' or 'mutual' protection for GI.[74] This requires Mexico and Chile to provide protection for all EU GI listed in the FTA. This eliminated the ability of domestic authorities to decide that certain uses of GI do not 'mislead the public' sufficiently to infringe upon rights holders.

Exceptions allowed in TRIPS Article 24: The Agreement with Mexico explicitly eliminates the exceptions allowed for in TRIPS.[75] The Agreement with Chile accords protection to a list of designating GI, thus eliminating the exceptions to TRIPS.[76] For instance, all trademarks deemed in violation of EU GI must be cancelled within 12 years for domestic use, within five years for use for export, and immediately upon entry into force for small quantity exports.[77]

Protection of 'Traditional Expressions': Regulation of 'traditional expressions' is only present in the FTA with Chile because of its apparent specificity to wine.[78] Similar regulations can be found in the EU FTA with South Africa, another major wine producer. This is a major TRIPS-Plus regulation, as 'traditional expressions' do not qualify as GI under TRIPS.

Trends: The sample of EU FTAs is too limited to discern general trends. However, it is worth noting the EU's focus on GI and its selective attention to sensitive areas for each trading partner. For instance, wine and spirit produces such as Chile and South Africa have agreements on both wine and spirits, Mexico only has an agreement concerning spirit drinks, and Morocco, a Muslim country with little production of alcohol, does not have an agreement on either wine or spirits.

Domestic Linkages The EU's focus on GI is a direct attempt to link its domestic protection to trading partners, and ultimately, a multilateral agreement. As mentioned above, the EU approach to GI is directly opposed to the US approach, as EU trading partners must cancel all existing trademarks that are similar to EU protected GI. EU FTAs eliminate the possibility of trading partners to decide that certain trademarks not sufficiently 'mislead the public', as allowed in TRIPS.

Asymmetrical Preference and Transitional Periods: The EU allows for differing transitional periods during which to accede to international conventions. The length of the transition periods appears to be based on variables beyond the scope of this study.

[73] See Article 5.1 of the EU-Chile Agreement on Trade in Wines and Article 4.1 of the EU-Mexico Agreement on Spirit Drinks.
[74] See Article 5.1 of the EU-Chile Agreement on Trade In Wines and Article 4.3 of the EU-Mexico Agreement on Spirit Drinks.
[75] See Article 4.4 of the EU-Mexico Agreement on Spirit Drinks.
[76] See EU-Chile Annex VI Article 5.
[77] See Article 7 of EU-Chile Annex V and Annex VI.
[78] See EU-Chile Annex V Article 3 (c).

3.8.3 EFTA

Free trade agreements implemented by EFTA include TRIPS-Plus provisions in three main areas:

- The extension of longer protection for industrial design. All EFTA agreements require a potential period of protection of 15 years, longer than the 10 required by TRIPS.[79]
- The extension of patent protection due to curtailment by delays in the marketing approval process. Agreements with Singapore, Chile, and Korea require TRIPS-Plus extension of patent life.[80]
- The protection of confidential information. The agreement with Chile requires 5 years of protection for information concerning pharmaceuticals and 10 years for agricultural chemicals.[81]

EFTA agreements progressively deepened protection for industrial design. In early agreements with Morocco and Singapore, protection was required for periods of 5 years, renewable two consecutive times. Later agreements all require a 15-year term of protection.

3.8.4 Japan

Out of the three published Japanese agreements in this study, only those with Singapore and Malaysia contain TRIPS-Plus provisions. However, these provisions are limited to the above-mentioned Joint Committee for Singapore and Malaysia, enhanced patent registration systems, and the limitation of liabilities for service providers in the agreement with Malaysia.[82]

3.8.5 Singapore

Of the agreements included in this study, only Singapore's free trade agreement with Japan includes provisions for intellectual property rights. The agreement calls for the creation of a Joint Committee, co-chaired by government officials from both parties, to monitor the implementation of the agreement and to foster cooperation between the two countries.[83] The only other substantive requirement holds that Singapore shall designate the Japanese Patent Office as a prescribed patent office in order to facilitate the patent process for applications filed jointly in Japan and Singapore.[84]

3.8.6 Conclusions

Recent FTAs have been TRIPS-Plus in areas ranging from the extension of patent and copyright terms, to the protection of undisclosed information, to the protection of geographic indicators for wine and spirits. However, these TRIPS-Plus provisions have been largely limited to the FTAs negotiated by the United States. Although the European Union has used

[79] Compare EFTA-Chile Article 5 and EFTA-Morocco Article 3.1 for differing approaches to protection.
[80] EFTA-Singapore Article 3 (b)(i), EFTA-Chile Article 3 (b), and EFTA-Korea Article 2 (b).
[81] EFTA-Chile Article 4.
[82] Japan-Malaysia Article 122.
[83] Singapore-Japan Article 4.10
[84] Singapore-Japan Article 4.11

FTAs to eliminate the exceptions for GI protection allowed in TRIPS, the EU has not negotiated TRIPS-Plus provisions in other IPR areas. The most notable exception to this dominance of IPR provisions by the US and EU is the extension of protection terms for industrial design included in all agreements negotiated by EFTA. For the most part, agreements negotiated by Japan do not address IPR issues in a way that go beyond TRIPS.

3.9 ENVIRONMENT

3.9.1 Introduction

Many FTAs, especially the more recent ones, mention the resolve of parties to promote sustainable development, and most of them specifically refer to the environment (Tebar Less and Kim, 2006). This applies to NAFTA and all subsequent agreements adopted by the United States, a majority of agreements signed by the EU, and a number of Asian treaties, including Japan-Mexico.

3.9.2 United States

General Requirement. In the Trade Act of 2002, Congress calls upon negotiators, among other things, 'to ensure that trade and environmental policies are mutually supportive', and in particular:

- to ensure that a party to a trade agreement with the US does not fail to effectively enforce its environmental laws in a manner affecting trade;
- to seek market access for US environmental technologies, goods and services; and
- to ensure that labour, environmental, health or safety policies and practices of the parties to trade agreements with the US do not arbitrarily or unjustifiably discriminate against US exports or serve as a disguised barrier to trade.

Enforcement of Environmental Laws. Since the passage of NAFTA, all FTAs concluded by the United States include an obligation to enforce existing domestic environmental laws. They usually provide that '[a] Party shall not fail to effectively enforce its environmental laws, through a sustained recurring course of action or inaction, in a manner affecting trade between the Parties'. Agreements recognise that lowering environmental regulations in order to attract investment is inappropriate.

Clarifying the Relationship between Trade and Environmental Rules. NAFTA (Article 104) has addressed an issue which remains unresolved in the WTO, by stating that in case of an inconsistency between NAFTA provisions and the obligations set out in certain multilateral and bilateral environmental agreements, such environmental obligations will prevail. However, in its bilateral agreements, the US has taken a different approach. In US-Singapore, for example, the parties simply recognise the 'critical importance of multilateral environmental agreements'. Similar wording is found in US agreements with Morocco, Australia and CAFTA.

As a result of a bipartisan agreement reached on 10 May 2007 between the US Administration and the Congress, parties to US FTAs will henceforth be required to implement seven MEAs,

including the Montreal Protocol on Ozone Depleting Substances, the Convention on International Trade in Endangered Species (CITES), the Convention on Marine Pollution, and the Ramsar Convention on Wetlands. The agreement has been interpreted as meaning that in case of any difference, the provisions of the MEA would prevail over trade provisions in the relevant FTA. These environmental obligations, and those on core labour standards described below, will be subject to the same dispute settlement procedures as the core commercial rules on tariff cuts. However, violations of these two sets of provisions will only become subject to dispute settlement if they demonstrably affect trade or investment.

Enforcement Mechanisms and Remedies. US agreements typically provide for state-to-state dispute settlement via biding arbitration, allowing parties to initiate formal dispute settlement proceedings in the case of alleged persistent patterns of failure by a Party to effectively enforce its environmental law. In a particularly interesting form of WTO-plus, some agreements provide for remedies other than retaliation. These agreements, including US-Chile and US-Morocco, provide that a Party in breach may have to contribute monetary assessments to a fund for appropriate environmental initiatives.

Public Participation. Some of the more recently concluded FTAs, such as US-Australia and US-CAFTA, make specific provision for open dispute settlement hearings and public participation.

Enhanced environmental performance. US agreements tend to include suggestions for improving environmental performance. US-Chile identifies specific goals that both Parties will work towards such as reducing mining pollution, developing a pollutant release and transfer register, and reducing methyl bromide emissions.
The 10 May 2007 accord between Congress and the Administration directs USTR to negotiate a new annex to the US-Peru FTA on forest sector governance with Peru, aimed at preventing trade in endangered forest products.

3.9.3 European Union

Collaboration and Dialogue. EU agreements, particularly those negotiated with developing countries and transition economies, commonly provide for cooperation aimed at preventing deterioration of the environment, controlling pollution and ensuring rational use of natural resources. EU-Egypt is a case in point.

Exceptions Clauses. Most of the agreements concluded by the EU (and some by EFTA) include exception clauses that largely reflect the language used in Article 30 of the Treaty Establishing the European Community. The construction of this exceptions clause differs from that of Article XX of the GATT in that it requires exceptions to be 'justified on specified grounds'. Moreover, the requirement of Article 30 that exceptions should not 'constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States' has been interpreted by the European Court of Justice to include the requirement to examine whether the measure is proportionate to its aim, and necessary to achieve the aim – ie, a necessity test.[85]

Public Participation. As with a number of US agreements, some EU arrangements, like EU-Chile, provide that dispute settlement panel hearings may be open to the public if both Parties

[85] The ECJ is unlikely to rule on the interpretation of a provision in an FTA, but precedent set in European law will clearly have a bearing on the EU's approach to such a provision in any joint committee procedure.

agree. The agreement also specifies that the panel may receive *amicus curiae* submissions, unless the Parties agree otherwise.

3.9.4 EFTA

The preamble of EFTA agreements contain references to promoting conservation, protecting the environment and promoting sustainable development.

3.9.5 Japan

Japan's agreement with Mexico states that it is inappropriate to encourage investment by relaxing environmental standards and allows for consultation among the Parties in case of such action. This is the NAFTA approach. The agreement with Malaysia states that encouraging investment through such actions shall not be done, but does not provide for the possibility of consultation between the Parties.

3.9.6 Singapore.

Agreements with Japan, India and Korea all contain references to protecting the environment and state that Parties retain the right to enact laws to protect human, animal and plant life, as well as the environment. The agreement with Korea is accompanied by a Memorandum of Understanding to further cooperation between the Parties.

3.9.7 Conclusions

Asymmetric Provisions: It seems that environmental cooperation is more prevalent in FTAs between countries with different levels of development. The EU, for example, while including provisions on environmental cooperation in the agreements with developing countries, such as the Cotonou Agreement, generally does not incorporate such provisions in agreements negotiated with developed countries. It may thus be that such cooperation is seen as a way of mitigating potential negative environmental effects resulting from trade provisions, which are often greater in developing countries.

Policy Trends: Three broad trends can be distinguished. Notwithstanding the WTO-plus character of environment provisions in many FTAs, these trends tend to re-affirm the importance of developments in the WTO:

- There has been a clear tendency for a number of countries to use Article XX of the GATT as a model for their environment-related exceptions clauses, though the precise language varies; in some agreements the language is broader than that in the GATT, in a few cases it is narrower.

- In a number of the more recent agreements (for example, US-Chile and US-CAFTA), there is a tendency, in dealing with the relationship with multilateral environment agreements, to refer to ongoing negotiations in the WTO.

- As in the WTO, the need for public engagement seems to be growing. For example, while NAFTA states that all dispute panel hearings are to remain confidential, NAFTA Trade Ministers in July 2004 instructed their officials to develop rules

governing open hearings. US-Australia, US-CAFTA and EU-Chile all provide for open hearings.

Links to Domestic Policy: A common feature of FTA treatment of the environment is an express recognition that each Party has the right to establish its own levels of domestic environmental protection. Correspondingly, it is the domestic environmental law that Parties undertake to comply with. This characteristic has met with criticism from environmental NGOs who lament the absence from these agreements of provisions to enforce core environmental standards.

Differences in Approach: Notwithstanding the similarity of approaches to FTA environmental provisions among the Core Entities, a number of differences can be identified:

Collaboration and dialogue among Parties, though by no means exclusive to EU agreements (see, for example, US-Jordan or Japan-Singapore), could be seen as featuring more prominently in EU FTAs than in other agreements.

While agreements recently concluded by the United States lay out some general principles on the relationship between trade and environment, leaving the particular objectives to be elaborated in side agreements (such as the North American Agreement on Environmental Cooperation), many recent agreements concluded by the EU refer to environmental cooperation, priorities and objectives. The latter approach means that the principles of environmental cooperation are present in the agreement as a cross-cutting theme, thus covering a wide range of issues.

EU agreements also tend to be distinguished by their provisions for the approximation of laws, as a condition of strengthened economic links between the Parties.

As already noted, EU agreements, and some EFTA agreements, are also distinguished by their reference to Article 30 of the EC Treaty, in dealing with exceptions, as an alternative to invoking GATT Article XX.

A particular feature of Japan's approach to the environment in FTAs is the inclusion of more elaborate provisions on cooperation for the implementation of MEAs. In the Japan-Mexico agreement, cooperation in the field of environment is focused on capacity and institution building to foster activities related to the Clean Development Mechanism under the Kyoto Protocol and exploration of appropriate ways to encourage the implementation of projects related to this mechanism.

3.10 LABOUR STANDARDS

3.10.1 Introduction

The exclusion of core labour standards from the work of WTO, other than through institutional cooperation with the ILO, tends to put the spotlight on FTAs – essentially those of the United States – which cover this issue. With the agreement reached on 10 May 2007 between the US Congress and the Administration, US emphasis on labour standards can be expected to strengthen.

3.10.2 United States

All of the US FTAs included in this study contain sections on Labour. NAFTA and its accompanying North American Agreement on Labor Cooperation are clearly the most comprehensive labour provisions required by any US FTA. The NAALC established the Commission for Labor Cooperation, which oversees the implementation of the agreement, reviews public letters on enforcement matters, and provides for an arbitral panel process to resolve disputes between Parties. However, the dispute mechanism of the NAALC, as is the case with all US FTAs, only allows for disputes over a Party's failure to 'effectively enforce its labor laws'.[86] Such limitations are usually stated as:
'Neither Party may have recourse to dispute settlement under this Agreements for any matter arising under any provision of this Chapter other than Article 16.2.1(a).'[87]

US FTAs after NAFTA have all reaffirmed the Parties' obligations as members of the International Labour Organisation (ILO) and the ILO Declaration of Fundamental Principles and Rights at Work and its Follow-up (1998). They also contain provisions on the following:

- Enforcement – each Party shall enforce its own domestic laws and recognises that lowering domestic labour laws to attract investment is inappropriate.[88]

- Procedural Matters – 'Each Party shall provide for appropriate access by persons with a legally recognized interest in a particular matter to impartial and independent administrative, quasi-judicial, or judicial tribunals for the enforcement of its labour laws.'[89]

- Public Participation – vague requirements that recognise the importance of public participation and state that each Party shall take into account public comments.

- Labour Consultations – Each Party may request consultations over disputes, but only in respect to the failure of a Party to enforce its own domestic laws.

- Creation of a Labour Cooperation Mechanism – Parties shall work jointly on initiatives such as to: establish priorities for cooperative activities on labour matters, exchange information, and promote compliance with ILO Convention 182 on child labour,

It is worth noting that the US agreements on Labour and the Environment are nearly identical, with the word 'Labour' often being substitutable for 'Environment".

As a result of the accord reached on 10 May 2007 between the US Congress and the Administration, Parties to US FTAs will henceforth be required to enforce worker protection as set out in the ILO's 1998 Declaration on Fundamental Principles and Rights at Work, including:

- Freedom of association and the effective recognition of the right to collective bargaining.

[86] For instance, US-Singapore 17.2:1 (a), US-Chile 18.2:1 (a), and US-Morocco 16.2:1 (a).
[87] US-Morocco 16.6:5
[88] For instance, US-Peru 17.2:2, US-Bahrain 15.2:2, US-Morocco 16.2:2.
[89] US-Morocco 16.3:1

- The elimination of all forms of forced or compulsory labour.
- The effective abolition of child labour; and
- The elimination of discrimination in respect of employment and occupation.

While falling short of invoking the ILO's eight Conventions, which the United States has not signed, this new undertaking clearly goes beyond the current requirement in US FTAs that Parties shall enforce their *own domestic laws*. As with the provisions on environment arising from this accord, violations of these labour provisions will only become subject to dispute settlement if they demonstrably affect trade or investment.

3.10.3 European Union

EU FTAs do not contain substantive requirements for labour standards. The FTA signed with Chile is the only EU agreement in this study that makes direct reference to labour standards. This agreement holds that the EU and Chile will cooperate to promote ILO Conventions dealing with issues such as the freedom of association, the right of collective bargaining, non-discrimination, the abolition of forced and child labour, and equal treatment for men and women.[90] FTAs negotiated with Morocco and Egypt both contain provisions on the fair treatment of Nationals of another Party legally working in the EU.[91] The FTA with Morocco holds that such treatment shall be non-discriminatory and that workers and their families shall be eligible for social security dealing with issues such as sickness, industrial accidents, and unemployment benefits.[92]

3.10.4 EFTA

FTAs negotiated by EFTA do not contain substantive requirements for labour standards. In fact, of all the EFTA agreements included in this study, only those with Mexico, Singapore, and Chile even make reference to labour in any way. Even in these agreements, the only mention of labour standards is the allowance – also provided for in the GATT/WTO - of trade barriers in order to protect against the products of prison labour.[93]

3.10.5 Japan

FTAs negotiated by Japan do not contain substantive requirements for labour standards. Of the agreements included in this study, only the FTAs with Singapore and Mexico make reference to labour standards of any kind. In these agreements, both Parties are allowed to use trade barriers in order to protect against the products of prison labour.[94]

3.10.6 Singapore

FTAs negotiated by Singapore do not contain substantive requirements for labour standards. Of the agreements included in this study, only the FTA with Japan makes reference to labour

[90] EU-Chile Article 44
[91] EU-Egypt Article 62 and EU-Morocco Article 65.
[92] EU-Morocco Article 65
[93] EFTA-Mexico Article 17(e), EFTA-Singapore Article 19(e), EFTA-Chile Article 21(e)
[94] Singapore-Japan Article 19(e) and Japan-Mexico Article 126(d)

standards of any kind. In this agreement, both Singapore and Japan are allowed to use trade barriers in order to protect against the products of prison labour.[95]

3.10.7 Conclusions

Asymmetric Provisions: Given the nature of concerns about compliance with core labour standards, they do not lend themselves to FTA provisions favouring the less advanced Party. Indeed, if anything, monitoring of compliance is likely to be more rigorous in respect of the developing country partner.

Policy Trends: Provisions dealing with labour standards are very much a characteristic of US agreements. As such, it might be expected that as the Democrats exercise their authority in Congress, and in light of the 10 May 2007 accord, even greater emphasis will be sought on the inclusion of labour provisions in US FTAs.

Any associated strengthening of the influence of organised labour in the United States could be expected to have a similar result, recalling the influence of the AFL-CIO at the Seattle WTO Ministerial when promoting trade sanctions for non-compliance with internationally agreed core labour standards.

Links to Domestic Policy: As with FTA provisions dealing with the environment, the commitments made in respect of labour standards relate to the domestic legislation of the Parties.

Differences in Approach: As noted above, concern with labour standards is a distinguishing feature of US FTAs.

[95] Singapore-Japan Article 19(e)

4.0 TRENDS IN FTA POLICIES OF THE CORE ENTITIES

4.1 UNITED STATES' FTA POLICY

A Wide Agenda

After obtaining Trade Promotion Authority in 2001, the current Bush Administration has adopted a more offensive policy on FTAs. Since the Administration took office, a total of 18 countries or groups of countries have participated in FTA negotiations with the United States, ranging over nations as diverse as Australia, Oman, Morocco, Colombia and Korea (for details, see Annex 1). Notwithstanding the agreement on trade issues reached between the Congress and the Administration on 10 May 2007, the subsequent expiry of Trade Promotion Authority will, as discussed below, bring some uncertainty to US policy on FTAs, though it is unlikely that the United States will abandon the pursuit of bilateral trade deals. The motivations of the United States in pursuing regional trade agreements are also highly diverse. In a speech to the Institute for International Economics in May 2003, the then United States Trade Representative (USTR) Robert Zoellick identified no less than 13 factors that guide US evaluation of the suitability of starting negotiations with a foreign party. Also in May 2003, the National Security Council issued guidelines to 'improve the process of assessing potential parties by, among other things, expanding the number on inter-agency groups involved with the assessments' (GAO 2004, page 13, cited in Evenett and Meier, 2006). As we shall see, motivations differ not only from agreement to agreement but also as between the Congress and the Administration. There are nevertheless seven key elements which have governed US pursuit of FTAs. These will be dealt with, briefly, in turn.

Key Elements

A fear of being left out. A concern about being left behind has been very clearly expressed by former United States Trade Representative Robert Zoellick, fearful of 'other nations seizing the mantle of leadership in trade from the United States' and observing:

> The United States has been falling behind the rest of the world in pursuing trade agreements. World wide the are 150 regional free-trade agreements and customs agreements; the United States is a party to only three. Each one sets new rules and opens markets for those that signed on and creates hurdles for those outside the agreement. (Editorial in *New York Times*, 14 April, 2002.)

This particular motivation has been mirrored, and in a sense confirmed, by the comment of EU trade commissioner, Peter Mandelson, that the successful conclusion of the US-Korea agreement (KORUS) 'strengthens the prospects for the planned EU-Korea free trade agreement'. (*Financial Times*, 3 April. 2007.)

The US fear of being left out is now most clearly manifested in Asia (also referred to below in the framework of foreign policy). The Director of the Institute for International Economics, Fred Bergsten, has observed that a full East Asian Free Trade Area (including ASEAN, China Japan and Korea) would carry substantial trade diversion costs for the United States (Bergsten 2005). He cites a study estimating that the creation of such a grouping would cause US exports to fall by $25 billion annually (Scollay 2001).

Dissatisfaction with progress in the multilateral trading system. Fears about being left behind in the pursuit of regional deals have been compounded by a range of factors that have weakened US commitment to the multilateral trading system.

The onset of multi-polarity has undoubtedly contributed to a moderated commitment on the part of the United States to multilateral approaches to economic diplomacy and, correspondingly, to reduced US leadership of such approaches.

Compared with US support for the Bretton Woods institutions in the post WWII period, a number of factors have reduced US engagement in multilateral economic diplomacy. Not least is the reduced relative economic power of the United States, meaning that it is less able to control institutions and their decisions. The evolution of the Kyoto Protocol on climate change and the questioning of the 'Washington Consensus' are each evidence of this. In the area of trade, reduced influence has been compounded by ongoing US pre-occupations, including concerns about 'free riding' in the multilateral trading system and periodic disenchantment with the dispute settlement system.

A moderated US commitment to multilateralism has also been fuelled by the need to keep things simple given the transparency of US domestic politics and the requirement for the Administration to engage and be accountable to Congress and to work within the constraints imposed by US domestic interests (Bayne and Woolcock 2003).

But the biggest US frustration with multilateral approaches arises from concern about the slow pace of progress. This is not new; the faltering of the Uruguay Round in the late 1980s was one of the triggers for launching NAFTA. More recent was the call by the then House Ways and Means Committee Chairman Bill Thomas in April 2006 for the Bush Administration to take its focus off the Doha Development Agenda, which he said was stalled because of European intransigence, and instead focus its energies on completing ongoing bilateral free trade agreements (*Inside US Trade*, 17 April 2006). Such a view may strike a chord with business interests, as product cycles get shorter and multilateral negotiating rounds longer. In contrast, KORUS, from the first round of negotiations to signature took only 10 months.

The forces moderating support for multilateral action tend to promote bilateralism and regionalism, rather than unilateralism, because the relative decline in US economic power also limits scope for unilateral pressure. While, in principle, as a large trader the United States could impose an 'optimum tariff', obliging foreign suppliers to reduce their price, thus improving US terms of trade, freedom to do this is constrained by the threat of retaliation, as well as by commitments to bind tariffs in the WTO. And while the US can and does implement unilateral defense measures through safeguard and anti-dumping action, this too is subject to greater discipline as a result of the Uruguay Round.

Opportunities for deeper integration. Among the 'pull' forces for US engagement in FTAs are the economic opportunities arising from deeper integration. This has been documented in Part 2, where WTO-plus elements are seen to be common and wide-ranging; these will be addressed in more detail below.

The US approach to deeper integration has been described as 'policed non-discrimination' (Woolcock 2006).

> The US approach tends to eschew policy approximation in favour of non-discrimination, policy competition and national treatment. In this sense the degree of integration is not especially deep, although there are specific sectors or policy areas

> where US-centred FTAs contain binding obligations to apply specific standards, such as in the case of IPRs, investment and some specific aspects of services. Outside of these sectors there is no attempt to lay down standards or rules, which leaves full scope for regulatory autonomy, but policy competition implies that there will be policy emulation, and the case of investment shows that this may well follow the US-determined norms. In other words, non-discrimination leaves the US Congress with policy autonomy by virtue of the asymmetric relationship between the United States and its partners in FTAs, but the size and importance of the US market obliges de facto policy approximation to the US rules on the part of the smaller parties.

In line with the concept of 'policed non-discrimination', US-centred FTAs tend to have strong enforcement mechanisms which are significantly more elaborate than those found in EU-centred agreements, except where EU accession is involved. A good example is provided by the investor-state dispute settlement provisions in US FTAs. These are so detailed and comprehensive that they take up half of the 'model' chapter on investment in NAFTA and US-Singapore. But investment is by no means the only example. In IPRs and telecommunications FTAs involving the United States have included strong enforcement provisions. And in government procurement the United States has championed 'bid challenge' mechanisms that provide companies who believe they have been badly treated with direct access to reviews of contract award decisions.

Advancing trade-related issues. Another aspect of WTO-plus, which is a particularly American feature of FTAs is the use of regional arrangements to exert pressure on partners to maintain or improve standards relating to public health, the environment or labour standards.

The provisions on access-to-medicines arising from the 10 May 2007 accord between Congress and the Administration are likely to foreshadow a heightened focus on health matters in US FTAs. In response to Democrats' concerns that the intellectual property protections in US FTAs were restricting access to lifesaving medicines in developing countries, the new template for regional agreements will allow US trading partners to bring generic drugs to market more quickly. Pharmaceutical test data will not be protected in partner countries beyond the period that it is in the United States, which will make it possible to bring generics to market at the same time in both. A public health exception from data exclusivity obligations will also be introduced. Furthermore, patent extension requirements for pharmaceutical products will be softened, and drug regulatory agencies will be allowed to approve generics without having to first establish that no patents have been violated. Finally, the new policy calls for making side letters on public health concerns part of the formal text of the FTAs, along with a re-affirmation of countries' right under WTO agreements to suspend patents in order to expand access to essential medicines.

Provisions dealing with the environment and labour standards are not new. Side agreements on labour and the environment were necessary to save NAFTA from congressional defeat. Echoing concerns about US leadership, USTR Zoellick, speaking in May 2001, said:

> …we need to align the global trading system with our values. We can encourage open and efficient markets while respecting national sovereignty. We can encourage respect for core labour standards, environmental protection, and good health without slipping into fear-based campaigns and protectionism. And we must always seek to strengthen freedom, democracy, and the rule of law (Zoellick 2001b).

With the changed composition of the US Congress, the issue of labour standards in US FTAs is now at centre stage. In an attempt to ensure congressional approval of pending Peru, Colombia and Panama FTAs, USTR proposed that the Parties pledge to adopt either International Labour Organisation codes or the equivalent US labour laws. This, however, was not enough to satisfy Congress. House Trade Subcommittee Chairman Sander Levin (D-Mi) said in March 2007 that anything short of strict compliance with ILO standards simply would not pass Congress (*Washington International Business Report* March 2007). The result was the accord reached between Congress and the Administration on 10 May 2007.

It is not the purpose here to pass judgement on Core Entities' motivations, but it should nevertheless be noted that this particular feature of US agreements has prompted criticism – that inclusion of provisions on labour and the environment causes US FTAs to bear the weight of too many objectives (Evenett and Meier) and, moreover, that these particular objectives go beyond the realm of trade policy and are motivated by, or could become hostage to, protectionist sentiment. (Bhagwati 2002). Their inclusion, while in part reflecting humanitarian concerns, is founded on fears about countries gaining an unfair competitive advantage from low standards, leading to a 'race to the bottom'. There is, however, no strong theoretical or empirical support for such a race (OECD 2000).

A stimulus to domestic reform. For some countries, such as Japan, regional agreements are invoked, in part, as a way of stimulating domestic reform through external pressure. This motivation is mentioned here, for completeness, though in fact there is little documentary evidence of this being a strong motivation in the case of the United States. Indeed, the basic US assumption is that their market is essentially open. Ambassador Zoellick again:

> American openness is high and our trade barriers are low, so when we negotiate free trade agreements with our counterparts we almost always open other markets more than we must change our own (Zoellick 2001).

There is, however, one feature of the 10 May accord between the Congress and the Administration which bears on the question of domestic reform. The agreement provides for expanded worker assistance and training in the United States, along with support for making health and pension benefits portable between different employers. These policies, through a Strategic Worker Assistance and Training Initiative, are intended to soften the blow of trade-related adjustment, and make it easier for workers to change jobs without losing benefits.

A stimulus to the multilateral trading system. US disenchantment with the multilateral trading system does not mean abandon. There is in fact a very carefully articulated view from Washington that a particular virtue of regionalism is that it can provide a stimulus to the successful conclusion of multilateral negotiations. It has thus been suggested (by Fred Bergsten of the Institute for International Economics) that it was the threat of APEC coming to fruition that persuaded the EU of the benefits of concluding the Uruguay Round. An updated version of this, untested and uncertain, view is that it could be the threat of APEC being converted into a preferential Free Trade Area of the Asia-Pacific that would provide the necessary stimulus to concluding the DDA.

The intellectual framework within which this notion of complementarity is placed is called 'competitive liberalisation', a concept dating from the 1990s but developed during the Presidency of George W Bush. It has been described in the following terms by a former Chief Agricultural Negotiator of USTR, Mr Alan Johnson:

> Our strategy is to incite competitive liberalisation by negotiating regional and bilateral agreements to complement our global strategy in the WTO. If others are ready to open their markets, America will be their partner. If some are not ready, or want to complain but not lower their barriers, the United States will proceed with countries that are ready. This competition in liberalisation strengthens the United States' already considerable leverage, including in the WTO. (Testimony before the US Senate's Committee on Foreign Relations, 20 May 2003, cited in Evenett and Meier.)

Robert Zoellick has indeed made competitive liberalisation the framework for US trade diplomacy at its broadest:

> When the Bush Administration set out to revitalise Americas's trade agenda almost three years ago, we outlined our plans clearly and openly. We would pursue a strategy of 'competitive liberalisation' to advance free trade globally, regionally and bilaterally. By moving forward on multiple fronts the United States can: overcome or bypass obstacles; exert maximum leverage for openness, target the needs of developing countries, especially the most committed to economic and political reforms; establish models of success, especially in cutting-edge areas; strengthen America's ties with all regions within the global economy; and create a fresh political dynamic by putting free trade on the offensive. (GAO 2004.)

A complement to foreign policy objectives. For the United States, and indeed all of the core entities, a long-standing and pervasive motivation for the conclusion of free trade agreements has been to serve broader foreign policy or strategic goals.

- NAFTA was driven in part by the desire to foster the growth and development of Mexico and so address the underlying causes of illegal migration.

- Bilateral agreements with countries such as Oman and Jordan have demonstrable foreign policy goals, as do those with Peru and Colombia. In both these pairs of bilateral agreements, there is an important regional dimension, in the one case linked to strategic and economic interests in a highly volatile environment, in the other case to the exercise of US influence, and the containment of that of Venezuela, in its immediate neighbourhood.

- The United States preparedness to enter an agreement with Australia, but not with New Zealand, was in part driven by the wish to recognise, and consolidate, the role of Australia as an ally in US engagement in Iraq.

- In writing to the Democratic leadership of Congress on completion of the bilateral agreement with Korea, President Bush said the deal would 'further enhance the strong US-Korea partnership, which has served as a force for stability and prosperity in Asia' (*Financial Times* 3 April 2007). USTR did not shy from the strategic link, saying that 'this FTA will strengthen the more than 50-year-old alliance… and will underscore the substantial US engagement in and commitment to East Asia [and] promote strong economic relations with the region' (Washington International Business Report April 2007). Washington's view that KORUS assures the United States' continued clout in the area can also be seen as implying a restraint on China, as well as on the idea of an

East Asian preferential block, first espoused by former Malaysian Prime Minister Mahathir and now characterised as ASEAN plus 3 (China, Japan and Korea).

- Washington's advocacy, at the 2006 APEC Leaders Meeting, of the transformation of APEC into a preferential block can also be seen as a way of exerting US influence more broadly in the Asia-Pacific region and, again, of containing – within APEC - the growing influence of China. APEC trade ministers, at their meeting on 5-6 July 2007, discussed 'the possibility of developing a Free Trade Area of the Asia-Pacific (FTAAP) as a long term prospect' (Bridges, Vol. 11, No. 25, 12 July 2007).

- Looking ahead, a recent study of a possible US-Indonesia FTA stresses the role that such an agreement could have in helping stymie radical Islam (Hufbauer and Rahardja, 2007).

4.1.2 The Primacy of Market Access

Though all motivations play a part, the relative importance of these seven key elements will clearly differ from agreement to agreement. Their importance will also differ depending on whose US-motivations one is talking about. Concerns about the foreign policy impact of regional deals are likely to loom larger in the Office of the President than in Congress. On the other hand, concerns about core labour standards are more pronounced in Congress than in the Administration; it has been observed (Hufbauer and Schott 2005) that although side agreements on environment and labour were added to NAFTA as a condition for congressional approval, they were not backed by meaningful financial resources or authoritative judicial mechanisms.

There is, however, one underlying objective that seems to be shared equally by Congress and the Administration, and that is the desire to use FTAs as a lever for improved market access for the goods and services produced and exported by the United States. If one accepts that the last three of the seven listed motivations (promoting, respectively, US domestic reform, the multilateral trading system and US foreign policy) are essentially 'tactical' uses of FTAs for other ends, and that the first four motivations are all related in some way to market opening, then market access emerges, perhaps not surprisingly, as the single most important direct driver of US FTA policy. The United States' high ambitions in respect of investment provisions – a feature of this study – can be seen in this light. Thus the goal of using investment provisions in FTAs to promote pro-market reform in partner countries and to protect US investment overseas can each be seen as related to the broader goal of advancing the United States' global market access interests. Similarly, concerns about a race-to-the-bottom in environmental and labour standards are rooted in fears about unfair competition – not least from China.

The pursuit of market opening has been a consistent theme of all three United States Trade Representatives of the Bush Administration.

We have seen how Robert Zoellick saw moving forward on multiple fronts as a way of exerting maximum leverage for openness. His successor, Ambassador Portman, stressed that even with Bahrain and Oman 'we have real export opportunities' (20 January 2006 at www.ustr.gov). And most recently, USTR Susan Schwab has said that she does not 'preclude bilateral agreements with either big countries or small countries where there is – and here is the key – the ambition to do a gold-standard free-trade agreement. [ ] The way we negotiate

FTAs, everything is on the table. And that includes our sensitivities and their sensitivities' *(National Journal* 15 July 2006).

On the basis of the analysis in Part 2, how successful has the United States been in achieving 'gold standard' FTAs?

Tariffs. US FTAs are generally, but not universally, characterised by comprehensive liberalisation of tariff lines by both Parties. In the four FTAs closely analysed in this study, 100 percent of tariff lines in the US schedule were liberalised entirely by the end of the transition period. While two to three percent of US tariff lines were subject to tariff rate quotas, all such quotas were eliminated by the end of the transition period. US agreements are thus highly WTO-plus with regard to US tariff elimination, albeit from a low initial level of tariff protection. US agreements also seek comprehensive tariff elimination by trade partners. Partners generally have not made use of longer transition periods than the United States, and have introduced the fewest tariff rate quotas as a percentage of tariff lines of all the studied agreements.

The negotiation of KORUS has demonstrated the bi-partisan importance for the United States of this aspect of market access. Concerns about autos and rice were the most important sticking points for US negotiators. And, on the side of Congress, Senate Finance Committee Chairman Max Baucus (D-MT) has declared that he will oppose KORUS until Korea fully opens its beef market (*Washington International Business Report,* April 2007).

It should be noted, however, that objectives, however clear and firm, will not always be realised. While it has been estimated that under KORUS, over $1 billion worth of US farm exports to Korea will become duty-free immediately, rice is not among them. And in the US-Australia FTA, the United States itself falls well short of full coverage of agricultural products.

Rules of origin. A question arising is the extent to which an ambitious approach to tariff reductions can be negated by restrictive rules of origin. The NAFTA regime is distinguished by its complexity, specificity and detail, and the US-Mexico RoO regime has been found as having the highest level of restrictiveness in the world. (Garay and Delombarde, 2006) However, the United States is much more flexible in more recent agreements, notably in the FTAs with Bahrain and Morocco, where the RoO regime is much less restrictive and simpler than in NAFTA.

Safeguards. US FTAs have consistently applied time limitations on the use of safeguard action that are tighter than those found in the WTO, with no reapplication possible on the same product. Additionally, the US-Chile RTA provides that on the termination of a safeguard, the rate of duty shall not be higher than the rate that would have been in effect one year after the initiation of the measure according to the agreed tariff schedule.

SBS/TBT. Many US FTAs are among those that require members to consider the technical regulations and standards of other Parties as *equivalent*. Commonly within these US FTAs Parties need to give an explanation when not applying the principle of equivalence to the regulations of other Parties, hence going beyond WTO rules. Many US agreements also encourage Parties to mutually recognise the results of their conformity assessment procedures and to explain the reasons when they do not do so. Many US agreements also call on the Parties to recognise the conformity assessment bodies in the territory of the other Party 'on

terms no less favourable than those it accords to conformity assessment bodies in its territory' (eg, US agreements with Australia, Bahrain, CAFTA-DR, Chile and Morocco). Finally, several US FTAs (eg (CAFTA-DR) encourage the recognition of suppliers' declarations of conformity, which do not require a third party to assess whether a product conforms to technical regulations and standards, and promote the conclusion of voluntary arrangements between conformity assessment bodies from each Party (Lesser, 2007).

Services. Though the relative impact of negative and positive listing needs to be assessed with care, if it is agreed that a negative-list approach tends to promote greater transparency, then consistent US support for this approach can be seen as a commitment to ambitious services liberalisation. US agreements tend to go beyond the GATS in rule-making in financial services, advancing on transparency measures, dispute settlement procedures, as well as detailed extension of the MFN clause to prudential recognition. In telecommunication services, US agreements expand on access and usage of public telecommunications transport networks and services, and are GATS-plus in respect of licensing processes, dispute settlement, independent regulation and privatisation. The provision in US agreements – pioneered in NAFTA - prohibiting local presence requirements goes beyond the criteria defined in Article 27 of the GATS on market access.

Investment. As noted above, US agreements, particularly NAFTA and the FTAs with Chile and Singapore, tend to be ranked high in terms of the comprehensiveness of their treatment of investment. Most recently, we have seen the investment provisions in KORUS that will ensure that US investors in Korea have the same rights and enjoy an equal footing with Korean investors.

Government procurement. NAFTA, like other US agreements, goes beyond the plurilateral Agreement on Government Procurement (GPA) by adopting lower thresholds and a negative list approach to the coverage of services procured by the listed entities. NAFTA has influenced other FTAs concluded in its periphery, including several of Mexico's bilateral agreements (OECD, 2003).

Intellectual property rights. The present study finds that, with few exceptions, the majority of TRIPS-plus provisions are found in the FTAs of the United States (and the European Union). US FTAs have thus progressively extended the 50-year term of copyright protection required by TRIPS, extended the minimum term of trademark protection from 7 to 10 years, and have eliminated the 'innocent infringement' clause in TRIPS that precludes penalties for 'unknown violation'.

In summary, the track record of the United States' FTAs seems to support the proposition that the attainment of improved market access, broadly defined, is the primary driving force of US regionalism. Whether the resulting agreements constitute 'gold standard' FTAs is a matter for debate. Comprehensive coverage – a condition for maximising welfare gains - is often lacking, even in US-based agreements. We have seen this in services. But agriculture stands out; in US-Australia, for example, while the Australian list has no agricultural tariff lines excluded, the US list has 196 lines that will not be completely liberalised at the end of the transition period and 83 tariff lines that are totally excluded from liberalisation commitments (Tsai in Woolcock 2006). And domestic subsidies in agriculture – the United States' greatest area of vulnerability in the Doha Round – are not susceptible to effective discipline in FTAs. Moreover, even where FTA coverage is comprehensive, the resulting improvements in market access are still on a preferential, and therefore discriminatory, basis. And because of

preferences, vested interests are created in opposition to multilateral liberalisation. Similarly in the rules area, while US FTAs oblige parties to use international norms for standards setting, given US antipathy towards agreed international standards, such measures will not result in much pressure to improve compliance. And while WTO-plus in some respects, some US FTAs' have less coverage than in the GPA. US Municipalities and many States are not covered by the public procurement obligations of the United States, and it can be hard to get a single licence for service provision across the whole of the country.

The importance of market access as a motivation for US regionalism is mirrored by US reluctance, notable in the area of tariffs, to offer asymmetric liberalisation commitments to its FTA partners. At first sight, there is a significant element of flexibility in agreements to which the United States is party. Unlike the EU, the US is not inclined to pursue regulatory harmonisation in its agreements. It has thus been observed that the US-centred model places less importance on approximation or policy harmonisation, as is reflected in the limited standards-harmonisation working groups established under NAFTA (Woolcock, 2003). In the area of TBT, US FTAs – unlike those of the EU - aim to promote *equivalence* rather than harmonisation of technical regulations and standards. Moreover, the recently negotiated CAFTA includes important SDT-type provisions, such as longer transition periods for developing members.

Before concluding, however, that the United States is actively engaged in promoting asymmetric commitments or that CAFTA might represent a model for future US agreements, some qualifications are in order. First, while there may be no formal pursuit of harmonisation in NAFTA, the US model appears to assume that market factors will bring about de facto approximation to US regulatory norms and standards (Woolcock, 2003). This would be borne out by the fact that the United States resisted asymmetric liberalisation commitments in the negotiation of NAFTA. Second, the US commitment to reciprocity was very clearly demonstrated in the, now abandoned, negotiations with the members of the Southern African Customs Union. SACU concerns that it lacked the institutional capacities to meet US expectations was met with the response that ways should be explored to strengthen the trade and investment relationship in the hope that SACU 'could undertake the obligations of a US-style FTA in the future'. In other words, the US preference appears to be to defer conclusion of an FTA rather than to dilute the reciprocal character of its agreements. In this light, the asymmetric elements of CAFTA might be seen as the product of particular economic, political and strategic factors. While going beyond the scope of this study, it is nevertheless worth noting that asymmetric commitments, by permitting a reduced commitment to market opening and structural reform will not necessarily serve the interests of the beneficiary.

As a focus for summing up, it is useful to reflect on the significance of the accord on FTAs reached between the Congress and the Administration on 10 May 2007 and of the subsequent expiry of Trade Promotion Authority, or Fast Track. One commentator believes that the 10 May agreement 'portends great changes for US trade policy' (Stokes, 2007). This is exaggerated. But the agreement does contain some important features, which should be welcomed. The accord is bipartisan, and by focusing on worker training it addresses a key requirement of successful adaptation to globalisation, namely that labour and capital should be allowed to move from declining to expanding areas of activity. And by addressing access-to-medicines, the agreement has an important humanitarian focus.

Indeed, the accord contains a large measure of continuity and as such needs to be assessed with caution. The strengthening of FTA provisions on core labour standards and the

environment is driven by fears of unfair competition, and as such is a confirmation of the overriding, if not exclusive, importance of market access as the driver of US FTAs. Should the Congress seek to extend the scope of the May agreement to the multilateral sphere, by re-opening the question of labour standards and the WTO, the impact on the DDA negotiations would be highly adverse.

The practical impact of the 10 May accord is likely to remain an open question for some time. In what is arguably the most critical of the areas covered – trade and labour, there are reasons to believe that the direct impact will be modest. First, the labour unions' contribution to the Democrats' campaign funding is in decline, falling from 15.6 percent of the Party's funding in the 2000 election cycle to 12.4 percent in 2006. Second, the Administration has shown no willingness to test the labour provisions in US-Jordan. And, third, and perhaps underpinning this unwillingness, it is by no means clear how in dispute resolution a causal link could be established between injury to US interests and an FTA partner's non-compliance with core labour standards. But the labour issue has been revived and the indirect consequence is likely to be heightened apprehension on the part of developing countries, whether as FTA partners or as participants in the Doha Development Agenda.

It had been hoped by the Administration that the 10 May accord would ease passage of the FTAs in the pipeline and help ensure renewal of fast-track authority. This was not to be. In a statement released on 29 June 2007, House Democrats said that the Peru and Panama agreements would not be implemented until these countries actually changed their laws in line with the 10 May accord's objectives. And implementation of the agreements with Korea and Colombia would be dependent on, respectively, improved access for US motor vehicle manufacturers and strengthened labour laws. It is unlikely that KORUS – arguably the most important of the pending agreements – will be implemented before 2008.

Meanwhile, with growing public concern about the effects of globalisation, the Democratic leadership has said that 'our legislative priorities do not include the renewal of fast-track authority' (*Washington International Business Report*, July 2007). None of the three leading Democratic presidential candidates supported extension when the TPA expired at the end of June, 2007. It should not be assumed, however, that the United States is about to vacate the field. First, it is not excluded that Trade Promotion Authority will be granted. If negotiations under the Doha Development Agenda were to be successfully revived, on the basis of Chairs' propositions and a possible 'Lamy Text', then Congress would be more amenable to granting fast-track authority. And, secondly, even if fast-track authority is not granted, there are a number of reasons for believing that the United States will continue its pursuit of bilateral FTAs:

- As is often observed, absence of fast-track authority, while it may complicate the conclusion of agreements, does not preclude the commencement of negotiations.

- US policy on FTAs requires that US partners, rather than the United States itself, initiate FTA proposals, and such initiatives can be expected to continue.

- As a result of the 10 May 2007 accord, there is bi-partisan agreement on the goals and conduct of FTA negotiations, with a strong focus on Congressional concerns related to the environment, labour and public health, underpinned by a shared pursuit of improved market access.

- And, as long as other major traders continue, as they will, to negotiate FTAs, the US fear of being left out will help ensure that Washington continues to seek trade, and broader foreign policy, advantage from bilateral arrangements.

It is unlikely therefore that there will be a moratorium on US bilaterals, but rather, in the words of presidential candidate Clinton, 'a little time out'.

In short, we might conclude that, apart from foreign policy or strategic objectives, the United States will continue to be attracted to FTAs as a way of improving market access, while at the same time addressing the political economy dilemma in trade liberalisation (concentrated losses and dispersed gains) by:

- Excluding difficult sectors.
- Focussing on a narrow range of selected partners.
- Avoiding MFN commitments, and therefore free riding by third parties.
- Securing reciprocity from partners.
- Addressing concerns about a race-to-the-bottom in labour and environment.

4.2 EUROPEAN UNION FTA POLICY

The European Union has shifted to a more offensive policy on FTAs over the past 18 months to two years. This has come after some debate among the Member States and within the European institutions on the advisability of such a shift. In May 2006 the EC announced it would be negotiating with Central American and in October 2006 it set out the objective of negotiating FTAs with a number of Asian countries, including in particular ASEAN. (European Commission, 2006) This followed various studies of the pros and cons of negotiating FTAs with Asian partners, and was followed in March 2007 by the adoption of negotiating mandates for FTAs with ASEAN, Korea and India.[96]

The EU is not new to preferential agreements. Indeed, until the surge in negotiations of preferential agreements during the 1990s the EC was by far the biggest user of such agreements. The EU also has a number of FTA negotiations 'in the pipeline'. The EC is has to negotiate Economic Partnership Agreements (EPAs) with the African Caribbean and Pacific (ACP) states by 2008 in order to replace the Lome preferences and to fulfil the conditions of the Cotonou Agreement of 2000. Since 1999 the EU has been negotiating an Association agreement with Mercosur. It is also negotiating Stability and Adjustment Association (SAA) agreements with the states in the western Balkans and has still agreements with Syria and the Gulf Cooperation Council ongoing. See annex 2 for details of the EU FTAs and negotiations.

4.2.1 Motivation

As in the case of all FTAs the motivation behind the EU policy has a number of driving forces. In broad terms it is possible to differentiate between three categories of FTA with somewhat differing motivation. First, there are the EU's near neighbours with which the EU negotiates Association agreements in which political and strategic factors tend to be the predominant motivation. These include, for example, the agreements with the central and East European states in the 1990s before these became accession states, the SAAs with the western

[96] A negotiating mandate has also been adopted for the negotiation of an Association Agreement with Central America/Andean Community.

Balkans and the Euro-Med agreements with the EU's southern near neighbours. The Association agreements with these countries include political and financial elements as well as trade liberalisation and are seen as means of promoting economic development and thus political stability. By promoting economic growth and employment in these partner countries, such Association agreements are seen as contributing to the EU's (and the wider Europe's) security. The Association agreements also seek to promote regulatory best practice and thus contribute to good governance in the countries concerned.

The second category of EU FTAs is with the ACP states and here the predominant motivation is development policy. Of course, the Euro-Med agreements also promote development, but agreements with the Caribbean or African states under the current EPA negotiations are more driven by a general desire to promote development in countries that are linked to Europe through the legacy of colonialism. From a commercial perspective very few of the ACP markets are very significant for EU exporters, and although there are sensitive sectors in agriculture, there is no significant competition from ACP exporters.

The third category of FTAs is primarily driven by commercial considerations. Into this category fall the FTAs negotiated with Mexico and Chile and the Asian countries with which the EU is now seeking to negotiate FTAs. The commercial considerations can take a number of forms. They may come in the shape of a desire to neutralise trade diversion resulting from other FTAs. EU-Mexico was such a case. Following the negotiation of NAFTA EU exporters and investors lost market share in Mexico, so the EU – Mexico agreement was negotiated to gain equivalent access to the Mexican market to that gained by US (and Canadian) companies. The EU was also motivated to launch negotiations with Mercosur (and as a result with Chile) by the prospect of the Free Trade Agreement for the Americas. Similarly, with the current negotiations with Central America, the Andean Community, following the conclusion of the CAFTA and the US Peru and Columbia agreements, Korea, following the KORUS FTA and ASEAN, following US FTAs with Singapore and negotiations with Thailand and Malaysia. In addition to the threat to EU markets from trade diversion, there appears to be a second commercial motivation in the shape of strengthening commercial links with regions undergoing economic growth, such as Latin America in the 1990s and South and East Asia today.

This general categorisation of EU FTAs should not disguise the fact that there are multiple motivations for negotiating FTAs. Clearly, there will be foreign policy considerations in all FTAs, especially given the nature of EU foreign policy and its heavy reliance of economic and commercial instruments. Equally, commercial and economic considerations will also play a role in all FTAs, so that the potential for conflicting interests is always present.

Before closing on the topic of motivations there are two other general motivations that have shaped EU policy rhetoric on FTAs if not so much the substance. These are both to do with projecting a European approach to economic relations and integration. The EU represents a distinctive model for deep economic integration. This finds expression in EU trade and thus FTA policy in a number of ways. First the EU pursues a policy of negotiating region-to-region agreements. In other words, the EU prefers to negotiate with partner regions, such as Mercosur, Central America, SADC, ECOWAS, Caricom and ASEAN etc. than with individual countries. The aim here is to use the leverage of access to the EU market to promote regional economic integration in other parts of the world. The EU experience with economic integration has been that it has promoted economic development and political stability. The Member States and European institutions therefore see it as natural to promote

such integration elsewhere. The promotion of the distinctive European approach to economic (and thus political) integration is also seen as a major element of EU 'soft power'.The record in region-to-region negotiations to date has, however, not been very good, largely because the policy is held hostage to the ability of the EU's partners to make progress towards regional integration. The region-to-region policy is aimed at promoting regional integration among the EU's partners, but it is also partly motivated by reciprocity. If the EU offers preferential access to the whole EU market it wants equivalent access to the partner region. If Mercosur is slow realising an integrated market or even a genuine customs union EU exporters and investors will not get regional access to the whole of Mercosur, while the Mercosur countries get access to the whole EU market. Delays in regional integration in Latin America, as well as the ACP regions in Africa and especially Asia (ASEAN) therefore create difficulties for the region-to-region policy. Individual members of certain regions may also prefer bilateral agreements with the EU.

The other motivation related to the EU's experience with regional integration in Europe is a desire to promote framework regulation for international trade and investment. The EU does not seek to export its domestic *acquis*, because it is clearly not appropriate or feasible in most instances. The EU *acquis* does however, shape EU policy just as domestic policies shape all trade negotiations. Indeed, the nature of the *acquis* means that it is more important in shaping EU policy because it has been arrived at through sometime arduous internal negotiations within the EU. The EU does however, favour international regimes for trade that mirror the European experience in that they establish a clear, consistent regulatory framework for international trade. This is one of the reasons the EU has pushed the 'Singapore issues' in the Doha Development Agenda and why it is likely to seek analogous comprehensive agendas in its FTAs. Whilst not mirroring the EU *acquis* there is a desire to see agreed norms and standards for trade that would serve a similar purpose in the international trading system to that served by the (constitutional) rules of the *acquis.* Like the region-to-region objective, this has not proved very successful as the EU's effort to promote a comprehensive agenda in the DDA has shown, but it remains a factor that can shape EU FTA policy.

4.2.2 Reasons for the Shift in EU Policy

In order to focus political attention on the aim of negotiating a comprehensive multilateral (millennium) round in the WTO the EU maintained a *de facto* moratorium on new FTA negotiations from 1999 until 2006. This was not a formal position in that it was not set out in a political decision of the Council, but the policy held because of a consensus among the Member States and the Commission. The policy held despite set-backs in the effort to negotiate a comprehensive round in Seattle and especially in Cancun and in November 2003 a Commission position on trade policy after Cancun held to the view that the DDA should retain the priority. This was supported by the European Parliament and by the Member States, especially Britain, Sweden and the other more liberally inclined governments. The November 2003 position did not however, rule out new FTAs if there was an economic or business case to be made for them and if the EU's FTA partners were making progress towards regional integration in cases of region-to-region negotiations.

The EU's formal policy position on FTAs was set out in the October 2006 position on the EU and globalisation. (European Commission, 2006) This states that the EU seeks to pursue multilateral negotiations in the DDA as well as negotiate FTAs and that these two objectives are complementary. At the same time the EU stresses the aim of ensuring that the FTAs offer improvements on the existing position, which implies WTO plus provisions, if a business case

for FTAs is to be made. Just whether these two aims are compatible will depend very much on the detailed substance of agreements discussed in this report.

Apart from the declared policy aims there seems to be little doubt that the EU shift in policy has to do with a concern to match what others, and in particular what the US is doing in terms of FTAs, the lack of progress in multilateral negotiations and a desire to strengthen links with Asia as a centre for future regional growth.

As noted above it is no coincidence that the EU has sought FTAs with countries that have concluded agreements with the US. Although the US has been pursuing a form of competitive liberalisation for some time, it was not able to make progress until the Bush administration had Trade Promotion Authority (see section above). The more offensive US policy on FTAs from 2001 onwards made it harder and harder for the EU not to respond. US policy on FTAs has therefore been a major factor in tipping the balance in favour of a more activist policy on FTAs on the part of the EU. This appears to be especially important in Asia, where the US has been negotiating a string of FTAs with ASEAN countries and Korea.

A second factor has clearly been the progressive reduction in the ambition of the DDA. Not only has the agenda been reduced by removing three of the Singapore agenda issues that the EU had a particular interest in, but the more conventional agenda in terms of NAMA and services in the DDA does not hold out much for EU offensive interests in industry and services. The option of moving ahead in FTAs therefore holds out more promise for the EU aims of including Singapore issues in the trade agenda and for the EU offensive interests in enhancing EU market access to some key markets. Of course, much will depend on whether the EU can achieve more through the FTA route than through the WTO.

A third factor could be a desire to seek to shape the rules and standards that will influence future access to some major markets. To date, deeper integration has been mainly something for the EU and to a lesser degree the US in their FTAs. But a growing number of FTAs are now beginning to include deeper integration issues in their agendas. To date, Asian governments have eschewed standards for safety or environmental protection, or rules for competition or investment. As the Asian economies develop however, one can expect to see such measures assume greater importance. This is beginning to be reflected in the content of the intra-Asian FTAs. The EU therefore has an interest in ensuring that the standards and rules developed are consistent with European standards and rules, otherwise European exporters may face future barriers to market access throughout the region.

The shift towards a more active EU policy on FTAs has not been controversial in the EU. A broad consensus has emerged among the Member States and between the Member States and the Commission on the desirability of negotiating more FTAs. The main debate was on timing, with some Member States such as the UK, Sweden and other more liberally inclined Member States wishing to hold back longer in order not to undermine the prospects for the DDA.

4.2.3 Policy Substance

The EU policy objective is to ensure compatibility between its FTAs and the multilateral system. At the same time it is seeking FTAs that make business sense, which implies provisions that extend beyond the scope and depth of WTO liberalisation. There are also other objectives such as the promotion of regional integration, the development of the EU's FTA

partners and wider political and strategic considerations. The aim of this section of the paper is to assess whether there are any clear policy trends in the substance of EU FTA policy. In the general debate on EU FTA policy there is a tendency to stop at generalisations. This report aims to get beyond this.

4.2.3.1 WTO Plus?

Broadly speaking the substance of the EU's FTAs to date has not been very WTO plus. Generally speaking it has stuck to the framework rules as set out in the WTO where these exist. This is for example the case for technical barriers to trade, SPS, public procurement and services. There are not very many cases of the EU going significantly WTO – plus in its agreements. This contrasts with the USA for example, where the US FTAs are significantly WTO plus in intellectual property rights and in the inclusion of comprehensive investment measures. The EU FTAs do however, include procedural measures that are WTO plus such as detailed provisions applying WTO principles and the establishment of relatively strong institutional provisions, such as specialist committees, to ensure implementation of the FTA and promote bilateral cooperation on a range of functional issues.

Turning to the coverage of agreements there is again little evidence to date of the EU FTAs including commitments on liberalisation that are significantly beyond the WTO. The EU offers tariff liberalisation for industrial goods, but does not offer much by way of greater access to agricultural markets in FTAs than in the WTO. Even in services the FTAs to date have not been very GATS plus, although the expectation must be that the EU will seek to match the level of commitment in the US FTAs in services and thus go GATS-plus. The EU only has investment provisions in the EU – Chile agreement and these are moest compared to the comprehensive nature of investment rules in the US FTAs.

Another generalisation that can be made of the substance of EU FTAs is that they stress the use of existing international standards. This is the case for TBT, public procurement and for intellectual property, in which the EU FTAs seek to promote the effective enforcement of the various international standards for protection of intellectual property, rather than introducing new standards through FTAs. The one major exception to this is geographic indicators.

The EU FTAs also appear to place importance on developing agreed international standards, where these do not exist, as a means of facilitating trade and investment. Here the FTA policy reflects the 'domestic' experience of the EU.

The 'domestic' *acquis* of the EU has shaped it approach to FTAs, but the EU has by no means sought to export the EU *acquis* through FTAs, except for potential accession states, if anything the EU has been rather 'flexible' in the content of its FTA, compared, for example the USA. This flexibility means that the EU has excluded sensitive sectors from liberalisation, such as a number of agricultural sectors. The EU has also been flexible in what it asks of its FTA partners. Another way of putting this is to say that the EU tailors the contents of FTAs to the particular circumstances of the FTA. For example, various agreements offer a number of options rather than requiring a specific policy. For example, the TBT provisions in EU – Chile agreement offer mutual recognition or equivalence.

4.2.3.2 Asymmetry

This brings us to the EU policy on asymmetry. The EU has not used a set agenda for FTA negotiations as appears to have been the case with the US use of NAFTA as the starting point for all FTAs. On the other hand, the EU FTAs showed greater uniformity in terms of what they expect of the FTA partner than Japan (at least in its early FTAs) or Singapore.

On tariffs, the EU offers asymmetry to developing countries on industrial goods. The EuroMed agreements for example, include provision for the developing country partner to reintroduce tariffs if these are needed as part of an infant industry strategy by the EuroMed partner. As suggested above, however, this flexibility works both ways in the sense that the EU has some asymmetry in its favour, such as for example in agricultural tariffs in the EU – Chile!

In the field of rules of origin, the current EU reform proposals for preferential rules of origin include simpler rules of origin based on a 45 percent (ex factory price) value content. This would constitute a form of asymmetry as it should simplify rules of origin for developing country FTA partners.

On a range of deeper integration issues the EU has been willing to accept modest commitments on the part of its developing country partners. For the EuroMed there are a number of commitments for the EU's partners to adopt European standards (TBT, SPS and competition), but these are long term aims without any specific implementation phase. Beyond the EuroMed the EU has been happy to accept very general provisions on public procurement and competition, two of the Singapore issues. One might have expected the EU to push more vigorously for significant provisions on these topics in FTAs as a substitute for the limit progress in the WTO.

4.2.3.3 Trends

Based on the EU's FTAs to date it is difficult to identify any clear trends. The content of EU FTAs varies between partner, depending on the level of development of the partner, how important they are for European security (i.e. near neighbours are treated differently) and in which sectors they constitute a competitive challenge. So variations over time are difficult to pick out.

The shift in EU policy clearly points to rather more ambition in future FTAs. Certainly the negotiations with Korea are being undertaken at some speed and the expectation is that the content of any EU – Korea FTA will be an advance on the EU – Chile agreement, which has to date been seen as 'the model' for EU FTAs.

It remains to be seen however, whether the EU will be successful with a more ambitious agenda.

- On tariffs it will be hard pressed to overcome the domestic opposition to significant liberalisation of the sensitive agricultural sectors that have to date been excluded from preferential liberalisation as well as non-preferential liberalisation in the WTO. Although the EU is likely to be able to offer near to 100 percent coverage for

industrial tariff liberalisation in its FTAs, the exclusion of sensitive sectors by the EU clearly opens the way for its FTA partners to likewise exclude sensitive sectors.

- On rules of origin the EU has been active in harmonising its own preferential rules of origin. But the PanEuro rules remain complex. The current review of EU preferential rules of origin is aimed at simplifying the RoO for developing countries. But this might paradoxically introduce a two tiered system for EU rules of origin, one for the developed economies and one for developing countries.

- In TBT and SPS the trend appears to be to use FTAs to apply the policies and principles in the WTO agreements. In this the EU should for the most part facilitate trade. But there may be a degree of WTO – minus application of the rules when it comes to precaution, which the EU wants to interpret in such a fashion that risk assessment and especially risk management should include social as well as scientific assessments of risk.

- The trend in public procurement is clearly to use the FTAs to extend the number of countries that effectively apply the GPA. Here the EU has been successful in its FTA with Chile, but the test will be whether the EU can succeed in extending coverage of at least the GPA framework rules to include the more advanced ASEAN countries and India.

- For services the EU is likely to seek to match the sector commitments achieved by the US in its FTAs. This will be the case for EU-Korea and for those ASEAN countries that have concluded agreements with the US. It will also be the case for Central America.

- In intellectual property the EU trend will be to seek more effective enforcement of existing IPR standards through its FTAs and to press for inclusion of protection for geographic indicators, where it is likely to have much less success.

- Finally on investment the EU can be expected to be rather more ambitious in its future FTAs. Within the EU there is work underway to define a minimum platform for investment rules for FTAs. This could well find application in some of the future FTAs, but will stop short of the kind of comprehensive investment rules that the US includes in all its FTAs.

4.3 EFTA FTA POLICY

4.3.1 Overview of EFTA

The European Free Trade Association (EFTA) is one of the oldest and most successful examples of a regional trade agreement as foreseen by Article XXIV of the GATT. Membership has waxed and waned since its creation in 1960 and today is constituted by two Nordic and two Alpine members – Iceland & Norway and Liechtenstein & Switzerland respectively. EFTA was once considered a serious alternative to EC European integration, eschewing supranational governance structures while preferring a more flexible and understated free trade area. This holds true for its members today, who prefer a more flexible intergovernmental structure and a more limited scope of issues – mainly economic and trade

related – as compared to the EU. The reasons for rejecting EU membership are varied depending on the member state, but EFTA's identity today is a legacy of its evolution vis-à-vis Europe. Most people's conception of EFTA is linked to its deep relationship with the EU through the EEA Agreement. Switzerland is not a member of the EEA and manages its relationship with the EU through a number of sectoral bilateral agreements. Most of EFTA's budget and personnel resources are devoted to the Secretariat in Brussels. However, the management and coordination of EFTA's so-called third country policy (i.e. countries outside of the EU) in Geneva is one of the most important functions of the organization. In the past decade, the EFTA States have slowly and deliberately built one of the largest and most dynamic free trade networks in the world. Their agreements cover approximately 50-52 countries and territories, in four continents, reaching a population that is fast approaching one billion.

4.3.2 General Policy Approach and Stated Aims

The EFTA approach to its bilateral and regional trade agreements is characterized by flexibility, pragmatism and a desire to gain market access for its economic operators. Its approach is inspired by its own institutional structures and working methods. An overall direction is promulgated twice yearly at EFTA Ministerial meetings, and a six month rotating presidency of the Council guides this work via a Chair's priority work programme. Negotiations are conducted by a Council appointed chief negotiator, usually the head negotiator of one of the Member States, and positions and strategies are continuously coordinated throughout the course of negotiations. However, it is important to keep in mind that Member States retain full and complete control over their own fate and a consensus must be reached before any decision is taken.

The then Liechtenstein Chair published its priorities in January 2007, articulating an ambitious agenda characteristic of EFTA's work in the past years. The paper calls for the conclusion of negotiations with Canada, Thailand, Egypt and the Gulf Cooperation Council (GCC). It aims to start FTA negotiations with Algeria, Indonesia, Colombia and Peru, and prepare the ground for immediate negotiations with Ukraine once its accession to the WTO is finalized. In addition, the paper mentions deepening economic relations with a select number of partners via Declaration on Cooperation – often a first step towards FTA negotiations – and mentions eleven possible/interesting partners for the future.[97] These agreements would supplement EFTA's current global network and signal a remarkable upsurge, both in ambition and scope, in a policy that is becoming ever more dynamic. Before we can postulate on the general trends and stated aims of the EFTA States, it is useful to look at how their third country policy has developed over the past 15 years.

4.3.3 Evolution of EFTA FTA Policy

Following the end of the Cold War, the EFTA States began to negotiate free trade agreements with countries outside of the EU. The evolution of its third country policy since 1990 can be divided into three phases:

Phase One was a network of free trade agreements, limited to free trade in industrial goods, signed with the Central and Eastern European countries (CEECs). The EFTA States were, according to the Secretariat, firstly guided by a desire to re-establish pan-European ties by

[97] This includes ASEAN, Central America, India, China, Japan, Vietnam, Pakistan, Russia, Malaysia, Montenegro and South East Europe.

contributing to the reconstruction of the former command economies and to supporting their transition towards market-based economies and democracy. Second, the agreements with the CEECs were in response to the European Agreements initiated by the EU in order to ensure that important economic interests in the EFTA States were not discriminated against or placed at a competitive disadvantage vis-à-vis their EU competitors.

Phase Two began at a Ministerial meeting in Bergen in 1995, when EFTA Ministers announced a change in third country policy by stating their intention to expand EFTA's network of FTAs beyond Europe to include the Southern and Eastern rim of the Mediterranean. This was very much a response to the Barcelona Process, launched by the EU in 1995 to create a Euro-Med Free Trade Area. The EFTA States, while not formally part of the Process clearly indicated their intentions to contribute to this Process. The creation of the Euro-Med cumulation zone was an important outcome of this phase.

The first two phases are distinguished from the third phase in that they were mostly defensive and based on a policy of *parallelism, or* negotiating with partners *after* the EU to mitigate any economic disadvantages. The next phase portended a much more offensive strategy, negotiating with partners worldwide to secure economic advantages and preferential market access over EU and other competitors. In this third phase, the EFTA States went global. Starting with Canada in 1998, negotiations with overseas partners have increasingly become a significant component of EFTA's third country activities. As the global market became more integrated and technological advances decreased transaction and transportation costs, geographical proximity was no longer central to trade flows. In adapting to this reality, the EFTA States have successfully concluded FTAs with Mexico, Singapore, Chile, Korea and the South African Customs Union (SACU). In addition to being trans-continental, these agreements tend to be broader in scope in that they cover new areas such as services, investment, public procurement and competition. These so-called second generation policy areas are particularly important to the EFTA States and reflect underlying national economic interests.

An argument can be made that the EFTA States are now moving into a fourth phase. This current phase foresees free trade agreements with some of the largest and most important markets outside of the Trans-Atlantic area. The EFTA States will continue to push for second generation agreements where possible but as the race to complete FTAs heats up the EFTA States will have to compete fiercely for the attention of negotiators in potential FTA partners, who might be more interested in larger markets. In this case, it is likely that the EFTA States will continue their flexible approach and scale down their level ambition depending on the partner. This phase also poses the most existential threat to EFTA since its three largest members – Austria, Finland and Sweden – left in 1994. Larger partners mean higher stakes and individual member States might prefer negotiating without their EFTA partners. As a result, any minor differences in approaches and interests also become more pronounced and cannot as easily be smoothed over or compromised away. Although the official rhetoric is that EFTA coordination is preferred, evidence to the contrary indicates that negotiating with larger FTA partners could seriously damage EFTA unity. For example, Iceland is now negotiating bilaterally with China, which to this point has deflected efforts to include the other EFTA States, and Switzerland has undertaken feasibility studies bilaterally with the United States and Japan, the latter leading to the commencement of negotiations in May 2007. Although values are rarely if ever discussed in the EFTA context the EFTA States do share common interests and characteristics, not to mention the advantages of attracting potential partners

because of their economic weight as a group. However, these benefits of membership are likely to be tested in the years to come.

4.3.4 EFTA FTA Policy Today

The EFTA States have consistently affirmed their commitment to the multilateral trading system in general, and the Doha Development round in particular. However, the frustration with the pace and ambition of the round has increased its reliance on the FTA option.

As mentioned, the EFTA States are pragmatic, flexible and opportunistic in their third country policy approach. They are similar to the EU in that they do not approach negotiations with a standard 'blueprint', such as some elements of the NAFTA model, and their agreements more often than not reflect the economic conditions and interests of their partners. For example, the FTA with the SACU States had to be scaled down considerably in scope and ambition once it became clear that the SACU States were not ready and willing to take on second generation commitments. In addition, the EFTA Agreements with the Euro-Med countries are very similar to the EU Association Agreements, reflecting the broad objectives of exporting the European regulatory model and integrating these countries into the single market. Much of the language of these agreements is identical to that of the EU agreements. Even with global partners, the EFTA States aim to receive concessions equivalent to those given to the EU, if such agreements exist. However, the EFTA States do share common interests and negotiating positions that, in general, favour a broader scope and deeper commitments.

The negotiating strategy is based on a quid pro quo. As small developed nations highly dependent on trade and investment and with low overall industrial tariffs, the EFTA States take a very offensive position on industrial goods, services, investment, procurement, IPR and competition. They desire a strong a deep rules-based trade regime that takes into account a wider scope of issues than is currently available under the WTO. On the other hand, the EFTA States are all members of the highly protectionist agriculture group called the G10 and take a defensive position vis-à-vis agriculture. The EFTA states also negotiate bilaterally on agriculture, because, unlike the EU there is no common EFTA policy on agriculture. This allows them more flexibility. An important distinction here is that fish products (Chapter 3 of the Harmonized System) that are considered by the EFTA States to be an industrial good and are therefore included as part of the more liberalized main agreement.

The EFTA States do not possess the political and economic clout to dictate terms or strongly influence partner country concessions in trade agreements. The agreements themselves are also not subject to the kind of scrutiny and political pressures one tends to find in the EU and US context. As a result, the EFTA negotiators have more flexibility and room for manoeuvre to conclude agreements.

Often, the EFTA States will offer technical assistance to ensure that their FTA partners can benefit from the new opportunities offered by the FTA. This is especially the case with developing partner countries, where technical assistance comes mainly in the form of bilateral assistance. It also comes in the form of institutional assistance and training programs through the Secretariat, but the yearly budget for these programs is minimal. Before analyzing evidence and revealing policy preferences based on the substance of particular agreements, let us examine some of the general motivations of EFTA's third country policy.

4.3.5 Motivations

In the case of EFTA FTAs, there have been a number of factors motivating each initiative. However, unlike EU or US FTA motivations, the EFTA States are almost wholly motivated by economic considerations. One could argue that other considerations - political, developmental or institutional - are also taken into account, but these are undoubtedly secondary motivations and will be dealt with briefly at the end of this section. First, however, this study will briefly look at the EFTA rationale for choosing potential FTA partners and the process this entails.

4.3.5.1 The Motivations in Choosing Partners

The process of choosing FTA partners takes place on multiple levels. Potential partners are vetted by each individual member state in consultation with domestic partners and legislative bodies and discussed at the EFTA level in the Council of Ministers. This can occur as a result of partner country interest in the EFTA States, as seems to be the case with Peru, Colombia and Pakistan, or through EFTA initiatives, as seems to be the case with China and certain ASEAN countries. As a general rule, EFTA does not *a priori* actively attempt to quantify the potential economic benefits of their free trade agreements through rigorous methodology/analysis or general equilibrium models. Specific economic studies might take place within individual member states but this remains outside of the EFTA context. The Secretariat does produce reports on potential partners, if requested by Member States, but these reports tend to be descriptive and superficial in substance.

Preliminary work towards FTA negotiations with selected partners tends to take on one of two forms: either a Declaration of Cooperation is signed or a feasibility study is launched. The latter appears to be increasingly favoured by the EFTA States and was used in the Korea, Indonesia and now the Malaysia context. Both methods foresee expert group consultation in specific sectors to gauge the ambition level of the agreement and the scope for possible action. In the context of the EFTA-Korea feasibility study, the Korean side commissioned an econometric analysis of the agreement to measure predicted commercial benefits and to justify FTA negotiations on the results of this study to sceptical domestic groups. The EFTA States do not appear to share such political constraints and are happy to justify partner choice based on potential market access opportunities and qualitative dynamics. In fact, many of these feasibility studies take place after a political decision has been taken at the EFTA level and - unless serious complications emerge - merely serve to support/justify this decision. However, the third country policy evolution towards ever larger countries and important markets indicates that these studies will take on a important role. In fact, the comprehensive Swiss-US feasibility study highlighted the political economy difficulties and divergent ambitions for the Swiss agricultural sector in particular, resulting in the decision not to pursue a free trade agreement between the partners.

Overall, the EFTA approach in choosing partners is ad hoc and opportunistic. Despite the fact that the EFTA States, as a single entity, were the 10th largest global trading entity in 2006 they are perceived by others as junior partners in Europe and have to compete fiercely to attract the limited negotiating resources of partner countries.

4.3.5.2 Economic/Commercial Motivations

As a commercial trading area the EFTA States are naturally motivated in their third country policies by economic considerations. Indeed, Joseph Deiss, the former Swiss Economics Minister succinctly articulated EFTA's main motivation when he stated that, *'the main objective of EFTA's FTA policy is to improve market access and to maintain the competitiveness of EFTA economies.'* [98]

One can identify three broad economic considerations: limiting trade diversion as a result of third party agreements, securing market access and economic competitiveness in fast growing markets/regions and enforcement of international trade rules.

Limiting Trade Diversion
The first consideration was the main driving force of EFTA's third country policy in the 1990s. These early agreements were motivated by parallelism - a defensive posture vis-à-vis the EU. Most of these agreements were with small trading partners around the Euro-Med region and the objectives of these agreements were twofold: to mitigate any potential competitive disadvantages vis-à-vis the EU and to link these agreements into the wider European strategy of integration. The scope of these agreements was minimal, limited to traditional trade liberalization, and can be characterized as first generation.

The Agreements with Mexico and Chile were also motivated by these same 'defensive' commercial considerations as domestic economic operators were concerned that they were losing market access to not only EU competitors, but also to the United States and other partners. The EFTA States demanded and largely received equivalent concessions, including services, investment and government procurement, to that offered to the EU. And although trade between the EFTA States and Mexico/Chile was increasing/marginally increasing, the EFTA States were worried about their relative position vis-à-vis their main competitors. The fact that the market size of most of these early partners was rather limited and the motivations were so closely tied to EU objectives is clearly illustrated in the following trade statistics; in 2005, EFTA's total exports to FTA partners were 76.8 percent and its imports were 79.6 percent of its total. However, if you discount the EU25 the numbers become much less impressive. Total trade with FTA partners outside of the EU was only 3.7 percent of the total, or 13.9 percent of overall global trade if you exclude the EU25. The EFTA States have thus far been unable, or unwilling in the case of Norway especially, to complete FTAs with some of their largest trading partners outside the EU, namely Japan, Canada, China, Russia, India, ASEAN and Brazil. There is considerable pressure from business interests in the EFTA States to move in this direction.

Market Access and Economic Competitiveness
The second consideration is perhaps the most important driving force of the EFTA's third country policy today. EFTA's approach towards the fast growing Asian region is at the forefront of its policy goals today. Indeed, if you exclude Russia and count ASEAN as one entity then seven out of the possible eleven partners mentioned in the Liechtenstein priorities are in Asia. It is in Asia where the EFTA States bypassed the EU and successfully completed FTAs with Singapore and Korea. They are also currently in the middle of negotiations with Thailand and the GCC and have announced their intentions to start negotiations with

[98] EFTA Bulletin: Free Trade Relations p.14

Indonesia. Contacts are ongoing with India and Malaysia , and there is an interest in deepening trade ties with other potential partners in South-East Asia. The bilateral initiatives between Iceland/China and Japan/Switzerland and the implications contained therein to EFTA unity has already been addressed in this chapter.

Market access and competitiveness are manifested not only in industrial goods, but also in other sectoral issues. The ambition is to follow the Singapore and Korea models and negotiate comprehensive second generation agreements to further EFTA's competitive advantage in services, investment and intellectual propriety. The main motivation for the EFTA shift towards Asia can be traced to a political economy dynamic, namely strong pressure from domestic and EFTA based business lobbies. Indeed, the Icelandic, Swiss and Liechtenstein Chambers of Commerce all urged for an active policy for EFTA in Asia in a recent edition of the EFTA Bulletin. For example, the Icelandic Chamber of Commerce noted that '*For Icelandic businesses, it is therefore important to have comprehensive second generation FTAs not least in the rising markets of Asia.'*

Overall, the Asian dimension of EFTA's third country policy has generally been the most active and dynamic, driven by the EFTA States' interest in getting a solid toe-hold in the region and taking advantage of Asia's new found affinity for free trade agreements.

4.3.5.3 Enforcement of International Trade Policies

Finally, the EFTA States are economically motivated to strengthen the implementation of existing trade rules through their free trade agreements. For example, the Swiss are very offensive minded when it comes to strengthening IPR provisions because of the size and influence of their industrial and pharmaceutical sectors. Indeed, the benefits of the second generation agreements are of a qualitative nature, difficult to measure and assess. The dynamic prospect of strengthening and locking in rules and market access are crucial motivational factors in EFTA's third country policy.

4.3.5.4 Social, Political and Institutional Motivations

As a result of EFTA's institutional structure and limited mandate, other motivational considerations are subservient to economic interests. Indeed, domestic pressures to include provisions for social, environmental or core labour standards in EFTA's FTAs are weakly articulated and have largely fallen on deaf ears. The fact that the built-in Consultative and Parliamentary Committees, whose mandate it is to guide/influence member state policy, is more focused on EEA issues and EU matters attests to this claim. However, that is slowly beginning to change as the profile of the EFTA FTA network has increased in the past few years.

Regarding social matters, Ingunn Yssen, the International Secretary in the Norwegian Confederation of Trade Unions, recently made an argument in favour of including social clauses in international trade agreements to the EFTA Bulletin. She stated that, '*It is important that authorities, when entering into free trade agreements, include social clauses that are based on the core conventions of the International Labour Organization (ILO), or that they encourage cooperation between the social partners to develop workers' rights and human rights in parallel with extended trade.'* She takes as her inspiration the EU's FTA with Chile, which includes Articles that aim to establish a common consultative committee to promote dialogue and cooperation between the various economic and social organizations in

the two parties – including the possibility for wider civil society participation. Whether or not these calls for action gain any traction is doubtful and could anyhow complicate the flexible and apolitical approach characteristic of EFTA FTAs.

Politically, one can argue that the EFTA FTAs with the CEECs and the Euro-Med region complement the EU motivation to create a stable and prosperous European Cold War order. In a development context, the Norwegians have highlighted the agreement with SACU countries using political rhetoric. According to Lars Nordgaard, former Norwegian Head Negotiator, one of the goals of this agreement was the promotion of fair and equitable trade relations between developed and developing countries. He noted that '*technical assistance and asymmetrical provisions could help facilitate the implementation of the FTA, to enhance trade and investment opportunities and to support the SACU States' efforts to achieve sustainable economic and social development.'* However, the political impact of the EFTA States is marginal – perhaps negligent – and does not guide the third country policy. If anything, the willingness of the EFTA States to grant China market economy status without political conditionality is more characteristic of its overall apolitical approach.

Institutionally, EFTA's third country policy is in effect its sole remaining raison d'etre. Indeed, the formation and management of the EEA Agreement and the Secretariat in Brussels has been given the moniker of *EFTA at 3*, given that Switzerland is not legally a member. And the management of the intra-EFTA **Vaduz Convention** is not particularly important given the small size of intra-EFTA trade. Therefore, the third country policy is a major remaining institutional reason for EFTA's continued existence. The fact that EFTA negotiators have to justify this expenditure and institutional arrangement is guided by outcomes in the form of the completion of FTA agreements. Recent developments, such as Swiss displeasure with its overall contribution to the EFTA budget and individual members pursuing bilateral initiatives with larger partners illustrate the fragility of this institutional relationship.

4.3.6 Revealed Policy Preferences Based on the Substance of Agreements

According to the EFTA Secretariat, concluding second generation agreements that cover new areas such as services, investment, public procurement and competition are a crucial component of the overall EFTA third country strategy. Indeed, the scope of EFTA's agreements have generally evolved from first to second generation, evidenced by recent FTAs with Mexico, Chile, Singapore and Korea. This trend needs to be conditioned, however, with the caveat that second generation agreements can only be negotiated if the partner country is willing and able to reciprocate. The EFTA States have been flexible enough in the past to limit their ambitions and adapt to partner country constraints, although they prefer a generally broad and comprehensive scope of issues. But the interests of the EFTA States are not identical when it comes to the scope of its agreements. Individual EFTA States, especially Norway and Switzerland, place a higher priority on different sectors/issues. For example, the Swiss positions on IPR and investment are much more offensive than the Norwegian positions. This is the result of inherent economic priorities, development concerns and the fact that Norway faces constitutional issues regarding investment. Any internal differences to date have been managed successfully, often utilizing creative techniques such as a separate investment agreement between all of the EFTA States and Korea, excluding Norway. In order to better examine what these priorities entail and the outcomes achieved we are obliged to look at the substance of the agreements.

Industrial Goods. According to the EFTA Secretariat, all EFTA free trade agreements cover trade in industrial products, including fish, and processed agricultural products. With some minor exceptions, all tariffs on industrial products in the EFTA States are eliminated once an agreement enters into force. Independent research on a select number of agreements reveals this to be the case. The EFTA FTA with Morocco gives them duty free access to 99.8 percent of all tariff lines. The Chile agreement provides for 95.2 percent and easily obliges the WTO criteria of substantially all trade coverage.

The EFTA States do allow for asymmetrical provisions in the form of extended transition periods. For example, the EFTA-Mexico FTA allows for transition period of seven years. It is even longer for partners with more acute development needs, such as Morocco and Tunisia.

Agriculture. The EFTA States do not have a common agricultural policy. Trade in basic agricultural products is covered by bilateral arrangements between the individual EFTA States and the respective partner country. According to the EFTA Secretariat, EFTA's agricultural policy can be summed up in three points:

- EFTA States seek to promote free trade in all processed agricultural products and only maintain duties on sensitive raw materials incorporated in these products;
- Sensitive products of significant importance generally remain subject to duties;
- Each FTA should be tailor-made to accommodate the specific trade flow between the EFTA partner and EFTA in agricultural products.

In other words, the EFTA States are protectionist when it comes to their agricultural policies. Independent research reveals that tariff line coverage is limited.

Rules of Origin. The rules of origin in EFTA's FTAs for industrial goods concerning the definition of the concept of originating products and methods for administrative cooperation are based on the current European model. Indeed, the EFTA States use the Pan-Euro rules of origin model in their free trade agreements and have already stated their desire take active part in the Euro-med cumulation zone. For FTAs concluded outside of the Euro-Med zone, the EFTA States have updated the European model by using simplified and less restrictive list rules. These rules are generally modelled after the EU (if such an agreement exists) but some flexibility is usually included. For example, the EFTA FTA with Mexico allows for some adjustments in the specific rules list to take account of actual trade flows. As a result, there are more liberal rules of origin in sectors where either party is faced with a lack of raw materials of components (e.g. chemicals, machinery and car parts).

Overall, the EFTA States utilize restrictive and complex rules of origin in certain sensitive sectors, particularly in agriculture. (See table 8 on page 124). They also use restrictive rules regarding process on textiles and apparel, similar to the EU, but flexible measures have been incorporated into some agreements depending on the trading partner and trade flows. Again, the EFTA-Mexico FTA provides one such example where Mexico allocates quotas to the EFTA States for importation into Mexico of textile and apparel goods under a more liberal regime.

Commercial Instruments. In general, the EFTA Agreements contain provisions that address commercial instruments, such as anti-dumping, competition, state aid and safeguard measures. The EFTA States have yet to apply any commercial instruments to their trade partners and have even agreed on the abolition of anti-dumping provisions – substituting a more stringent competition policy instead – in their agreements with Chile and Korea. The

EFTA FTAs also deviate from WTO norms in their stricter time line for the application of safeguard measures, from four to eight years maximum in the WTO to one to three years maximum in the EFTA FTAs. Compensation shall also be offered prior to the adoption of any safeguard provisions and various exemptions on the application of safeguard measures on moral and security grounds are foreseen.

Government Procurement All of the EFTA States are signatories to the plurilateral WTO Government Procurement Agreement (GPA). As such, the EFTA States aim to include provisions of the GPA into their free trade agreements, or at least nudge partners who are signatories to take on certain provisions of the GPA. In their agreements with fellow GPA members Singapore and Korea, the GPA is incorporated into the agreements. With non-members, such as Chile, the EFTA threshold is identical to its GPA commitments, with the noted exception of the electricity sector. And the EFTA threshold with Mexico is also identical to its GPA commitments, while that of Mexico is identical with its NAFTA commitments. Here EFTA has followed the same approach as the EU to reconciling the GPA and NAFTA. For developing partners and first generation agreements like the EFTA-Morocco FTA, the ambition is limited to language professing the progressive liberalization of government procurement at some future date.

Services. The EFTA FTAs contain a positive list approach regarding service commitments save for the agreement with Mexico, which contains a negative list approach. GATS plus provisions differ between agreements, characteristic of EFTA's flexible approach and specific interests vis-à-vis different partners. For example, although most of the second generation agreements provide for new commitments on rules in financial services and telecommunications, the FTA with Mexico is unique in its provision on maritime transport services and a standstill provision on new discriminatory measures. In general, all of EFTA's FTAs contain commitments to eliminate further trade discrimination within given time frames.

For the EFTA States, services account for approximately 70 percent of their overall GDP. Trade in services is particularly important as their share of services to goods in total external trade constitutes a higher percentage relative to the other core entities. This is especially true for the two Nordic countries. According to the United Nations Common Database (UNCD), trade in services accounted for 36 percent of overall trade in Iceland, 28 percent in Norway and 20 percent in Switzerland in 2003.

According to the then Head of EFTA Division at the SECO, the EFTA motivation to strengthen services commitments through its FTA network stem a frustration and perceived lack of progress at the multilateral level.[99]

'The GATS negotiations were finished more than 10 years ago (1994). Considering the dynamism experienced in trade in services over this last decade, it is fair to assume that the commitments are not up to date... [discusses the lack of progress in the Doha Round]. In this situation, bilateral negotiations on services allow parties to move ahead and benefit from an 'early harvest' on the offers made in the WTO context.'

[99] Christian Etter 'Services and Investment', EFTA Free Trade Relations, *EFTA Bulletin* July-August 2006 pages 20-22.
http://secretariat.efta.int/Web/Publications/EFTABulletin/EFTABulletin/thirdcountry.pdf

Investment. The EFTA States were frustrated by the exclusion of investment provisions from the Doha Development agenda and regarded bilateral agreements as an easier and more conducive format for achieving their investment ambitions. The goal here is twofold: to improve legal security for foreign economic operators and to open new sectors to foreign investment. The EFTA States have WTO-plus investment measures with a number of partners. The FTA with Singapore is among the most progressive in terms of investment provisions, covering for the first time the right of establishment for nationals of each respective partner. It also foresees the possibility of direct dispute settlement between a Party to the agreement and an investor of another Party. An evolutionary clause and institutional cooperation mechanisms also encourage Parties to take further liberalizing measures once the time is ripe.

Intellectual Property Rights The EFTA States include a chapter on the protection of intellectual property in all their free trade agreements with third countries. Indeed, many industries in the EFTA States are based on research and development, such as Swiss pharmaceutical firms, and would benefit from a strong legal framework that would secure a level of protection. According to Ingo Meitinger, Deputy Head of the International Trade Relations Department of the Swiss Federal Institute of Intellectual Property, the idea behind the chapter on IPR in free trade agreements is to create a legal environment which is beneficial for all parties. While the agreements themselves share a reaffirm the Parties'[100] commitments to international agreements such as TRIPS, Paris Berne and Rome, specific substantive issues reveal that the EFTA approach is dependent on the partner country in question. For example, provisions for geographical indications vary widely from agreement to agreement. However, it can be said that EFTA FTAs are TRIPS-plus when it comes to the following IP issues: Industrial designs, patents and undisclosed information. (See Excel annex completes 3.8.1 to 3.8.6)

Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT). The EFTA States are closely linked to the EU SPS and TBT regulatory models. However, SPS and TBT commitments in EFTA's Free Trade Agreements do not go much beyond reaffirming the Parties' rights under the existing multilateral SPS and TBT agreements in the WTO.

The most comprehensive SPS measures are to be found in the EFTA-Chile FTA, which mentions consultation, cooperation, contact points and the prospect for developing bilateral arrangements including agreements between their respective regulatory agencies at some future point. Nowhere in any of EFTA's FTAs is there mention of mutual recognition, equivalence or harmonization measures. This might reflect the fact that the EFTA States do not want to forego any policy flexibility in their protected agricultural sectors.

Regarding TBT commitments, the EFTA FTAs contain three basic types of provisions on technical regulations:

- The FTA with Turkey contains an information procedure on draft technical regulations.
- Other FTAs, e.g. Morocco and Tunisia, contain no such information procedure but provide for consultation and cooperation. They also foresee notifications in

[100] In the case of EFTA this means the commitments of the individual countries as EFTA has no competence in intellectual property.

accordance with the weaker WTO Agreement on Technical Barriers to Trade (TBT).

- The FTAs with Mexico, Chile and Singapore state that the rights and obligations of the parties are to be governed by the WTO TBT Agreement. They specify areas of cooperation and call on the parties to facilitate the exchange of information. As is the case with the second category of FTAs, a consultation mechanism has been set up for these FTAs, the aim being to work out solutions in conformity with the WTO Agreement on TBT.

Environment and Labour. The EFTA States have to date not incorporated any environmental or labour standards into their free trade agreements. Calls for their inclusion have thus far been minimal but a growing awareness of the importance of EFTA's third country policy combined with an increased stature of environmental and labour concerns could galvanize influential voices within the EFTA States to demand their inclusion. However, as an intergovernmental organization with a limited commercial mandate, the inclusion of these issues could be problematic on a number of different levels.

4.4 JAPAN'S FTA POLICY

4.4.1 A Recent Development

Japan has been a latecomer to bilateral FTAs, with only three Agreements having entered into force (Mexico, Malaysia, and Singapore). Twelve other agreements are in varying stages of ratification, negotiation or exploration. Final Agreement documents have been published for Mexico, Malaysia, Singapore and the Philippines (see Annex 4 for details).

Agreements with Indonesia, Chile, Philippines and Thailand have all been signed and/or agreed upon in principle. According to a December 13, 2006 article in the *Asia Times*, FTAs with the Philippines, Chile, Indonesia and Brunei are all expected to go into effect by the end of 2007. The Agreement with Thailand has also shown recent progress toward signature. Negotiation of a bilateral agreement with Switzerland began on 11 May 2007.

Japan's relatively recent embrace of FTAs has contributed to the fact that the countries with which it has agreements account for only a small proportion of Japan's trade: 7.1 percent in 2005. This value increases to 33.8 percent if all FTAs in the pipeline or contemplated come into fruition but is still smaller than corresponding figures for the US (36 percent) or EU (60 percent) (Urata, 2007).

Japan calls most of its agreements Economic Partnership Agreements (EPAs) to indicate that they go beyond traditional FTAs to include agreements on the free movement of labour, tourism, intellectual property considerations, etc. There seems to be consensus (and admission by METI) that EPAs are practically similar to what other countries would call FTAs.

As will be developed more fully below, while Japan has particular motivations for negotiating FTAs, the shift from a multilateral-only approach to trade diplomacy can be seen as part of an Asia-wide change of tack. This change has been prompted by a range of factors, including concern about trade diversion effects of NAFTA, political incoherence in Southeast Asia following the Asian financial crisis of 1997-98, the failure of the Seattle and then the Cancun

Ministerial Meetings of the WTO, and a growing realisation of the limited trade liberalisation potential of APEC (Garnaut and Vines, 2006).

4.4.2 Key Motivations

A fear of being left out. The immediate response of senior Japanese politicians to the successful conclusion of negotiation of the Korea-US FTA was a vivid illustration of Japan's fear of being left out. Japanese foreign minister, Taro Aso, emphasised the importance of resuming free trade talks with Korea; chief cabinet minister, Yasuhisa Shiozaki, said that 'Japan is ready to resume FTA negotiations (with Korea) at any time and will intensify our call to restart the process at an early stage'; and Shinzo Abe, Japan's prime minister, widened the scope of the response by saying that an FTA with the United States was something 'Japan needs to consider as a future topic' (*Financial Times*. 4 April 2007).

Underpinning this reaction are data prepared by the Ministry of Economics, Trade and Industry (METI) suggesting that, as a result of closer integration, NAFTA's share of global FDI inflows grew from 20 percent to 35 percent between 1991 and 1999, while that of the EU grew from 40 percent to 50 percent from 1986 to 2000. METI, in saying that 'promoting EPAs is the key to energising economies', record the intra-NAFTA share of US exports as rising from 30 percent to 40 percent between 1990 and 1999, and the intra-EU share of EU Members' exports as growing from 60 percent to 80 percent from 1986 to 2000 (METI, 2005).

Dissatisfaction with progress in the multilateral trading system. Dissatisfaction with the pace of WTO negotiations is widely cited in the academic literature as a motivation for Japan's pursuit of regionalism, and the failure of the Seattle Ministerial in 1999 and of Cancun in 2003 can certainly be seen as being amongst the triggers for the subsequent spate of FTA activity. But in the official documentation of the Japanese government, the link is implicit rather than direct. Thus METI's explanation of the policy goals which EPAs are intended to address includes:

- 'Substantially expand and facilitate trade in goods and services' (a key goal of the DDA)

- 'Eliminate economic disadvantages caused by absence of EPA/FTA' (a task of ongoing MFN liberalisation and rules strengthening in the WTO).

- 'Promote acceptance of specialised and skilled workers' (in part the goal of mode 4 negotiations in the GATS).

Opportunities for deeper integration. Japan's pursuit of FTAs needs to be seen, at least in part, within the broader context of East Asia – still the main arena for Japan's regionalism. Among the triggers for regionalism in Asia was the experience of the Asian financial crisis of 1997-98, and the lessons drawn from it. The crisis, and the perceived failure of APEC to respond to it, prompted the regional economies to realise the importance of closer economic cooperation among themselves (Kawai, 2004). This extended well beyond trade, and included important financial sector cooperation, including the creation of a regional liquidity support arrangement, establishment of surveillance mechanisms and the development of Asian bond markets. But cooperation through trade was also part of the move to closer integration and helps explain, for example, the Japan-Singapore EPA initiative. Closer integration through

preferential trade arrangements was also prompted by the growing increase in intra-Asian trade intensity.[101] In 2001, East Asia's trade intensity index (at 2.22) was higher than that of either NAFTA (2,12) or the EU (1.67), suggesting a trade environment conducive to preferential deals (see the theoretical discussion above, where Lipsey points out that opportunities for trade creation are enhanced and risks of trade diversion reduced where an FTA groups countries that are already major trading partners). Closer formal integration represented therefore a response to crisis, an institutionalisation of the strong trade and economic links already established and an attempt to further intensify those linkages.

The institutionalisation of East Asian linkages is acknowledged by the Gaimusho as an important driver of Japan's pursuit of FTAs :

> 'Economic relations between Japan and East Asian countries in particular have deepened and developed rapidly, and given the necessity for the formation of a legal structure commensurate to these new relations, Japan has moved to promote EPAs.' (Ministry of Foreign Affairs, *Diplomatic Bluebook*, 2006)

The objective of concluding a comprehensive agreement between Japan and ASEAN (the Japan-ASEAN Comprehensive Economic Partnership) is presented, by METI, as an attempt to foster regional integration by building on individual bilateral agreements and, through the Japan-ASEAN Cumulative Rules of Origin, enabling companies located in the Japan-ASEAN region to do business with no tariffs.

Consistent with the, somewhat contrived, distinction drawn by Japan between EPAs and FTAs, Japan's promotion of regional liberalisation is thus portrayed as "an attempt to achieve deeper integration with its trading partners on a formal basis, going beyond reductions in border restrictions – pursuing investment liberalisation, promoting greater competition in the domestic market, and harmonising standards and procedures" (Kawai).

A stimulus to domestic reform. Among the objectives of Economic Partnership Agreements, METI includes the need to 'promote Japan's economic and social structural reforms'. As one of the strongest advocates of FTA analysis by the OECD Trade Committee, Japan invokes, among other things, the role of FTAs in helping promote domestic reform. And in some particular areas of reform, such as financial sector liberalisation, the role of regionalism has been emphasised.

A stimulus to the multilateral trading system. There appears to be no Japanese equivalent to the advocacy by the United States of 'competitive liberalisation'. Nevertheless, the foreign ministry states that 'Japan is also promoting rule-making appropriate for the diverse range of economic relations that exist among countries through Economic Partnership Agreements as a means to complement the functions of the WTO' (*Diplomatic Bluebook*). Beyond this, it has been observed that in negotiating EPAs, Japan's 'challenge is to maintain not only consistency with, but also to promote, the WTO liberalisation framework' (Kawai).

A complement to foreign policy objectives. As with all Core Entities, foreign policy and broader strategic objectives are a key element of Japan's drive to preferential trade arrangements. Referring to deliberations of the Council of Ministers on the Promotion of Economic Partnership on 21 December 2004, METI includes the following among the policy

[101] A calculation of intra-regional trade shares with a control for a region's relative size in world trade.

objectives of EPAs, under the heading of 'creation of international environment beneficial to our country':

- 'Community building and stability and prosperity in East Asia'
- 'Strengthen our economic power [and ability to] tackle political and diplomatic challenges'
- 'Reinforce Japan's position [in] international society'

Elsewhere, METI invokes what is perhaps the most pervasive of all the elements of Japan's economic diplomacy – the need to 'promote stable import[s] of natural resources and safe food, and diversification of suppliers'. The recently concluded FTA between Japan and Indonesia includes an energy security partnership clause that will oblige Indonesia to honour all existing energy-supply contracts with Japan, even if it imposes broad restrictions on oil and gas exports. Indonesia is currently Japan's largest supplier of natural gas, third largest supplier of coal and sixth largest supplier of crude oil. In return for Jakarta's undertakings on energy, Tokyo has offered to increase technical assistance in areas such as energy-saving measures and coal-to-liquid technology.

The Gaimusho observes that 'in concluding the EPA with Chile it is expected that Japan would secure a base in the South American region'.

The dominant and growing role of China is also a key element in Japan's foreign economic diplomacy. In the framework of FTAs, this is seen most clearly in Japan's advocacy of the Comprehensive Economic Partnership in East Asia (CEPEA), an FTA covering ASEAN+6 (Australia, China, India, Japan, Korea and New Zealand). This proposal is widely considered to be a counterproposal to that of China of an East Asia Free Trade Agreement covering ASEAN+3 (China, Japan and Korea). By extending the range of the grouping to include Australia, India and New Zealand, Japan would draw in important food and raw material suppliers, but would also dilute the influence of China, not least through the presence of India. Widening the net even further, Japan has also expressed support for the Free Trade Area of the Asia Pacific, a US proposal that would see APEC converted into a preferential arrangement. Japan is thus drawn in opposing directions: the pursuit of closer Asian integration with neighbours and key trading partners; and the widening of formal economic linkages beyond the East Asian region in order to pursue broader economic, foreign policy and strategic interests.

4.4.3 An Overriding Objective?

In the case of the United States it was concluded that while foreign policy considerations loom large, concern about improved market access was the most widely-held and strongly advanced motivation for the pursuit of FTAs; it was found to be the single most important direct driver of US FTA policy. In the case of Japan the situation is less clear. As with the United States, Japanese motivations based on the fear of being left out, dissatisfaction with the progress in the WTO and maximising opportunities for deeper integration all have an important market access dimension. METI has vaunted the Japan-Mexico EPA on the grounds that 'Mexico will become increasingly attractive as a base not only for exporting to the North American market but also to Latin America as well (Mexico has FTA agreements with Venezuela, Colombia, Bolivia Uruguay etc)'. And the Gaimusho has said of the Japan-Malaysia EPA that it 'provides a framework for expansion and liberalisation of bilateral trade and investment'. A primary aim of the FTA under negotiation with Switzerland will be to

increase Japanese exports of electronic goods, while also strengthening the protection of intellectual property rights. However, compared with the United States, Japan has been less successful in implementing FTAs that reflect a high level of ambition, albeit with exceptions, to improve market access.

Tariffs. Research for this study finds that tariff liberalisation in the Japan-Chile EPA goes further than in the earlier agreement with Singapore, for example liberalising 32 percent more of the total Japanese agricultural schedule and providing significantly more duty-free treatment of industrial lines. Against this, however, it must be acknowledged that Japan-Singapore is particularly restrictive – only India could claim to be more defensive on either agricultural or industrial goods in any of the studied agreements. So despite the shift following the agreement with Singapore, Japanese agreements as a whole remain relatively defensive. Both of the agreements examined in detail (with Singapore and Chile) exclude over half of Japan's agricultural schedule, and Japan's industrial schedules are more restrictive than for any of the other Core Entities. Japan has also made increasing use of longer transition times for sensitive sectors. With the 2005 agreement with Mexico, Japan extended transition times to 11 years; more recent agreements with Malaysia, Chile and Thailand include transitions of 16 years. And Japan-Mexico introduced tariff rate quotas for the first time. It is reported that in negotiation of the Japan-Switzerland FTA agricultural products will not be comprehensively covered (*Bridges,* Vol.11, Number 17).

Because of Japan's relative defensiveness, Japan's EPA partners are more liberal in agricultural and industrial goods, and have less resort to quotas than Japan. It might thus be argued, in purely mercantilist terms, that Japan through its EPAs is succeeding in gaining market access in its overseas markets without yielding commensurate concessions. But by offering less, Japan is presumably getting less in return than it might otherwise achieve, whilst also forgoing the opportunity to promote domestic reform and restructuring.

Rules of origin. While the Asian rules of origin regime, which is used by Japan, has been characterised by its simplicity, the present study finds that newer agreements tend to adopt a hybrid version of the more the restrictive criteria found in the NAFTA and Pan-Europe models.

Material from other sources tends to confirm these findings in respect of tariffs and rules of origin:

- Completion of the Japan-ASEAN Economic Partnership Agreement has been delayed by Japanese reluctance to reduce and then phase out agricultural tariffs and by its insistence on restrictive and often product-specific rules of origin, especially for agricultural products (Sally, 2006).

- Suspension of talks between Japan and Korea is essentially due to market access factors and reluctance (of both parties) to eliminate tariffs in sensitive areas, ranging from tobacco to gear boxes.

- In the Japan-Thailand EPA, Japan has exempted rice, cassava, beef, dairy, sugar and some other products; rules of origin are very restrictive on agricultural and fisheries products – at Japanese insistence; and Thailand has long transition periods for phasing out tariffs in steel and auto parts, and it has exempted large passenger cars from the agreement.

- In the Japan-Indonesia FTA, sensitive farm products such as rice, wheat and meat have been excluded from the agreement.

Safeguards. While, like other Core Entities, Japan's FTAs involve a shorter permissible duration for the use of safeguard measures than found in the WTO, the length of the permitted period has become progressively longer in each of Japan's three completed agreements (Singapore, Mexico and Malaysia).

Services. Japan has not been found, in the present study, to be strongly GATS-plus. Its treatment of new financial services tends to be more restrictive than in the GATS Understanding. Japan trails both Korea and Singapore in the depth of services liberalisation achieved in its FTAs. And in the Japan-Malaysia EPA Malaysia's services commitments offer only limited value added relative to the GATS (Fink and Molinuevo, 2007).

Investment. While the investment chapter in the Japan-Singapore EPA is based on NAFTA, it is weaker than the investment chapter in NAFTA.

Government procurement. While the Japan-Singapore EPA (2002) is WTO-plus in having thresholds that are lower than in the plurilateral Government Procurement Agreement, this is not the case in the more recent Japan-Mexico EPA (2005), where Japan has excluded its Defence Ministry from the central government entities. And in the Japan-Malaysia EPA (2006) there are no government procurement provisions.

Intellectual property rights. The present study finds that the majority of TRIPS-plus provisions are to be found in the FTAs of the United States and the European Union. Many of the agreements negotiated by Japan do not even include sections dealing with intellectual property rights.

One must conclude that either (1) for Japan, like the United States, improved market access is a key objective, but that the power of vested interests has so far constrained the realisation of the objective to a greater extent than it has in the United States, or that (2) for Japan, the principal motivation for FTAs is the attainment of foreign policy objectives – including security of raw material supplies - through formal arrangements of cooperation, rather than the aggressive pursuit of improved market access. Evidence would suggest that the first explanation is the most likely. It has thus been said (Urata, 2007) that Japan's ability to embark on a bold and strategic economic policy is undermined by its own domestic policy making dynamics. The demonstration of this, it is suggested, is the success of the agricultural and labour lobbies in avoiding substantial liberalisation commitments and in compromising the quality of Japanese FTAs. The problem is compounded by coordination arrangements within the Japanese bureaucracy. While an Overseas Economic Cooperation Council has been established to coordinate Official Development Assistance (ODA) strategies, no such Council has been established to assess trade strategies. There is a Council of Ministers on the Promotion of Economic Partnership Agreements, but it is not active and is not involved in discussion of EPA strategies (Urata).

A related question arises from the apparent lack of a blueprint for Japan's FTAs. As already noted, there is a mixture of positive and negative listing from one agreement to another. There is not a consistent treatment of domestic tariff schedules in Japan's FTAs. And rules of origin are similarly varied. For example, the Japan-Mexico agreement is one of the strictest overall,

with regional value content (RVC) at around 50-60 percent - equivalent to NAFTA levels – and with specific rules on tobacco for example requiring a 70 percent RVC and no possibility for cumulation. The Japan-Malaysia agreement on the other hand, has rather lenient rules that are less stringent in terms of content requirements. This might reflect a deliberate flexibility on Japan's part, so that agreements can reflect particular circumstances and differing wishes of Japan's partners. It might equally, however, reflect again domestic political constraints on the implementation of a consistently ambitious approach to FTAs. Only with the conclusion of more agreements is the picture likely to become clearer.

4.5 SINGAPORE'S FTA POLICY

4.5.1 Introduction

Singapore has become one of the leading exponents of FTAs over the recent past. Although a leading member of ASEAN and a founding member of APEC, Singapore pursued an active policy of unilateral and multilateral liberalisation until the mid-to late 1990s. Most of Singapore's FTAs began to attract the attention of its trading partners around the world with the Singapore – New Zealand Closer Economic Partnership Agreement in 1999. But it is important to bear in mind that Singapore had been an active member of ASEAN from its inception. In 1991 Singapore was one of the main movers behind the aim of creating the Asian Free Trade Agreement, with the aim of eliminating tariffs within ASEAN by 2010. [102] AFTA can be seen as motivated by a desire to promote economic integration within the region and as a response to developments elsewhere, such as the deepening of regional integration within Europe, with the EU's Single Market programme and the beginning of negotiations on NAFTA.

Singapore has conducted a policy of unilateral liberalisation that has resulted in essentially zero applied tariffs. Much of its trade policy has therefore been concerned with tariff binding, deeper integration or regulatory issues. In this sense it contrasts with many developing countries or emerging markets for which tariffs are still a major policy issue. Singapore's interest in negotiating deeper integration issues dates back to the mid 1990s when it was instrumental in promoting AFAS, the ASEAN Framework for Services (signed in 1995), the ASEAN Investment Area AIA agreement, signed in 1995 and the ASEAN Framework Agreement on Mutual Recognition Agreements, signed in 1998. These initiatives sought to promote deeper integration within ASEAN and provided Singapore with experience in negotiating deeper integration agreements.[103]

Singapore's trade policy was therefore already well prepared for negotiations on more comprehensive trade agreements than straightforward tariff liberalisation. Indeed, zero applied tariffs in Singapore made such negotiations of little value. This meant Singapore was well placed when the general shift to negotiating deeper FTAs came in the late 1990s, early 2000s.

[102] In order to accommodate the CLMV Cambodia, Laos, Myanmar and Vietnam, the deadline for total tariff elimination was extended to 2015. But remained at 2010 for the more developed ASEAN members including Singapore.

[103] Singapore's first experience with such measures probably dates from its involvement in similar work in APEC.

4.5.2 Motivations

Singapore like the other core entities has been motivated by a number of factors to negotiate FTAs. These include strategic reasons, such as desire to address China's growing presence in the region and to retain US engagement. ASEAN was initially a security arrangement for south east Asia in the face of the communist threat from the North. Singapore's FTA policy has continued to be influenced by developments in China. For example, the ASEAN plus 3 negotiations represent a means of placing relations with China on a sound footing. The Japan Singapore New Age Economic Partnership (JNEPA) negotiated between 2000 and 2003 was also in part motivated by a desire to respond to the growing influence of China. The US Singapore FTA (USSFTA) concluded in 2003 was also partially motivated by a desire to consolidate ties with the US for political and strategic reasons.

Commercial motivations have taken a number of forms. First, Singapore has sought to establish business links with all regions and to defend Singapore's role as a hub in the global economy. Singapore has long held a position as a regional hub, but the negotiation of FTAs with all regions appears to be an extension of this strategy with a view to establishing Singapore as a hub in the wider global economy. This may for example, explain Singapore's interest in FTAs that include investment and e.commerce. Singapore's agreements with Jordan (SJFTA) in 2003, EFTA and the Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA, which groups Brunei, Chile, New Zealand and Singapore, and which is also known as P4) were all justified in terms of establishing firmer foundations for trading ties with the various continents.

Singapore has also been motivated by the actions of other parties. The Asian financial crisis of 1997/98 is generally seen as the trigger for the growth of FTAs in the Asian region. (Dent, 2005) This led to a recognition of the need for the region to strengthen the institutional basis for trade and cooperation. Hence the efforts to strengthen ASEAN and the FTAs with Japan. At the same time the crisis influenced views of the region in the US and other members of APEC. The US began to see APEC as ineffective and ASEAN as immobile as the Asian economies focused on their domestic problems. This helped trigger the more active use of FTAs by US and other APEC states (New Zealand) as a means of supporting economic integration with these countries. As the US began to pursue FTAs this led to emulation by Singapore and other Asian states.

By the early 2000s Singapore had developed considerable negotiating expertise in FTAs. It was therefore ready to negotiate with the big beasts of the EU and US. The EU, which was still maintaining its *de facto* moratorium on new FTA negotiations did not respond to Singapore's request for an FTA.[104] If one looks at the timing of Singapore's FTA negotiations, (see Chart 5) it suggests a managed process in which Singapore's negotiating capacity was used in a rational fashion. As in all the Core Entities one must therefore assume that there were institutional interests in negotiating FTAs among Singapore's trade negotiators.

[104] The European Commission argued that there was not a 'business' case for an FTA with Singapore as the market was largely open anyway.

4.5.3 General Features of Singapore's FTAs

There are three general features that characterise Singapore's policy on FTAs. First, there is the apparent willingness to negotiate FTAs with a wide range of different partners, from Jordan to the USA. As noted above, this is linked to the aim of establishing Singapore as a hub for investment and multinational corporate activity. FTAs that protect investment and intellectual property rights and otherwise facilitate global production and investment, will tend to make Singapore an attractive location for multinational companies. Companies with a substantial presence in Singapore will benefit from such agreements regardless of their origin. Therefore FTAs combined with Singapore's well endowed human capital and infra-structure make for a rational approach to globalisation by a small city state.

Second, all Singapore's FTAs, at least since the JSEPA have involved deeper integration issues. The JSEPA may have excluded agriculture altogether, but it did include services, investment, government procurement and stronger bilateral dispute settlement provisions. The JSEPA was clearly intended to break new ground in the scope of Asian FTAs. (Dent, 2003) Singapore's agreement with EFTA (ESFTA) was also fairly comprehensive with a strong focus on services. It was the US Singapore FTA however, that set the standard for future agreements. This was comprehensive with 21 chapters covering the range of topics included in the NAFTA model. The inclusion of investment, GATS-plus commitments on services and TRIPs plus commitments, clearly made this WTO-plus. (Koh and Lin, 2004) The Singapore – Jordan FTA appeared to be motivated by a desire to match the US – Jordan FTA and thus the 'gold standard' being set by the US in its FTA policy. Finally, the TPSEPA (or P4) which covered trade in goods, TBT/SPS measures (including detailed provisions on standards, mutual recognition and conformance assessment), services, public procurement, intellectual property right, competition and dispute settlement, showed that Singapore's desire to include deeper integration issues was not due to pressure from more developed FTA partners. The TPSEPA/P4 even included environment and labour issues. This desire to negotiate comprehensive FTAs was also reflected in the India Singapore Comprehensive Economic Cooperation Agreement (CECA) of 2005 that also included the whole range of issues, including goods, service, investment protection, mutual recognition for TBT and SPS, movement of persons and cooperation in intellectual property. Finally, the Korea-Singapore FTAs (KSFTA) concluded in August 2005 follows a similar pattern.

The third characteristic of Singapore's FTAs is that they are pragmatic in the sense that they allow their FTA partners wide flexibility in terms of the depth and coverage of the agreements. This is probably a feature of the limited negotiating leverage of Singapore given its previous unilateral liberalisation and small market. The result however, is that there is no uniformity in the detailed substance of Singapore's FTA partner commitments.

4.5.4 The Substance of Singapore's FTAs

The pragmatic or flexible nature of Singapore's FTA policy in terms of its expectations of its FTA partners is revealed by a look at the detail of the various policy areas For tariffs Singapore generally liberalises 100 percent of its tariff lines immediately on the entry into force of an FTA. Only 6 of 10,000 tariff lines have been excluded (these relate to alcoholic drinks). The liberalisation is straight forward and simple, achieved often by means of a single sentence. This compares to the very complex schedules of the EU, EFTA and Japan. When it comes to liberalisation by Singapore's FTA partners however, things look very different. In

the FTA with Japan 81 percent of all agricultural tariff lines were excluded from any liberalisation, with the result that agriculture was effectively excluded from the FTA altogether. In the case of the 'Comprehensive' Economic Partnership agreement with India, India committed to liberalise just 25 percent of all industrial tariff lines after a transition period and only 12 percent of agricultural tariff lines. Singapore has also shown flexibility when it comes to the structure of tariff schedules, allowing either positive or negative listing by its FTA partners.

A similar picture emerges in rules of origin. There are virtually no uniform rules of origin in Singapore's preferential agreements. The FTA with the US contains the more than 300 pages of NAFTA origin rules designed to address the interests of US sectors such as textiles. The FTA with EFTA uses PanEuro rules and with Korea a complex combination of CTC, CTH, ECT and VC rules. On the other hand Singapore's agreements with developing countries, such as Jordan use a simple, liberal 35 percent value content rule across the board. This diversity of rules of origin suggests that Singapore has a veritable noodle bowl of rules of origin and does not exhibit any of the kind of counter trend observable in Europe towards more harmonisation. This is clearly one of the down sides of a flexible approach to FTAs. Singapore's FTAs may also be becoming more complex as its Asian FTA partners begin to develop more complex rules of origin.

When it comes to commercial instruments Singapore follows the basic WTO precedent. But in commercial instruments flexibility has had the positive effect of allowing experimentation. Thus anti-dumping rules have been linked to competition in a number of Singapore's FTAs and the criteria for assessing dumping have been tightened in a fashion that has not been possible at the multilateral level.

Singapore has a sophisticated and centralised system for dealing with technical barriers to trade and regulating risk. It is therefore able to negotiate comprehensive agreements covering mutual recognition, standards harmonisation and cooperation across a range of standards-making and certification issues. This is reflected in the agreements Singapore has signed with Korea (KSFTA) and P4. Singapore is also a signatory to a range of mutual recognition agreements under the APEC framework and is negotiating mutual recognition agreements with its trading partners in Asia and in the P4. On the other hand the FTA with the USA, which is otherwise WTO plus in many respects, has only very modest provisions on TBT and SPS and adopts the preferred approach of the US which is for a minimum of institutional structures. There is no joint committee but only 'coordinators' for TBT measures to deal with market barriers on a pragmatic basis. So once again Singapore tailors the content of its FTAs to the preferences of its FTA partners.

In government procurement Singapore is a signatory of the WTO's GPA. In agreements with other signatories to the GPA there is therefore simply a reference to existing obligations. Otherwise Singapore appears to be only slightly GPA plus in that some of the thresholds used to determine coverage are slightly lower than the GPA thresholds. In FTAs with developing partners, Singapore like Japan is happy to drop procurement if the partner is not keen to include it.

On services, intellectual property and investment Singapore's FTAs have been generally WTO plus. Commitments on services have been GATS plus and there has been a tendency for Singapore to negotiate fairly ambitious provisions on skilled/essential workers. There is also a mutual recognition agreement with Korea for engineers. The flexibility/pragmatism in service

negotiations has taken the form of accepting the preferred scheduling approach of its FTA partners, i.e. either positive or negative listing. In investment, Singapore has effectively adopted the NAFTA approach in its FTAs provided its FTA partners have been willing to accept this. In other words the investment provisions are comprehensive, including pre and post investment national treatment and investor state dispute settlement. The Singapore US FTA constituted the 'gold standard' for IPR provisions when it was negotiated, and therefore included a number of TRIPs plus provisions.

4.5.5 Asymmetry Provisions

By virtue of the flexible approach of Singapore to FTAs, there is plenty of scope for asymmetric provisions. It has clearly been willing to accept less by way of commitments from some of its developing country partners. The CEP with India for example, constitutes a highly asymmetric agreement in terms of tariffs, which no doubt reflects the relative size the markets concerned as much as anything.

Singapore provides technical assistance to its Asian FTA partners that are less developed.

Chart 5 Singapore's FTAs

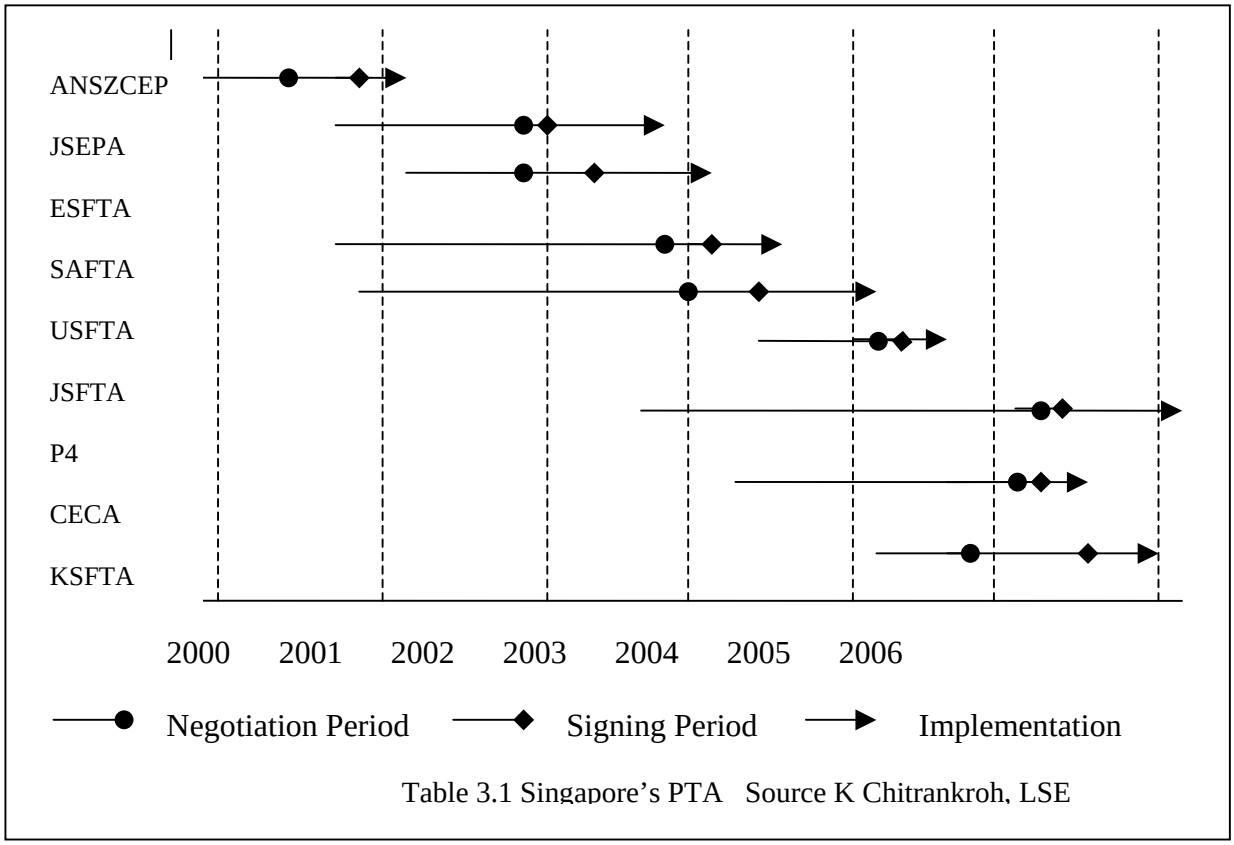

Table 3.1 Singapore's PTA Source K Chitrankroh, LSE

5.0 CONCLUSIONS: LOOKING AHEAD

As indicated in the introduction to this study, there is scope to explore more intensively the effects on trade and investment of FTA liberalisation in specific products and services. The present study suggests that while overall measures of trade creation and trade diversion may not be striking, there can be pronounced effects at a more disaggregated level.

A discussed in the Executive Summary this study has identified, with some confidence, a number of broad trends in the evolution of FTAs. It has also identified some recent developments where the outcome is less certain, but potentially important. These developments also warrant closer attention, and could be the focus of any follow-up analysis or discussion.

With respect to the Core Entities' approaches to FTAs:

- How will US policy on FTAs (and trade policy more broadly) be affected by the accord reached between the US Congress and the Administration on 10 May 2007 and by the expiry of Trade Promotion Authority?
- How successful will be the EU's efforts to negotiate more ambitious FTAs with Korea, due to be completed by the end of this year, ASEAN and India, both of which are on a longer time scale? Will the EU continue to show 'flexibility' in its FTAs or will it move to a more uniform and thus hard cutting edge?
- Will Japan's agreements become more consistently ambitious or will domestic political considerations continue to constrain their development?
- Will the coherence and integrity of regional initiatives such as EFTA and ASEAN be weakened by their members' pursuit of bilateral deals with third parties? How will the role of China influence this development?

With respect to the treatment of key policy areas in FTAs:

- Will agriculture continue to be carved out, or will FTAs begin to erode the existing levels border protection?
- Are rules of origin set to become ever more complex as more emerging markets negotiate more sophisticated FTAs? Will the NAFTA and PanEuro models of rules lists come to dominate? Will the desire to introduce simpler rules for developing country members of FTAs result in yet more confusion in rules of origin, or provide the catalyst for simpler rules all round?
- Will FTA members steadily reduce their resort to contingency measures ?
- Will the right of non-establishment become more common?
- Will bilateralism and the pursuit of agreements between countries that are both geographically and economically disparate weaken the pursuit of regulatory harmonisation?
- Will FTA focus on competition policy and investment grow or diminish?

A common thread through all of these outstanding questions is the remarkable growth in recent years of bilateral trade arrangements. It is the development of bilateralism that might be proposed as a focus both for examination of the present study and for any planned follow up.

Annex 1

The United States of America Free Trade Agreements

Summary of Agreements and Negotiations as at August 2007

Overview

1. The United States has successfully negotiated and implemented seven Free Trade Agreements (FTA) since the United States-Israel FTA of 1985. Six of the seven agreements were negotiated and implemented under the Bush Administration between 2001 and 2006.
2. Free Trade Agreements have been implemented with Australia, Bahrain, Chile, Israel, Jordan, Morocco, and Singapore.
3. FTAs have been signed, but not yet ratified and/or implemented, with the CAFTA-DR countries, Colombia, Oman, Peru and Korea. Negotiations have been concluded with Panama, but an agreement has not yet been signed.
4. According to the Office of the United States Trade Representative, FTA negotiations are either ongoing or intended to begin with Malaysia, Thailand and the United Arab Emirates.
5. The United States has also negotiated 40 Bilateral Investment Treaties (BITs) and 24 Trade and Investment Framework Agreements (TIFA), agreements it considers steps toward future FTAs.

Agreements Implemented (7)

1. **Australia**
   Implemented 1 January 2005
2. **Bahrain**
   Implemented 1 August 2006
3. **Chile**
   Implemented 1 January 2004
4. **Israel**
   Implemented 1 September 1985
5. **Jordan**
   Implemented 7 December 2001
6. **Morocco**
   Implemented 1 January 2006
7. **Singapore**
   Implemented 1 January 2004

Agreements Signed and/or Agreed Upon in Principle (5)

1. **CAFTA-DR**
   The United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic agreed in principle to the CAFTA-DR in August 2004.

   The treaty has been entered into force by:

United States: 2 August 2005
El Salvador: 1 March 206
Guatemala: 1 July 2006
Honduras: 1 April 2006
Nicaragua: 1 April 2006
Costa Rica has not ratified CAFTA-DR - The international Affairs Committee of the Costa Rican Congress approved CAFTA-DR on 12 December 2006. Final ratification by the Costa Rican Congress has been delayed by an expected revision by the Costa Rican Supreme Court.
The **Dominican Republic** has ratified CAFTA-DR but has not set a date for implementation.

2. Colombia

Negotiations for a bilateral FTA were launched on 18 May 2004 as part of the negotiations for a US-Andean Free Trade Agreement. Signed by Deputy US Trade Representative John Veroneau and Colombian Minister of Trade, Industry and Tourism Jorge Humberto Botero on 22 November 2006. The accord reached between the Congress and the Administration on 10 May 2007 is expected to help facilitate congressional approval. However, leading Congressional Democrats, including House Speaker Nancy Pelosi (California) and Ways and Means Committee Chair Charles Rangel (New York) have said they would oppose the FTA until there is concrete evidence of reduced violence against trade unionists.

3. Oman

Signed by President Bush on 26 September 2006 and approved by Congress and Senate in June and July. Agreement has not yet been implemented.

4. Peru

Negotiations for a bilateral FTA were launched on 18 May 2004 as part of the negotiations for a US-Andean Free Trade Agreement. Signed by US Trade Representative Rob Portman and Peruvian Minister of Foreign Trade and Tourism Alfredo Ferrero Diez Canseco on 12 April 2006. The agreement has not yet been ratified. The accord reached on 10 May between the Congress and the Administration is expected to facilitate congressional approval. Leading Democrats have declared the FTA as being worthy of support but require a change in Peruvian labour law prior to giving approval..

5. Korea

Negotiations were completed at the end of April 2007 and the text finalized on 30 June. However, Leading Democrats, including House Speaker Pelosi and Ways and Means Chair Rangel have said they will oppose the FTA because of the imbalance in US-Korea trade in automobiles.

<u>Agreements with Negotiations Concluded but No Final Agreement (1)</u>

1. Panama

Completed negotiations on 19 December 2006, with the understanding that it is subject to further discussions regarding labor. Democrat leaders have declared

the FTA as being worthy of support but require a change in Panamanian law prior to giving approval.

Agreements in Negotiation (4)

1. **Ecuador**
   Negotiations for a bilateral FTA were launched on 18 May 2004 as part of the negotiations for a US-Andean Free Trade Agreement.

2. **Malaysia**
   US Trade Representative Rob Portman announced the intention to negotiate a Free Trade Agreement with Malaysia on 8 March 2006.

3. **Thailand**
   President Bush first announced his intent to enter FTA negotiation in October 2003. Progress was made through six rounds of negotiations in 2004 and 2005, but significant work continues.

4. **United Arab Emirates**
   On 15 November 2004 the USTR announced its intent to negotiate an FTA. Negotiations have been ongoing since March 2005.

Potential Negotiations (?)

1. Negotiations could be forthcoming with many countries that have signed either a Bilateral Investment Treaties (BITs) or Trade and Investment Framework Agreements (TIFA) with the United States. All potential FTA partners must have signed a TIFA with the US.

2. Free Trade Agreement negotiations are most likely to occur with countries that are potential members of the Free Trade Area of the America (FTAA), countries that are part of the Association of South East Asian Nations (ASEAN), and Middle Eastern countries affected by the Middle East Free Trade Initiative (MEFTA).

3. The list of countries that have signed either BITs or TIFA include:
   Albania, Argentina, Armenia, Azerbaijan, Bangladesh, Bolivia, Bulgaria, Cameroon, Democratic Republic of the Congo (Kinshasa), Democratic Republic of the Congo (Brazzaville), Croatia, Czech Republic, Egypt, Estonia, Georgia, Grenada, Jamaica, Kazakhstan, Latvia, Lithuania, Moldova, Mongolia, Mozambique, Poland, Romania, Senegal, Slovakia, Sri Lanka, Trinidad & Tobago, Tunisia, Turkey, Ukraine, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, the members of COMESA, West African European Monetary Union, Afghanistan, Algeria, the members of ASEAN, Cambodia, Ghana, Kuwait, Mauritius, New Zealand, Nigeria, Pakistan, Qatar, Saudi Arabia, South Africa, Yemen.

Annex 2

European Union FTAs and RTAs
Summary of Agreements and Negotiations, Dec.22, 2006

Customs Union entered into force (2)

1. Andorra
    a. 01.07.1991
2. Turkey
    a. 31.12.1995

FTAs /RTAs entered into force (20)

1. Bulgaria
    a. Europe Agreement
    b. 31.12.1994
2. Romania
    a. Europe Agreement
    b. 01.05.1993
3. Faroe Islands (Denmark),
    a. Free Trade Agreement
    b. 01.01.1997
4. Switzerland
    a. Free Trade Agreement
    b. 01.01.1973
5. Macedonia,
    a. Stabilisation and Association Agreement
    b. 01.05.2004
6. Croatia
    a. Stabilisation and Association Agreement
    b. 01.02.2005
7. Chile
    a. Association Agreement and Additional Protocol
    b. 01.02.2003
8. Mexico
    a. Economic Partnership, Political Coordination and Cooperation Agreement
    b. 01.07.2000
9. South Africa
    a. Trade, Development and Co-operation Agreement
    b. 01.01.2000
10. Certain Overseas Countries and Territories (OCT/PTOM II)
    a. Association Agreement
    b. 01.01.1971
11. Algeria
    a. Association Agreement (EU-Mediterranean Agreement)
    b. 01.09.2005
12. Egypt

a. Association Agreement (EU-Mediterranean Agreement)
b. 31.12.2003

13. Israel
a. Association Agreement (EU-Mediterranean Agreement)
b. 01.06.2000

14. Jordan,
a. Association Agreement, (EU-Mediterranean Agreement)
b. 01.05.2002

15. Lebanon
a. Interim Agreement (EU-Mediterranean Agreement)
b. 01.03.2002

16. Morocco
a. Association Agreement (EU-Mediterranean Agreement)
b. 01.03.2000

17. Palestinian Authority
a. Association Agreement, (Interim EU-Mediterranean Agreement)
b. 01.07.1997

18. Syria
a. Co-operation Agreement (EU-Mediterranean Agreement)
b. 01.07.1977 (Negotiations for Association Agreement concluded in 2004, but agreement not yet signed)

19. Tunisia
a. Association Agreement (EU-Mediterranean Agreement)
b. 01.03.1998

20. ACP countries
a. Partnership Agreement (Cotonou Agreement)
b. 01.03.2000

FTAs/ RTAs signed and/or agreed upon in principle (1)

1. Albania

a. Negotiating Directives for a Stabilisation and Association Agreement (SAA) adopted by the Council on 21-23 October 2002

b. Negotiations formally opened on 31January 2003

c. The Stabilisation and Association Agreement with Albania and the Interim Agreement with Albania were signed in Luxemburg on 12 June 2006. Date of entry into force of IA is not defined yet but expected in early 2007.

FTAs /RTAs in Negotiation Phase (10)

1. ACP countries
a. Draft directive adopted by the Commission on April 2002; Council Decision on 17 June 2002
b. Negotiation of Economic Partnership Agreements
c. 1st phase "all ACP" launched on 27September 2002, 2nd phase "regional negotiations" began in October 2003
d. Negotiations are ongoing, conclusion expected by 2008

2. Euro-Mediterranean Free Trade Area

a. At a bilateral level, every Mediterranean country involved in the EuroMed Partnership, except Syria, has concluded and currently implements Association Agreements with the EU. Collectively, the Association Agreements replace the previous generation of cooperation agreements signed in the 1970s and constitute the foundation for the FTA.
b. At the 5th Trade Conference held on 24 March 2006 in Marrakech, EuroMed ministers confirmed the ongoing negotiations with a view to conclusion in 2010.

3. Mercosur
   a. Negotiating directive for an Association Agreement 13 September 1999
   b. Negotiations are ongoing but slow progress due to DDA

4. Gulf Cooperation Council (GCC)
   a. Revised & updated Negotiating Directives for an FTA from July 2001
   b. Negotiations are ongoing

5. Bosnia and Herzegovina
   a. Negotiating Directives on a Stabilisation and Association Agreement adopted on 21/11/2005
   b. Negotiations are ongoing

6. Iran
   a. Negotiating Directives June 2002
   b. Negotiations are ongoing

7. Iraq
   a. Negotiating Directive March 2006
   b. Launch 20.11.2006

8. Kazakhstan
   a. Recommendation from the Commission to the Council to authorise the Commission to open negotiations for a new Enhanced Agreement Negotiation mandate adopted by the Council on 13/11/2006
   b. Negotiations are ongoing

9. Montenegro
   a. Negotiating Directives on a Stabilisation and Association Agreement adopted on 3/10/2005 for negotiations with the State Union of Serbia and Montenegro. Following Montenegrin independence in May 2006, new negotiating directives adopted on 24/7/2006
   b. Negotiations are ongoing

10. Serbia
   a. Negotiating Directives on a Stabilisation and Association Agreement adopted on 3/10/2005 for negotiations with the State Union of Serbia and Montenegro. Following Montenegrin independence in May 2006, revised negotiating directives adopted on 24/7/2006
   b. Negotiations put on hold on 3 May 2006 due to Serbia's lack of cooperation with ICTY. Negotiations to resume once full cooperation with ICTY reached.

11. South Korea
   a. Negotiating mandate adopted in April and negotiations under way. Expectation is for a quick completion due to political timetable in Korea.

12. India
   a. During EU-India summit on 7 September 2005, the EU and India adopted a Joint Action Plan to further increase bilateral trade and economic cooperation.

b. The EC commissioned consultant reports on the feasibility of an EU-India FTA.
c. Negotiating mandate adopted in April.

FTAs/RTAs in Exploration Phase (9)

2. ASEAN
   a. ASEAN-EU Vision Group Report on possible FTA endorsed by the EC and ASEAN governments in May 2006.
   b. If regional approach fails, then bilateral FTAs planned.

3. CAN
   a. At the EU-LAC summit in May 2002 the door for future negotiations of an EU-CAN FTA was opened.
   b. As long as Venezuela is legally a CAN member, it is likely to veto any negotiation with the EU. Once Venezuela formally leaves the group the issues is likely to be revived. (negotiations now started)

4. CAFTA
   a. At the 4th EU-LAC summit in May 2006, the decision on the launch of negotiations of an EU-CAFTA FTA was taken.
   b. The EC is currently working on a draft mandate to put to the Council. (negotiations now started)

5. Canada
   a. Recommendation from the Commission to the Council to authorise the Commission to negotiate a bilateral Trade and Investment Enhancement Agreement (TIEA) with Canada (15 June 2004).
   b. Under discussion in Council.

6. China
   a. Negotiating mandate to launch negotiations on a new Partnership and Cooperation Agreement with China, including aspects of trade and investment, was approved by the Council December 2005.
   b. Negotiation formally launched at the EU-China Summit September 2006, but no meeting scheduled yet. Negotiation modalities still to be agreed.

7. Russia
   a. Recommendation from the Commission to the Council to authorise the Commission to open negotiations for a new Enhanced Agreement.
   b. Negotiation mandate adopted by the Council on 13/11/2006.

8. Ukraine
   a. Recommendation from the Commission to the Council to authorise the Commission to open negotiations for a new Enhanced Agreement. Recommendation not yet adopted.

9. Moldova
   a. Partnership and Cooperation Agreement (PCA) between Moldova and the EU was signed in 1994 and entered into force on July 1998.
   b. Art.4 of the PCA states that the parties shall examine jointly whether circumstances allow the start of negotiations on the establishment of an FTA.
   c. No recent progress.

Annex 3

EFTA's Free Trade Agreements

EFTA's Free Trade and Joint Declarations on Co-operation Agreements
Summary of Agreements and Negotiations, December 21, 2006

Overview

1. The EFTA States claim to have the world's largest free trade network, covering 51 countries and territories, and reaching a population of 900 million people on 4 continents. Regardless if this is the largest network or not - and it depends very much on interpretation - the EFTA States are today at the forefront of the FTA 'game'.

2. EFTA and the EEC were the first two successful examples of regional trade agreements as foreseen by Art. XXIV of the GATT. In addition to the bilateral agreements signed with the EEC in the mid-70s, the EFTA countries, as a group, signed their first FTA with Spain in 1979.

3. Since 1990, EFTA's third country policy has gone through three distinct phases:

- 1990-1995 – Basic FTAs signed with the transition economies of central and eastern Europe,
- 1995-2000 – Basic FTAs signed with countries on the southern and eastern rim of the Mediterranean. As with the first phase, the second phase was a response to EU initiatives for regional integration. This policy was known as *Parallelism* and it was meant to avoid any discrimination for EFTA's economic operators vis-à-vis the EU.
- 2000-present – EFTA goes global and becomes offensive in its pursuit of FTAs. These trans-continental agreements are also broader in scope in that they cover new areas such as services, investment, public procurement and competition.

4. In addition to Free Trade Agreements, the EFTA States have also signed a number of Joint Declarations on Co-operation. These are framework agreements signaling both sides' desire to pursue a FTA at some point in the future when the time is 'ripe'. It institutionalizes the relationship as the parties meet in a Joint Committee, usually every two years, to review their co-operation on trade and related matters and to discuss any other issues of mutual interest.

5. The EFTA States are increasingly using feasibility studies as a first method to explore the possibility of furthering trade relations. For instance, the groundwork for the EFTA-Republic of Korea FTA was established by a feasibility study.

6. The EFTA FTAs have thus far been limited to relatively small or medium sized economies. But the coherence of EFTA as one negotiating partner will be increasingly challenged as the pressure to conclude FTAs with more significant economies mounts. For example, Iceland is negotiating a FTA with China outside of the EFTA framework. Switzerland is also conducting a bilateral Joint Feasibility study with Japan without its EFTA partners.

Agreements Finalised (19)

1. **EFTA 4 (Vaduz Convention)**
    a. Entered into force on June 1 2002
2. **EU 25**
    a. EEA (Iceland, Norway and Liechtenstein) Entered into force on May 1 1994
    b. Bilateral Agreements (Switzerland) Entered into force June 21 1999
3. **Bulgaria**
    a. Entered into force on July 1 1993
4. **Croatia**
    a. Entered into force on April 1 2002
5. **Faeroe Islands**
    a. Bilateral Agreements with all EFTA States. Iceland signed a comprehensive trade agreement, creating a common market, with the Faeroes last year
6. **Macedonia**
    a. Entered into force on 1 May 2002
7. **Romania**
    a. Entered into force on 1 May 1993
8. **Turkey**
    a. Entered into force on 1 April 1992
9. **Morocco**
    a. Entered into force on 1 December 1999
10. **Tunisia**
    a. Entered into force on 3 May 2005 (For CH and FL)
11. **SACU 5**[105]
    a. Signed 26 June 2006 – Awaiting ratification
12. **Israel**
    a. Entered into force on 1 January 1993
13. **Republic of Korea**
    a. Entered into force on 1 September 2006
14. **Lebanon**
    a. Anticipated entry into force on 1 January 2007
15. **Palestinian Authority**
    a. Entered into force on 1 July 1999
16. **Singapore**
    a. Entered into force on 1 January 2003
17. **Chile**
    a. Entered into force on 1 December 2004
18. **Mexico**
    a. Entered into force on 1 July 2001
19. **Egypt**
    a. Negotiations concluded on 31 October 2006 – Awaiting signature and ratification

FTA Ongoing Negotiations (4)

[105] Botswana, Lesotho, Namibia, South Africa, Swaziland

1. **GCC 6**[106]
    a. The second round of negotiations took place in Riyadh, 13-15 November 2006.
2. **Canada**
    a. After being stalled for the better part of a decade, FTA negotiations between the EFTA States and Canada resumed in November 2006. It is believed that a political solution has been found regarding shipbuilding, which had been the main stumbling bloc to the Agreement's conclusion.
3. **Thailand**
    a. The second round of negotiations between the EFTA States and Thailand took place from 16-20 January 2006. A third round was scheduled to take place in April 2006 but was postponed due to the political situation in Thailand.
4. **China**
    a. Iceland and China have finalized a feasibility study and are expected to begin FTA negotiations in early 2007. The Chinese seem to be unwilling to expand this process to the other EFTA States. It is likely that Switzerland's tough stance during China's WTO accession has weighed into this decision (my opinion).

FTA Ongoing Feasibility Studies (4)

1. **Indonesia**
    a. A Joint feasibility study between the EFTA States and Indonesia was launched in December of 2005.
2. **Japan**
    a. The Swiss-Japanese study group met in Tokyo, 22-24 November 2006, to conclude their feasibility study. The results of that meeting are still unknown but the other EFTA States continue, with 'tacit' Swiss approval, to push the Japanese for an EFTA approach. The Japanese have been reluctant to approach Norway and Iceland because of their strong offensive interests in fisheries. I am informed that current signals from the Japanese seem to be more positive.
3. **India**
    a. EFTA Ministers signed a Record of Understanding with India's Minister for Commerce and Industry, HE Mr. Kamal Nath, in November 2006. The deal establishes a Joint Study Group to examine the feasibility for negotiating a possible comprehensive Economic Agreement between India and the EFTA States.
4. **Malaysia**
    a. Feasibility stage.

Joint Declaration on Co-operation

1. **Albania**
    a. Signed on 10 December 1992
2. **Serbia**
    a. Signed on 12 December 2000. There is some confusion following the breakup of Serbia & Montenegro but it seems that the Joint Declaration on Co-operation only applies to Serbia, as Serbia is legally obligated to take over all

[106] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE

agreements formerly signed by Serbia & Montenegro. The EFTA States are following Serbia's developments with the EU and are unwilling to move towards FTA negotiations at this time. Serbia, however, has made repeated requests to move forward.

3. **Ukraine**
    - **a.** Signed on 19 June 2000. The EFTA States, esp. Norway and Iceland, are eager to move the process forward towards FTA negotiations but will not do so until Ukraine accedes to the WTO. There is however a consensus developing within the EFTA circle to start preliminary, informal 'negotiations'. This is also influenced by developments in the Ukraine-EU relationship.
4. **GCC 6**
    - **a.** Signed on 23 May 2000. Negotiations were launch on June 21 2006 (see above)
5. **Algeria**
    - **a.** Signed on 12 December 2002. At the third Joint Committee Meeting, 8 November 2005, both sides affirmed their desire to begin FTA negotiations in 2006. Informal negotiations have taken place on the margins of technical assistance workshops this past year and it is difficult to gauge progress. Both sides need to finalise the Agreement to take advantage of the Euro-med cumulation agreement (2010).
6. **Egypt**
    - **a.** Signed on 8 December 1995. FTA Negotiations were finalized on 31 October 2006. Fish and agriculture had been the main stumbling blocs before the impasse was broken at the political level.
7. **Colombia**
    - a. Signed on 18 May 2006. The first Joint Committee meeting took place in Bogotá on 6 October 2006.
8. **Peru**
    - a. Signed on 24 April 2006. The first Joint Committee meeting took place in Lima on 3 October 2006.
9. **MERCOSUR 4**
    - a. Signed on 12 December 2000. There have been two Joint Committee meetings, the last in November 2004. There are both substance and political issues that would make future negotiations unlikely in the near future. The EFTA States will however keep a close eye on EU MERCOSUR developments and, most likely, base future actions on any breakthroughs between the two sides. It is my understanding that a MERCOSUR member has approached the EFTA States about a possible bilateral deal outside of the MERCOSUR framework.

<u>Possible FTAs for the Future (14)</u>

1. Countries for which the EFTA States have indicated an interest, or have been approached, in furthering trade relations:
    - **a.** United States (the Swiss actually did a bilateral study but decided against a FTA because of agricultural concerns)
    - **b.** Vietnam
    - **c.** Central America (especially given recent EU actions)

d. Russia (the EFTA States have signed a Memorandum of Understanding and would like to begin FTA negotiations as soon as Russia accedes to the WTO)
e. Montenegro
f. Bosnia Herczegovina – Once political developments and relations with the EU allow it.
g. Iran – Once political developments and relations with EU allow it
h. Libya - Once political developments and relations with EU allow it
i. Syria - Once political developments and relations with EU allow it

Annex 4

Japan's Free Trade and Economic Partnership Agreements
Summary of Agreements and Negotiations

Overview

7. Japan has been a latecomer to bilateral FTAs, with only three Agreements having been entered into force (Mexico, Malaysia, and Singapore). Twelve other agreements are in varying stages of ratification, negotiation or exploration.

8. Final Agreement documents have been published for Mexico, Malaysia, Singapore and the Philippines.

9. Agreements with Indonesia, Chile, Philippines and Thailand have all been signed and/or agreed upon in principle. According to a December 13, 2006 article in the Asia Times, FTAs with the Philippines, Chile, Indonesia and Brunei are all expected to go into effect by the end of 2007. The Agreement with Thailand has also shown recent progress toward signature. Negotiation of a Japan-Switzerland RTA began on 15 May 2007.

10. Japan calls most of its agreements Economic Partnership Agreements (EPAs) to indicate that they go beyond traditional FTAs to include agreements on the free movement of labour, tourism, intellectual property considerations, etc. There seems to be consensus (and admission by METI) that EPAs are practically similar to what other countries would call FTAs.

Agreements Entered Into Force (3)

20. Singapore (JSEPA)
   a. Entered into force on November 30, 2002

21. Mexico
   a. Entered into force on April 1, 2005

22. Malaysia
   a. Entered into force on July 13, 2006

FTAs/EPAs Signed and/or Agreed Upon in Principle (4)

5. Philippines (JPEPA)
   a. Signed by PM Koizumi and President Arroyo on September 8, 2006; Ratified by Japan on December 6, 2006; Still pending in the Philippine Senate and likely to be considered for ratification soon after the holiday recess.

6. Chile (JCEPA)
   a. Agreed upon in principle by PM Abe and President Bachelet on November 17, 2006. The Agreement has not yet been signed or ratified.

7. Indonesia (IJEPA)
   a. Agreed upon in principle by PM Abe and President Yudhoyono on November 28, 2006, and subsequently signed.

8. **Thailand (JTEPA)**
    a. Agreed upon in principle by PM Koizumi and PM Shinawatra on September 1, 2005. Rules of Origin issues remained outstanding prior to signature of the Agreement, but its future became uncertain after the Thai coup on September 19. The Thai Deputy PM announced on October 25 that JTEPA would be considered in a cabinet meeting in December, and that it would be debated in the Assembly in January of 2007. The Thai Cabinet confirmed progress on December 20, 2006, and said that the next step will be a debate in the Assembly.

FTAs/EPAs in the Negotiation Phase (6)

1. **South Korea (JKFTA)**
    a. Negotiation of the JKFTA was launched in December of 2003 and six rounds of negotiations were conducted, the last of which was held in November of 2004. Negotiations then stalled due to worsened political relations and disagreements over agricultural issues, and have not resumed.
2. **Brunei**
    a. The first round of negotiations was held in June of 2006, and while press reports have indicated that further negotiations in December have led to a basic agreement, neither the Japanese nor Brunei foreign ministries have posted a formal statement since the June talks.
3. **Vietnam**
    a. A first round of formal EPA negotiations was be held in January of 2007.
4. **Gulf Cooperation Council**
    a. The first round of negotiations was held on September 21/22 in Tokyo.
5. **ASEAN (AJCEP)**
    a. The fourth round of negotiations was held in June of 2006. A broad-based agreement with ASEAN is intended to grow out of bilateral agreements with member states.

6. **Switzerland**
    Negotiations began on 15 May 2007.

FTAs/EPAs in the Exploration Phase (2)

10. **Australia**
    a. A Joint Study Group issued a final report in December of 2006 with the recommendation that "Australia and Japan should conclude an FTA as a matter of priority." Negotiations have not been announced.
11. **India**
    a. On December 15, 2006, after a visit by PM Singh to Japan, a Joint Ministerial Statement was issued announcing that the two sides will launch negotiations for an EPA through a new Joint Task Force. The expressed goal is to complete negotiations for the EPA within two years. No specific dates were given for the start of the talks.

Possible FTAs for the Future (14)

2. Countries for which Japan as indicated that "private sector studies are ongoing…or their governments/business community have indicated interest in EPA with Japan" include:
    - **a.** United States
    - **b.** Canada
    - **c.** MERCOSUR
    - **d.** Brazil
    - **e.** Argentina
    - **f.** Iceland
    - **g.** Norway
    - **h.** Israel
    - **i.** Morocco
    - **j.** Egypt
    - **k.** South Africa
    - **l.** China
    - **m.** Taiwan
    - **n.** Mongolia

Annex 5

Singapore's Free trade Agreements

Overview

1. Singapore's drive in pursuing free trade agreements starts in the mid-nineties (the ASEAN Declaration was signed in 1967 but its Common Effective Preferential Tariff came into effect in 1993) and its FTA efforts gain stamina in the late nineties. This recent rise is explained by three main factors:
    a) as a strategy to differentiate itself from the rest of ASEAN countries which adopted semi-protected economic policies in response to the Asian crisis
    b) the growing perception of the WTO as a weak forum for an open multilateral trading system
    c) to meet challenges from India and China, whose cheap goods and services can possibly threaten Singaporean enterprises, as has already been the case with garments and many other manufacturing industries.

2. Singapore's FTAs are all WTO plus as the Ministry of Trade and Industry considers that the three basic components of FTAs are the chapters in trade in goods, trade in services and investment. Additionally, Singapore normally includes additional chapters covering government procurement, intellectual property protection, competition policy and other cooperation measures. This policy of comprehensive FTAs is underpinned by the Ministry of Trade and Industry's goals for Singapore's network of FTAs as going beyond trade and business expansion and addressing support for its business community in moving up the value added ladder and knowledge chain. The Ministry of Trade and Industry emphasizes that international exchange of skills and knowledge is essential for development.

3. Singapore has two sets of FTAs: the first group are those addressed via the multilateral track as a part of ASEAN and the second group are those concluded on a bilateral basis by Singapore alone.

Agreements entered into force

1. ASEAN

ASEAN has two tiers of nations. The so-called ASEAN-6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) are the original members of the ASEAN Free Trade Area (AFTA). The Common Effective Preferential Tariff (CEPT) Scheme for the AFTA came into effect in 1993. In the CEPT the ASEAN-6 agreed to reduce their tariffs to 0 -5 percent over 15 years but this schedule was accelerated and this threshold was achieved in 2002.
The second tier includes the new ASEAN countries which joined between 1995 and 1999 (Cambodia, Lao PDR, Myanmar and Vietnam) and these have more flexible liberalization commitments.

2. ASEAN- China

The ASEAN-China FTA Trade in Goods Agreement entered into force on 20 July 2005 just between China, Brunei, Indonesia, Malaysia, Myanmar, Thailand and Singapore. Implementation for other ASEAN countries will be delayed, but no deadline has been set.

3. ASEAN-Korea

Entered into force on July 2006, except for Thailand who continues to negotiate due to concerns in agriculture.

4. Singapore-Australia

Entered into force on 28 July 2003.

5. Singapore-EFTA

Entered into force on 1 January 2003.

6. Singapore-Hashemite Kingdom of Jordan

Entered into force on 22 August 2005.

7. Singapore-India (Comprehensive Economic Cooperation Agreement)

Entered into force on 1 August 2005. Until this comprehensive agreement was signed, most Indian FTAs tended to concentrate only in goods. The CECA is the first Indian agreement that includes goods, services, provisions on investment protection and a double taxation treaty.

8. Singapore-Japan

Entered into force on 30 November 2002. This Agreement is currently being reviewed by the Japan-Singapore New Age Economic Partnership Agreement (JSEPA) in order to expand the product coverage, improve the rules of origin and enhance the financial services commitments.

9. Singapore-Korea

Entered into force on 2 March 2006.

10. Singapore-New Zealand

Entered into force on 1 January 2001.

11. Singapore-Panama

Entered into force on 24 July 2006.

12. Trans-Pacific Strategic Economic Partnership Agreement (Trans-Pacific SEP)

An ambitious and high-standard WTO plus FTA between Brunei, New Zealand, Chile and Singapore. The Agreement was signed by Chile, New Zealand and Singapore on 18 July 2005, while Brunei signed on 2 August 2005. The Agreement entered into force between New Zealand and Singapore on 28 May 2006, on 12 July 2006 for Brunei and on 8 November 2006 for Chile.

13. Singapore-United States

Entered into force on 1 January 2004. The first free trade agreement signed by Washington with an Asian state.

Negotiations concluded

1. Singapore-Quatar

In 10 June 2005 Singapore's Minister for Trade and Industry and Quatar's Minister of Economy and Commerce signed a declaration stating that the negotiations had been substantially concluded and the agreement is expected to be formalized soon.

Agreements under negotiation

1. ASEAN-Japan

The fourth round of negotiations was held in June 2006.

2. ASEAN- Australia/New Zealand

The seventh round of negotiations was held last September 2006.

3. ASEAN-India

In November 2006, ASEAN doubled the number of products included in its negative list (items exempted from phased tariff cuts) rendering uncertain the outcome of these long-pending negotiations. The original time frame for the FTA in Goods mandated that the ASEAN-India FTA was to commence from 1st January 2007 and negotiations had to be concluded by 30th June 2006.

4. Singapore- Canada

During the 2006 Ministerial Meeting of the Asia-Pacific Economic Cooperation Council, the Ministers of International Trade of Canada and Singapore agreed to resume formal negotiations, which had stalled in late 2003, with a view to concluding by early 2007.

5. Singapore- China

Negotiations were launched on 25 August 2006. The first round of negotiations was held on 26 October 2006 in Beijing.

6. Singapore- Egypt

On 13 November 2006 Singapore and Egypt signed a Declaration of Intent to start negotiations on the Egypt-Singapore Comprehensive Economic Agreement (CECA), envisaged as a high standard and comprehensive agreement which will include the establishment of a free trade area between the two countries.

7. Singapore-Mexico

Negotiations for the Mexico-Singapore FTA started in July 2000. Six rounds of trade talks have taken place to date, along with a series of road-shows in Mexico to drum up support among the Mexican business community.

8. Singapore-Pakistan

The third round of negotiations was completed in May 2006.

9. Singapore-Peru

The third round of negotiations was concluded on 29 September, 2006.

10. Singapore-State of Kuwait

The second round of negotiations was held from 11-13 April 2005 in Kuwait.

11. Singapore-The Gulf Cooperation Council

During the Prime Minister of Singapore's official visit to Saudi Arabia from 24 to 27 November 2006, the two countries agreed to hold the first round of negotiations in early 2007.

12. Singapore-United Arab Emirates

On 11 March 2005 Singapore and the United Arab Emirates signed an Economic, Trade and Technical Cooperation Agreement which included the declaration that this agreement would lead to the launch of negotiations of a bilateral trade agreement.

Exploration phase

1. Singapore-South African Customs Union (South Africa, Botswana, Lesotho, Namibia and Swaziland)

In April 2005, Singapore and the South African Customs Union announced that they would begin talks on a free trade agreement.

2. Singapore-Saudi Arabia

In early 2005 Singapore and Saudi Arabia announced that they were exploring the possibility of signing an FTA along with an Investment Guarantee Agreement (including some of the typical provisions normally included in BITs).

3. Singapore- Bahrain

Preliminary discussions on this FTA were held on the sidelines of the Prime Minister of Singapore's official visit to Bahrain in February 2004.

4. Singapore-Sri Lanka

Exploratory talks began in October 2003 for a Comprehensive Economic Partnership (CEPA) with a view towards launching formal negotiations in the middle of 2004, but these haven't been launched yet.

Possible future FTAs

1. Singapore-European Union

In May 2006, Lim Hn Kiang, Singapore's trade and industry minister, urged the EU, as Singapore's second largest trading partner, to negotiate a free trade agreement.

2. Singapore-Uzbekistan

On 2 November 2006 Singapore and Uzbekistan signed an Economic Cooperation Agreement, a declaration to strengthen and develop trade and investment cooperation between the two countries.

3. Singapore-Slovak Republic

An Investment Guarantee Agreement (including typical BIT provisions) was signed between them on October 13, 2006.

4. Singapore-Iran

In July 2004 Singapore and Iran committed to explore a free trade agreement as part of a wider network to deepen bilateral economic ties. This was followed by a visit by then Prime Minister of Singapore Goh Chok Tong to Iran. However, the trend towards growing international pressure to curb Iran's nuclear program and the recent sanctions mandated by the UN Security Council constitute major setbacks to progress in this FTA.

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LSE Enterprise

Preferential services and investment liberalization in Asia: Implications for Switzerland

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Trade and investment linkages and Asian economic integration: a literature review

Production networks are extensive in Asia – in particular in manufacturing and electronics – due in no small measure to the progressive lowering of service links costs among different production blocks. The fragmentation of production patterns throughout the region has a substantial impact on regional trade and investment flows. This does not mean, however, that Asian countries are becoming less dependent on western markets, as much intra-Asian production sharing is dependent on demand outside the region and western MNEs – including Swiss companies - are deeply integrated into these networks.

The literature on trade and FDI linkages suggests that exports typically increase as a result of FDI; i.e. trade and FDI tend to display a strongly complementary relationship. This is most prevalent for intermediate inputs and in particular trade within firms. Complementarity between FDI and trade is highest in the early stages of internationalisation, whereas substitution of local sales over exports – for instance to third countries - seems to be more likely as operations in host countries become competitive over time. Finally, high tariffs can lead to a substitution of market-seeking FDI over exports for big multinationals.

Such a complimentary relationship is borne out in studies on trade-FDI linkages in Asia. This is particularly the case for intermediate inputs and intra-firm trade. Similarly, increased trade among Asian countries leads to increased intra-Asia FDI-flows. The growth of FDI among Asian countries thus contributes to the regionalisation of Asian trade; and vice versa, increased trade among Asian countries contributes to the regionalisation of Asian investment flows.

It is important to recall, however, that even though Asian economic integration is increasing, this is not necessarily bad news for non-Asian countries or their MNEs. First of all, much of Asian production sharing is dependent on market demand outside the region and therefore does not entail a de-linking of Asia from the global marketplace – quite the contrary. Secondly, non-Asian MNEs plugged into Asian production networks are able to benefit from increased economic opportunities in the region and much Asian trade is thus carried out between foreign affiliates of MNEs. Swiss' and other multinationals are already inside players in this process, both promoting (albeit indirectly) more integrated markets as well as enjoying the benefits deriving from such closer integration.

Trade and FDI policies – such as export processing zones – directed towards the establishment of production networks have played an important role in promoting the trade-FDI nexus. Also, whereas tariff-jumping is most likely not important for intra-Asian FDI flows, exports of multinationals in Asia do respond to protectionist measures, as has been observed in Thailand and Indonesia. Lowering preferential tariffs through Asian regional and bilateral agreements could thus stimulate Swiss multinationals' economic activities in the region even further. This, in turn, raises the important issue of whether increased opportunities for intra-Asian trade due to preferential agreements divert economic activities away from parent countries.

Preferential Services Liberalisation in Asia

ASEAN member states are increasingly active in liberalisation and integration of trade in services within the region as well as with key third country partners, both within and outside Asia. Such partners include China, India, Japan, Korea, Australia, New Zealand and the

United States. Such liberalization processes have taken the form of regional trade agreements, as in the case of the ASEAN Framework Agreement on Services (AFAS), as well as bilateral free trade agreements. The region features 25 agreements governing services trade already in force, with an estimated 40 more negotiations currently underway. While some of these PTAs do not go significantly beyond the rules and the depth commitment achieved within the multilateral trading system (based on Uruguay Round commitments under the WTO's General Agreement on Trade in Services and offers made to date under the Doha Development Agenda), others extend well beyond WTO bindings (or proposed new commitments) and rules. The latter developments raise important questions regarding their potential effects, both positive and negative, on third countries.

The ASEAN Framework Agreement on Services (AFAS)

The AFAS provides a framework for the progressive liberalisation of services within ASEAN member states, based on a set of GATS-like rules and the periodic negotiation of liberalisation packages that lock-in the collective sets of individual ASEAN countries' liberalisation commitments in specific sectors. While intra-ASEAN liberalisation efforts have been prioritised in the sectors of air transport, business services, construction, financial services, maritime services, telecommunications, tourism, and professional services (via mutual recognition agreements in engineering and nursing to date), AFAS commitments also extend to a range of other service sectors in individual member's schedules. This paper's assessment of AFAS achievements yields the following results:

- ***Rules** – Little advances has been achieved under AFAS on services rule-making, with the notable exception of two areas. First, ASEAN members have reached agreement on mutual recognition of licensing and professional practice regimes in nursing and engineering services, with a third ASEAN MRA on architecture being close to completion. Such agreements establish principles, provisions and institutions to facilitate the movement of persons across borders. Second, the rule of origin for Mode 3 in services extends the benefits of intra-ASEAN liberalisation to juridical persons with substantial business operations in the territories of AFAS members. On the other hand, AFAS rules fall short from the GATS in many respects, with generally weak disciplines on regulatory transparency and non-discriminatory domestic regulation (i.e. the Article VI:4 work programme under GATS). It is notable that no progress can be reported within AFAS on the outstanding rule-making challenge of emergency safeguard measures for services trade, an issue on which ASEAN countries have maintained a demandeur posture in WTO/GATS discussions.*

- ***Depth and scope of liberalisation** – The five packages of progressive liberalization negotiated to date under AFAS extend the scope of ASEAN members' sub-sectoral commitments by an estimated 50% over existing GATS commitments. However, the depth of such of such commitments remains low and often only marginally improves commitments undertaken or offered in GATS. Within ASEAN, Thailand, Indonesia and the Philippines have significantly improved their level of bound liberalization over and above their GATS bindings, although this tends to reflect the paucity of these countries' existing WTO commitments or DDA offers rather than the actual depth of their AFAS commitments.*

- ***Effects on Switzerland** – This paper's analysis suggests that the trade diversion effects resulting from AFAS liberalization may be expected to be small, due to the relatively small margin of preference embedded in ASEAN members' AFAS commitments and the liberal stance adopted with regard to the treatment of third country investors. It cannot be excluded however that AFAS liberalisation, if deepened, may not generate negative effects on third country suppliers, particularly in Modes 1, 2 and 4, such that Switzerland*

should be targeting recent AFAS commitments, particularly under Modes 1 and 4, in its WTO dealings with key ASEAN partners. Furthermore, since some of the priority areas in the AFAS include areas of interest to Switzerland, such as air transport services, logistics, financial services and business services, Switzerland must guard against the possibility that future AFAS liberalisation yield greater trade diversion or hamper the possibility for Swiss service providers to penetrate ASEAN's rapidly growing service markets. The recent launch of formal negotiations between the EU and ASEAN Member countries (and India), combined with the protracted state of the WTO Doha Round and the modest prospects for significant new market openings under the GATS, suggest that Swiss authorities and the country's private sector may need to ponder the scope for securing preferential access on par (be it AFAS or EU-ASEAN parity) with that of its key trading partners and chief competitors.

Asian PTAs with third countries

- ***Rules*** *– The growing network of PTAs covering services that ASEAN countries have entered into with non-ASEAN partners in recent years can be characterized as AFAS+ and GATS+ in character in regard to both rule-making (though less systematically so) and market opening (almost systematically so, particularly in agreements concluded with the United States). Such advances include new and improved rules governing trade and investment in financial services, regulatory transparency, telecommunications (including pro-competitive regulatory disciplines in the sector that go beyond the rules contained in the GATS' Reference Paper on basic telecommunications). A number of PTAs also develop standards, principles and disciplines for the movement of natural persons in certain professional fields and promote regulatory and other forms of cooperation well as cooperation in various areas of services policy, such as small and medium enterprises or research and development. Fully 40% of all PTAs concluded between ASEAN member countries and third countries (though not with EFTA) operate on the basis of a negative list approach to market opening, although the gains in transparency and added liberalization vary depending on the sectoral scope and breadth of appended reservations.*

- ***Depth and scope of liberalisation*** *– The depth of liberalisation varies considerably across the sample of third country PTAs reviewed in this paper. While some agreements marginally deepen liberalisation beyond that scheduled under the GATS or AFAS, others significantly improve liberalisation commitments in terms of sectoral coverage and the quality of bindings. Status quo bindings locking in existing levels of market access are noticeably more prevalent under PTAs than under ASEAN countries' current GATS commitments or their DDA offers. In modal terms, substantial GATS+ improvements have been achieved with regard to commercial presence (mode 3). Progress is also notable in some agreements in regard to the movement of natural persons (mode 4), though not in the case of recent US agreements. However, in terms of quality and depth of commitments, commitments in both areas remain subject to numerous restrictions, such that full liberalisation remains more prevalent (as under the GATS) as regards cross border supply (mode 1) and consumption abroad (mode 2). The experience in Asia suggests that liberalisation through negative listing does not necessarily lead to better results than liberalisation through positive listing, though overall levels of commitments do appear greater overall under negative list agreements. Negative list agreements, however, can bring significant gains in regulatory transparency and more easily lock in the regulatory status quo.*

- ***Effects on Switzerland*** *– The possible trade diversion effects on Switzerland, or the negative results stemming from the non-extension of preferential access to sectors of interest to Switzerland, are likely more significant in the case of Asian PTAs entered into with third countries relative to AFAS. Such effects differ across sectors and modes of*

supply as well as between individual ASEAN members based on their importance as trading and investment partners for Switzerland. Potential trade diversion effects worthy of closer negotiating scrutiny on the part of Switzerland include the following: Brunei - architectural and engineering services, computer-related services, modes 1 and 2; Laos – all sectors in modes 1, 2 and 3, professional services, financial services, and distribution services; Philippines - engineering services, financial services, environmental services and air transport services; Singapore – modes 1 and 2 as well as financial services; Thailand – distribution services, architectural and engineering services, air transport services, environmental services, and financial services. The tendency for most PTAs entered into between individual ASEAN members and third countries to adopt a liberal rule of origin for investment in services (a denial of benefits clause operating via a substantial business operations test) implies a generally limited potential for investment diversion detrimental to established Swiss operators or to those willing to entering these markets via a commercial presence. It should however be noted that the remaining high degree of protection of ASEAN service markets in several sectors of interest to Swiss industry suggests that individual bilateral agreements or a deepened EFTA agreement with ASEAN as a whole could yield positive gains in all key sectors and modes of supply in which Switzerland maintains offensive interests in services trade.

Preferential investment liberalisation in Asia

The study focuses attention on the key investment provisions found in a sample of 19 Asian preferential trade and investment agreements (PTAs) and assesses their implications for third country – including Swiss - investors. As investors in services are often treated separately, interactions between investment and service chapters are also discussed. The main findings – some of which are based on secondary literature – are as follows.

Most PTAs in the region – including the two EFTA-agreements, with Korea and Singapore - use a broad and 'asset-based' definition of investments in the investment chapter, whereas a narrower 'enterprise-based' definition of service investments is used in service chapters. Most definitions of commercial presence require ownership or control by natural or legal persons covered under the agreement as defined under agreements' rules of origin/denial of benefits clauses (see below).

The services chapters of EFTA agreements solely govern national- and most-favoured-nation treatment for commercial presence. This stands in contrast to US agreements with EFTA partners – Korea and Singapore – which cover both service and non-service investors in investment chapters. The US approach reduces the risk over conflicting obligations and increases transparency. It furthermore gives service investors access to investor-to-state dispute arbitration in more cases (see below). The Commission's recent mandate to negotiate an EU-ASEAN agreement applies an enterprise-based definition of investors, but is highly transparent as one single chapter governs all investors.

In general, rules of origin as applied for services and investment are fairly liberal. The most restrictive origin-criterion for juridical persons – ownership and control – is only applied in two of the PTAs reviewed. Swiss juridical persons constituted or otherwise organised under the laws of a party with substantial business operations there – or in some cases in any party – therefore enjoy preferential treatment in most agreements. Rules of origin for natural persons extend benefits to permanent residents in some agreements including those of EFTA (with the possibility of reservations for particular types of service suppliers). This is not the case for past or currently negotiated US or EU agreements, however.

Even if rules of origin are liberal overall, market access restrictions for services – such as maximum levels for foreign equity participation - still restrict coverage substantially in some

cases. In contrast, some countries such as Singapore have made significant market access commitments. EFTA's PTA partners – Singapore and Korea – seem to have committed to 'deeper' market access obligations in their PTAs with the US as well as in the agreement between themselves.

Swiss service providers (Modes 1, 2 and 4) covered under Asian PTAs can expect to be granted national treatment (NT) less often than investors (Mode 3). EFTA agreements list NT for services on a positive list basis and investments on a negative list basis, whereas EFTA's partners – Korea and Singapore – typically include NT on a negative list basis for both services and investments in their other agreements. Whereas an in-depth analysis of each country's sector and sub-sector schedules is necessary to establish whether obligations are more far-reaching in one agreement over the other, the negative list approach used in EFTA partners' other service agreements does indicate wider coverage.

Most PTAs include most-favoured-nation (MFN) clauses. There is no apparent pattern, however, as to which types of agreements exclude MFN provisions or a clear association between MFN disciplines and whether agreements are based on negative or positive list approaches. EFTA agreements include a wide exception to MFN treatment for all other PTAs in regional economic integration organisation (REIO) exception clauses. NAFTA-inspired agreements – such as the US agreements with Korea and Singapore - allow the parties to benefit from better treatment granted to third parties in another PTA signed after – but not before - the entry into force of the PTA. As more recent agreements tend to include wider commitments, the NAFTA approach to MFN-treatment – if still imperfect – is better able to multilateralize preferential commitments. In any event, the tendency towards permitting broad exemptions to MFN treatment reduces its practical relevance in the context of Asian PTAs.

In both NT and MFN clauses there are semantic differences across agreements, which could have important implications. Negative list service chapters use the term 'like circumstances' instead of GATS-like 'like service suppliers and services', which tends to be used in positive list agreements such as EFTA agreements. If future jurisprudence establishes that the first term is broader in cope, then Swiss service suppliers may have obtained lesser coverage as, for instance, US companies in Korea and Singapore. On the other hand, future jurisprudence might also clarify whether mentioning both 'services' and 'service providers' – as in EFTA agreements - entails wider coverage than only referring to the latter as is the case in US agreements with Singapore and Korea.

In contrast to treatment standards, investment protection typically doesn't vary depending on whether the investment is in services or in other sectors. The study focuses attention on key protection provisions found in the sample agreements reviewed, including umbrella clauses[5]*, transfer provisions, overall treatment standards, expropriation clauses and compensation requirements. Apart from certain exceptions, protection provisions are largely comparable to those of BITs.*

The EFTA agreements are the only agreements reviewed that include an umbrella clause. However, recent jurisprudence provides conflicting answers as to whether this clause allows investors to resolve contractual claims against host countries under arbitration provisions of the investment agreement, rather than under the dispute resolution provisions of the contract in dispute.

[5] An umbrella clause stipulates that the host country assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party and thus not only in connection with an investment agreement.

Transfers of capital in connection with foreign investments are protected in a relatively consistent and robust manner in Asian PTAs. Agreements guarantee investors the right to transfer current and capital transactions without delay, and to use a particular kind of currency at a specified exchange rate, subject to common exceptions in the case of serious balance-of-payments, exchange rate or monetary policy difficulties.

It is not clear from available case law whether 'fair and equitable treatment' is an independent treatment standard. If it is, then Swiss investors might have obtained stronger protection rights under EFTA PTAs than investors covered under agreements that a) don't include this standard; or b) include it but mention that it is similar to established customary international law as is the case in US agreements.

Apart from EU agreements, all reviewed PTAs with investment coverage more or less copy standard BIT-provisions on direct and indirect expropriation and compensation requirements. However, the EFTA-Singapore agreement refers to 'de facto' rather than 'indirect' expropriation and does not specify compensation requirements in detail. Whether this has important implications is again not clear from available jurisprudence, but is in this particular case doubtful given Singapore's overall investor-friendly environment and the fact that the two terms often are used interchangeably.

Except for EU agreements, all PTAs with investment coverage offer investors the choice of investor-to-state dispute settlement under ICSID or ad hoc procedures using UNCITRAL rules in most instances. Service investors will not be able to bring a dispute to investor-state arbitration if it relates to matters not covered by the investment-chapter, and they thus have to rely on ad hoc state-to-state arbitration. US service companies therefore have access to investor-to-state arbitration for all aspects covering investment in services, whereas NT and MFN for commercial presence are not covered by the investor-to-state mechanism in EFTA agreements.

Again in contrast to US agreements, the EFTA PTAs require consent by the disputing parties – though only in the case of pre-establishment disputes for the Korea agreement – and do not include explicit transparency provisions. EFTA agreements moreover don't allow for a consolidation of two or more separately submitted claims with a question of law or fact in common and arising out of the same events or circumstances.

The EFTA and US agreements with Singapore and Korea are compared in Table V.7. It is particularly in services where US agreements seem to have more comprehensive provisions by for instance providing service investors the same treatment standards as those offered to other investors. Other differences such as REIO clauses, umbrella clauses, etc. are cited above. It is notable that NAFTA-inspired provisions have been adopted in non-US PTAs such as Singapore-Korea, Chile-Korea, Japan-Mexico and this approach is thus proliferating (OECD, 2007).

De jure integration: assessing the effects of trade and investment agreements

The study review of the available literature confirms the fact that Asian integration has so far been driven mostly by market forces. However, it also points out that the recent surge in PTAs is likely to lead to an increased regionalisation of both trade and investment flows in Asia. It is important to remember that when compared to multilateral or unilateral liberalisation, such a process can represent a potentially significant source of discrimination against outsiders. Fortunately, there are reassuring signs that this process might not be as 'malign' in Asia as has been observed elsewhere. Many Asian PTAs include comprehensive liberalization commitments as well as far-reaching behind the border reforms and regulatory cooperation initiatives, which will most likely create more opportunities for trade and

investment for both Asian and non-Asian operators. The liberalisation of the service sector holds the potential to bring about substantial economy-wide benefits, as well as benefits both for specific service sector MNEs and for firms involved in regional production networks who depend on low service inputs. In this regard, a number of Asian countries – notably Singapore, Japan and Korea – have committed to GATS+ levels of market opening. Such liberalization could be regarded as a building block for further multilateral liberalization.

More problematic are complex and conflicting rules of origin for trade in goods, which could prove onerous for Swiss MNEs in the region. Investment diversion has been a genuine problem under some PTAs. It follows, then, that it would be in Switzerland's interest to advocate for a more comprehensive agreement on rules of origin (and stricter rules on their use in PTAs) in the WTO while also suggesting the desirability of tackling investment issues more comprehensively in the next multilateral negotiating round. To the extent that Switzerland wishes to confront or overcome such potential problems by joining the Asian PTA race, three basic policy recommendations follow from the review of existing literature.

First, it bears recalling that trade diversion is a problem not only for third countries but can also be problematic for signatory countries of PTAs from an efficiency perspective (Viner, 1950). In order for PTAs to create more economic activity than they divert, they therefore need to include deep tariff cuts in practically all sectors and goods.

Second, in order to lessen compliance costs (the so-called Asian noodle-bowl problem) stemming from the overlap of varying rules of origin, a simple and liberal approach is preferable. This has the added advantage of further decreasing the extent of possible trade diversion.

Third, the largest liberalisation benefits on offer, in Asia and elsewhere, are often to be found in non-goods trade, such as in services and FDI. A 'WTO-plus' approach with progressive reductions in restrictions to market access, national and MFN treatment in these areas could thus have large positive effects. This is particularly so given that production networks tend to encompass investment, service providers as well as trade in goods. "Shallow" PTA commitments on any one of the above trinity of issues is therefore not recommendable. Moreover, the ability of Swiss investors and service providers to derive third country benefits from Asian preferential trade and investment liberalisation requires that Asian PTAs continue to adopt liberal denial of benefits/rules of origin clauses in the services and investment fields.

As regards, finally, the influence of investment treaties (protection and liberalisation) on induced FDI activity, available studies suggest that is far from certain whether BITs promote investment. It seems safe to conclude, however, that BITs concluded between Asian countries should not have a substantial impact on investment flows in and out of Asia. Also, even though BITs have proven powerful in protecting Swiss and other investors, they are most likely not determinative instruments in promoting Swiss FDI to the region.

I. Introduction

Developing countries in Asia have a huge stake in maintaining an open global system of trade and investment. The integration of the region into the world economy has been largely driven by market forces, particularly by private foreign direct investment and the related rise of intra-industry trade. When assessing the growth of Asia's trade and the respective roles of policy, technology, and markets in influencing patterns of regional integration, a key conclusion that emerges is that technological change, markets, and the private sector, particularly multinational firms (hence FDI), have been crucial in deepening integration. To date, empirical studies suggest that bilateral and regional trade and investment agreements have had only a limited impact on Asia’s integration process, the most significant liberalization efforts having been unilateral in character.

Increasing trade integration within East and Southeast Asia has been closely associated with changes in industrial organization and the spread of international production sharing, or the fragmentation of vertically integrated supply chains. The attractiveness of East and Southeast Asia as production and investment platforms has been enhanced by a variety of measures that reduce the frictions and costs of trade, such as investments in ports and other infrastructure, the establishment of special economic zones and bonded industrial warehouses, and duty drawback schemes. These arrangements have allowed investors to take advantage of economies of scope and specialization.

There are, however, unmistakable signs that the dynamics of Asian integration are changing, not least because of the protracted difficulties encountered in multilateral trade negotiations but also in light of the emergence of – and concomitant competitive threats and opportunities from - China and India as regional giants.

Countries in Asia and in other regions are increasingly experimenting with preferential trade agreements, most often on a bilateral basis. Such a trend is today on a strong upswing throughout Asia and increasingly spans several regions. Indeed, Asia's "noodle bowl" is not only expanding, but is increasingly involved with complex agreements in other parts of the world. Such cross-regional agreements are driven by a variety of concerns such as energy security, access to minerals and other natural resources. They also represent efforts by Asian countries to "lock in" reforms by making them part of formal trade and investment treaties with a major developed country or region. Many such agreements are also motivated by political considerations, as countries seek to cement diplomatic alliances by providing economic benefits to partners.

As Asia's preferential trade and investment agreements are still for the most part at an early stage, this obviously complicates attempts at assessing their effects empirically and assigning structural influences to their core provisions. Yet during the time that they are implemented, such agreements will begin to impact on both regional and global trade and investment flows. Accordingly, it is important that preferential trade and investment liberalisation be conducted in such a way that it supports, rather than contradicts, the openness that has so far been a defining characteristic of Asia's trade expansion and its integration into world markets.

This study takes stock of recent trends in the services and investment dimensions of deepening economic integration in Asia and its likely implications for third country investors and service suppliers, including most particularly those from Switzerland.

The study is structured as follows. Section II provides the context for the study by depicting the forces underlying recent trends in Asian regionalism. The section draws particular attention to the distinction between *de facto* (i.e. driven by markets) and *de jure* (i.e. driven by formal institutional arrangements) forms of integration. Section III of the study offers a literature review of trade and FDI linkages in Asia, placing special emphasis on the implications of such evolving linkages for Swiss/third country operators in the region.

Section IV reviews the salient features of preferential attempts at liberalizing services trade in Asia, focusing attention both the process of services liberalization conducted among ASEAN countries as well as between individual ASEAN countries and a set of key third country partners in Asia and beyond. Section V attempts a similar exercise in the field of investment rule-making and liberalization, drawing on a sample of eighteen key preferential trade agreements featuring disciplines of various degrees of comprehensiveness governing the protection and liberalization of cross-border investment activity.

Section VI turns to the possible effects of the recent shift towards *de jure* or treaty-driven forms of integration services and investment liberalization and rule-making, offering insights on the implications of ongoing trends for third country investors and service providers operating in the region. Section VII offers summary and concluding thoughts.

II. Understanding the rise of Asian regionalism

Key issues addressed:

- The shift from *de facto* to *de jure* regionalism in Asia
- Contrasting the practice of regionalism in Asia and Latin America
- Asian regional integration: stylized facts and driving forces

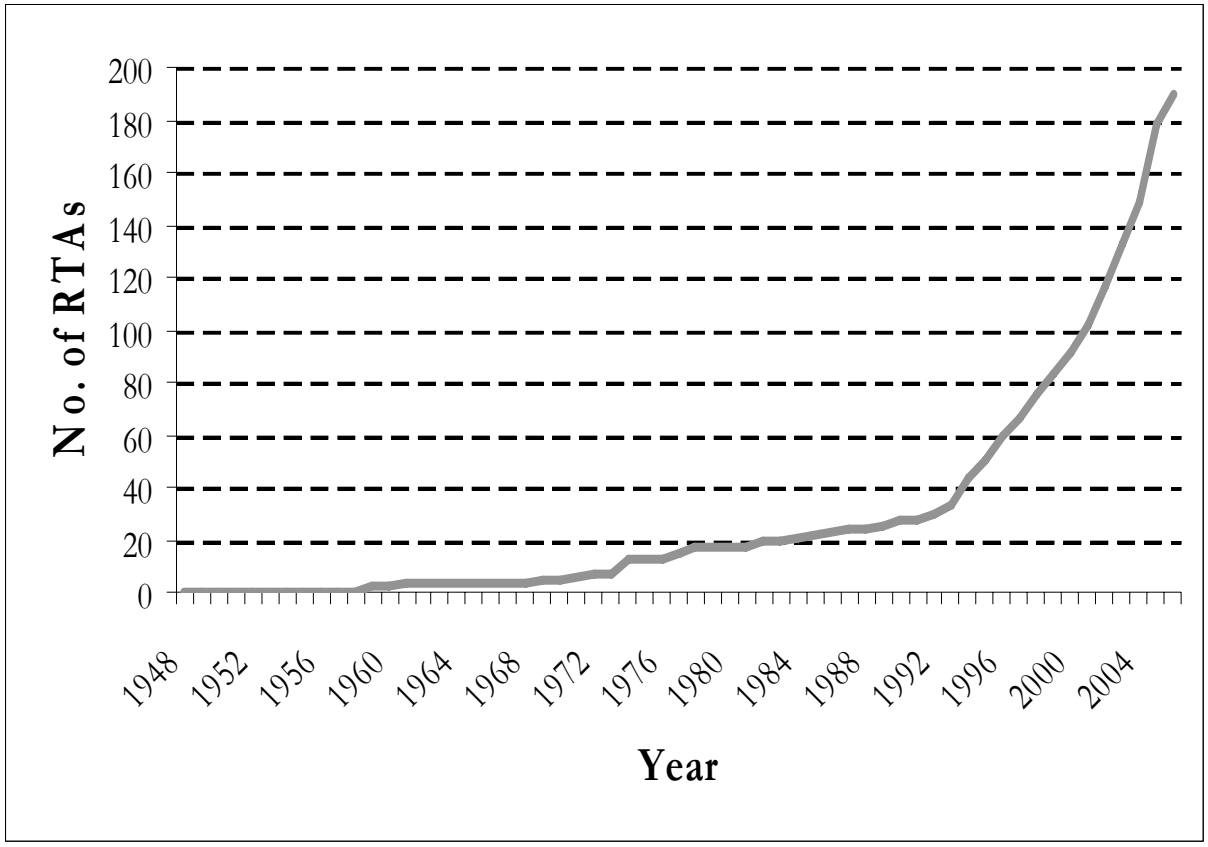
The last decade has witnessed a major transformation in the global governance of international trade relationships. The first major development occurred in 1995 with the creation of the World Trade Organization (WTO), the global institution governing the conduct of international trade. Rules contained in the Marrakech Agreement that established the WTO feature the most ambitious and comprehensive multilateral provisions ever ratified by member countries. Somewhat paradoxically, the period since 1995 has witnessed the second major development in international trade relationships—the proliferation of bilateral, regional and other preferential trade agreements among nations. As the WTO's Doha Development Agenda (DDA) continues to sputter, signs abound that recourse to preferential trade and investment liberalisation will proliferate further in the coming years. Such developments are forcing many WTO members, among them Switzerland, to review and reassess their trade policy strategies and priorities. The need for such a reassessment has arguably acquired greater salience now that Switzerland's largest trading partner - the European Union – has recently renounced the moratorium on new PTAs it informally decreed in 1999 and entered into formal PTA negotiations with India, Korea and the member countries of ASEAN.

The conclusion of preferential trade agreements (PTAs) is by no means new. But as Figure II.1 below shows vividly, the sheer number and the speed with which such agreements have been negotiated over the past dozen years are simply astonishing. All but one WTO member – Mongolia – today conduct some measure of their trade relations on a preferential basis under one or more PTAs, and it is estimated that more than half of world trade activity today is governed by preferential rules. This section of the study analyzes the recent history, characteristics and political economy of regional and bilateral trade integration from the viewpoint of two core concepts: *integration of markets vs. integration by agreements,* with a particular focus on the East Asian incarnation of these two phenomena.

As its name suggests, the concept of *integration of markets* focuses on the idea that economies can integrate among themselves by relying primarily on the forces of the marketplace, i.e. by allowing the private sector to be the vanguard of trade and investment

integration. This has at times been dubbed *de facto* integration. The second core concept is *integration by agreements,* which focuses on trade integration centred on recourse to *de jure* trade and investment treaties. This second channel of integration emphasizes the primacy of legal instruments to further economic integration among countries.

Figure II.1 Evolution in the number of multilaterally notified preferential trade agreements, 1948-2006



Source: WTO (2007).

There is little doubt that the two channels of integration described above are closely related and indeed ultimately complementary in nature. The integration of markets without formal trade and investment agreements can create uncertainty for businesses inasmuch as the institutional foundations of an integrating area may not be sufficiently clear, transparent or predictable. At the same time, *de jure* integration can be vacuous if the underlying economic forces are not favourable towards integration, as the early experiences at trade integration in Africa and Latin America in the 1960's and 1970's have so clearly revealed. In today's globalizing environment characterized by deeper forms of integration among nations and the operation of regional and global innovation (R&D) and production networks, the question

does arise of which means of integration is more successful and more fundamental in driving trade integration? Is there a logical sequence for policymakers to consider when examining these two channels of integration? Given that Asia and Latin America are two fertile regions in which various types of PTAs have been proliferating in recent years, we turn briefly to the experiences of these two regions in seeking answers to the above questions.

Compared to Latin America, Asia has long lagged in concluding formal trade agreements as key trading powers in the region – notably Japan, Korea, Singapore and Hong Kong, China had traditionally been more supportive of an open multilateral system, while China and Chinese Taipei themselves only recently joined the WTO.

The process of regional integration in Asia can be regarded as *de facto* in character even though since the end of 1990s most East Asian countries have shown considerably greater interest in *de jure* regionalism. The recent momentum towards formal *(de jure*) regional integration has been accompanied by the proliferation of bilateral PTAs not only within Asia but also with extra-regional countries, in particular with Latin America. Figure II.2 and Table II.1 below capture this process in a graphic manner, describing the intricate web of bilateral and plurilateral PTAs now in existence or under negotiation in the Asian region.

After a first wave of largely failed attempts promoting treaty-based forms of regional integration in the 1960's and 1970's, Latin American countries renewed with *de jure* integration efforts in the early 1990s, with two agreements - the 1994 North American Free Trade Agreement (NAFTA, linking Canada, Mexico and the United States, itself an extension of the 1988 Canada-United States Free Trade Agreement) and the 1995 Common Market of the South (MERCOSUR), linking Argentina, Brazil, Paraguay and Uruguay, setting a process in motion that would witness the emergence of a large and growing number of bilateral and regional PTAs among Latin American countries and with extra-regional countries by the end of 1990s (see Figure II.3 below). It is noteworthy that, given the different models of regional integration that have predominated in the two regions, intra-regional trade in Latin America remains considerably lower – by a factor of almost four to one - than that observed in East Asia despite Latin America's putative first mover advantage in *de jure* integration (see Table II.1).

Table II.1 East Asian and Latin American Intra-Regional Trade, Various Years

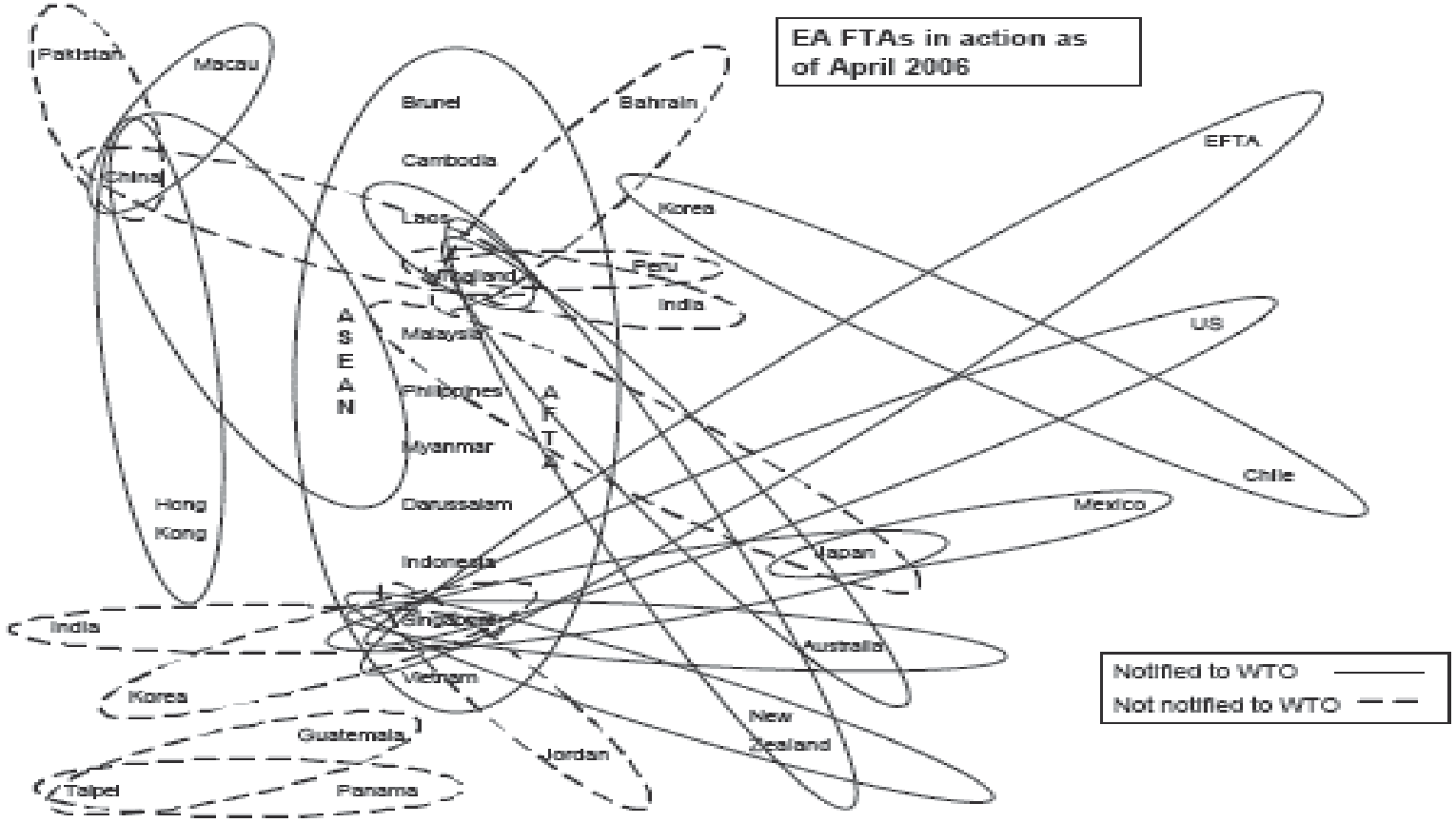
Year	Share of Intra-Regional East Asian Exports in Total East Asian Exports	Share of Intra-Regional Latin American Exports in Total Latin American Exports
1985	34,1%	10,0%
1990	39,7%	10,9%
1995	48,1%	17,2%
2000	46,4%	13,1%
2006	51,7%	13,1%

Source: Adapted from Aminian *et al*. (2007) based on UN COMTRADE Statistics.

The (timid) starting point of Asian *de jure* integration came with the Free Trade Area (AFTA) initiated by the member countries of the Association of Southeast Asian Nations (ASEAN) in 1992 (see Box II.1). This process had been preceded by the launch in 1989 of the Asia-Pacific Economic Cooperation (APEC) forum (Petri, 2006). APEC of course is not a formal regional trade agreement but a rather unique institutional setting – a best practice club of sorts – aimed at promoting trade and investment liberalization, economic and technical cooperation and regulatory convergence on a voluntary basis among its twenty-one member economies. Although APEC is not a PTA in legal terms, it features a roadmap – known as the Bogor Goals - to achieve free trade and investment in the region by 2010 for its developed country members and by 2020 for its developing country members.[6]

[6] At Osaka in November 1995, an agreement was reached on a set of fundamental principles to bring about the liberalization of trade and investment among APEC member economies. If the Bogor Goals are realized and the commitments of the twenty-one member economies are fully implemented, APEC countries could enjoy a substantial improvement in aggregate welfare through free trade and investment opportunities in the region, without however having formally entered into formal treaty arrangements. APEC adopted "open regionalism" as its underlying paradigm with the intention of sharing the benefits of free trade with non-members and thus trying to comply with the most favoured nation (MFN) principle of the WTO. The work of APEC in trade and investment liberalization has not however achieved the hoped for success so far. However, this need not necessarily be viewed as a failure of "open regionalism", but rather the result of the broadening of APEC's agenda, which now includes such topics as security, trade facilitation and best practices in regulatory reform.

Figure II.2 On the Rise: Asian PTAs, April 2006



Source: Nicolas (2006)

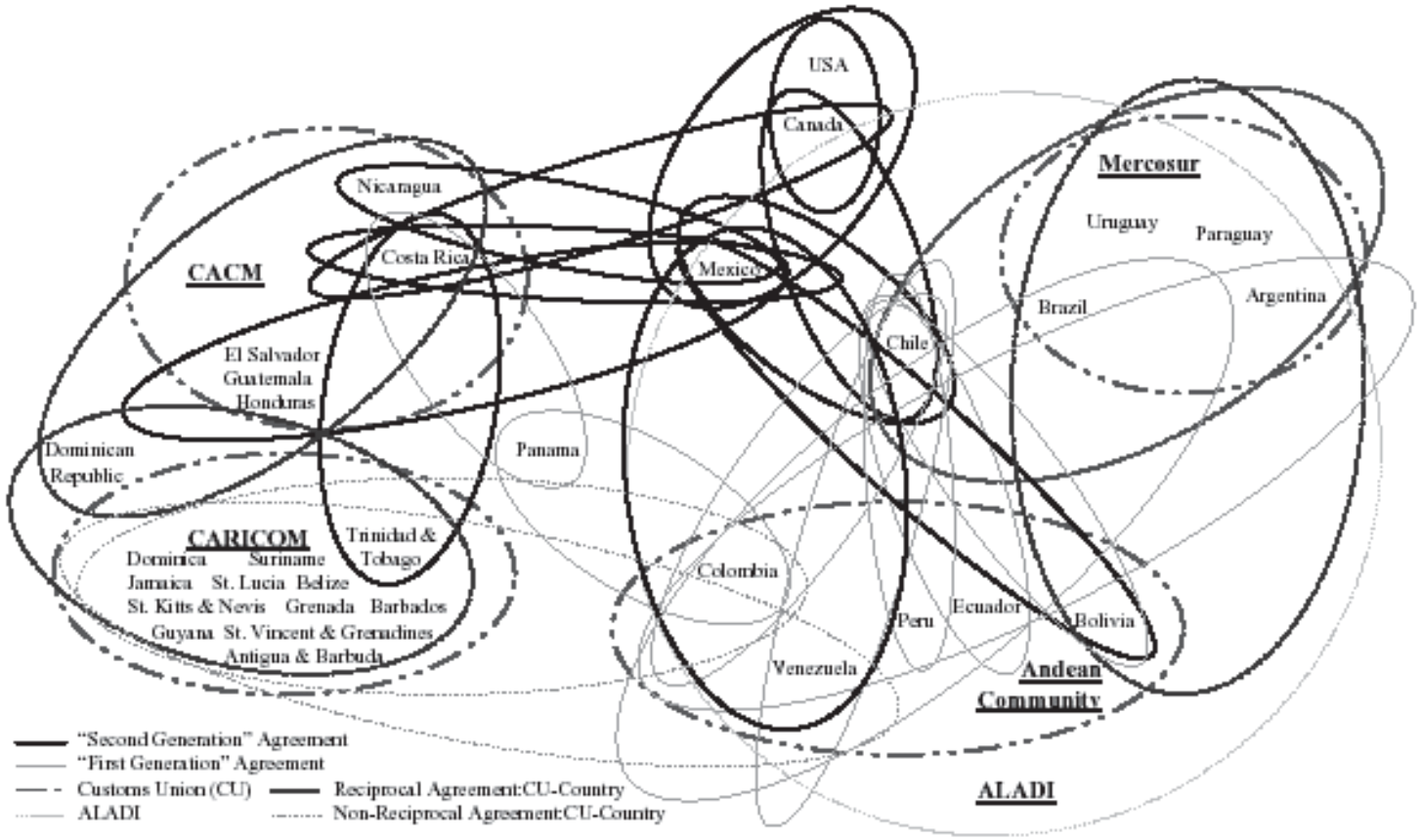
Table II.2 A typology of PTAs in Asia
(Entries in italics refer to agreements under negotiation)

Bilateral		Regional/Plurilateral	
Exclusively East Asian	**Geographically diverse**	**Exclusively East Asian**	**Goographically diverse**
Japan-Singapore (2002)	China-Pakistan (2005)	AFTA (1992)	APEC (1989)
Japan-Malaysia (2005)	China-Chile (2006)	China-ASEAN (2004	Singapore-EFTA (2003)
Japan-Philippines (2006)	*China-Australia*	(goods) and 2006	Korea-EFTA (2005)
Japan-Brunei (2007)	*China-New Zealand*	(services)	*Thailand-EFTA*
Japan-Indonesia	*Indonesia-Australia*	Korea-ASEAN (2006)	*ASEAN-India*
Japan-Korea	Japan-Mexico (2005)	*Japan-ASEAN*	*China-GCC*
Japan-Thailand	Korea-Chile (2004)		*China-SACU*
Japan-Vietnam	Korea-United States (2007)		Trans-Pacific (Singapore,
Korea-Singapore (2006)	*Japan-Australia*		Brunei, New Zealand, Chilei)
Malaysia-Korea (2005)	*Japan-India*		(2005)
Thailand-China (2003)	*Korea-Mexico*		*EU-ASEAN*
Thailand-Laos (2001)	*Korea-Canada*		*EU-India*
China-Hong Kong (2004)	*Malaysia-Australia*		*EU-Korea*
China-Macao (2004)	*Malaysia-New Zealand*		
	Malaysia-Pakistan		
	Malaysia-United States		
	Singapore-New Zealand (2001)		
	Singapore-Australia(2003)		
	Singapore-United States (2004)		
	Singapore-Jordan (2004)		
	Singapore-India (2005)		
	Singapore-Bahreïn		
	Singapore-Canada		
	Singapore-UAE		
	Singapore-Egypt		
	Singapore-Kuwait		
	Singapore-Mexico		
	Singapore-Pakistan		
	Singapore-Panama (2006)		
	Singapore-Peru		

	Singapore-Qatar *Singapore-Sri Lanka* Thailand-India (2003) Thailand-New Zealand (2005) Thailand-Australia (2005) Thailand-Bahrein (2002) Thailand-Peru (2005) *Thailand-United States*		

Source: Nicolas (2006); updated by author.

Figure II.3 A Western Hemisphere spaghetti bowl: the landscape of preferential trade agreements in the Americas, end-2005



Source: Stephanou (2007).

Box II.1 Trade and investment liberalization within ASEAN: stylized facts

The Association of South East Asian Nations (ASEAN) encompasses 10 South East Asian countries: Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Burma/Myanmar, Philippines, Singapore, Thailand and Vietnam. ASEAN has been one of the most successful regional groupings among developing countries to date. Its combined GDP (at purchasing power parity) totalled US$ 2.86 trillion at the end of 2006, roughly 4.3 of the World GDP, while its exports reached US$ 769 billion, approximately 8 percent of total world exports.[7] The ultimate objective of the ASEAN Free Trade Area (AFTA) is to increase ASEAN member countries' competitive edge as a production base geared towards the world market through trade and investment liberalisation and closer economic co-operation. Currently, four main ASEAN agreements seek to achieve this objective. These are:

(i) the Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (CEPT-AFTA), which was signed in 1992;
(ii) the ASEAN Framework Agreement on Services (AFAS), which was signed in 1995;
(iii) the Basic Agreement on the ASEAN Industrial Cooperation Scheme (AICO), which was signed in 1996; and
(iv) the Framework Agreement on the ASEAN Investment Area (AIA), which was signed in 1998.

T*rade in Goods*

The CEPT-AFTA is a cooperative arrangement amongst ASEAN Member Countries whose aim is to reduce intra-regional tariffs and remove non-tariff barriers. This process, which began on 1 January 1993, seeks complete tariff elimination by 2010 for the regional grouping's most advanced economies – the so-called ASEAN 6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) and by 2015 for its four poorest members, the so-called CLMV group (Cambodia, Laos, Myanmar, Vietnam).

ASEAN members have made significant strides in liberalizing trade in goods within the region under the AFTA. In January 2003, tariffs between member countries were reduced to 0-5% for all products, except those on the general exception and sensitive product lists of each member country.

The ASEAN Secretariat reports that tariffs on 98.99% (or 65,080 out of the total 65,743 tariff lines) of the products of the ASEAN-6 have been reduced to a 0-5 percent tariff range. For the four (CLMV) remaining members, 71.05% of tariff lines are today in the 0-5 percent tariff-range. Overall, 88.84% of ASEAN tariffs are now in the 0-5%, and 46,600 of these tariff lines are at 0% (Cordenillo, 2006).

Intra-ASEAN trade dominates ASEAN trade, followed by trade with Japan, the USA, the EU (15) and then China. The period since 1993 has witnessed important shifts in the structure of ASEAN trade flows, with reductions in the share of trade of Japan, the US and the EU (15) having been absorbed by intra-ASEAN trade, China and other markets. This shows that over the years, not only has intra-ASEAN trade grown, but that ASEAN countries have also diversified their markets. The most recent figures show that the fastest growing trading partners of ASEAN are Russia, India, China, Australia and New Zealand. With the exception of Russia, all are trading partners with whom ASEAN countries are currently involved in FTA negotiations.

[7] CIA(2007).

Trade in Services

The service sector today plays an increasingly important role in ASEAN economies, as reflected in the rising share of the service sector in GDP, employment and export performance. The ASEAN Free Trade Agreement on Services (AFAS) signed in 1995 recognizes such developments and aims at harnessing them for the mutual development of the region's economies. The year 2015 has been agreed as the end-date for the liberalization of all services sector across the region.

Under the AFAS, ASEAN countries endeavour to substantially eliminate restrictions to trade in services amongst themselves; to improve the efficiency and competitiveness of ASEAN service suppliers by progressively liberalising services sectors; and to promote cooperation amongst service suppliers across the region. Since its entry into force in 1996, 5 packages of commitments building on each Members' WTO GATS commitments have been agreed.

A number of sectors have been prioritised under AFAS, including: business services, communications, construction, finance, health-related services, recreational services, transport and tourism. In order to support the liberalization of trade in services, a Mutual Recognition Agreement (MRA) in engineering services was signed in 2004 and an MRA for nursing in 2006. MRAs in architecture, accountancy, land surveying and tourism are currently also under discussion.

Foreign Direct Investment

Foreign direct investment has historically played a prominent role in integrating ASEAN economies in regional and global production networks. Conceived in the immediate aftermath of the Asian financial crisis with a view to enhancing the region's battered investment climate, work towards achieving an ASEAN Investment Area (AIA) was formally launched in January 2003 through liberalisation of a temporary exclusion list for FDI in manufacturing. Its aim is to substantially increase the flow of investments into ASEAN from both ASEAN and non-ASEAN investors through a liberal and transparent environment.

While the AIA aims to attract greater doses of FDI in all sectors, it devotes particular attention to five sectors and to services incidental to such sectors. These are: (i) manufacturing; (ii) agriculture, (iii) fishery, (iv) forestry and (v) mining and quarrying.

FDI inflows to ASEAN grew by 39% to US$25.6 billion in 2004, the latest year for which FDI data is currently available. ASEAN's top FDI sources are the European Union, the United States and Japan. It bears noting that intra-ASEAN FDI is the fourth largest source of foreign investment in the region. Meanwhile, by sector, manufacturing, financial services and mining and quarrying are the top three FDI recipients.

In addition to the significant FDI inflows to the region, ASEAN member countries like Singapore and Malaysia today rank among the world's largest outward investors. Such developments suggest that a number of ASEAN firms have already established a track record among the world's leading investors and are actively pursuing portfolio diversification strategies to remain globally competitive.

As with the AFAS, investment liberalization under the AIA is undermined by extensive lists of sector-specific exemptions, revealing a reluctance of some member countries to make binding commitments in an area where domestic policy has long been quite open and where significant unilateral liberalisation has occurred (Sauvé, 2006). For Lao PDR, Vietnam, and Myanmar, the AIA will only become effective in 2010.

Starting in the late 1990s, leading Asian economies began to seek an accelerated path towards regional integration, namely via the conclusion of a growing number of preferential trade agreements. These typically took the form of free trade agreements or, when extended to new areas of economic cooperation, what came to be known as closer economic partnership (or relations) agreements typically featuring comprehensive disciplines on trade and investment liberalization. As noted above, the ASEAN Free Trade Area (AFTA) was set up formally to realize a free trade area within 15 years, beginning on 1 January 1993. In September 1994, AFTA's time frame was shortened to 10 years with the aim of achieving the Agreement's goals by 2003.

During this period, ASEAN's membership expanded to ten countries to include Cambodia, Laos, Myanmar and Vietnam, the so-called "CLMV" countries. ASEAN members agreed to eliminate tariffs among the original ASEAN six members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) by 2010 and by 2015 for CLMV countries. Moreover, the leaders of ASEAN announced that they aimed to transform the AFTA into an ASEAN Economic Area with full, EU-like, mobility of goods, services, capital and people by 2015.

The period since the late 1990's also saw key Asian trading powers progressively renounce their MFN-centric approach to trade policy and engage in preferential liberalisation initiatives within and outside the region. Japan initiated the movement by first seeking a PTA with Mexico so as to achieve *de facto* NAFTA parity in North American markets but negotiations with the Mexican government did not progress smoothly. The first PTA signed by Japan was a "New Age" free-trade agreement with Singapore in October 2002. The agreement included provisions aimed at promoting mutual recognition on some licensing procedures and increasing worker mobility between the two countries. Japan finally reached agreement on a PTA with Mexico in 2004. It has since concluded PTA negotiations with Brunei, Malaysia and the Philippines and is negotiating with Australia, Indonesia, India Korea, Thailand and Vietnam as well as with the whole of ASEAN.

China joined the WTO in 2001 and is in the process of implementing its ambitious set of accession commitments. The onerous nature of such commitments may explain why China's interest in regional trade agreements was initially somewhat muted. This however has since changed as China's economic diplomacy has been highly active in recent years, both within and beyond the Asian region. China today notably ranks among one of the countries with the most extensive network of bilateral investment treaties. On the trade front, China has acted decisively to assert its economic leadership in the region by concluding PTAs with ASEAN (initially on trade in goods in 2004 followed in 2006 by a PTA on trade in services). It has also

concluded PTAs with Chile and Pakistan and is negotiating PTAs with Australia, New Zealand, the member countries of the Gulf Cooperation Council (GCC) as well as with the member countries of the Southern Africa Customs Union (SACU).

Korea and Singapore have also been particularly active recent converts to the cause of preferentialism. As Table II.2 above reveals, Singapore operates the most extensive network of PTAs in East Asia and remains active on numerous negotiating fronts within and outside the region, aiming to consolidate its key role as a trade and FDI hub. Korea has similarly completed PTAs with a large number of countries in the region and beyond, including the member countries of the European Free Trade Association in 2005 and, most significantly, with the United States in 2007.

China, Japan and Korea have also been discussing and investigating the feasibility of a trilateral PTA. Separately, Japan and Korea have announced a desire to conclude a bilateral PTA. China appears hesitant for various historical and political reasons to enter into a bilateral PTA with Japan as it competes with the latter for economic and political leadership in the region. China secured a regional first mover advantage over Japan through its agreements with ASEAN, which Japan has yet to replicate. While China may have raced ahead with ASEAN as a group, Japan is further along with individual ASEAN member countries. Meanwhile, efforts are afoot to expand the circle of ASEAN-led integration to China, Japan and Korea (so-called ASEAN +3, and to link such a configuration to Australia, India and New Zealand (ASEAN +3+3, or the so-called East Asian Summit).[8]

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[8] The creation of an East Asian Community was agreed by East Asian leaders at a meeting held in Vientiane, Laos, in November 2004. The first East Asian Summit was held in Kuala Lumpur, Malaysia in December 2005, with the participation of ten ASEAN Members together with China, Japan, Korea (the so-called ASEAN+3 grouping) as wel as India, Australia and New Zealand. A second Summit was held in Cebu, The Philippines, in January 2007. The idea of creating an East Asian Community was first proposed by the East Asia Vision Group in 2001. The Vision Group called for reinforced cooperation among the ASEAN+3+3 countries in the areas of trade, finance, security, environment, culture and institutions. According to the Vision Group, the principal aims of an East Asian Community relating to trade and investment integration can be summarized as follows: (i) establishment of the East Asian Free Trade Area (EAFTA) and liberalization of trade well ahead of the APEC Bogor Goal (2020 for developing country members); (ii) expansion of the Framework Agreement on an ASEAN Investment Area to all of East Asia; (iii) promotion of development and technological cooperation among regional countries to provide assistance to less developed countries; and (iv) realization of a knowledge-based economy and establishment of a future-oriented economic structure. The Group thus envisaged the progressive integration of the East Asian economies, ultimately leading to a pan-Asian economic community. Once a region-wide FTA was formed and institutions for regional policy research, financial management and exchange rate coordination were established, the Group felt that the basic foundations for an East Asian economic community will have been created. Work towards the establishment of an Asian Economic Community raises important issues of economic and political leadership and governance in the region, particularly as regards China and Japan. To date, China has tended to favour an ASEAN+3 route towards regional policy consolidation whereas Japan has tended to favour an ASEAN+6 architecture. Meanwhile, work on the vision continues to benefit from concrete

The recent surge in Asian PTA negotiations can be seen as the region's response to a number of important factors. First, the halting pace of multilateral negotiations at the WTO combined with the success of deeper integration initiatives within the EU and NAFTA, have raised interest in efforts at closer economic integration with 'like-minded' countries, including in the neighbourhood (Bergsten, 1997). The most recent generation of PTAs typically cover a number of policy areas that go well beyond existing multilateral disciplines and offer deeper market access commitments (OECD, 2007). This includes 'behind the border' subjects such as services, investment and competition policy that can lower service link costs between production networks, a subject to which we return below (Kimura and Ando, 2005; Thorbecke and Yoshitomi, 2006).

A second main reason behind the rising interest in institutionalized integration owes to the much keener sense of Asian interdependence that took root in the aftermath of the Asian financial crisis of 1997-98 which, combined with the 'benign neglect' of multilateral financial institutions like the IMF, resulted in increased support for heightened regional coordination and integration (Van Hoa, 2002; Nicolas, 2007).

Before 1997, most economists considered Asian economic cooperation (through trade and investment) as an example of a successful *de facto* regionalism, i.e. explained by the predominant interplay of market forces. However, the financial crisis of 1997-98 revealed the weaknesses of informal regional cooperation arrangements. The financial crisis and its subsequent contagion to a number of economies in Northeast and Southeast Asia painfully demonstrated that the region's economies were closely intertwined and that a resolution of the crisis called for heightened regional cooperation in the trade and financial fields.

A rising sense of Asian identity has emerged since the crisis. After the proposal to create an Asian Monetary Fund (AMF) failed to materialize over US objections, ASEAN leaders responded by inviting China, Korea and Japan to join in an effort to achieve greater economic cooperation in the region. The ASEAN+3 summit in November 1999 produced a "Joint Statement on East Asian Cooperation" that covered a wide range of areas for regional cooperation. In the early 2000s, other new economic situations - such as the quick recovery and recurring growth in Korea, the emergence of China as an economic superpower and the continued stagnant state of the Japanese economy – provided fresh impetus to new forms of Asian economic regionalism, including PTAs.

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backing from leaders, one recent example being the decision to create a pan-regional economic policy research institute (to be called the Economic Research Institute for ASEAN and East-Asia or ERIA).

Although the financial crisis might have been the direct cause, a number of additional factors have contributed to the breakthrough and proliferation of the policy-led regionalism in Asia. First, regionalism was the natural result of decades of fast growth and the industrial transformations and economic restructuring that came in its wake. In a very tangible manner, *de facto* regionalism has paved the way and greatly facilitated the region's subsequent quest for *de jure* integration. The developments depicted above have created a new centre of Asian economic gravity that has begun to pose a genuine competitive challenge to North America and Europe in terms of its contribution to world output, trade and FDI. This is so even as two-way trade and FDI linkages between Asia and both regions have deepened.

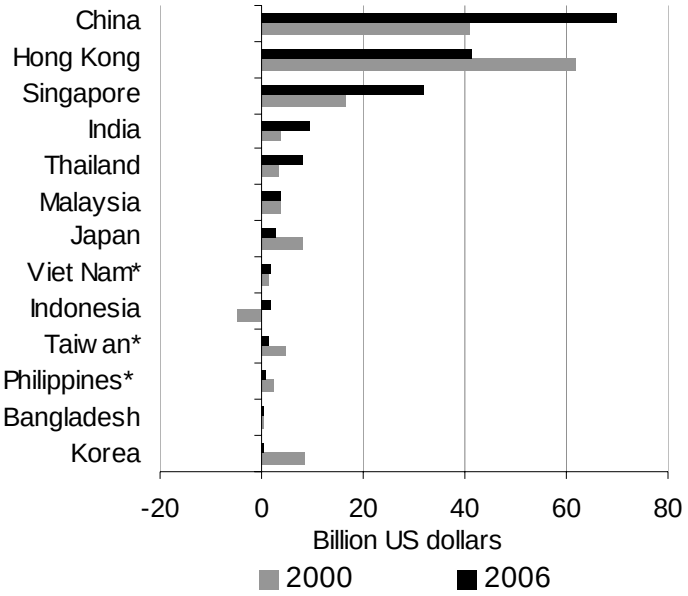
A third factor encouraging the trend towards de jure integration in Asia is also closely connected to the fallout from the financial crisis, and is linked to region-wide perceptions of "benign neglect" on the part of international financial institutions, particularly the IMF, in the aftermath of the Asian crisis. Policymakers in the region perceived that major international institutions and the main global trading powers, particularly the United States, fell short in their support for Asian economies or in the obstacles it placed on the path to deepened cooperation, particularly in the monetary and financial fields.

A final impulse is more inherently defensive in nature, owing to rising concerns throughout Asia over the competitive threats, including in terms of FDI attractiveness, of China's rise as the manufacturing hub of the world and of India's growing assertiveness in services innovation and trade.

There can indeed be little doubt that the rise of China and its growing economic and political influence and assertiveness in the region and beyond, appears to have elicited a more favourable view of regional and bilateral cooperation and agreements, notably in Japan whose private sector began to express fears over the loss of market shares, wild swings in currency values and declining FDI attractiveness (Pangestu and Gooptu, 2004; Masuyama, 2004; Gaulier et al., 2005; Damuri et al., 2006).

For countries like India, Malaysia and Thailand, who compete with China for horizontal FDI, Eichengreen and Tong (2006) note that these countries have experienced greater difficulties in attracting foreign investment as a result of China's emergence. The latter countries' version of the China threat – that of an "FDI sucking sound", has arguably provided them with a strong incentive to enter into PTAs (see Figure II.4 below).

Figure II.4 The rise of China: inward FDI-flows, 2000 and 2006



***** 2005 data.

Notes: UNCTAD notes that Korea's 2006 figure (0,5) is likely to be an underestimation.

Source: UNCTAD 2006 & 2007

Using the Asian Development Bank's Asian Regional Integration Center (ARIC) FTA Database, Kawai (2007) recently identified several key features of East Asian PTAs, focusing on their configuration, outward-orientation, scope (or "WTO+" nature) as well as the their rule of origin regimes. Box II.2 below summarizes the ADB findings.

Box II.2 Salient features of East Asian PTAs[9]

Configuration

East Asian PTAs can be divided into bilateral and plurilateral (regional) agreements. Bilateral refers to agreements between two countries, whereas the term "pluruilateral" covers agreements involving more than two customs territories, one territory (or territories) and a trading bloc, or two trading blocs. On the whole, East Asian countries are primarily opting for simple bilateral PTA configurations rather than the more complex plurilateral ones as the former may be easier and speedier to negotiate and may be preferred by leading trading partners. There were 25 bilateral PTAs concluded by East Asian countries as of mid-2007, representing 76% of all concluded PTAs). Among those currently under negotiation, bilateral PTAs also predominate, making up 80 % of the total. There are eight plurilateral agreements among concluded PTAs in East Asia, and an additional eight other agreements under negotiation.

[9] The ADB defines "East Asia" as comprising the following group of countries: the People's Republic of China, including the Special Administrative Regions of Hong Kong and Macau, Japan, the Republic of Korea, Mongolia and Taipei, China.

Orientation

Looking at East Asian PTAs, the high degree of outward orientation is striking. Of all concluded PTAs, 22 were with countries or groups of countries outside East Asia in mid-2007. The outward orientation of East Asian PTAs under negotiation is even higher at 85 percent. Having launched PTA negotiations with India, Australia and New Zealand, ASEAN as a group has most recently commenced PTA negotiations with the European Union. Singapore has concluded 8 cross-regional PTAs with a wide geographical spread from North and Latin America to the Gulf states. Korea, Thailand, China and Japan have also all concluded PTAs with trading partners in Latin America. China has concluded a PTA (goods only) with Pakistan and is negotiating PTAs with the member countries of the Gulf Cooperation Council as well as Iceland. The above trends lend support to East Asia's purported aim to maintain strong commercial ties with the rest of the world even as integration deepens internally.

Scope

The 33 PTAs (covering goods and/or services) concluded in East Asia can be broken down into four sub-categories based on their scope of coverage: (i) goods-only; (ii) goods and services; (iii) goods, services and the so-called "Singapore Issues" (e.g. trade facilitation, trade and investment, trade and competition, transparency in government procurement); and (iv) goods, services, Singapore Issues and deepened regulatory cooperation in areas such as labour standards, trade and environment, small and medium-sized enterprises, regulatory harmonization or convergence. Two thirds of PTAs agreed to date (i.e. by mid-2007) by East Asian countries – a total of 21 agreements, featured WTO+ provisions beyond goods and services trade (the treatment of trade-related intellectual property-related matters being subsumed under goods trade). Of the total, 9 feature disciplines on the Singapore Issues only while 12 are yet more comprehensive in scope by featuring disciplines on both the Singapore Issues and regulatory cooperation matters.

Rule of origin regimes

Rules of origin exist to determine which goods will enjoy preferential tariff treatment and thus prevent trade deflection among PTA members. Three such regimes can be found in PTAs: (i) a change in tariff classification (CTC) rule defined at a detailed Harmonized System (HS) level; (ii) a regional (or local) content or value-added rule requiring a product to satisfy a minimum regional (or local) value added (VA) in the exporting country or region of a PTA; and (iii) a specific process (SP) rule mandating a particular production process for individual goods or product categories. Of the 28 Free Trade Agreements (FTAs) concluded in East Asia, the majority – 18 – have adopted a combination of the three RoO regimes depicted above rather than applying one specific regime. Of the remaining, 3 adopt the VA rule, another 3 use a combination of VA and CTC rules, while another four combine VA and SP rules. The simplest rule of origin can be found under AFTA and the ASEAN-China FTA, which specifies a 40 percent regional value content (VA) across all tariffs. Many agreements involving Japan, Korea and Singapore tend to use a combination of rules of origin.

Source: Kawai (2007).

III. Trade and investment linkages and Asian economic integration: a literature review

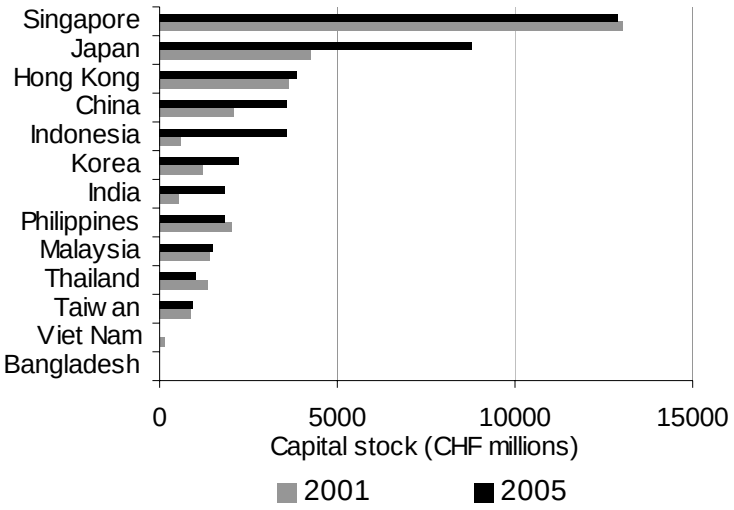
Key issues addressed:

- Recent trends in Asian trade and investment performance
- The rise of production sharing arrangements
- Determinants and evolution of trade and FDI linkages in Asia

III.1 Trade and investment linkages in Asia: key trends

FDI flows to Asia and Oceania reached a new high in 2006 of $230 billion - up 15% from 2005. The share of this region in total FDI to developing countries thus rose from 59% to 63%. In 2005, Swiss capital stock in Asia grew CHF 10 billion to CHF 45 billion. Singapore is the most important destination for Swiss FDI in Asia due to its function of serving as a hub of investments in other Asian countries (See Figure III.1).

Figure III.1 Swiss direct investment in Asia, 2001 and 2005

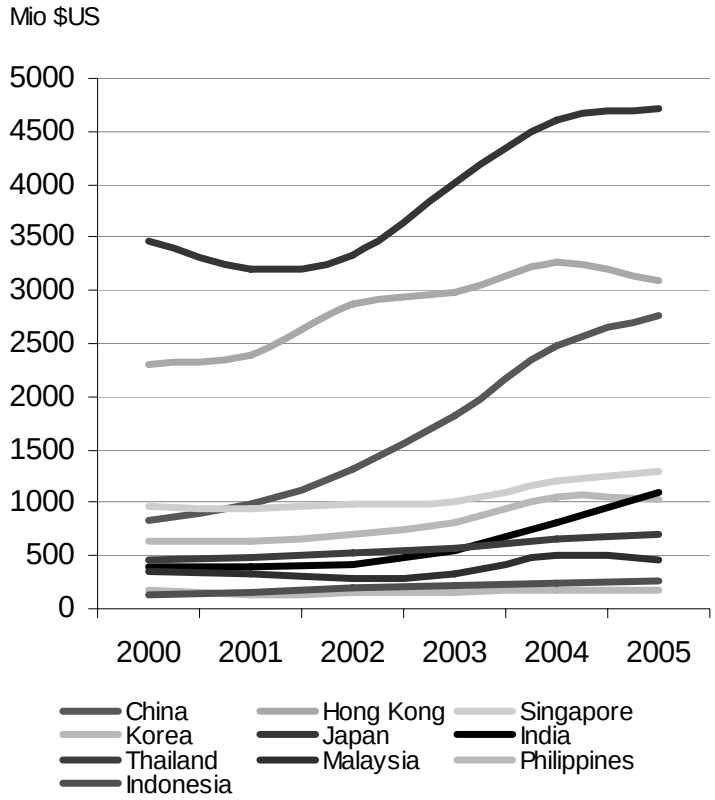


Source: Swiss National Bank 2006

Asian merchandise trade increased around 25 % from 2003 to 2004, and 16 % from 2004 to 2005. China is by far the biggest trader in the region, with merchandise imports worth $660 billion in 2005 and exports of $762 billion. In comparison, total ASEAN merchandise imports reached $594 billion, and total exports $653 billion. Japan and India exported for $595 billion and $95 billion, respectively, while imports were $515 billion and $135 billion. The bulk of Swiss exports to the region are destined to Japan, China and the two ports, Hong Kong and Singapore, often for re-exporting (See Figure III. 2).

In 2005, the value of world commercial services exports grew by 11 per cent, to US$2.4 trillion (see table IV.1 below). Cross-border commercial services exports expanded for the third year in a row less rapidly than world merchandise exports. Asia's commercial services exports and imports have been far more dynamic than world commercial services trade. China's and India's services trade expansion exceeded that of other Asian countries by a large margin, although incomplete information (China) and methodological changes in recording (India) exclude a precise year-to-year comparison at this moment (WTO, 2006).

Figure III.2 Swiss exports to selected Asian countries, 2000-2005



Source: UNCOMTRADE database

Compared to merchandise trade, the volume of Asian trade in commercial services remains of marginal (if growing) importance. Table III.1 documents the ratio of commercial services trade to total merchandise trade across major trading regions and countries at year-end 2005. ASEAN services exports amounted for just under a sixth (15,9%) of merchandise exports in 2005, a level significantly below that obtaining in the OECD area though marginally higher that that of MERCOSUR member countries (14,1%). A measure of SwitzerlanId's specialization in services can be gleaned by the fact that its ratio of 35,7 percent exceeds that of North America (28,7 percent) and the EU-25 (27,7 percent) by a

significant margin and is only slightly lower than that of the United States at 39,0 percent. Also noteworthy is the remarkably high contribution that services trade makes to India's overall trade performance, the country's ratio of commercial services exports to merchandise exports standing at 75,9 percent in 2005.

Table III.1 Ratio of commercial services trade to total merchandise trade, selected regions and countries, 2005 (percentages)

	Exports	Imports
North America	28,4	16,3
United States	39,0	16,7
EU-25	27,7	25,1
Switzerland	35,7	20,7
Asia	19,6	22,9
China	10,6	12,9
India	75,6	50,8
Japan	18,0	26,4
ASEAN (10)	15.9	22,3
MERCOSUR (4)	14,1	27,4

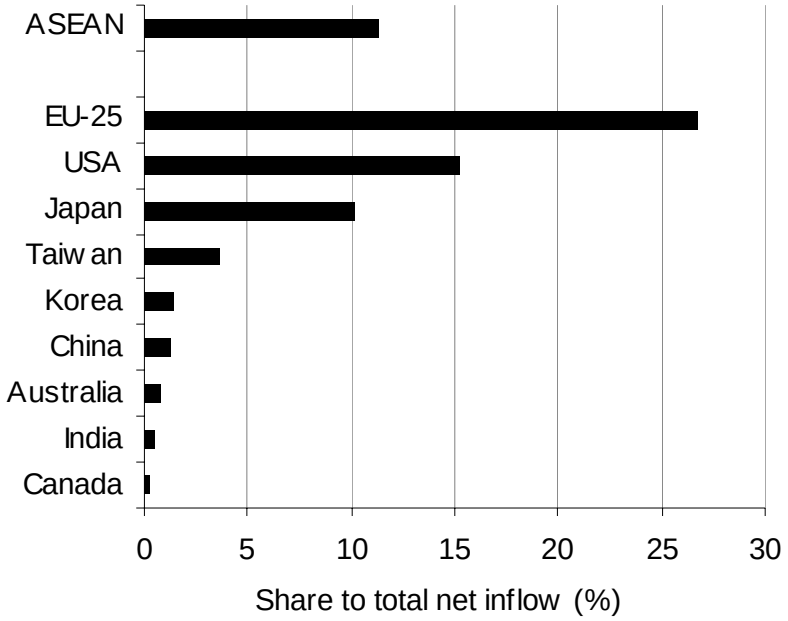
Source: WTO (2006)

Services trade will of course assume greater prominence throughout Asia in the not too distant future, however, as privatization and market liberalisation initiatives take root further, physical infrastructure improves, the supply of skilled human capital increases and as the relocation of service sector R&D, call centres and back-office operations of increasing sophistication continue to expand throughout the region and as the creation of regional and global supply chains redefine the international landscape of services trade and investment. Such a trend can already be observed in India, where trade in commercial services increased 22 % in 2003-05 compared to a 16 % increase in merchandise trade and where services exports accounted for three quarters of merchandise exports at the end of 2005. Also, while developed countries dominate services trade overall, Asian countries such as the Philippines, Singapore and Hong Kong have utilized their ports as hubs for international trade by becoming global players in sectors such as shipping and trade facilitation services.

Most FDI to and from the Asian region continues to come from the EU, the US and Japan. However, apart from Japan, other Asian countries are increasingly investing within the region (Figure III.3). Taiwan thus invested more than $4 billion in ASEAN countries during the 2001-2005 period, making the island economy the 6th largest investor in the ASEAN block. Korea and China are also investing heavily in the region, having become the 9th and 10th most important investors, respectively, to ASEAN from 2001 to 2005. During the same period,

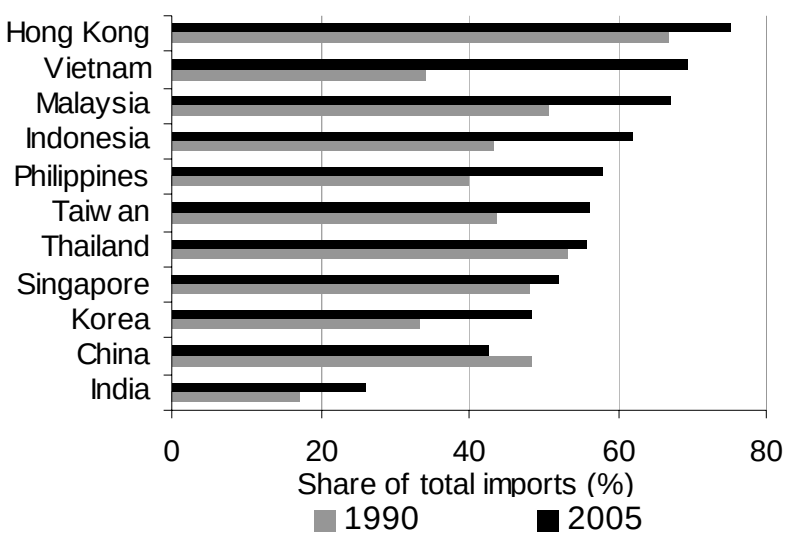
intra-ASEAN FDI was more than $13 billion, constituting 11 percent of total FDI to the region. As with FDI, there is a parallel rise in intra-Asian imports and exports (Figures III.4 and III.5). An estimated 14 % of world trade took place was among Asian countries in 2005, with 51 % of merchandise exports and 58% of merchandise imports staying within the region.

Figure III.3 ASEAN FDI net inflow from selected countries/regions, 2001-2005



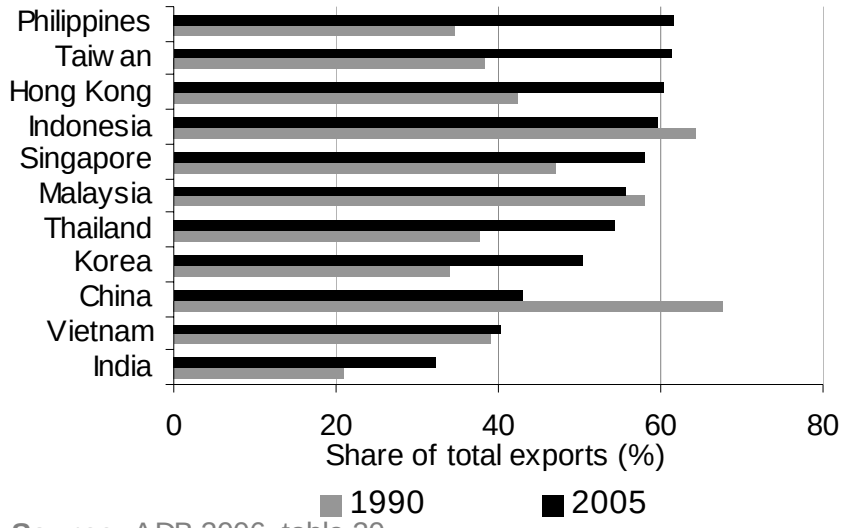
Source: ASEAN 2006, tables 26 & 27

Figure III.4 Merchandise imports from Asia, 1990 and 2005



Source: ADB 2006, table 21

Figure III.5 Merchandise exports to Asia, 1990 and 2005



Source: ADB 2006, table 20

III.2 The emergence of regional production networks

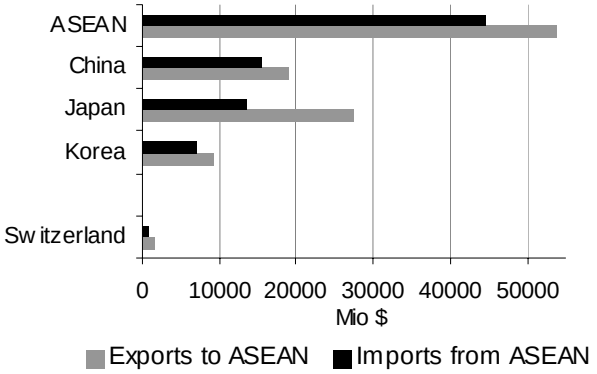
International production sharing - or the fragmentation of vertically integrated supply chains - is widespread in Asia (UNCTAD, 1993; Hummels et al., 1998; ADB, 2003). In turn, Asian production networks have contributed to a gradual 'upgrade' of comparative advantages and industrial capacities into products – goods and services - with higher sophistication and technological intensity (Gaulier et al., 2005; Damuri et al., 2006). In the following section, we review the voluminous literature devoted to the emergence of such networks, with a particular focus on East and South-East Asia.

While international/regional production networks have been observed between Germany, Hungary, and the Czech Republic in Europe and between US and Mexico in North America, their Asian brethren are distinctive since they:

i) have become a substantial part of each country's economy and trade;
ii) involve large numbers of countries at different income levels; and
iii) include both intra- and inter-firm relationships (Kimura and Ando, 2003).

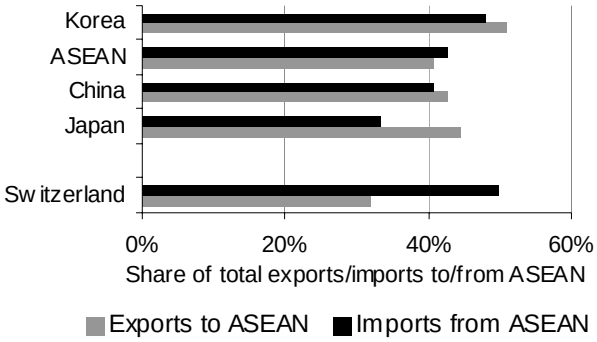
There are numerous quantitative indicators depicting the emergence of production networks and their effects. One such indicator looks at trade in machinery and parts (see Figures III.6 and III.7 and Appendix 2 for a definition). ASEAN and East- and North-East Asian countries trade heavily with each other in these intermediary product categories.

Figure III.6 ***Trade with ASEAN in machinery parts and components, 2005 (imports)***



Source: UN COMTRADE online database

Figure III.7 ***Trade with ASEAN in machinery parts and components, 2005 (exports)***



Source: Own calculations, based on UN COMTRADE online database

This suggests a large portion of back-and-forth transactions of intermediary goods in regional and international production networks. Firms from Switzerland are highly integrated into these networks, as almost 50% of Swiss imports from the ASEAN bloc consists of machinery parts and components (see Figure III.6). [10]

Using data for the ASEAN-5 economies[11], China, Japan, Korea, Hong Kong, and Taiwan, Thorpe and Zhang (2005) find that while intra-industry trade consisted of 25 % of all trade in 1971, the proportion increased to slightly more than half by 1996. Horizontal intra-industry trade (HIIT) dominated during this period, but vertical intra-industry trade (VIIT) also played a significant role throughout.

Fukao et al. (2003), Athukorala and Yamashita (2006), Wakasugi (2007) also find that production sharing through FDI has substantially increased VIIT in East Asia. The result has been that developing Asia's share of world trade in parts and components rose from 16 % in 1992 to 32 % in 2003, exceeding the share of NAFTA and equalling that of the EU in 2003 (Athukorala and Yamashita, 2005).

One crucial factor in the development of production networks has been the industrial policies of many developing (particularly East) Asian countries. Even though Asian latecomers, such as Cambodia, Laos, Myanmar and (less so) Vietnam (the so-called CLMV countries), all have low labour costs, poor government support policies have so far prevented them from being significantly connected to such networks (Kimura and Ando, 2003; Bui, 2004). Conversely, countries such as Singapore, South Korea, Taiwan, Hong-Kong, Thailand,

[10] Figures vary depending on the reporting country; in this case ASEAN records of imports/exports are used.
[11] Indonesia, Malaysia, Philippines, Singapore, Thailand.

Indonesia, the Philippines, China, and Malaysia, have all been relatively successful in implementing 'export processing zones', duty-drawback systems, etc.

Traditionally, the latter countries tried to promote a 'dual track approach'; i.e. fostering both import-substituting industries and export-oriented industries at the same time (Radelet, 1999, UNCTAD, 2002; Pangestu, 2003; Brooks and Hill, 2004). Over the last 20 years, however, most Asian countries have switched their industrial/FDI policies from a policy of selective acceptance to one predicated essentially on 'accepting everybody' (Kimura and Ando, 2003, 2005; Hill, 2004). Such a shift has coincided with increased activities linked to the outward investment by the region's more developed economies (see figure 3; Damuri et al., 2006). East Asian production networks have thus given rise to a 'triangular trade pattern': Japan and the newly industrialised countries[12] (NIEs) export capital and intermediate goods to ASEAN countries (excl. Singapore) and China, which in turn process them for exports destined to the US and European markets (Ng and Yeats, 1999; Gaulier et al., 2005; Kimura and Ando, 2003).

China is particularly interesting in this regard, as its economic development process is currently realigning production and FDI patterns throughout the Asia region (Wang, 2004). More than 80% of intermediate Chinese imports come from Asia and more than 60% of Chinese exports of parts and components are directed to Asia. China's share in intra-regional trade almost doubled from 1990 to 2002, from 10% to 20%. Both Asian and non-Asian multinational enterprises (MNEs) have thus turned towards China in recent years, and in particular to industrial clusters such as the Pearl and Yangtze River Deltas (Zhaoyong and Kang, 1997). Gaulier et al. (2005) report that 40 % of Chinese processed exports consists of intermediate goods supplied by Japan, Hong Kong, South Korea and Taiwan. Masuyama (2004) reports that many Japanese electronics firms thus either closed or reduced their presence in ASEAN countries during the late 1990s and early 2000s, while shifting investment to China, most of which is focused on exploiting production networks to build export platforms. For NIEs, investments in China typically constitute part of a larger international production network linked with firms in advanced economies (Masuyama, 2004). Taiwanese investments in China have for instance mostly focused on assembling IT products and components of companies such as Dell and IBM (Jenn-hwa, 1997; Masuyama, 2004). Major Korean conglomerates have similarly made substantial investments in high-tech sectors. China's emergence has contributed in no small measure to increased calls for regional cooperation and integration through trade and investment agreements in Asia.

[12] Hong Kong, Singapore, South Korea and Taiwan.

As the possibility and costs of production sharing varies substantially depending on the technique of production, vertical specialisation is stronger in some industries, such as the machinery and electronics sectors (Gaulier et al., 2005). In the electronics sector, intra-firm trade accounted for over 43 % of East Asian trade with Japan in 2000, for instance. Meanwhile, electronics MNEs from Singapore and Taiwan have relocated lower-end production to neighbouring countries such as Malaysia, Indonesia and the Philippines (Yue, 1997; Pangestu, 1997; Jenn-hwa, 1997; Ling and Yong, 1997; Alburo and Gochoco-Bautista, 1997). Lall et al. (2004) and Ernst and Guerrieri (1997) thus find strong East Asian networks in the electronics sector with substantial impacts on regional and extra-regional trade flows. To illustrate, Table III.2 below looks at trade with China in one specific product component of electrical machinery – telecommunications parts and accessories (SITC 7649). This is the 4-digit product most traded by Japan, China, and ASEAN 5 countries, accounting for 60 percent of electronics exports of East- and South East Asian countries (ADB 2007). Growth of trade in SITC 7469 has been fastest in China, and Japan, Hong Kong and Korea are playing particularly important – and growing - roles in this process. Korean exports of these components to China were for instance 35 times higher in 2005 than in 1995.

Table III.2 ***Trade with China in electrical machinery parts and components*, 1995 and 2005***

Exports/ imports (mio. $)	1995	2005
Switzerland	6,153	8,273
	0,721	5,550
UK	90,964	58,579
	12,602	324,098
Germany	66,206	171,846
	62,961	628,972
USA	400,996	467,602
	263,807	2387,952
India	0,000	2,107
	12,398	254,314
Philippines	0,914	15,579
	3,890	145,480
Indonesia	0,280	25,928
	15,935	44,256
Thailand	5,158	71,920
	14,639	308,491
Singapore	95,431	408,851
	128,044	1623,544
Japan	478,992	2891,724
	511,392	3412,969
Korea	136,535	4714,924
	120,849	965,906
Malaysia	13,795	251,335
	82,645	706,466
Hong Kong	3089,476	15057,711
	1304,285	8376,421

** SITC code 7649*
Source: UN COMTRADE database

It is important to recall however that even when the manufacturing sector is often the predominant focus of regional production networks, the service sector has a key role too. At a general level, the reduction in 'service links costs' - i.e. transport costs, telecommunication costs, and various search and coordination costs - allow investors to take advantage of economies of scale and specialization in the region (Kimura and Ando 2003). Well functioning providers of roads, ports, electricity, water supply, telecommunications and various business services are thus the very building blocks of the fragmentation of production.

Furthermore, service providers are no longer solely the 'instrument' of production

networks in the region. Efficiency seeking FDI is increasingly turning towards R&D, outsourcing and back office services, covering computer and related, business, professional and financial services (OECD, 2004a). As noted already, India has proven particularly adept in these areas, but countries such as Hong Kong, Korea, Malaysia, Singapore, Taiwan, and – to a lesser extent - Vietnam and the Philippines are becoming important players too. The above analysis suggests that considerable potential exists for economically beneficial reforms in the service sector, which would further strengthen Asian production networks to the benefit of all economic actors – domestic and foreign - present in the region.

III.3 Trade-FDI linkages

As Asian economic integration increases, a key question for third countries is what effect this will have on FDI and trade flows? At a general level, international trade and FDI can be either *substitutes* or *complements*. If multinationals tended to sell locally in host nations instead of exporting from the home or a third country, FDI would substitute for exports. One distinct reason for trade substitution is the case of 'tariff jumping', where investment is chosen over exports due to the high costs of cross-border trade. Alternatively, FDI complements international trade if the demand for intermediate inputs and other products from the home country as well as third countries increase as a result of FDI activity abroad. Also, multinationals abroad might facilitate marketing and distribution channels and thus create new opportunities for trade. Substitution effects would be detrimental to investor and third countries except in the case of tariff-jumping, where the welfare effects are ambiguous. Complementary effects are beneficial for both investor and third countries. After briefly reviewing the overall empirical evidence of the relationship between trade and investment, we address what the literature has found on these linkages in Asia.

III.3.1 General observations on trade-FDI linkages

Substitutes or complements?

In their studies on US investment abroad, Lipsey and Weiss (1981, 1984) find positive associations between exports and FDI, as well as a positive correlation between total exports of the parent and the local production of the affiliate. This result has been confirmed by several US-based studies. Sachs and Shatz (1994) investigate US bilateral trade with 40 countries and find that the share of intra-firm bilateral trade is associated with much higher overall US trade with the country considered. Buigues and Jacquemin (1996) examine US direct investment in the EU across six industries over ten years, and similarly find a complementary relationship between FDI and exports. In a later study, Hejazi and Safarian

(2001) also find that US exports are positively affected by outward FDI in both manufacturing and services. At the macro-level – as opposed to the firm or industry level - Eaton and Tamura (1994) investigate bilateral exports and FDI-flows between the US and about 100 other countries from 1985-1990, and find a large and positive relationship between outward FDI and exports. This is confirmed by Graham (1998). For the OECD area as a whole, OECD (1998) finds large FDI-associated trade flows for most OECD countries from 1980-1995. Using slightly more rigorous techniques, Henry (1994) comes to the same result.

The FDI-trade relationship is likely to vary across contexts, however. Investigating 458 of the world's largest industrial MNE's, Pearce (1990) concludes that the positive association between exports and FDI is particularly prevalent for intra-firm – as opposed to inter-firm - exports. This highlights the importance of vertical relationships among international affiliates, which is of particular relevance for Switzerland having one of the highest shares of intra-firm trade relative to other industrialised countries (OECD, 2002).

A related variation is explored by Swenson (2004), who distinguishes between trade in finished products and intermediate inputs. Swenson shows that FDI in the US by foreign firms leads to a decline in imports from host countries of the same finished *products*; i.e. there is a substitution effect. This result does not hold, however, for Germany and Switzerland. Also, Swenson notes that his results seem to indicate that the relationship between intermediate *inputs* and FDI are complements rather than substitutes. On this question, Fontagné (1999) cites evidence for both France and the US that even though exports of final products might be substituted by local sales, this is offset by increased demand for inputs largely provided by the parent or other subsidiaries of the same group often located in the investing country.

The relationship between FDI and trade furthermore varies over time. Bergsten *et al.* (1978) find that an initial complementary effect between FDI and US exports is turned into a substituting impact as multinationals become more competitive abroad. Pearce (1990) similarly finds that as internationalization advances, trade between affiliates in different host countries gradually replaces trade between the home country and affiliates.

Such impacts appear more likely for countries, which are smaller than the United States – such as Switzerland (Fontagné, 1999). Svensson (1996) concludes that the complementary relationship between Swedish FDI and exports found by Swedenborg (1979, 1982) was overturned in the 1980s. Home exports to other third markets was replaced by exports from affiliates to those markets, which might stem from the advanced stage of internationalisation

of Swedish MNCs. Blomström and Kokko (1994) and Andersson et al. (1996) similarly conclude that such conditions have impacted on the structure of Swedish production and, in turn, the relations between FDI and Swedish exports. At the industry-wide level in France, UK and the US, Fontagné (1999) confirms these results by finding exports of intermediate and capital goods to increase as a function of FDI in the short term, whereas substitution effects are more prevalent in the long run as internationalisation reaches more advanced levels.

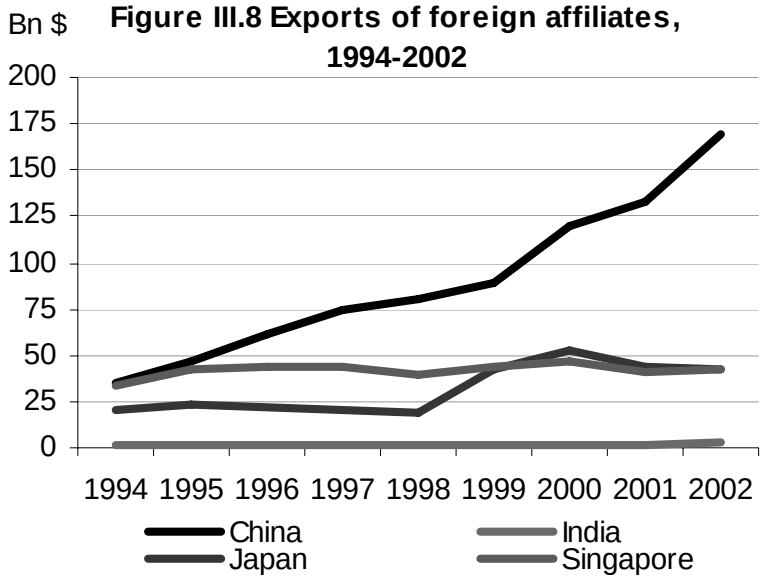
Tariff jumping

There have been relatively few studies testing the tariff-jumping hypothesis. Studies using *industry* measures have come to mixed conclusions (Grubert and Mutti, 1991; Kogut and Chang, 1996; Blonigen, 1997). Conversely, studies using more precise *firm*-level data of for instance antidumping duties have found robust evidence of tariff-jumping FDI (Belderbos, 1997; Blonigen, 2002). Blonigen's (2002) results strongly suggest that tariff-jumping is mostly observed for MNEs – as opposed to small exporting firms - in developing countries seeking to penetrate Western markets.

III.3.2 Trade-FDI linkages in Asia

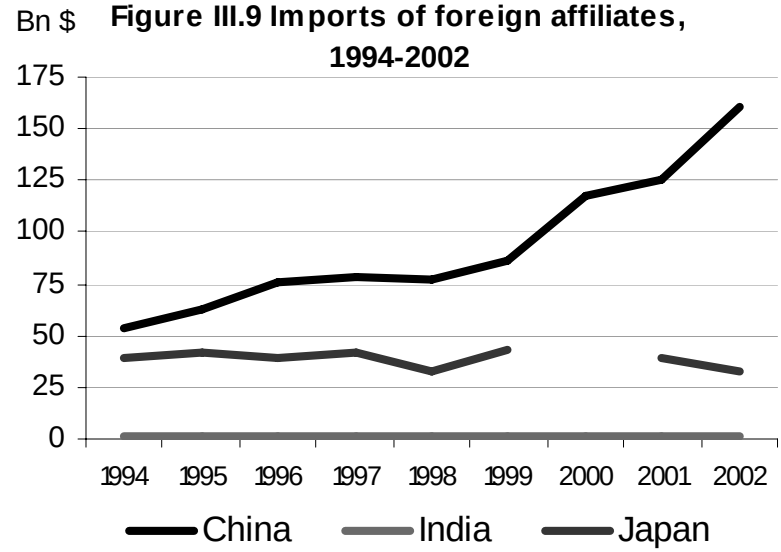
FDI has provided a major boost to Asian trade in recent decades (ADB, 2006). As noted earlier, production networks within the region have spurred trade in parts and components to other Asian countries, whereas vertical supply chains with countries outside the region have increased trade in capital goods, intermediate goods and final products. Through their global distribution and marketing chains, multinationals investing in Asia have played an important part in this process. This is reflected in the growing role of foreign-owned firms in exports for developing Asian countries (see Figure III.8; ADB, 2006).

Figure III.8 Exports of foreign affiliates, 1994-2002



Notes: For Singapore, data only refer to manufacturing.
Source: UNCTAD 2006

Figure III.9 Imports of foreign affiliates, 1994-2002



Notes: Data for Japan is not available for 2000.
Source: UNCTAD 2006

Trade and FDI in Asia: Substitutes or complements?

The 'rise' of Japan in the 1980s and early 1990s spurred numerous studies on Japanese FDI and its linkage to international trade. Eaton and Tamura (1994) find a complementary relationship between FDI and exports in the case of both Japan and the US. This result is confirmed by Buigues and Jacquemin (1996), Graham (1998), Kawai and Urata (1998),

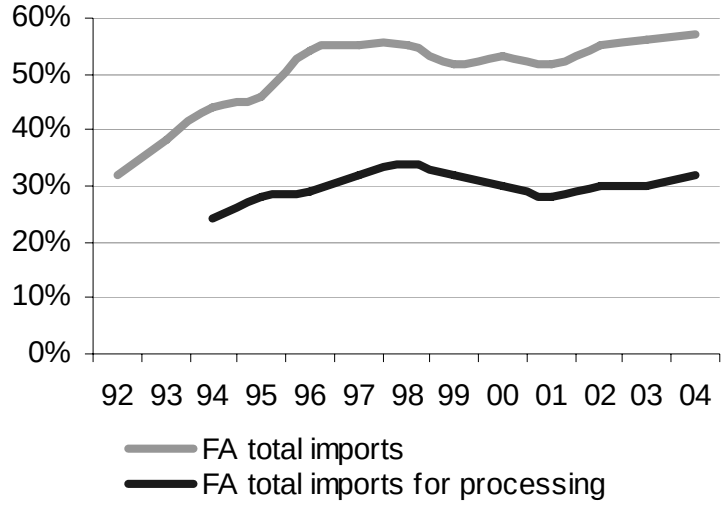
Lipsey (1999), and Lipsey et al. (2000). With 1986, 1989 and 1992 data, the latter study finds that parent firm exports from Japan to a foreign region are positively associated with production in that region by affiliates of that parent. Also, a Japanese parent company's worldwide exports are larger (relative to its output), the greater its production abroad. Barrel and Pain (1999) find that prior market penetration influence Japanese investment flows, confirming the intuitive notion that multinationals tend to facilitate marketing and distribution channels abroad and thus increasing the probability of future investments for the same or other firms. The complementary relationship between trade and FDI is not confined to Japan, but is also found for other Asian countries. Liu and Graham (1998) investigate the trade-FDI relationship for Taiwan and South Korea in 1994. Both countries' FDI is mostly concentrated in Asian countries (particularly in China in the case of Taiwan). The results confirm the studies cited above. Taiwanese and South Korean outward FDI and exports are thus complements and not substitutes. The export promoting effect of South Korean FDI is also confirmed by Abe (2002) and Lee (2002a). Surveys of multinationals in Thailand, Hong Kong and Malaysia, Phillipines and Indonesia (Dobson and Yue, 1997), similarly concludes that MNE's in Asia tend to rely on their home markets for imports of intermediate inputs – particularly through intra-firm trade. In turn, this means that the increased activity resulting from intra-Asian investment contributes to the increased regionalisation of Asian trade.

Also, the observed complementarity between FDI and exports suggests that outward direct investment is not associated with "hollowing out" or "deindustrialization" in Asian countries. Instead, Graham (1998) notes the opposite to be true: as direct investment abroad expands, affiliates of Asian MNEs increase demand for goods produced in the home economy, which in turn increase Asian exports. As mentioned above, there is an important distinction between trade in intermediate inputs and trade in final goods. Blonigen (2001) show that new FDI in the US by Japanese firms increases Japanese exports of related intermediate inputs for these products, whereas new FDI leads to a decline in Japanese exports of the same finished products. Again, this is similar to the results of Swenson mentioned above. Head and Ries (2001) show similar evidence when using Japanese firm-level data. As for the relationship between *inward* FDI and trade, Liu et al. (2001) examine bilateral FDI and international trade for China and 19 countries/regions over the 1984-1998 period. Their results indicate a synergy effect between China's inward FDI and trade: exports to China are followed by FDI from the same country. In turn, inward FDI leads to Chinese exports to that country. The latter is most likely a result of two factors.

First, FDI to China is still mostly efficiency-seeking (as opposed to market-seeking) due to China's still abundant endowment of relatively cheap labour. So after FDI has facilitated

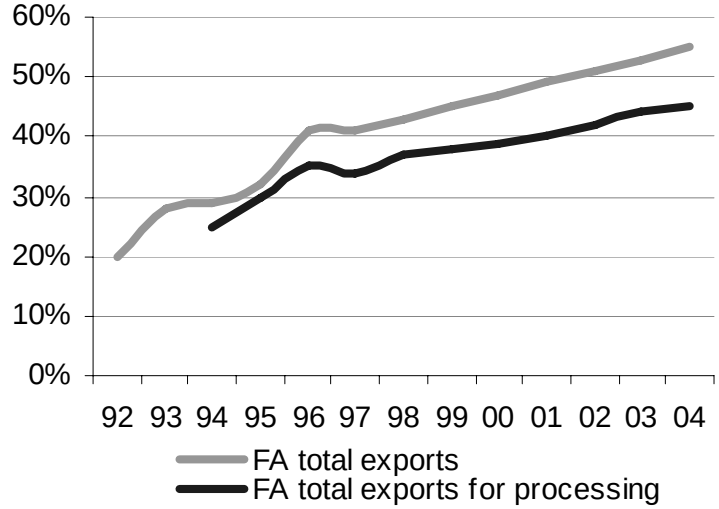
production in China, the final products are typically sold back to parent countries. Such efficiency-seeking investment is more likely to complement rather than substitute trade. Barboza (2006) thus estimates that about 60 % of China's manufactured exports is generated by foreign-owned firms and UNCTAD (2002) noted that foreign affiliates accounted for around 50 % of total Chinese exports in 2001 and 81 percent of technology-intensive products in 2000. Similarly, Gaulier et al. (2005) estimate that foreign affiliates accounted for between 60% and 70% of China's imports from Japan and NIEs in 2004 and for more than 60% of China's exports to Japan, Hong Kong and Singapore. (see Figures III.10 and III.11). Lee (2002b) finds that the vertical integration of South Korean and Japanese MNEs means that Japanese and South Korean FDI into China tend to stimulate Japanese and Korean intra-firm and intra-industry exports and imports.

Figure III.10 Share of foreign affiliates (FA) in total Chinese imports, 1992-2004



Source: Gaulier et al. 2005

Figure III.11 Share of foreign affiliates (FA) in total Chinese exports, 1992-2004



Source: Gaulier et al. 2005

Second, China's FDI policy has been predicated on encouraging foreign firms to export their products and particularly firms from newly industrialised countries use China as their main export platform. UNCTAD (2002), Wang (2004) and Gaulier et al. (2005) thus confirm the importance of export processing zones in China for promoting an interlocked FDI-export relationship.

The investment-trade complementarity for foreign firms is also found in Vietnam by Ngoc and Ramstetter (2004), where foreign multinationals have much higher trade propensities than Vietnamese firms. Athukorala (2006a; 2006b) similarly finds that MNEs in Asia are highly export-oriented. The same holds for Thailand, Hong Kong, Indonesia, Singapore and Taiwan, where companies with high foreign ownership shares show higher export propensities which is mostly due to sales of finished products back to parent- and other countries as was observed with China (Ramstetter, 1999; James and Ramstetter, 2005). These results hold after taking into account that trade propensity could be determined by foreign ownership shares due to policies allowing foreign firms to export a large portion of their output.

A related result, found by James and Ramstetter (2005) investigating the trade and FDI patterns of Thailand and Indonesia, is that liberal trade policies in electric, office and computing machinery industries facilitated rapid export growth of multinationals, while protectionist measures in the transportation machinery industry reduced the incentive to export among multinationals. Trade policies thus impacted the investment and trade decisions of MNEs, and lowering preferential tariffs among Asian countries could thus spur export growth of multinationals even more.

Asian tariff-jumping?

As for 'tariff-jumping', studies are mostly confined to the case of Japan. Dunning (1991), Encarnation and Mason (1994), Belderbos (1997) and Barrel and Pain (1999) find that Japanese FDI to Europe and the US in the 1980s was associated with protectionist measures against Japanese companies such as the regimes of 'voluntary export restraints' and antidumping measures used extensively – and directed in particular towards Japanese producers - during this period.

However, Mody et al. (1998) find that trade barriers do *not* have an impact on Japanese investment in Asia. The authors note that in contrast to Europe and the US firms investing in

Asia are not under threat of barriers to exports. Rather, they seek to participate in the rapid growth in Asia and tend to choose cheap production locations (Kimura and Ando, 2003). The motives for investing are thus quite different, and tariff-jumping is therefore far less prevalent in intra-Asian investment patterns.

IV. Preferential Services Liberalisation in Asia

Key issues addressed:

- Intra-regional services liberalization: ASEAN's Framework Agreement on Services
- Assessing the depth of AFAS market-opening and rule-making advances: a third country perspective
- Assessing the nature and scope of extra-regional services liberalization in Asia and its implications for Swiss traders and investors

IV.1 Overall Trends

ASEAN member states have been increasingly involved in the liberalisation of trade in services within the ASEAN region as well as with a growing network of countries in Asia, Europe, Oceania, America and the Middle East in recent years (see Box IV.1 and Figure IV.1 below). Such trends respond to the rising salience of services trade in the region's external accounts (see Table IV.1 below). The ASEAN Framework Agreement on Services (AFAS) signed in December 1995 provides the key framework for the progressive liberalisation of trade and investment in services between ASEAN member countries. Such a liberalisation process is carried out through successive negotiating rounds, resulting in packages of commitments by individual ASEAN members. Five such rounds have taken place to date, the latest of which having been completed towards the end of 2006.

With the aim of further facilitating trade and overcoming negotiating roadblocks arising from significant intra-ASEAN diversity (both economic and political), an amendment was introduced in 2003 allowing two or more ASEAN member economies press ahead with the liberalisation of services trade without extending agreed concessions to other members. Such variable geometry has so far been used mainly to advance intra-ASEAN market opening in professional services, namely through the conclusion of mutual recognition agreements.

Efforts at services liberalisation have in recent years extended well beyond the sub-region, and most ASEAN members are today highly active in negotiating preferential trade agreements (PTAs) that typically feature detailed provisions on the liberalisation of services trade (and investment). Such initiatives are increasingly seen, both within and outside the region, as offering a genuine alternative to the protracted set of multilateral negotiations carried out under the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) in the context of the Doha Development Agenda (DDA), despite the fact

that they can in some instances give rise to negative repercussions for third party suppliers, notably through possible trade and investment diversion.

Box IV.1 Asian PTAs and trade in services: stylized facts

25 agreements covering trade in services are in force in Asia, of which:

- 3 regional/plurilateral agreements (AFAS, AFAS-China, Trans-Pacific SEP)
- 22 bilateral agreements (including EFTA-Korea and EFTA-Singapore)

Such agreements involve 16 Asian countries; 11 non-Asian countries, including EFTA members and one non-WTO Member (Laos PDR)

2 in 5 (40%) Asian PTAs in services operate on the basis of a negative list approach to scheduling liberalization commitments

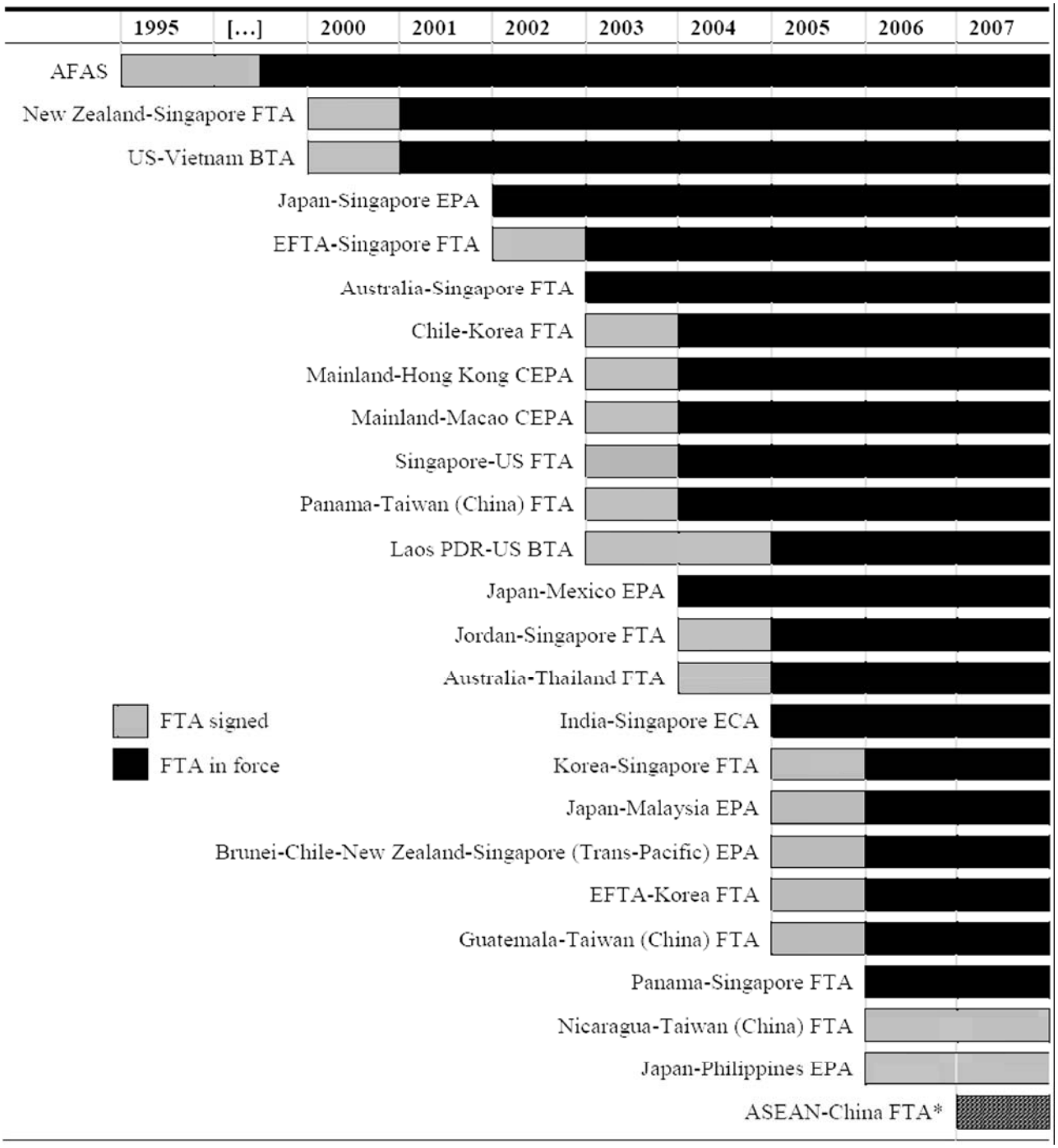
Close to half (48%) of Asian PTAs in services adopt a GATS-hybrid list approach to liberalization agreements (including the EFTA-Singapore and EFTA Korea agreements)

There are some 40+ such agreements currently under negotiation and involving countries or country groupings in the region, including EFTA-Thailand, Switzerland-Japan and EU-ASEAN.

This section of the study reviews recent and current initiatives towards the integration of services markets within the ASEAN region and between individual ASEAN members and a select group of key third country partners: China, India, Japan, Korea, Australia, New Zealand and the United States. The section also examines the relevance and likely effects of ongoing integration efforts for Swiss service providing firms, with particular emphasis placed on those sectors in which Switzerland maintains offensive interests and in which it has formulated market opening demands in the context of the DDA's ongoing set of collective requests under GATS.

The section is constructed as follows. It first examines the ASEAN Framework Agreement on Services (AFAS), its architecture and rulemaking, and assesses the scope and depth of liberalisation achieved to date. The section then examines ASEAN members' PTAs with key third country partners. It does so both in terms of the evolving architecture of services disciplines found in such PTAs and the GATS+ or AFAS+ levels of liberalisation achieved therein.

Figure IV.1 Asian PTAs featuring services provisions, 1995-2007



Source: Fink and Molinuevo (2007)

Table IV.1 World trade of commercial services by region and selected countries, 2005
(Billion dollars and percentage)

	Exports					Imports				
	Value	Annual percentage change				Value	Annual percentage change			
	2005	**2000-05**	**2003**	**2004**	**2005**	**2005**	**2000-05**	**2003**	**2004**	**2005**
World	2415	10	15	19	11	2361	10	14	18	11
North America	420	5	5	11	10	373	7	9	15	10
Europe	1233	11	19	19	7	1119	11	19	16	8
European Union (25)	1104	11	19	19	7	1034	10	19	16	7
Switzerland	45	10	15	24	9	25	10	11	25	7
Asia	543	12	10	26	19	595	10	10	25	15
Japan	107	8	8	25	12	136	3	3	22	1
China	81	22	18	34	…	85	19	19	31	...
Four East Asian traders*	175	8	9	18	9	165	8	8	21	10
India	68	33	21	66	...	67	29	23	53	...
ASEAN (10)	104	8	2	22	10	132	9	9	21	14

* Chinese Taipei; Hong Kong, China; Republic of Korea and Singapore.

Source : WTO (2006)

IV.2 AFAS and the liberalisation of services within ASEAN

The AFAS establishes a framework for the progressive liberalisation of trade in services among ASEAN members. Its objectives are to enhance cooperation in services with a view to promoting greater overall efficiency and improving the competitiveness of ASEAN economies as well as a diversification of production and supply. The AFAS aims at liberalising trade in services beyond the commitments of individual ASEAN members under the GATS, and to establish a PTA in services by 2015 as a part of the ASEAN Economic Community (AEC). Furthermore, the services provisions of AFAS aim to include GATS+ advances in rule-making, notably in the area of mutual recognition (ASEAN 1995).

Liberalisation of services trade under AFAS is conducted through the Coordinating Committee on Services (CCS), which has established negotiating groups in seven priority sectors agreed upon by ASEAN members. These are: (i) air transport; (ii) business services; (iii) construction; (iv) financial services; (v) maritime services, (vi) telecommunications; and (vii) tourism. The liberalisation process is carried out through successive rounds of negotiations, resulting in so-called packages of commitments by individual ASEAN members according to a GATS-like hybrid list approach.

The means of achieving liberalisation under AFAS differs from that employed under the GATS. Instead of relying on GATS-like “requests and offers”, the AFAS foresees recourse to a “common sub-sector approach” and the “minus X approach”. The common sub-sector approach holds that any particular sub-sector would be identified as a common sub-sector in the case that three or more ASEAN members have committed to this sector under the GATS or the AFAS. The minus X formula provides that any combination of two or more ASEAN members may conduct negotiations and agree to liberalise trade in services for specific sectors or sub-sectors without extending the benefits of such agreed commitments to other ASEAN members. The latter remain free however to join such a liberalisation process at a later stage (ASEAN 2003; Thanh and Bartlett 2006).

As far as services rule-making is concerned, AFAS can be argued to improve on the GATS in a few areas but also to fall significantly short in several other areas (see Table IV.2 below). GATS+ rule-making advances can be found in two areas: mutual recognition and rules of origin. ASEAN members have so far concluded two mutual recognition agreements (MRAs) in professional services. A first AFAS MRA on engineering services was concluded at the end of 2004. The agreement provides measures on recognition, qualifications and eligibility, guidelines on criteria and procedures and provide for an ASEAN Chartered Professional

Engineer status. It also deals with professional regulation, monitoring and supervision issues between national licensing authorities and creates several bodies to administrate the agreement and its implementation. A second ASEAN-wide MRA was adopted in the area of nursing services at the end of 2006. The MRA covers the practice of nursing care and encompasses preventive, curative and rehabilitative practices which may also include education and research services. It provides for rules similar to those applying to engineers, but refines the latter in the area of dispute settlement. ASEAN members are close to completing a third MRA in the area of architectural services, and are also involved in MRA discussions in the areas of accountancy, land surveyance and tourism (tour guides). In the case of rules of origin, or denial of benefits, AFAS extends the benefits of liberalisation to juridical persons with substantial business operations in the territory of any of the parties. Like many services PTAs, the AFAS does not develop particular criteria designed to establish what constitutes substantial business operations.

Beyond the two areas described above, the AFAS features provisions that are either identical to the GATS or drafted in a GATS-minus manner. The most significant GATS-minus provisions relate to transparency, domestic regulation, competition, and subsidies and emergency safeguards (ESM). The latter issues may be deemed as being GATS- minus by virtue of their absence from the AFAS.[13]

The AFAS features an MFN clause meant to extend the benefits of intra-ASEAN liberalisation to all members on a non-discriminatory manner. However, the minus X approach described above – agreed in response to the considerable diversity in service sector development levels between the original ASEAN six members and the more recently-acceded CLMV countries, is tantamount to a conditional MFN approach since it enables two or more parties to liberalise trade faster than others, without extending benefits to other ASEAN member states.

While the GATS provides for measures such as notification, publication, designation of enquiry points and official publications, as well as information-sharing requirements, the AFAS is completely bereft of provisions on transparency. The lack of AFAS disciplines on regulatory transparency is particularly troublesome given its importance in sectors characterized by considerable regulatory intensity. Such a shortcoming is somewhat

[13]. For countries that are advocating the introduction of an emergency safeguard measure (ESM) under the GATS, the lack of disciplines in this regard in FTAs will also be considered as a GATS-minus. For a fuller discussion of the question of ESMs for services, see Sauvé (2006a).

surprising given that transparency disciplines are found in almost every PTA covering services and often go further than those of Article III of the GATS. The lack of provisions on the issue of emergency safeguard measures for services is particularly telling, to the extent that much of the demand for such disciplines under GATS has emanated from ASEAN circles. Moreover, the ESM-like provisions found in the ASEAN Investment Area (AIA) do not cover investment in services.

The Vientiane Action Programme adopted by ASEAN member countries to drive economic integration from 2004 to 2010 identified 11 key sectors to be fully integrated by 2010, of which 4 are services sectors: (i) air travel services; (ii) information and communication technologies (ICTs); (iii) healthcare and (iv) tourism (ASEAN 2004). The five packages of liberalisation commitments concluded to date under the AFAS include the following seven main sectors (Thanh and Bartlett 2006):

- Air transport: sales and marketing of air transport services, computer reservation services, aircraft repair and maintenance services.

Table IV.2 AFAS Rules Benchmarked vis-à-vis the GATS

AFAS Disciplines	Differences with GATS
Type of agreement	Positive-list/hybrid
MFN	–
National treatment	=
Market access	=
Transparency	–
Domestic regulation	–
Mutual recognition	++
Monopolies , exclusive service suppliers and anti-competitive behaviour	–
Rules of origin	+
Timed commitment to eliminate trade discrimination	+
Emergency Safeguards	–
Subsidies	–
Dispute Settlement	–

- Business services: IT services, accounting, auditing, legal, architecture, engineering, market research, etc.
- Construction: construction of commercial buildings, civil engineering, installation works, rental of construction equipment, etc.
- Financial services: banking, insurance, securities and broking, financial advisory services, consumer finance, etc.
- Maritime transport: international passenger and freight transport, storage and warehousing, etc.
- Telecommunications: basic telecommunications services, mobile phone services, business networks services, data and message transmission services, etc.
- Tourism: hotel and lodging services, food/catering services, tour operator services, travel agency services, etc.

Table IV.3 provides a quantitative analysis of the number of sectors and sub-sectors committed by each member in each of the above seven priority areas. Although those sectors form the lion's share of ASEAN members' commitments to date, the packages include commitments in other sectors such as environmental, distribution, health, transport and education services.

A closer analysis of the 5 packages of liberalisation commitments conducted under the AFAS reveal a greater than 50% improvement (in numerical terms) in the sectoral coverage of AFAS commitments when compared to ASEAN members' GATS commitments. Such an improvement is however unbalanced as between ASEAN members, with some countries undertaking a greater number of GATS+ commitments than others. When compared to their GATS schedules, Brunei, Indonesia, Myanmar and the Philippines had the richest harvest of AFAS commitments. While not yet a WTO member, Laos also undertook far-reaching commitments in its PTA with the United States. Singapore, Thailand, Cambodia, Malaysia, and Vietnam had relatively less comprehensive AFAS commitments in view of the fact that their GATS schedules were already significantly more extensive. In the case of Cambodia and Vietnam, the latter situation owes significantly to the high entry cost embedded in their status as recently acceded WTO members.

Table IV.3 Quantification of Sectors and Sub-Sectors Committed by ASEAN Member States in the 5 Packages (Main Sectors)

	Air Transport						Business Services						Construction						Financial Services					
	I	II	III	IV	V	T[1]	I	II	III	IV	V	T	I	II	III	IV	V	T	I	II	III	IV	V	T
Brunei Darussalam	1	-	2	1	-	**4**	-	1	7	4	36	**48**	-	6	8	8	8	**30**	-	1	4	6	-	**11**
Cambodia	-	2	1	1	-	**4**	-	1	4	7	24	**36**	-	-	8	8	5	**21**	-	1	5	13	-	**19**
Indonesia	-	1	2	-	-	**3**	-	12	11	-	22	**45**	-	1	8	-	8	**17**	-	1	2	9	-	**12**
Laos	-	2	-	-	-	**2**	-	2	7	1	9	**19**	-	2	8	-	8	**18**	-	2	4	11	-	**17**
Malaysia	2	-	1	-	-	**3**	-	15	9	9	27	**60**	-	7	7	7	7	**28**	-	4	1	-	-	**5**
Myanmar	-	1	2	3	-	**6**	-	2	4	-	12	**18**	-	1	7	-	8	**16**	-	2	1	1	-	**4**
Philippines	-	1	2	-	-	**3**	2	7	9	-	20	**38**	-	7	8	-	6	**21**	-	5	4	1	-	**10**
Singapore	1	-	1	1	-	**3**	-	1	4	7	29	**41**	-	1	7	-	2	**10**	-	1	3	1	-	**5**
Thailand	-	2	3	1	-	**6**	-	10	6	9	27	**52**	-	4	8	8	8	**28**	-	3	2	1	-	**6**
Vietnam	-	3	4	4	-	**11**	-	4	4	4	19	**31**	-	7	8	8	8	**31**	-	7	1	15	-	**23**
Sub-Total	4	12	18	11	0		2	55	65	42	225		0	36	77	39	68		0	27	27	58	0	

	Maritime Services						Telecommunications						Tourism						Total sector and sub sector coverage in the 7 sectors
	I	II	III	IV	V	T	I	II	III	IV	V	T	I	II	III	IV	V	T	
Brunei Darussalam	2	-	-	-	2	**4**	-	2	4	9	15	**30**	1	-	1	1	3	**6**	133
Cambodia	-	-	2	3	2	**7**	-	-	3	12	-	**15**	-	3	3	3	5	**14**	116
Indonesia	3	-	1	-	5	**9**	-	9	9	-	26	**44**	2	2	6	4	12	**26**	156
Laos	-	2	-	-	2	**4**	-	2	6	-	8	**16**	3	2	3	2	3	**13**	89
Malaysia	1	-	-	2	9	**12**	-	4	1	9	20	**34**	2	-	3	2	9	**16**	158
Myanmar	-	1	2	3	5	**11**	-	2	1	5	17	**25**	4	1	3	1	5	**14**	94
Philippines	-	2	-	2	11	**15**	-	1	7	-	21	**29**	1	1	4	3	5	**14**	130
Singapore	-	1	2	2	7	**12**	-	1	1	14	13	**29**	1	-	3	2	7	**13**	113
Thailand	2	2	2	5	9	**20**	-	2	3	9	21	**35**	5	1	3	4	10	**23**	170
Vietnam	-	3	2	4	7	**16**	1	1	5	14	16	**37**	3	1	3	1	4	**12**	161
Sub-Total	8	11	11	21	59		1	24	40	72	157		22	11	32	23	63		

T – Total commitments in sector, by ASEAN member.

Source: Own calculations, Bureau of Trade in Services Negotiations, and Thanh and Bartlett (2006).

When measured in qualitative terms, i.e. in terms of the actual degree of new market opening afforded, the depth of ASEAN members' commitments under AFAS – i.e. the extent of elimination of trade barriers - falls short of the broad sectoral coverage achieved in the liberalisation packages. Applying the Hoekman approach[14] to measuring individual countries' levels of restrictions, Thanh and Bartlet found that the elimination of services trade restrictions under the first four liberalisation packages of AFAS was on average some 10% higher than that taken by ASEAN members under the GATS.

[14] The Hoekman approach is a frequency measurement of restrictiveness to trade in services. The approach classifies commitments made in services according to three levels : 1. If no restrictions are applied for a given mode of supply in a given sector, a value of 1 is assigned; 2. If no policies are bound for a given mode of supply in a given sector, a value of 0 is assigned; and 3. If restrictions are listed for a given mode of supply in a given sector, a value of 0.5 is assigned.

Despite overall improvements, including those realized in the latest package, and notwithstanding the very real achievements of ASEAN on the MRA front in a number of regulated professions, it would appear that the AFAS has yet to lead to a substantial reduction of services trade barriers beyond that achieved already or on offer at the multilateral level. By way of consequence, it may also be inferred that the potential trade and investment diversion effects of AFAS on third countries is likely to be marginal, all the more so given AFAS' liberal denial of benefits clause which provides third country investors – including those from Switzerland – with a level of investor access to ASEAN markets that largely approximates MFN treatment. At the same time, since the level of restrictiveness of ASEAN services regimes under the GATS remains high, there is considerable scope for greater services liberalisation in the region on either a bilateral, regional or multilateral basis.

Singapore and Malaysia, the biggest importers and exporters of services within ASEAN, have improved on their GATS commitments under AFAS in a marginal way when measured on a sectoral basis. Singapore and Malaysia have respectively scheduled only 22 and 39 new liberalised bindings under AFAS. Because of its recent WTO accession negotiation, Vietnam has not improved on its GATS commitments in the latest AFAS package and has in fact scheduled more commitments under the GATS than the AFAS. Many of Vietnam's "unbound" commitments across particular modes of supply under AFAS are already partly committed under the GATS.

The biggest margins of AFAS preferences in services concern Thailand, Indonesia and the Philippines, where more than 140 new partial and/or full commitments were scheduled under AFAS relative to these countries' GATS bindings. For these members, AFAS liberalisation may be expected to generate potentially greater trade diversion effects on third countries. They may thus be countries that Switzerland may wish to consider more closely in the context of potential future bilateral PTAs.

Similar results confirming the relatively modest improvements made by AFAS were found by Fink and Mulinuevo (2007). Their analysis shows that most schedules of commitments under AFAS offer little improvement over GATS schedules and that in fact only a small number of new sectors have been listed. The difference between their findings and the relatively higher number of newly committed sectors found by Thanh and Bartlet can be explained in terms of sectoral aggregation: many of the new sectoral commitments observed by Thanh and Bartlet are new sub-sectoral commitments in sectors already bound under GATS.

Table IV.4 Depth of Commitments in the first 4 packages of AFAS[15]

	GATS		GATS+AFAS (1-4)		Improvement [5]	
	'None' and 'Partial' [1]	'Unbound'	'None' and 'Partial'	'Unbound'	'None' and 'Partial'	'Unbound'
Brunei Darussalam	63	41	154	198	91	157
Cambodia [2]	343	241	415	293	72	52
Indonesia	119	125	276	104	157	-21
Laos [3]	-	-	-	-	-	-
Malaysia	275	213	314	302	39	89
Myanmar	72	72	216	216	144	144
Philippines	126	18	313	123	187	105
Singapore	288	120	310	134	22	14
Thailand	334	174	498	190	164	16
Vietnam [4]	295	261	281	323	-14	62
Total ASEAN	1915	1265	2777	1883	862	618

[1] 'None represents no restrictions for trade; 'Partial' represents bounded restrictions and partial opening; 'Unbound' represents non-binding.
[2] Cambodia was not a party to AFAS package one.
[3] Lao is not a WTO member and does not have GATS commitments.
[4] Based on its latest WTO offer.
[5] Improvement represents the difference in the number of sectors bounded in GATS and AFAS' four packages combined and GATS bindings. A negative number represents higher level of binding in GATS.

Source: Based on Thanh and Bartlett (2006).

Two additional observations regarding ASEAN members are that: first, the regulatory *status quo* - i.e. the actual level of trade restrictiveness - is typically lower than that which is bound under AFAS packages (as indeed under the GATS). This is not, however, always the case of individual ASEAN members in their bilateral PTAs. Second, such commitments cover less than half of the possible total sub-sectors covered by the GATS.

Summing up, AFAS has to date made only a modest contribution to opening intra-ASEAN services trade liberalisation over and above that on offer at the multilateral level. Such a conclusion holds even more with regard to the services rules found in AFAS, where evidence of GATS-minus provisions can be found. AFAS advances on mutual recognition in

[15] The approach used by Thanh and Bartlett for purposes of cross-country comparisons of liberalization levels provides little by way of qualitative information on the extent of actual market opening, on the relationship between bound commitments and the prevailing regulatory *status quo* as well as on the nature of limitations retained under unbound or partial commitments and the extent of their restrictiveness. Though time and resource constraints precluded the use of more sophisticated evaluation methodologies, it should be noted that such policy research tools have been developed. See notably the quantitative approach developed by the Swiss government in SECO (2005) available at http://www.seco.admin.ch/themen/00513/00586/00587/00589/index.html), as well as the frequency index first developed in Hoekman (1995).

professional services are an important exception and must however be viewed as a significant development in trade-facilitating services rule-making.

Despite its lofty ambitions, ASEAN's record on service sector trade and investment liberalization has been less than stellar. A recent assessment of a decade of attempts at prying open regional services markets noted that: "…AFAS's performance has not been impressive. Against only one performance criterion has AFAS's performance been rated higher than adequate. AFAS has achieved wider bound liberalisation than GATS, and it has removed restrictions to services trade amongst its constituent members. However, the margin of preference varies substantially by ASEAN Member Country, with the two biggest providers of intra-ASEAN services, Singapore and Malaysia, providing the least margin of preference. The depth of liberalisation, represented by the extent to which commitments are bound, is also poor." (Tranh and Bartlett, 2006).[16]

IV.3 AFAS advances: a look at individual ASEAN members

Japan, Korea, Australia, New Zealand and the US have been extensively involved in PTAs and their bilateral negotiations tend to involve all ASEAN countries apart from Cambodia, Laos and Myanmar. China, India and Korea have focused their efforts so far on Singapore, the Philippines and Thailand. Table IV.5 above shows that with the exception of Cambodia and Myanmar, all ASEAN member states have concluded or are negotiating PTAs with the non-ASEAN partners. So far, Singapore has been the most active ASEAN state in signing PTAs and had already concluded agreements with all ASEAN Plus countries, with the exception of China with whom it is currently in negotiations. Thailand has been also very active and concluded three PTAs and is negotiating several more. Malaysia and Indonesia are also in the process of engaging with several non-ASEAN partners.

The remaining part of this section examines ASEAN integration in services in two aspects. First, it analyses ASEAN members' sectoral commitments in their PTAs as well as in the AFAS, investigating how far they have gone beyond their GATS commitments. In so doing, special attention will be paid to those sectors that are of specific offensive interest to Switzerland (see Box IV.2 and Table IV.5 below). The section concludes with a discussion of GATS+ rule-making advances in ASEAN member states' PTAs with third countries.

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[16] Against this disappointing backdrop, the scorecard does however reveal some positive findings. Notably, good has been made in modes 1 and 2, both with respect to bound commitments and a genuine attempt to improve transparency and predictability through the obligation to report reasons for diverting from 'none' in these modes. Similarly, the fact that there is 50% more sub-sector coverage under AFAS than GATS when summed across all member countries should not be lost.

Box IV.2 Assessing Switzerland's offensive interests in services trade

A quantitative assessment of individual countries' interests in services liberalisation in foreign markets is generally difficult to perform since many of the traditional economic tools used in goods trade (such as Revealed Comparative Advantage indices) cannot be readily applied in the services field due in large measure to inadequate statistical information. Reliance must thus be made on qualitative information, to which evidence of significant export activity and/or domestic competitiveness can be added.

Alternative approaches for assessing a country's offensive interests in services trade can be based either on detailed industry surveys concerning barriers faced abroad, on detailed firm-level analysis detailing sources of competitiveness, or through observation of countries' requests for liberalisation directed towards third countries in GATS negotiations.

Since the first two options are not feasible given the time and resource constraints of the present study, a proxy of revealed Swiss offensive interests in services trade can be derived from those sectors that Switzerland has targeted in its bilateral negotiating requests in services trade as well as those where Switzerland features as a *demandeur* in the process of collective requests initiated pursuant to a decision taken at the December 2005 WTO Ministerial meeting, held in Hong Kong, China. Such collective requests, which remain for most countries complementary (and not substitutes) to the process of bilateral requests and offers, nonetheless provide some information regarding specific services and modes of supply of broad interest to Switzerland. They also help to identify – and gain a better overall sense – of the range and type of countries that are targeted by Switzerland's liberalisation requests. This data is complemented with other publicly available information concerning Switzerland's service industries interests (SECO 2002; WTO 2005; Leuthard 2007). [17]

It is generally accepted within services negotiating circles that bilateral requests are more finely representative of a country's offensive priorities, whereas participation in collective requests may respond to broader market opening or systemic considerations and not always reflect domestic priorities within countries formulating the collective request. For instance, although Switzerland has signed onto collective requests in the areas of environmental and air transport services, the sectors do not rank among its top negotiating priorities in bilateral request-offer discussions under the GATS. Similarly, Switzerland has not co-signed a collective request in two sectors – tourism and the movement of managers and specialists – in which it maintains strong offensive interests in bilateral discussions with its key trading partners.

Switzerland's requests in services concern some fifty WTO Members (with the EU as one). Industrialized countries, particularly the EU, Japan and the United States, are the country's key targets, as befits the sophisticated nature of Switzerland's most competitive service sectors. Least developed countries, and particularly countries in Sub-Saharan Africa, were in principle excluded from Switzerland's June 2002 bilateral requests. In general, Switzerland's requests in services trade take account of the development level of its trading partners. Switzerland has not submitted any requests to least developed countries (SECO (2002)).

[17] For further information, see
http://www.seco.admin.ch/themen/00513/00586/00587/00589/index.html

As regards the sectoral coverage of Switzerland's requests, they focus predominantly on the following six: (i) financial services (e.g. banking and insurance services); (ii) the mobility of managers and specialists; (iii) transport-related services (e.g. freight, cargo-handling); (iv) various business-related services (e.g. foreign legal consultants, engineering, accountancy, IT/computer-related services, as well as services linked to testing, maintenance and repair of equipment); (v) distribution services; and (vi) tourism-related services (e.g. hotel management and training and travel agency services).

Swiss requests do not concern market access in sectors such as education, health, road and railway transportation, postal as well as audio-visual services, which are excluded in light of Switzerland's view of public servicea or because of a lack of export interests in the above sectors.

Table IV.5 below summarizes the individual Asian countries targeted by collective requests in some sectors. Though this list cannot be used to infer the content Swiss requests, it indicates which ASEAN countries are more involved in GATS negotiations in the sectors concerned.

Table IV.5 Asian targets of DDA collective requests in services

Switzerland's interests	Target Countries in Bilateral or Collective Requests	
	ASEAN	**ASEAN Plus**
Architectural and Engineering services	Indonesia, Malaysia, Philippines, Singapore, Thailand	China, India
Transport-related services (freight, cargo-handling, logistics)	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand	China, India, Korea, US
Financial services (banking and insurance)	All countries[18]	All countries
Tourism services (hotel and travel agency services)	All countries	All countries
Modes 1 and 2	Brunei, Malaysia, Indonesia, Philippines	Australia, Japan, Korea, China, US
Mode 3	Indonesia, Malaysia, Philippines, Singapore, Thailand	Australia, New Zealand, China, India, Korea, Japan
Mode 4 (intra-corporate transferees - managers, specialists and other key personnel; business visitors)	All countries	All countries

[18] The term "all countries" excludes least-developed countries.

IV.3.1 Brunei

Brunei's commitments under AFAS duplicate to a considerable extent its GATS commitments. Added value of particular interest to Switzerland include Brunei's undertakings in architectural and engineering services, where extensive market access liberalisation has been implemented with some limitations on foreign equity. National treatment is completely liberalised for those sectors in modes 1 and 2 but is unbound in modes 3 and 4. Brunei has also scheduled extensive liberalisation in both market access and national treatment across modes 1, 2 and 3 in computer-related services, a sector in which Switzerland appears in the collective request target group. Overall, Brunei is more open with respect to modes 1 and 2, but remains protective for mode 3, with foreign equity limitations a recurring restriction across sectors. The chapter on services in the Brunei, Chile, New Zealand and Singapore Trans-Pacific Strategic Economic Partnership (SEP) Agreement does not include services commitments by Brunei, although the country is under the obligation to negotiate its commitments on services this year.

IV.3.2 Cambodia

Cambodia is not a signatory to PTAs with countries outside of ASEAN. Its commitments under the AFAS are similar to those under the GATS, probably due to the extensive liberalisation undertaken by Cambodia when it negotiated its way into the WTO. Among the most important improvements in access to the Cambodian services market is the removal of national treatment limitations for subsidies under modes 1 and 2, and in the field of financial services the right for all foreign banks to engage in deposit services provision without restriction. Cambodia has fully liberalised access conditions in several sub-sectors of architectural and engineering services, with the exclusion of mode 4. It is also extensively committed in computer-related services, telecommunications and education services.

IV.3.3 Indonesia

Indonesia has yet to conclude its ongoing PTA negotiations with Japan and Australia. Within AFAS, it has improved on its GATS commitments with full liberalisation commitments under Modes 1 and 2 of those sub-sectors in which it has made partial GATS commitments. Such a development is very much in line with Swiss interests in services trade. Architectural and engineering services, and a relaxation of foreign equity restrictions in many sectors in the light of recent liberalising changes to Indonesia's Investment Law, are additional areas of importance where broad AFAS undertakings have been made. Other improvements in liberalisation include AFAS bindings in sectors of which Switzerland is itself a target country

under GATS: education, computer-related services, and communications (telecoms and audio-visual services).

IV.3.4 Laos

As Laos is still not a WTO Member - it is currently negotiating its accession to the world trade body, its commitments under AFAS are the sole relevant benchmarks. As noted above, Laos' commitments in its bilateral agreement with the US are considered to be the most liberalised bindings taken by any country to date in services trade (meanwhile, the US is bound under the agreement to its GATS level of commitments. Laos has taken full national treatment commitments in all its service sectors for all modes of supply excluding mode 4. Extensive market access commitments were also scheduled, with Laos undertaking commitments in key sectors such as professional services, financial services, telecommunications, audiovisual, health, construction, tourism and distribution services.

IV.3.5 Malaysia

Overall, Malaysia has not significantly improved beyond its GATS commitments in its dealings with ASEAN members. The country's commitments under AFAS provide little advancement, although with regard to Switzerland's offensive interests in services trade, Malaysia did agree to new market opening commitments in the latest package of AFAS commitments in the areas of architectural and engineering services. In the field of architectural services, national treatment was almost fully liberalised across modes 1,2 and 3 and was fully liberalised for modes 1 and 2. The cross-border supply of engineering services has been further liberalised while foreign equity limitations have been maintained. Malaysia's FTA with Japan provides for enhanced liberalisation commitments in a range of new sub-sectors linked to the construction and engineering services. However, the extent of such new bindings remains rather limited.

IV.3.6 Myanmar

Myanmar has no bilateral PTA with non-ASEAN countries, owing in large measure to the nature of its domestic politics. While the country's AFAS commitments are wider than those taken under GATS, their depth and quality remain limited. Contrary to other ASEAN members, Myanmar offers in its AFAS undertakings full foreign ownership under mode 3 for several sectors. This is notably the case of construction, architectural and engineering services. Another commitment affecting competitive conditions in the country's logistics industry relates to the liberalisation of storage and warehousing services under services auxiliary to all modes of transport.

IV.3.7 Philippines

Commitments under the AFAS improve on the Philippines' GATS bindings under Modes 1 and 2, where it fully liberalised several professional services (including architectural and engineering services), tourism, telecommunications, and construction services. Some GATS+ improvements were also made with regard to mode 3, notably in the tourism sector where full ownership in luxury hotels is allowed. The Philippines also improved its liberalisation undertakings in architectural and engineering services with regard to mode 4, although important barriers such as economic needs tests and reciprocity requirements remain in place even for ASEAN country nationals. The PTA with Japan improves on liberalisation in many categories of construction and engineering services, as well as in health and health-related services. It also provides for limited liberalisation in environmental services (sewage services), an area of interest to Switzerland in which limited progress has to date been made at the multilateral level. Similar liberalisation in environmental services was also scheduled under the fifth package of AFAS. The Japan PTA also provides for notable GATS+ commitments in financial services, in marked contrast to their general absence under the AFAS. Moreover, the Philippines has made AFAS commitments in several sub-sectors relating to air transport, such as aircraft repair and maintenance services, services supplied by non-scheduled carriers, services auxiliary to all modes of transport, general sales agents, and cargo sales agents.

IV.3.8 Singapore

Singapore's AFAS commitments offer very little improvement over its GATS bindings despite the inclusion of several new sub-sectors. In line with its ASEAN partners, Singapore has made new commitments on architectural and engineering services (primarily relating to modes 1 and 2) while also maintaining limitations affecting mode 3 trade. Environmental services were also liberalised completely for modes 2 and 3 in sanitation-related services, cleaning of exhaust gases and noise abatement services. Singapore's bilateral PTAs with non-ASEAN members offer much wider liberalisation than the AFAS, and improves significantly on the range of sub-sectors covered by the GATS. Such wide coverage is notable, in particular as Singapore already ranked among those emerging economies with the most extensive set of GATS commitments. Singapore's experience suggests the clear GATS+ properties to be had from bilateral PTAs in services even with countries that have liberalised significantly at the multilateral level. Singapore's PTAs are notable for removing several restrictions on modes 1 and 2 and for developing some path-breaking provisions on trade in digital products. Singapore's liberalisation commitments in financial services has improved marginally under its PTAs. However, the Singapore–US agreement is an exception and provides for a phase-out of commitments under which Singapore agreed to liberalize its

entry regime for foreign banks within 18 months of the agreement's entry into force. The latter agreement also offers deeper market access commitments in the area of telecommunication services.

IV.3.9 Thailand

The AFAS provides for a modest extension of GATS liberalisation bindings for Thailand, particularly in terms of sectoral coverage. The fifth AFAS package saw Thailand liberalise several services of particular interest to Switzerland, notably architectural and engineering services, environmental services and services auxiliary to transport. In architectural and engineering services, Thailand has undertaken almost complete liberalisation for both market access and national treatment across modes 1, 2 and 3. Similar liberalisation steps were taken for several environmental services, such as sewage services, refuse disposal, sanitation and similar services, cleaning of exhaust gasses, noise abatement services, nature and landscape protection and other environmental protection services. Services auxiliary to all modes of transport liberalisation include custom clearance services and storage and warehousing services, but are of more limited scope. The Thailand–Australia features improved commitments in distribution and construction services, as well as substantially longer work permit periods for Australians supplying services on a temporary basis in Thailand under mode 4 (up to 5 years compared with 6 months under the GATS). The Thailand–New Zealand FTA has a built-in agenda for the liberalisation of services within three years of its entry into force (i.e. 2008) and thus does not yet include any provisions on services. Thailand's recently completed agreement with Japan features less liberalisation than is to be found under the AFAS in the areas of construction, architectural and engineering services, and there are no bindings made on mode 1 for both market access and national treatment in these sectors. Moreover, many sectors otherwise covered by the agreement (such as business services or communications) can hardly be described as subject to liberalisation commitments since they remain unbound for all modes of supply in respect of both market access and national treatment obligations. The agreement does however feature commitments on environmental services in the same sub-sectors as those advanced under the AFAS, as well as several partial commitments on financial services. Air transport services are covered in three sub-sectors covered by the GATS: aircraft repair and maintenance services; supporting services for air transport, computer reservation systems, as well as storage and warehouse services.

IV.3.10 Vietnam

Vietnam's AFAS commitments do not substantially deviate from its GATS undertakings. Architectural and engineering services were partially liberalised under AFAS's fifth package.

The latest round of AFAS commitments also saw limited additional liberalisation of environmental services that are not considered as public utilities, such as sewage services, solid waste disposal, cleaning of exhaust gasses and noise abatement services. The Vietnam–US bilateral trade agreement provides for substantial liberalisation in all major service sectors, with the exclusion of transport services. Under both the AFAS and in its BTA with the US, Vietnam's liberalisation commitments are extensive in scope and depth. However while foreign equity restrictions are lifted under AFAS, they were maintained under the US BTA albeit subject to a gradual phase-out in most areas. Vietnam's recent accession to the WTO saw it afford WTO members afford a considerable degree of parity of treatment to that found in the US BTA, including in financial services, where Switzerland maintains important offensive interests.

IV.4 Developments in Asian PTAs

The former section examined ASEAN member states' intra-regional liberalisation in services and the extent to which such liberalisation goes beyond that on offer under GATS. This section assesses individual ASEAN member states' initiatives to liberalise services trade with a select number of key countries from outside ASEAN's regional integration framework: China, India, Japan, Australia, New Zealand and Korea (hereinafter, ASEAN Plus). Table IV.5 below shows the matrix of existing and negotiated agreements between these countries. In what follows, an aggregate assessment of the depth and scope of liberalisation of Asian PTAs is attempted. This is followed by a country specific analysis as well as by an examination of the extent to which such agreements have achieved GATS+ advances in services rule-making.

Three issues merit elaboration from an aggregate level: (i) the depth of liberalisation beyond the GATS and patterns of sectoral commitments; (ii) the modalities or architecture of liberalisation; and (iii) the modal distribution of liberalisation commitments.

Table IV.6 A cross-tabulation of Asian PTAs in force and under negotiation[1]

	Asia				Oceania		North America
	China	**India**	**Korea**	**Japan**	**Australia**	**New Zealand**	**United States**
ASEAN	2003	2004	2006	N	N	N	
Brunei Darussalam				N		2005 (with Singapore and Chile)	
Indonesia				N	N		N
Malaysia				2006	N	N	N
Philippines				2007			N
Singapore	N	2005	2006	2002	2003	2001, 2005 (with Brunei and Chile)	2004
Thailand		N		2007	2005	2005	N
Cambodia							
Laos							2005
Myanmar							
Vietnam							2001

Signed

N Currently Negotiated

[1] Updated as to June 2007

IV.4.1 Depth of liberalisation

The depth of liberalisation varies considerably across ASEAN Plus agreements. On the one hand, several PTAs only marginally deepen liberalisation beyond the GATS. This is the case for instance of the Thailand–Australia and of the Malaysia–Japan PTAs. On the other hand, some agreements significantly deepen their members' GATS commitments in terms of the breath and quality of sectoral bindings (level of restrictiveness). The Laos–US Bilateral Trade Agreement lies at one extreme, with Laos adopting full national treatment commitments in all sectors as well as an extensive set of unrestricted market access commitments. Given the LDC status of Laos, it is arguable that the level of its services commitments is probably more reflective of the country's acute negotiating capacity constraints than its commitment to sweeping services liberalisation.

An aggregated measure of the GATS+ nature of market opening commitments in Asian PTAs in services can be found in the exhaustive analysis recently carried out by Fink and Molinuevo (2007). Such results, the sectoral breakdown of which is summarized in Figure IV.2 below[19], reveal that while GATS+ PTA advances are significant across all sectors, they are particularly noticeable in the areas of business services (reflecting the emergence of

[19] It bears noting that these aggregate figures drawn from Fink and Molinuevo's work include AFAS commitments.

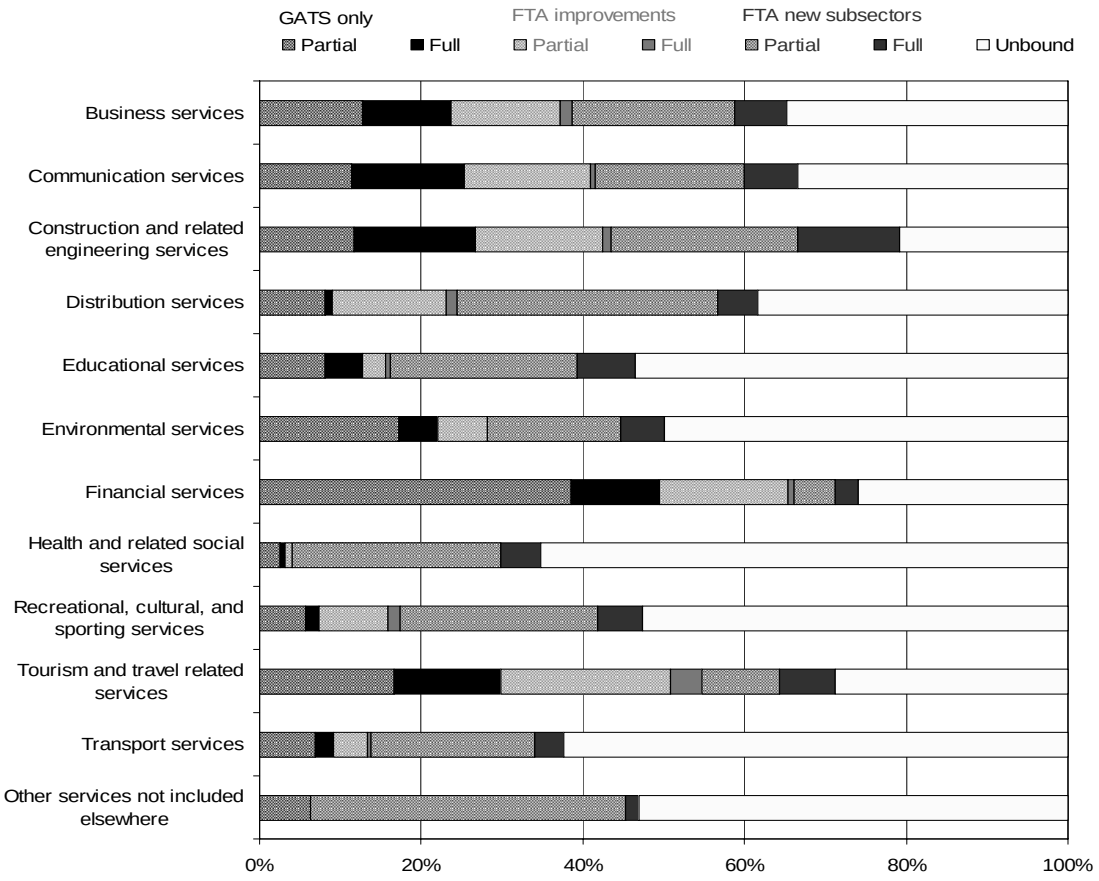
digital trade, e-commerce and the outsourcing revolution in services); distribution; education, health and transport services, all areas that have proven difficult in the WTO context in both the Uruguay Round and the DDA.

Meanwhile, the lesser relative progress registered in areas such as telecommunications and financial services recall that these are precisely the sectors where GATS negotiations have to date been most successful, lessening the scope or perceived need for significant new advances in a PTA context.

IV.4.2 Negotiating modalities

Significant variation exists regarding the liberalisation modalities used in PTAs between ASEAN countries and third countries. As Table IV.6 shows, three basic approaches to scheduling commitments can be found in East Asian services PTAs.

Figure IV.2 GATS+ advances in Asian PTAs covering services: sectoral breakdown



Source: Fink and Molinuevo (2007)

Table IV.7 Negotiating modalities in Asian PTAs covering services

GATS/hybrid list approach	Negative list approach	Pure positive list approach	Other approaches (only a list of sectors)
AFAS ASEAN-China Australia-Thailand EFTA-Korea EFTA-Singapore India-Singapore Japan-Malaysia Japan-Philippines Japan-Singapore Jordan-Singapore NewZealand-Singapore Vietnam-U.S.	Australia-Singapore Chile-Korea Guatemala-Taiwan Japan-Mexico Singapore-Korea Nicaragua-Taiwan Panama-Singapore Panama-Taiwan Singapore-U.S. Transpacific SEP (Brunei, Singapore, New Zealand, Chile)	China-Hong Kong China-Macau	Lao PDR-U.S.

Close to half (12 of 25, or 48%) of Asian PTAs covering services use a GATS-like hybrid list approach to scheduling liberalisation commitments, which combine a positive selection of sectors, sub-sectors and modes of supply and a negative listing of non-conforming measures maintained in committed sectors, sub-sectors and modes of supply.

The other method of scheduling is the negative list approach, whose presumption is that all measures affecting trade and investment in services are automatically fully bound at free (i.e. with no limitations) *unless* they are specifically reserved in annexes to the Agreement (including annexes affording scope for reserving future measures. Forty percent (10 of 25) of Asian PTAs covering services follow such an approach.

Yet a third approach involves a pure positive list, whereby Members agree to specify solely those measures that are free of restrictions in specific sectors, sub-sectors or modes of supply. As Table IV.5 reveals, only two such agreements can be found in Asia, both of them involving China with the separate customs territories that belong to it (Hong Kong and Macau). Finally, a fourth negotiating modality, found exclusively in the Laos-United States Bilateral Trade Agreement, consists of listing sectors in which trade can take place unencumbered.

A review of commitments in Asian PTAs in services suggests that the often-held belief that negative listing yields inherently greater and more transparent liberalisation requires some nuance. While such an outcome should be expected insofar as regulatory transparency is

concerned, the devil tends to be in the detail, such that some agreements using negative listing clearly provide a clearer roadmap of existing regulatory impediments whereas others fall short of expected transparency through recourse to sweeping sectoral or modal carve-outs[20] or by excluding entire categories of measures (for instance sub-national measures).

The evidence is also mixed in terms of the impact of negative listing on induced levels of liberalisation. Several hybrid list agreements have indeed achieved a greater degree of liberalisation than that on offer under negative list agreements by the same partners. Thus Singapore's positively listed commitments in its PTA with Japan are significantly greater in terms of coverage than Singapore's negatively listed commitments in its PTA with Australia. Done properly, however, there is little doubt that negative list agreements may yield important benefits by way of regulatory transparency and by locking in the regulatory *status quo*.

A new development of note in this regard, and which has been embedded to date in the most recent Japanese PTAs, aims to secure the best properties of negative and hybrid listing. The Japanese PTAs thus maintain a GATS-like hybrid approach to scheduling, preserving countries' right to pick and choose those sectors, sub-sectors and modes of supply in which they desire to make commitments, but assorts such flexibility with the twin obligations to: (i) schedule the regulatory *status quo* (i.e. no GATS-like right to schedule commitments that offer less access than that which exists under the scheduling country's current laws and regulations) and (ii) to exchange non-binding lists of non-conforming measures (i.e. a non-binding negative list of trade and investment restrictions in all sectors is embedded in the PTA) so as to promote greater regulatory transparency.[21]

IV.4.3 Modal advances

Asian PTAs in services confirm the partial nature of market opening in services. Such an observation is particularly apparent when commitments are analysed on a modal basis, as can be seen from Figure IV.3 below.

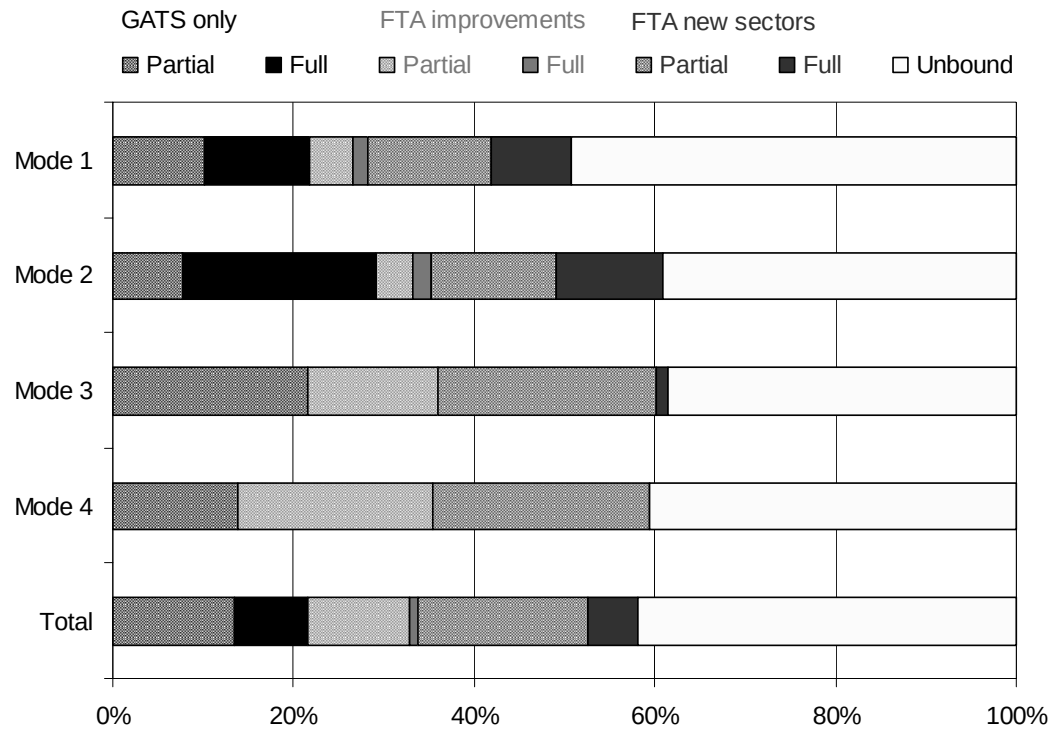
From a positive (albeit not entirely surprising point of view given the reluctance of countries to contemplate Mode 4 liberalization on an MFN basis), the most significant sources of

[20] One troubling example stems from recent US PTA practice, which increasingly sees sweeping negative list reservations that exclude all measures affecting services maintained at the sub-national level. Recent US PTAs are notable as well for excluding Mode 4 commitments.
[21] To date, Switzerland's approach to scheduling commitments on services trade has been a flexible one, using both the hybrid (i.e. GATS-like) or negative list approaches depending on the trading partners concerned.

GATS+ advances in Asian PTAs are to be found in respect of the two modes of supply that are likely to generate the strongest developmental returns: mode 4 (movement of natural persons) – the least committed of all modes under GATS – and mode 3 (commercial presence) – the most committed of all modes subject to GATS bindings.

The Asian PTA experience reveals, once again not surprisingly, lesser improvements with regards to modes 1 (cross border supply) and 2 (consumption abroad), reflecting, in the latter case, the limited capacity of home countries to influence Mode 2 trade determinants, as well, in the case of cross-border trade, the reluctance to commit that which host countries cannot (or cannot easily) regulate.

Figure IV.3 GATS+ advances in Asian PTAs covering services: modal breakdown



Source: Fink and Molinuevo (2007)

However, closer scrutiny reveals that the results described above require some nuance. Thus, mode 4 advances in Asian PTAs actually tend to be somewhat marginal (and always partial, as can be expected) and tend to result in quite minor (if potentially symbolic and

precedent-setting) changes to labour market outcomes.[22] At the same time, full liberalisation is more frequent for modes 1 and 2, possibly reflecting rising comfort levels towards digital trade and e-commerce (for Mode1) and the near impossibility of - and limited policy interest in – restricting transactions initiated by sovereign consumers (for Mode 2 trade).

Summing up, ASEAN members have moved beyond the GATS in their PTAs with non-ASEAN countries in several areas of potential interest to Switzerland. Such advances concern sectors such as architectural and engineering services, environmental services, financial services as well as services relating to air transport. ASEAN countries have also committed to deeper PTA liberalisation under modes 1, 2 and 3, all of which are of trade interest to Switzerland.[23] ASEAN members have, with a few exceptions, undertaken deeper and wider liberalisation in their PTAs with non-ASEAN countries than among themselves.

IV.5 Asian PTAs: GATS+ rule-making?

We conclude this section with an assessment of the extent to which ASEAN members deviate from - and go beyond - the rules set out in the GATS. Such an assessment is based on rule-making contained in the PTAs that Singapore, Thailand, Malaysia, the Philippines and Vietnam have reached with non-ASEAN countries. Tables IV.7-11 below provide country summaries of the GATS+ nature of PTA rules on services entered into by the five ASEAN members. Tables IV.8 to IV.12 provide country summaries of GATS+ advances in selected ASEAN member countries.

IV.5.1 Singapore

Singapore's PTAs follow three different modalities of liberalisation: positive/hybrid listing (in the GATS sense), negative-listing and a combination of both (i.e. positive listing and negative listing in different sections). All of its PTAs feature GATS+ advances on the rule-making front, though with some variance depending on the partner concerned, the time at which the agreement was concluded, and the level of reciprocal ambition embedded in the various PTAs it has signed. Government (i.e. public) services, transportation and related services,

[22] One example relates to the labour mobility provisions that have been associated to recent Japanese PTAs which feature novel provisions aimed at assisting partner countries with training in the home country prior to admission in Japan with a view to comply with Japanese licensing requirements in nursing and other health-related occupations. While the numerical quotas agreed to by Japan in these areas remains extremely low relative to the supply capacity (and negotiating interests) of sending countries, such provisions nonetheless represent a step forward in the treatment of Mode 4 issues in a context of population ageing and labour market shortages in OECD countries.

[23] It should be noted that some observers question ASEAN states implementation of their services commitments. See Vandoren (2005).

subsidies, investment (typically addressed in a generic chapter) and government procurement are generally excluded from the scope of the services chapters of Singapore's PTAs.

Excluding the PTA with New Zealand, Singapore's agreements with India, Korea, Japan, Australia and the US all provide for rules in financial and telecommunications services. The financial services framework shows variance across different PTAs and at times includes financial sector-specific investment disciplines, as in the case of the PTAs with Korea and Australia. Singapore's PTAs typically feature GATS+ disciplines on transparency (notably by introducing prior notification requirements) and sometimes on definitions (but not in the case of its PTA with India). GATS+ provisions also exist in some of the PTAs regarding dispute settlement in financial services. Several of Singapore's PTAs incorporate binding elements drawn from the GATS' Understanding on Commitments in Financial Services. While the PTA with Korea is based on a negative list approach, the section on financial services is characterised by positive-list undertakings.

The chapters on telecommunication services found in Singaporean PTAs typically exclude cable and broadcast distribution of radio and television programming, while providing new rules that extend beyond the GATS' Reference Paper on pro-competitive regulatory disciplines. Such rules relate to definitions, transparency disciplines, access to and use of public telecommunications transport networks and services, independent regulation, universal service obligations, licensing procedures, treatment of scarce resources, enforcement and dispute settlement. Also featured are disciplines aimed at curbing the potentially anti-competitive behaviour of dominant suppliers.

The PTA with Korea includes rule-making in maritime transport in addition to providing a list of sectors where additional commitments are taken. GATS+ provisions on mutual recognition in the South Korean PTA feature criteria for the development of professional standards, and also encourage the temporary licensing of professional service providers. Furthermore, with regard to engineers, South Korea committed to recognizing the degrees from 2 Singapore universities, while Singapore committed to recognising those from 20 South Korean universities. The chapters in the PTAs dealing with the temporary entry of business persons go beyond the GATS framework on the movement of natural persons by listing general principles and obligations for common disciplines governing temporary entry. The chapters also deal with information provision and dispute settlement. Furthermore, they typically grant specific commitments on temporary entry categories of business visitors, traders and investors, intra-corporate transferees, as well as specify durations of stay. The PTAs with

Australia and India also define service sellers and short-term service suppliers for the purposes of movement of natural persons. They also prohibit labour market testing on those persons permitted to move under the agreement.

Singapore's PTA with the United States was one of the first, alongside that concluded between the US and Chile (and later largely replicated by the EU in its own PTA with Chile), to feature a detailed set of provisions dealing with trade in digital products (goods and services).

IV.5.2 Thailand

Thailand has generally made only modest rule-making advances in its services PTAs to date. To some extent, such an outcome can be ascribed to the fact that it has yet to reach agreement with the United States and accept the range of GATS+ provisions (both in terms of rule-making and especially market opening) that a PTA with the US typically entails (Roy, Marchetti and Lim, 2006). Thailand's liberalisation modality for services tend to follow the GATS approach, notably in its PTAs with Japan and Australia, although in the case of the Japan PTA, it did agree to bind the regulatory *status quo* in scheduled areas and exchange a non-binding negative list of trade and investment-restrictive measures in services trade. Thailand's PTA with New Zealand features no current provisions on services – the two countries having agreed to negotiate at a later date (they are currently doing so). Government procurement, government services and access to the labour market are excluded from the scope of Thailand's services PTAs, none of which feature language on emergency safeguard measures, a topic on which Thailand has been an incessant *demandeur* in GATS discussions. The PTA with Japan also excludes air transport services and maritime cabotage.

Thailand's PTA with Australia includes rules similar to the GATS in the areas of financial services and telecommunications (i.e. adoption of the relevant GATS chapters), while its PTA with Japan is silent on these issues even though the sectors are covered for market opening purposes. GATS+ advances were made in Thailand's PTA with Japan regarding disciplines on (non-discriminatory) domestic regulation, as disciplines in this area (which are substantively rooted in GATS language) apply to all covered services and not only to those where commitments have been scheduled. The PTA with Australia features a new provision on deepened cooperation in services that include research and development, human resources and professional development, trade in services data management and small and medium-sized enterprises' capacity enhancement. Furthermore, it specifies education,

healthcare and tourism services as sectors for specific cooperation, and calls for the facilitation of temporary entry of business people.

IV.5.3 Malaysia

Malaysia has to date entered into only one PTA covering services, with Japan. This agreement follows a GATS-like positive/hybrid list approach that excludes from its scope air transport services, maritime cabotage, government procurement, government services as well as access to the labour market. Like many other PTAs in the region, it features a commitment towards future liberalisation (through periodic negotiations), but tends to replicate GATS language in almost every respect of rule-making. One exception however relates to the PTA's provisions on financial services, which incorporate disciplines drawn from the GATS' Understanding on Commitments in Financial Services (which Malaysia has not scheduled multilaterally) and provide for sector-specific rules on dispute settlement.

IV.5.4 Philippines

Like Malaysia, the Philippines has to date concluded only one PTA covering services with a non-ASEAN partner, that with Japan. The PTA follows a GATS-like positive/hybrid list approach along the lines featured in the Japan-Thailand PTA (i.e. an obligation to schedule the regulatory *status quo* and the provision of a non-binding negative list for purposes of regulatory transparency). The PTA with Japan mimics that with Malaysia and Thailand by excluding air transport services, maritime cabotage, government procurement and government services, as well as access to the labour market. It goes beyond the GATS in three aspects. First, it provides for more detailed rules on transparency and includes a commitment for detailed publication requirements, including at sub-national levels of government. Second, it achieved concrete progress on the movement of natural persons by adding a chapter on the entry and temporary stay of nationals for business purposes. This chapter provides principles, definitions, means of information-exchange, dispute settlement, and defines categories for business purposes according to intra-corporate transferees, investors, and nationals of a party who engage in professional business activities on the basis of a personal contract with a public or private organisation in the other party. Furthermore, the PTA includes provisions on natural people who engage in supplying services which require technology, special skills and knowledge, as well as special provisions on nurses and personal care workers featuring Japanese commitments to train such workers in the Philippines so as to enhance their technical competence and help them meet Japanese licensing requirements prior to entering the Japanese labour market. An annex to the PTA provides detailed rules concerning the categories of recognised natural

persons. Finally, the agreement adopts some of the provisions of the Understanding on Commitments in Financial Services.

IV.5.5 Vietnam

The bilateral trade agreement that Vietnam negotiated with the United States prior to its accession to the WTO features no GATS+ provisions. In many regards, this agreement was a precursor to GATS compliance, and Vietnam's accession to the WTO saw much effort directed at extending the terms of the US BTA to all WTO Members on an MFN basis. The BTA incorporates various GATS provision directly, such as the annexes on financial services and telecommunications services, as well as the telecommunications reference paper. The agreement can be said to be GATS-minus in respect of its generally weaker disciplines on transparency disciplines and domestic regulation.

Table IV.8 GATS+ Provisions: Singapore

	India	Korea	Japan	Australia	New Zealand	United States
Type of agreement	Positive-list	**Hybrid**	Positive-list	**Negative-list**	Positive-list	**Negative-list**
Rules and obligations						
MFN	=		=	=	=	=
National treatment	=	=	=	=	=	=
Market access	=	=	=	=	=	=
Transparency	=			=		+
Domestic regulation	=	=	=	=	=	=
Mutual recognition	=	+	+	=	+	+
Movement of natural persons	+	+	+	+		+
Monopolies , exclusive service suppliers and anti-competitive behaviour	+	+	+	+	=	
New provisions	+ Services-Investment linkages; Air services		+ Extension to non-party juridical persons constituted in a party		+ Extension to non-party juridical persons constituted in a party	= Prohibition on local presence requirement
Timed commitment to eliminate trade discrimination	+	+		+		
Sector-specific measures						
Exclusions	Government services Nationals seeking employment Shell companies	Investment Government procurement Subsidies Government services Transportation and non-transportation services	Air transport services Maritime cabotage Government procurement Subsidies Government services	Government procurement Subsidies Government services Air transport services (with exceptions) Natural persons seeking access to employment market		Air transport services Investment Government procurement Government services Nationals seeking employment
Financial services	=	+	+	+		+
Telecommunication services	+	+	+	+		+
Maritime transport services		+				

Table IV.9 GATS+ Provisions: Thailand

	Japan	Australia	New Zealand
Type of agreement	Positive-list	Positive-list	No obligations taken yet and services chapter to be negotiated
Rules and obligations			
MFN	=		
National treatment	=		
Market access	=	=	
Transparency	=		
Domestic regulation	+		
Mutual recognition	=	=	
Movement of natural persons	+		
Monopolies , exclusive service suppliers and anti-competitive behaviour	=		
New provisions		+ cooperation in services	
Timed commitment to eliminate trade discrimination	+	+	
Sector-specific measures			
Exclusions	Air transport services Maritime cabotage Government procurement Government services Nationals seeking employment		
Financial services		Subsidies Government procurement Government services Nationals seeking employment	
Telecommunication services		=	
Maritime transport services		=	

Table IV.10 GATS+ Provisions: Malaysia

	Japan
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	=
Domestic regulation	=
Mutual recognition	=
Movement of natural persons	=
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions	
Timed commitment to eliminate trade discrimination	+
Sector-specific measures	
Exclusions	Air transport services Maritime cabotage Government procurement Government services Nationals seeking employment
Financial services	+
Telecommunication services	
Maritime transport services	

Table IV.11 GATS+ Provisions: Philippines

	Japan
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	+
Domestic regulation	
Mutual recognition	=
Movement of natural persons	+
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions **Timed commitment to eliminate trade discrimination**	
Sector-specific measures	
Exclusions	Air transport services Maritime cabotage Government procurement Government services Subsidies Nationals seeking employment
Financial services	+
Telecommunication services **Maritime transport services**	

Table IV.12 GATS+ Provisions: Vietnam

	United States
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	
Domestic regulation	=
Mutual recognition	
Movement of natural persons	=
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions **Timed commitment to eliminate trade discrimination**	
Sector-specific measures	
Exclusions **Financial services**	=
Telecommunication services **Maritime transport services**	=

V. Preferential investment liberalisation in Asia

Key issues addressed:

-The treatment of investment in selected Asian PTAs: lessons from practice and implications for third country investors
- A comparative assessment investment provisions in the Asian PTAs of EFTA and the United States: implications for Swiss investors and service providers

This section of the study focuses attention on the key investment provisions found in a sample of 19 Asian preferential trade and investment agreements (PTAs) and assesses their implications for third country – including Swiss - investors. As investors in services are often treated separately, interactions between the investment and service chapters of the agreements reviewed are also discussed. Box V.1 below lists the sample of Asian agreements featuring investment provisions under review.

Box V.1 Investment in Asian PTAs: agreements under review

Japan-Malaysia Economic Partnership (2006)
Japan-Mexico Economic Partnership (2005)
Japan-Singapore New-Age Economic Partnership Agreement (2002)
Thailand-Australia Free Trade Agreement (TAFTA) (2005)
EC-Chile Association Agreement (2003-2005)
Commission mandate to negotiate an EC PTA with ASEAN (excl. Myanmar, Laos and Cambodia) (2007)
Free Trade Agreement between EFTA and Singapore (2003)
Free Trade Agreement between EFTA and Korea (2006) (Norway is not a party to the investment chapter)
Trans-Pacific Strategic Economic Partnership among Brunei Darussalam, Chile, New Zealand and Singapore (May 2006) (not notified to the WTO)
The New Zealand-Singapore Closer Economic Partnership (2001)
Free Trade Agreement between the Republic of Korea and the Republic of Chile (2004)
Free Trade Agreement between the Republic of Korea and the Republic of Singapore (2006)
India-Singapore Comprehensive Economic Co-operation Agreement (2005)
Framework Agreement on ASEAN Investment Area (AIA) (1998) and the ASEAN Framework Agreement on Services (AFAS) (1995) as amended by the 2003 Protocol
Draft for Free Trade Agreement between the United States and the Republic of Korea (2007)
Free Trade Agreement between the United States and Singapore (2004)
Proposal by the United States for an investment chapter in a PTA with Thailand (2006)
Services chapter of the China-ASEAN Free Trade Area (2007)

V.1 Investment and commercial presence: definitions and relationship

Most PTAs follow the practise of the WTO by covering investments under separate chapters depending on whether they are services or not. Below we review the definitions of investments in both services and non-services – and thus the scope of the agreements - as well as the interaction between horizontal investment disciplines and services (see Table V.1).

V.1.1 Investor definitions

As is standard in the majority of BITs, most PTAs reviewed – including those of EFTA - use a broad and 'asset based' definition of investment. The definition is typically followed by an illustrative/open list including five categories of assets. The first is movable and immovable property (such as land) and any related property rights such as mortgages. In contrast to 'commercial presence' in service chapters (see below) this definition therefore covers legal interests in property that are less than full ownership. The second category is various types of interests in companies, such as shares, stock, bonds or any other form of participation. Portfolio investment is in other words covered and the foreign investor is not required to control the company. The exception is AIA, which explicitly excludes portfolio from the agreement (article 2.b). The third category is claims to money, claims under a contract having a financial value and loans directly related to a specific investment; i.e. long- and short-term contractual rights – such as management agreements – are included. The fourth is intellectual property rights such as trademarks, patents and copyrights. Finally, business concessions, including natural resource concessions are typically included. Variations in the precise language used to describe these categories are of minor importance because the list is illustrative, and an interest that doesn't fall within any of the categories is still an 'investment' if it can be considered an asset (UNCTAD, 2000c).

TAFTA and agreements entered into by the EC depart from this definition. TAFTA refers to the International Monetary Fund's (IMF) definition of FDI, which uses a 10 percent ownership threshold to distinguish FDI from portfolio investment, whereas EC agreements follow an 'enterprise based' approach as in most service chapters (see below). Instead of referring to investors, the EC-Chile agreement refers to juridical and natural persons performing an establishment, which covers direct investment, including branches[24].

[24] Inspired by GATS' definition of commercial presence, establishment is defined as: *'(i) the constitution, maintenance or acquisition of a legal person, or (ii) the creation or maintenance of a branch or a representative office (..)'.*

The GATS notion of 'commercial presence' is typically used to define investment in services. In contrast to the definition of foreign investment, 'commercial presence' is only regarded as direct investment in the context of the relationship with an enterprise. It typically encompasses any type of business or professional establishment, including the constitution, acquisition or maintenance of a legal person or the creation or maintenance of a branch or a representative office within the territory of a party for the purpose of supplying a service. This is also the approach used in the Commission's mandate to negotiate a PTA with ASEAN, where all investors are grouped into one based on GATS' definition of commercial presence. In order to extend the definition to non-service investors, the text replaces '*supply a service*' in the GATS-definition by '*seeks to perform or performs an economic activity*'[25]. The draft is based on the Commission's recent template chapter for EC-wide PTAs, which it intends to use in future agreements as well.

The GATS concept of commercial presence is much narrower than the definition of non-services investments as it only covers foreign investments in services, where the foreign investor – who is covered by the agreement - holds more than 50 percent of the equity interest or exercises control (GATS Article XXVIII(m)). Foreign investments with a minority equity stake and no exercise of control are thus not covered by service disciplines, though they would typically be covered by horizontal investment disciplines (see below). There are exceptions. While otherwise following the GATS approach, EC agreements do not include an ownership or control requirement in their definitions of a legal person. The same is the case in the Trans-pacific and New Zealand Singapore agreements.

V.1.2 Relationship between services and horizontal investment disciplines

By applying separate provisions for service investors and their investments, there is a risk of inconsistencies between services and investment disciplines. Most reviewed agreements include rules to confront this (see Table V.1)

Investment in services is completely removed from the scope of investment disciplines in the AIA with the exception of services incidental to manufacturing, agriculture, fishery, forestry,

[25] The full definition of an 'investor' is: '*any natural or juridical person that seeks to perform or performs an economic activity through setting up an establishment'.* 'Establishment' is defined similarly as in the EC-Chile agreement: '*any type of business or professional establishment through: (i) the constitution acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or representative office within the territory of a Party for the purpose of performing an economic activity'.*

and mining and quarrying. The interaction between AFAS and AIA thus relies on the rules of interpretation of international law (OECD, 2007). The India-Singapore, US-Thailand[26] and Japan-Malaysia agreements give precedence to service chapters in case of inconsistencies. For the latter agreement the precedence only applies to the investment chapter's obligations on NT, MFN, and performance requirements.

EFTA agreements and the New Zealand-Singapore agreement have chosen a more transparent approach by specifying that the two overlapping obligations in the investment and services chapters - NT and MFN for commercial presence – are governed by the services chapter alone. Note, that NT and MFN obligations in the same agreements still apply to those forms of investments not covered by the services chapter such as investments with a minority equity stake and no effective foreign control, whereas the EFTA-Singapore agreement extends the non-application of NT and MFN to all investments in services (Fink and Molinuevo, 2007).

US-agreements with EFTA's partners – Korea and Singapore – as well as the Japan-Mexico, Chile-Korea, and Singapore-Korea agreements have used an even simpler approach by having investment in services governed by the investment chapter. Instead of *parallel* rules for investors in manufacturing and services, these agreements thus have *complementary* rules that are even more transparent than those in EFTA agreements. This also has implications for the coverage of investor-to-state arbitration clauses, as we will return to below.

As mentioned above, the EC mandate to negotiate with ASEAN intends to inscribe commitments in one single schedule. This completely avoids inconsistencies between services and investment disciplines, and is somewhat similar to TAFTA, which – in contrast to the EC mandate – has separate chapters for service and non-service investments, but nonetheless inscribe commitments in one single schedule.

Finally, the Japan-Singapore agreement doesn't establish a rule defining the relationship between the two sets of disciplines. Since service commitments are based on a positive list basis and investment commitments on a negative list basis without identical sector coverage this approach is far from transparent and has a real danger of inconsistent rules (Fink and Molinuevo, 2007). In order to confront this Singapore (but not Japan) gives precedence to the services disciplines in case of inconsistencies with the investment chapter's obligation on NT and performance requirements.

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[26] Based on the US proposal.

In sum, EFTA agreements follow the practice in most PTAs by using a broad and asset-based definition of investments and an enterprise-based definition of service investments. The definition of commercial presence requires ownership or control by a natural or legal person covered under the agreement (as defined by rules of origin; see below).

US agreements with EFTA partners use a more transparent and simple approach than EFTA-agreements by covering both service and non-service investors in the agreements' investment chapter instead of applying two sets of disciplines. The EC's recent template to negotiate with ASEAN does not include the broad and asset-based definition of investors, but is highly transparent as one single chapter governs all investors.

V.2 Rules of origin[27]

Along with investment-definitions, rules of origin – also referred to as denial of benefits clauses - define the scope of commitments in PTAs. Liberal rules of origin open up preferential market access to companies from non-member countries and thereby reduce potential investment- and trade diversion (see also literature review). On the other hand, more restrictive rules can (in theory) promote learning-by-doing processes by infant industries - since they alone benefit from preferential treatment - thereby preparing them for global competition. Table V.2 offers a synthetic depiction of origin rules affecting investment (including investment in services) in Asian PTAs

V.2.1 Juridical persons

Two PTAs – TAFTA and India-Singapore - stand out as having relatively restrictive rules of origin. For these two agreements benefits are limited to domestically-owned or controlled firms. This is only allowed under GATS article V.3b if both parties to the preferential agreement are developing countries. Countries that are not least-developed countries can decide for themselves whether they are to be considered 'developed' or 'developing' countries under the WTO. Like all measures affecting services subject to the GATS, such a decision can be challenged by other WTO members.

Ownership is defined in the two agreements as domestic persons holding a majority equity share in the company and control is defined as domestic persons having the power to name

[27] This section borrows heavily from the work on services rules of origin by Fink and Nikomborirak (2006), and Fink and Molinuevo (2007).

the majority of directors or otherwise directing the juridical person's actions. The domestic ownership or control requirement does not apply to the Australia-Thailand agreement's investment chapter. In contrast to service investors, Swiss manufacturing investors therefore do not have to be established through minority joint ventures with local companies in order to enjoy preferential treatment under the agreement. For the India-Singapore agreement, the requirement applies to services supplied through mode 3 as well as to non-service investors. However, for modes 1 and 2 the agreement allows a party to deny preferential benefits if a juridical person is owned or controlled by persons from the denying part.

Such requirements are highly restrictive as most service providers typically prefer to enter into foreign markets through majority or fully owned affiliates. It is thus fortunate, from a Swiss (third country) investor perspective, that in all other agreements reviewed juridical persons generally *don't* have to be owned or controlled by nationals of a PTA (see, however, the section below on 'market access'). Benefits typically extend to juridical persons constituted or otherwise organized under the laws of a party with substantial business operations in the territory of that party. For all PTAs but the Japan-Malaysia agreement, this includes branches of enterprises of third states. Swiss investors with activities in the region (i.e. more than just 'mail-box' companies) can in other words take advantage of commitments under most non-Swiss/EFTA PTAs. Swiss service suppliers can typically also use a commercial presence in one location to serve the whole PTA, when delivering services on a cross-border basis (Mode 1) or through consumption abroad (Mode 2)[28]. The New Zealand–Singapore agreement goes even further, by only requiring establishment or registration under a party's applicable laws irrespective of whether the investor has substantial business operations there.

For Mode 1, restrictions would typically arise for certain categories of regulated professional service providers in light of intra-ASEAN mutual recognition agreements using nationality as a basis for the mutual recognition of professional licenses held by ASEAN natural persons.

Several agreements – including the EFTA-Korea agreement as well as the recent EC mandate to negotiate a PTA with ASEAN - extend benefits to service investors with substantial business operations in *any* PTA party, and not just the PTA territory in which the juridical person is constituted.

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[28] Most service chapters of PTAs apply to Mode 1 and 2 services that are supplied '*from or in the territory of another party';* i.e. preferential treatment is granted when services originate within the territory of the exporting party.

ASEAN's investment agreement – AIA – addresses foreign equity requirements in manufacturing by allowing foreign companies to comply with local equity requirements of any ASEAN member country by counting the local equity participation in all other ASEAN countries on a cumulative basis towards that local requirement. Indirect holdings in related entities can be included in the cumulative total. For instance, say Thailand requires 51 percent equity ownership by nationals, but Thai nationals only own 30 percent of the equity in a manufacturing enterprise, with a Swiss multinational taking 49 percent of its shares. In this case the enterprise will not be granted AIA benefits. However, if the other 21 percent equity interest of that manufacturing enterprise is owned by nationals of Malaysia, then the enterprise qualifies as an ASEAN investor, as the ASEAN cumulative equity is 51 percent, and thus complies with Thailand's national-equity requirements.

What exactly constitutes 'substantial business operations' is left undefined in most agreements. Implementation is therefore left to the parties of the agreement. Typical options are the possession of a business or service license, payment of local profit taxes, owning or renting premises and a certain level of sales or years of establishment. As for the concept of 'constitution or other organization', juridical persons arguably cover non-incorporated legal entities such as branches or representative offices (as long as the substantial business criterion is met). One exception is the investment chapter of the Japan-Malaysia agreement, which excludes branches of enterprises of third states from the definition of 'investor of the other party'; i.e. Swiss non-services branches in either of the two countries are not covered by the agreement.

Finally, it is worth noting that a number of agreements have incorporated foreign policy-related exceptions to otherwise liberal rule of origins. In particular, several agreements allow a party to deny PTA benefits to a juridical person from a non-party if i) the denying party does not have diplomatic relations with the non-party; or ii) the denying party prohibits transactions with the enterprise in question. It is not clear, however, whether such provisions are in accordance with GATS article V.

V.2.2 Natural persons

All reviewed agreements extend trade benefits to nationals - or 'citizens' - of the signatory parties. Moreover, a number of agreements extend benefits to individuals that have the right to permanent residency in a PTA member. This is typically regardless of whether individuals actually reside in the territory of a party or not. For instance, a Swiss citizen with permanent

residency status in Chile but living in Thailand is still covered under the Chile-Korea agreement. US and EC agreements generally don't extend benefits to permanent residents.

In the EFTA agreements' service chapters, permanent residents qualify for trade preferences if the importing party grants substantially the same treatment to permanent residents as it does to nationals in respect of measures affecting services trade. This requirement is not matched by EFTA's PTA partners – Korea and Singapore – in other agreements with the exception of AFAS and the New-Zealand agreement for Singapore.
In sum, the most restrictive origin criterion for juridical persons – ownership and control – is only applied in two of the agreements reviewed. Swiss juridical persons constituted or otherwise organised under the laws of a party with substantial business operations in a party to a PTA – or in some cases in any party to a PTA – therefore enjoy preferential treatment under most agreements.

Some agreements – including those of EFTA (with reservations for service suppliers) – extend benefits to permanent residents. This is not the case for past or currently negotiated US or EC agreements, however. Nonetheless, the overall picture of rules of origin in the Asian region, as applied for services and investment, is fairly liberal.

V.3 The treatment of investment and services

In customary international law, states are obliged to treat foreigners and foreign investments with a minimum level of fairness, but there are no requirements to treat all aliens equally or as favourably as nationals (Sornarajah, 1994). To confront this, treatment standards are typically included in trade- and investment agreements. Main provisions that determine the treatment of investment and services include market access, national treatment (NT), and most-favoured nation treatment (MFN). Tables V.3 to V.5 summarize the treatment provisions found in Asian agreements covering investment.

V.3.1 Market access for services

In the investment chapters of PTAs, liberalisation and general treatment commitments are covered under NT and MFN provisions, whereas service chapters typically adds provisions on 'market access'. Under the GATS, market access provisions cover restrictions on 1) the number of service suppliers; 2) the value of service transactions or assets; 3) the total number of service operations or total quantity of service output; 4) the total number of natural persons that may be employed; 5) the form of legal establishment; and 6) foreign equity participation. Even though the GATS does not distinguish between pre- and post-

establishment on this matter, market access provisions clearly cover both (OECD, 2007). The overlap between these market access and national treatment provisions is addressed in GATS Article XX:2, which specifies that measures inconsistent with both provisions should be scheduled under market access and are then considered as a limitation on national treatment as well.

In order to ensure consistency with multilateral disciplines almost all PTAs reviewed have reproduced the GATS approach by including disciplines on market access in their services chapters. OECD (2007) notes that PTAs with market access provisions as specific commitments that apply only in sectors and for modes of supply inscribed in a member's schedule (i.e. a 'positive' list basis as in GATS[29]) include fewer sectors and have more limitations, when compared to PTAs using a negative list approach (as in NAFTA). Many AFAS members, for instance, still reserve the right to restrict foreign equity participation in their market access schedules. So even if AFAS covers a Swiss service provider constituted - and with substantial business operations - in an ASEAN country through a majority or fully owned affiliate, this does not necessarily mean that it is granted market access in particular sectors and sub-sectors. It is important to recall, however, that circumvention of statutory ownership is widespread by multinationals in parts of Asia. A country such as Thailand, for instance, has foreign equity participation restrictions in most service sectors. Nevertheless, Thailand often fails to prevent foreign companies exercising control over companies that are directly majority owned by Thai natural or juridical persons (Fink and Nikomborirak 2006). Service suppliers ultimately owned and controlled by Swiss persons may therefore still be able to enjoy the benefits of the PTA in practise even if market access provisions (or rules of origin) are put in place to prevent it.

Not all positive list agreements include significant market access restrictions. Singapore, for instance, has made very few reservations to its market access commitments in its agreements even though many are on a positive list basis (OECD, 2007). So whereas Switzerland has almost the same schedule of commitments in the EFTA-Singapore agreement as it has in GATS, this is not the case of Singapore, which goes further than its GATS-obligations by including market access commitments on distribution services, educational services, environmental services and health-related and social services. The same goes for Japan that similarly has signed several PTAs with positive lists of market

[29] Note that we refer to the GATS-approach as 'positive' although this strictly speaking hides that the fixing of the level of openness in sectors inscribed involves elements of both negative and positive listings.

access obligations but nonetheless has expanded its service liberalisation commitments considerably.

EFTA's two PTA partners in the region – Korea and Singapore – include market access provisions (excluding Mode 3) on a negative list basis in their own PTA as well as their agreements with the US (including Mode 3). The Chile-Korea agreement similarly includes market access on a negative list basis. This is in contrast to the EFTA-agreements. So while acknowledging that positive list agreements don't necessarily entail fewer commitments as mentioned above, it nevertheless seems that by choosing the 'NAFTA-' rather than the 'GATS-approach', Switzerland's PTA-partners have been willing to extend market access commitments further than they do in the EFTA-agreements.

Finally, it is worth mentioning that four negative list agreements—Korea-Singapore, Singapore-US, Singapore-Korea and the Trans-Pacific agreement—do not cover restrictions on foreign equity participation under market access. Arguably, this should have no implications, however, since such limitations are covered under the agreements' NT commitment, as they are discriminatory by nature (Fink and Molinuevo, 2007).

In sum, market access provisions for services are included in most Asian PTAs. Some countries such as Singapore have made significant commitments whereas others haven't. EFTA's PTA-partners – Singapore and Korea – seem to have committed to 'deeper' market access obligations in their PTAs with the US as well as the agreement between themselves. The latter outcome should perhaps not be surprising for two reasons: first, it is arguable that Singapore and Korea had little choice in accepting the negative list template the United States has been using in virtually all its post-NAFTA agreements; and second, the US FTAs were subsequent to the EFTA negotiations, and most assuredly entailed greater negotiating pressure applied to countries whose dependence on the U.S. market is generally higher than on those of EFTA member countries.

Even though Swiss investors and service suppliers may still in practice benefit from preferential treatment under service agreements, foreign equity restrictions continue to limit the benefits of PTAs for third party investors as they increase trade and investment diversion in services.

V.3.2 National treatment

National treatment (NT) ensures that foreign investors covered under the PTAs are not faced with more restrictive policy measures than domestic investors. For service providers, GATS

grant NT in sectors and sub-sectors mentioned in a country's schedule. Most PTAs in Asia include NT for both services and non-services sectors (See Tables V.4 and V.5).

The majority of investment chapters in reviewed agreements include NT on a negative list basis pre- and post-establishment, as is the standard case in BITs. The opposite approach has often been taken in service-chapters, where only six of the agreements reviewed include NT on a negative list basis. All others have NT for services on a positive list basis as in the GATS. The major differences in treatment standards thus seem to be within services rather than manufacturing, and Swiss service providers covered under Asian PTAs can thus expect to be granted NT less often than investors in other sectors.

As with market access obligations, EFTA's PTA partners – Korea and Singapore – have granted NT for services on a negative list basis pre- and post-establishment in their own agreement as well as their agreements with the US[30]. The Chile-Korea agreement similarly grants NT on a negative list basis. This is in contrast to EFTA agreements, which list NT for services on a positive list basis. Even though it must be stressed again that positive and negative list agreements in principle can cover the same obligations, it nevertheless seems that EFTA's PTA partners again have been willing to commit to more extensive liberalisation and treatment obligations for services in their other agreements. In support of this, Fink and Molinuevo (2007) find that negative list PTAs are often – but not always - associated with a wider inclusion of sub-sectors and modes of supply.

NT standards typically depend on whether foreign and domestic investors/investments or service providers/services are considered alike. The service chapters with positive lists - such as the EFTA-agreements - have adopted the language of GATS Article XVII, which mandates no less favourable treatment to *'like services and service suppliers*'. As mentioned, the EC has in its negotiating mandate with ASEAN grouped services and non-services investments into one chapter, and like service suppliers are therefore covered under the term '*like investors*'. By contrast, NT clauses in negative list agreements use the term '*like circumstances*'. Here the comparison shifts to the general context of the investment/services instead of the nature and characteristics of investors/service suppliers and investments/services (UNCTAD, 2000d). This includes the Singapore-EFTA investment chapter, and EFTA's PTA partners – Singapore and Korea – similarly use this term in their

[30] Financial services in the Korea-Singapore are an exception as they are scheduled on a positive list basis, and the US-agreements use positive lists of cross-border trade in financial services.

agreements using the negative approach. The term '*situations'* is used instead of circumstances in Singapore's agreements with EFTA and New Zealand however.

A further distinction is made in that the NT provision of US agreements with Korea and Singapore only applies to service suppliers, whereas the other four negative list agreements refer to both services and service suppliers. Investment chapters in the same agreements refer to both investors and investments. The EFTA-Singapore agreement refers to service suppliers and services as well as investors and their investments, whereas there is no reference to like investors, investments or circumstances in the investment chapter of the EFTA-Korea agreement. This corresponds to the Swiss model BIT, and UNCTAD (2000d) notes that the EFTA-Korea approach has the widest coverage, since any matter, in principle, can bet considered when establishing whether the foreign investor is being given national treatment or not.

What is a 'like' investor; situation or circumstance needs to be determined on a case-by-case basis, which is often not easy, as the experience of GATT/WTO Dispute Panels has shown (Mattoo, 1997). For example, where NT refers to both services and service suppliers, Fink and Molinuevo (2007) ask that if only services are "like" but service suppliers are "unlike" is the criteria of likeness then met? Or do both services and service suppliers have to be "like"? Similar questions could be posed for non-service investors and investments. In the EC-Chile agreement, reference is thus only made to juridical and natural persons, but not – as in the new EC-ASEAN negotiating mandate – to '*all measures affecting establishment'.* Finally, does likeness extend across different modes of supply for services? Future jurisprudence might clarify these issues and therefore also, which standard of 'likeness' is narrower or broader.

In sum, service providers covered under Asian PTAs can expect to be granted NT less often than investors in other sectors. EFTA agreements list NT for services on a positive list basis and investments on a negative list basis, whereas EFTA's partners – Korea and Singapore – typically include NT on a negative basis for both services and investments in their other agreements. Whereas an in-depth analysis of each country's sector and sub-sector schedules is necessary to establish whether obligations are more far-reaching in one agreement over the other, the negative list approach in EFTA-partners other service agreements does indicate wider coverage.

Available case law has not yet determined whether the terms 'like services and service suppliers'– as used in EFTA-agreements – are narrower than the term 'like circumstances'

as used in numerous other agreements entered into by EFTA-partners. If it turns out that the latter term is broader, then Swiss service suppliers haven't obtained the same coverage as, for instance, US companies. On the other hand, future jurisprudence might also clarify whether mentioning both 'services' and 'service providers' – as in EFTA agreements - entails wider coverage than only referring to the latter – as in US agreements with Singapore and Korea. Such semantic differences could thus turn out to have important implications.

V.3.3 Most-favoured-nation treatment

It is general practise to include MFN-clauses in bilateral, regional and multilateral investment-related agreements. The MFN rule is particularly relevant for non-service investors since they don't enjoy MFN treatment at the multilateral level, as service providers do under the GATS. In general, the MFN principle found in PTAs relates to two sets of investors: investors within an agreement involving more than two countries and investors from countries not party to the agreement. For the first set of investors, MFN can ensure treatment no less favourable than that accorded to other investors covered under the agreement. For the latter, it can ensure treatment no less favourable than that obtained in the partner-country's other PTAs, in particular in more recent agreements that could offer more favourable treatment (see Tables V.4 and V.5).

In this context, it is worth recalling that the scope of application of the MFN clause has been subject to debate (UNCTAD, 2007e). The prevailing – but not universally accepted - view is that a MFN clause can generally only be used to improve the terms of substantial rights already granted under a PTA (UNCTAD, 2005b; Roughton, 2007). For instance, if two treaties to which Switzerland is a party contain expropriation provisions but with different terms, Swiss investors may be able to claim the benefit of whichever treaty provides more favourable provisions under the (extra-regional) MFN obligation. On the other hand, an MFN clause would not generally allow Swiss investors to benefit from an investor-to-state dispute settlement mechanism in another PTA, if none exist in the PTA under which they are claiming.

The most important Asian PTA involving more than two countries is ASEAN. AFAS/AIA – as well as ASEAN-China – requires that trade preferences are granted on an MFN basis *among* members. There is not, however, a requirement that trade preferences accorded to non-parties are extended to ASEAN members. Future Swiss preferences from PTAs with one or more ASEAN members are thus not automatically extended to all ASEAN members. Interestingly, the agreements allow two or more members to liberalize faster than in their

AFAS/AIA-schedule without extending these so-called ASEAN-X commitments to the remaining ASEAN members.

For PTAs only involving two countries, the MFN principle is particularly relevant in the context of preferences granted to third parties. Nonetheless, investment-chapters of the Japan-Singapore, India-Singapore, EC-Chile and Korea-Singapore agreements only refer to 'best-endeavour' or similar international soft-law disciplines. Even though they encourage an extension of other PTA benefits to the other party, they don't establish binding extra-regional MFN obligations as such. Investment-preferences in the US-Singapore agreement, for instance, are therefore not automatically extended to Korea under the Singapore-Korea agreement. For services, the three above-mentioned agreements are joined by the TAFTA, Chile-Korea, and New Zealand-Singapore agreements, which don't grant MFN treatment either.

All other agreements reviewed include MFN-provisions pre- and post-establishments. There are typically major exceptions to MFN treatment, however. EFTA-agreements – as well as the Chile-Korea agreement – include so-called regional economic integration organisation (REIO) clauses. For Switzerland this means that an extension to Singapore, Korea, Chile, etc of the more favourable treatment granted to members of future Swiss PTAs on an MFN basis is not required. Potential new PTA-partners of Switzerland therefore know that negotiated preferences will not automatically be extended to others, and it should thereby make Switzerland a more attractive PTA-partner. On the other hand, Switzerland doesn't automatically enjoy the benefits of other agreements entered into by EFTA-partners - Korea and Singapore - either. Moreover, the possible discriminatory treatment between the parties of different PTAs signed by Switzerland is unfortunate in economic terms and reduces transparency in a set of already complicated and overlapping rules.

There are two ways of limiting this risk of investment distortion. First of all, agreements with REIO-clauses allow for extending the more favourable treatment of parties to the agreement simply through a joint meeting or exchange of letters between the parties (OECD, 2007). When GATS-inspired agreements – such as the service chapter of Japan-Malaysia – doesn't have a REIO exception clause, it is assumed that the commitments are already reflecting the 'most favoured' treatment available in a PTA but includes a non-binding provision that the better treatment granted to a third party in another PTA is extended to the parties of the agreement (OECD, 2007). Secondly, investment distortions can be minimized by negotiating PTAs with the same liberalisation commitments and same reservations. OECD (2007), notes that this seems to be what most countries have done since schedules of commitments made

by the same country in different agreements are more or less consistent. However, OECD also notes that more recent agreements tend to include more commitments, which Switzerland will not enjoy the benefits of due to the REIO clause.

There are certain variations in the content of the REIO-clause. One is the recent EU mandate to negotiate a PTA with ASEAN. The derogation of MFN treatment is here limited to regional economic integration agreements '*requiring the parties thereto to approximate their legislation'*. Such agreements includes, for instance, EEA or EU-accession processes but not future EC PTAs in the Asian region, such as the proposed agreement with India. Secondly, service chapters in EFTA-agreements specify that other PTAs exempted from the MFN clause have to be notified under GATS article V. Third, even though they are not referred to as REIO-clauses, NAFTA-like agreements often also have exceptions to MFN treatment. These are listed as a non-conforming measure in the annex of the agreement and regards commitments made in other regional or multilateral agreements signed before – but not after[31] - the entry into force of the PTA. In other words, Swiss investors or investments covered under, for instance, the Japan-Mexico agreement - that entered into force in 2005 - will not be extended the benefits of NAFTA but will enjoy benefits of the Japan-Malaysia agreement since it entered into force in 2006. Note, however, that in contrast to GATS-inspired agreements, this approach allows for new exceptions and non-conforming measures, when sectors are listed in parties' schedules of commitments.

When granted, MFN treatment tends to apply to all covered investments and investors as well as services and service suppliers, although exceptions may be added through schedules of commitments. Fink and Molinuevo (2007) note that - as in the case of NT – service chapters with negative list provide for MFN treatment in 'like circumstances' whereas positive agreements use the terms 'like services' and/or 'like service suppliers'. As is also the case for NT, most investment chapters refer to 'like circumstances'. This is the same in the EFTA-Singapore agreement though the term 'circumstances' is again replaced by 'situations'. As for the agreement's NT provision, 'like services and service suppliers' is used in the EFTA-Korea PTA, whereas there is no reference to like investors, investments or circumstances in the investment chapter. This should have no important implications, however, as international law has generally recognised the *ejusdem generis* principle for MFN treatment; i.e. a MFN clause can only apply to the same subject matter (OECD, 2004). Nonetheless, the exact scope of application of the MFN principle is not always clear, and the interpretive

[31] In some agreements this is with the exception of aviation, fisheries and maritime matters (incl. salvage). In NAFTA itself, telecommunications is also exempt from MFN treatment.

questions raised in the context of NT, such as what like circumstances are, etc. holds for MFN clauses also (Fink and Molinuevo, 2007).

Again, if future jurisprudence establish that the term 'like circumstances/situations' entails wider coverage than the GATS-language of 'like investors/investments' or 'like service suppliers/services', then Switzerland's service suppliers covered under the EFTA-Korea agreement, for instance, have obtained 'weaker' treatment standards than US service suppliers under the US-Korea (draft) agreement.

In sum, there is no clear pattern as to how MFN provisions are being applied in Asia. Moreover, there is not a clear association between MFN disciplines and whether agreements are based on negative or positive approaches. There are two exceptions.
First, EFTA and other positive list agreements include a wide exception to MFN treatment for all other PTAs, whereas NAFTA-inspired agreements allow the parties to benefit from better treatment granted to third parties in another PTA signed after the entry into force of the later one. This latter approach – if still imperfect – is better able to multilateralize preferential commitments, particularly because recent agreements tend to have wider coverage.

Secondly, the negative-list service chapters use the term 'like circumstances' instead of 'like service suppliers and services' as in positive-list agreements such as EFTA-agreements. The interpretative questions of these terms raised in the context of NT apply in for MFN clauses too.

In any event, the scope for MFN-clauses to level the playing field for foreign investors is severely limited and - apart for non-discrimination among parties to PTAs with many members - one can therefore question the practical relevance of the provision in the context of Asian PTAs (OECD, 2007).

V.4 Investment protection and dispute resolution

BITs have been the traditional instrument to protect investors abroad. Increasingly, PTAs have begun to include protection provisions, however, and in cases where their content and coverage are considered to be more comprehensive to those in BITs, the latter are typically replaced (OECD, 2007). This is the case with the EFTA-Korea agreement, which replaces Switzerland's BIT with Korea. In contrast, the Singapore-Swiss BIT as well as BITs of the EU and ASEAN countries coexist alongside their PTAs. Table V.6 summarizes the investment protection and dispute settlement provisions found in Asian investment agreements.

Note that for all PTAs reviewed, protection disciplines apply to service investments also because the broad asset-based definition of investment includes 'commercial presence', which service disciplines are typically based upon (OECD, 2007). Even when the service chapter includes protections from the investment chapter – as in the India-Singapore agreement as well as some financial services chapters – the investment chapters' protections apply to other investments that meet the asset-based definition of these chapters (OECD, 2007).

V.4.1 Umbrella clause

Only EFTA-agreements include a so-called 'umbrella'-clause, which stipulates that the host country assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party and thus not only in connection with an investment agreement. UNCTAD (2007) notes that around 40 percent of all BITs include umbrella clauses, but they are typically not included in recent agreements[32] (UNCTAD, 2007). One reason a country like the US has refrained from including umbrella clauses in agreements is the recent investment disputes involving this provision. Above all, the two cases mentioned in the literature review involving the Swiss-based multinational Société Générale de Surveillance (SGS), generated conflicting jurisprudence on the precise nature and effect of this obligation – and thus also its scope in EFTA's PTAs. The arbitrators in the Philippines-case argued that a breach of a state contract was a breach of the umbrella clause in the BIT, whereas the tribunal in the Pakistan-case argued it wasn't. It can thus be argued that the latter judgement, *de facto,* deprived the umbrella clause of any independent meaning.

In sum, recent jurisprudence involving the Swiss multinational SGS does not provide a clear answer as to whether umbrella clauses allow investors to resolve contractual claims against host countries under arbitration provisions of the investment agreement, rather than under the dispute resolution provisions of the contract in dispute. It thus seems that future case law will have to clarify,whether Swiss investors have obtained stronger protection rights in their PTAs with Singapore and Korea than for instance the US (see Table V.7).

V.4.2 Transfers

Transfer clauses guarantee investors the right to transfer current and capital transactions without delay, and to use a particular kind of currency at a specified exchange rate. These

[32] Important exceptions are Chinese BITs, which still consistently include umbrella clauses.

are included in all agreements reviewed, and typically include exceptions in the case of serious balance-of-payments, exchange rate or monetary policy difficulties. The EC-agreement with Chile allows for free movements of capital relating to direct investment and the liquidation of these capitals (with reservations). From the draft available it is not clear whether this is also the case for the Community's mandate to negotiate with ASEAN. But since capital movements fall under Community competence and transfer-provisions have been included in all EC PTA-agreements to date (Szepesi, 2004), there is no reason to suspect they will be excluded from future agreements.

A transfer clause is included in both service and investment chapters in the Korea-EFTA agreement. In the service chapter the provision briefly prohibit restrictions on international transfers and payments for current transactions relating to the supply of a service with another party, whereas the investment chapter (to which Norway is not a party) has more detailed provisions as is standard in investment chapters. This should have no implications, however, as both transfer obligations apply to investments in services, and parties have to abide by the higher standard in cases of conflict as stipulated by international law (OECD, 2007).

In sum, transfer of capital in connection with foreign investments is provided in a relatively consistent manner in Asian PTAs.

V.4.3 Standard of treatment

BITs and PTAs typically oblige parties to grant foreign investors *fair and equitable treatment*. There is a debate, however, as to whether mentioning fair and equitable treatment provides a separate standard for foreign investors and their investments, or the standard is no different from general obligations under customary international law. UNCTAD (2007) points out that future jurisprudence clarifying this question will have substantial implications, since a breach of this obligation will probably be found in fewer cases if it simply confirms customary international law than if it entails higher standards. Moreover, given that the violation of any other provision included in the agreement would mean that the host state has mistreated the foreign investor, it could also constitute a violation of the fair and equitable treatment standard.

EFTA-agreements refer to fair and equitable treatment. This is not the case, however, for the Japan-Singapore, New-Zealand Singapore, EC-Chile and India-Singapore agreements. Moreover, several PTAs that do include the term stipulate that fair and equitable treatment does not entail any treatment beyond customary international law and that the violation of

other obligations in the PTAs does not mean a violation of this standard. This is the case with the Korea-Singapore, Korea-Chile as well as US-agreements.

In sum, if future jurisprudence establishes that 'fair and equitable treatment' is an independent treatment-standard, Swiss investors could have obtained stronger protection rights under EFTA-PTAs, than investors covered under agreements that i) don't include this standard; or ii) include it but mention that it is similar to established customary international law.

V.4.4 Expropriation and compensation for losses

Customary international law states that if property of aliens is taken – either through direct or indirect expropriation - it must be for public purposes, non-discriminatory, with compensation, and under due process of law (Sornarajah, 1994). Most PTAs have adopted these basic principles.

Of PTAs with investment coverage, it is only EC agreements that exclude expropriation provisions. This is because expropriation falls under exclusive national competence in the EC, and certain member states still refuse to include them in Community-wide agreements (Poulsen, 2006). These matters therefore continue to be mostly left for individual EC countries' BITs, and the EC is thus in the process of developing two levels of law (in addition to multilateral disciplines) for their investors abroad.

All other PTAs with investment coverage include obligations for both direct and indirect expropriation and require such measures to be for a public purpose, on a non-discriminatory basis and under due process of law. The New Zealand-Singapore agreement does not include expropriation provisions as such, but grant NT and MFN treatment for protection, expropriation matters, compensation and transfers.

Direct measures of expropriation include outright nationalization and large-scale taking of land. Indirect measures are defined by UNCTAD (2000a) as the slow and incremental encroachment on one or more ownership rights of a foreign investor that diminishes the value of its investment without directly removing the legal title to the property. Examples could be forced divestment of shares, interference in the right of management and excessive taxation. Moreover, regulatory takings in relation to the environment, health, morals, culture or economy that destroys the ownership rights of an investor in its tangible or intangible assets are in some cases covered also. If such takings take place by the host state, PTAs'

typically require compensation to be prompt, effective and adequate and settled in a freely convertible currency without delay. This is also the standard in most BITs.

Instead of 'indirect' expropriation the EFTA-Singapore agreement refers to *'de facto* expropriation'. The Switzerland-Singapore BIT refers to 'indirect' expropriation. These two concepts are overlapping though not indistinguishable. In contrast to *de jure* expropriation, a *de facto* expropriation takes place without a formal legislative decree. However, it covers 'direct' and immediate measures since it can include physical seizure or appropriation of property. The exact implications of the different terms and to what extent certain *de facto* governmental measures amount to indirect expropriation, for instance, is far from clear in available case law (Heiskanen, 2006). Future jurisprudence will therefore have to establish the implications of this term in the EFTA-Singapore agreement, when compared to the language of other agreements. However, it is seems safe to conclude that since the two terms are used interchangeably in many contexts, and Singapore is a highly investor-friendly environment, these differences are perhaps not critically important.

There is a second difference between the Singapore-EFTA agreement (and Switzerland-Singapore BIT) and the EFTA-Korea agreement as well as several other PTAs entered into by both Singapore and Korea. The EFTA-Singapore agreement doesn't specify in detail the issue, which has raised most debate among developing and developed countries in the context of BITs and PTAs - namely what amounts to adequate compensation (UNCTAD, 2007). It simply states that expropriation has to be '*accompanied by the payment of compensation. The amount of compensation shall be settled in a freely convertible currency and paid without delay to the person entitled thereto without regard to its residence or domicile*'. In contrast, AIA, US-agreements as well as the EFTA-Korea, Singapore-Korea, Chile-Korea, Japan-Singapore and India-Singapore agreements go in more detail specifying that compensation has to represent the fair market value of the expropriated investment immediately before the expropriatory action was taken or - in some cases - became public knowledge, whichever is more favourable. Moreover, most of these agreements also specify that compensation shall include interest at a (normal) commercial rate from the date of dispossession until the date of payment. Such specifications are not included in the EFTA-Singapore agreement. These differences are mirrored in BITs, which also vary in their specification of compensation standards, but the implications still remain to be seen in future jurisprudence (UNCTAD, 2007).

In sum, apart from EC agreements, all reviewed PTAs with investment coverage more or less copy standard BIT-provisions on direct and indirect expropriation and compensation requirements.

Future jurisprudence might establish whether the EFTA-Singapore agreement has important differences with other agreements by referring to 'de facto' rather than 'indirect' expropriation and not specifying compensation requirements in detail.

V.4.5 Investor-to-state dispute resolution[33]

As mentioned in the literature review, Switzerland has consistently included investor-to-state arbitration clauses in the BITs it concluded after 1981, with the exception of the 1985-BIT with Morocco and the 1997-BIT with Thailand (Liebeskind, 2002). The latter refer to ICSID conciliation and arbitration, but shall only enter into force the day Thailand becomes a member of the Washington Convention and thus ICSID. Thailand signed the Washington Convention in 1985 but has yet to ratify it. In contrast to Swiss BITs with China, Pakistan, Philippines[34], Laos, Vietnam, Hong Kong, and India, Swiss investors can thus not file a claim directly under BITs with Singapore, Indonesia and Malaysia as these agreements were signed before 1981[35].

All reviewed PTAs offer recourse to investor-to-state tribunals in the case of a dispute. The one exception is EC agreements, however, which don't include the investor-to-state dispute settlement option even though it is legally possible under EC law (Karl, 2004). This situation arises as a result of the issue of shared competence between the European Commission and member states in the investment field.

Unlike their American counterparts, Swiss investors enjoy access to international arbitration solely on matters relating to investment protection and not to market access (i.e. investment liberalization), a decision the Swiss authorities have voluntarily renounced. In contrast to protection disciplines, the coverage of investor-to-state dispute settlement clauses depends on the rules that define the relationship between trade in services and horizontal investment chapters (Fink and Molinuevo, 2007). Swiss service suppliers cannot therefore bring national treatment or MFN violations to international third-party investor-to-state arbitration under

[33] Treaty provisions on state-to-state arbitration will not be covered here.
[34] Cf. cases concerning Pakistan and Philippines mentioned in the section on umbrella clauses.
[35] Several Swiss BITs are currently under (confidential) re-negotiation.

EFTA agreements[36]. This stands in contrast to US agreements, where all horizontal investment disciplines apply to investments in services (see Table V.7).

Most agreements allow recourse to investor-to-state dispute tribunals, both pre- and post-establishment. Pre-establishment disputes are excluded from the AIA, TAFTA and the India-Singapore agreements however. In the latter agreement, India has agreed to subject pre-establishment disputes to compulsory investor-state settlement procedures in the agreement, if India does so in any other international agreement with third-countries (given that Singapore provides the same undertaking to India).

No agreements – including those of EFTA - require local remedies to be exhausted before an international claim can be pursued, such as the case in the Swiss-Jamaica BIT for instance. So even though investors typically are obliged to attempt to settle a dispute amicably through consultations or negotiations before initiating a legal claim, they are free to pursue internationalized remedies.

In most agreements, several choices of international venues for settling disputes are included. Most refer to the institutional system of the International Centre for Settlement of Investment Disputes (ICSID) under the auspices of the World Bank and *ad hoc* procedures using the internationally accepted United Nations Commission on International Trade Law (UNCITRAL) rules of arbitration. A few agreements furthermore allow other *ad hoc* rules – such as those of the Permanent Court of Arbitration - to be used as long as both parties agree. In the Thailand-Australia agreement, only UNCITRAL rules can be used, owing to the fact that Thailand is not a member of the Washington Convention and thus ICSID[37]. Disputes under the ASEAN investment agreement can be taken to ICSID, *ad hoc* procedures using UNCITRAL rules, the Regional Centre for Arbitration at Kuala Lumpur or any other regional centre for arbitration in ASEAN. It bears noting moreover that unlike other investment agreements, ASEAN host states can also bring disputes against foreign investors under the AIA.

Typically the investor chooses the venue - whether national or international. There are exceptions though. Both disputing parties have to agree on a suitable body for arbitration

[36] As mentioned above, the Singapore-agreement excludes all sectors – scheduled or not – whereas the Korea-agreement only excludes sectors covered in the services and financial services chapter. The agreement has a specialized investor-to-state arbitration mechanism for disputes concerning financial services.

[37] The agreement could, however, have allowed for ICSID Additional Facility Rules in case one party is not a member of ICSID.

under ASEAN. If they don't within a period of three months, an arbitral tribunal consisting of three members shall be formed (with one member selected by the investor, one by the host state and the third by both). If that fails too, the President of the International Court of Justice is allowed to make the required appointments. The EFTA-Singapore agreement also requires consent by both parties, though this is not explicitly spelled out in the agreement itself, and the EFTA-Korea agreement requires consent by both parties for pre-establishment disputes before they can be taken to either ICSID or an *ad hoc* procedure using UNCITRAL rules[38]. This contrasts US agreements with both Korea and Singapore as well as the Korea-Singapore agreement, where prior consent has been given for investors to choose the venue except if the choice is an *ad hoc* venue not using UNCITRAL rules, in which case consent is required. Singapore's PTA with India does not allow for *ad hoc* venues not using UNCITRAL rules, but automatic consent is granted regardless of whether the investor choose UNCTIRAL or ICSID rules/jurisdiction. EFTA agreements have in other words not provided Swiss investors and service companies with the same guarantee that disputes can be taken to international third-party settlements as other agreements entered into by EFTA partners[39].

US-modelled agreements have detailed rules on the circumstances surrounding dispute proceedings based on the 2004 US-model BIT. US agreements with Korea and Singapore, for instance, allow disputing parties to request a consolidation of two or more separately submitted claims with a question of law or fact in common and arisen out of the same events or circumstances. This right is also included in the Japan-Mexico and Chile-Korea agreements but not in the EFTA agreements. The latter do not feature a specific safeguard against inconsistent jurisprudence on disputes relating to the same subject matter. Valid arguments of judicial economy can be made against allowing multiple disputes arising out of the same set of events or circumstances, which has been illustrated by the more than 40 claims against Argentina after the country's financial crisis.

In contrast to EFTA agreements, US agreements with Singapore and Korea include specific provisions on transparency. Tribunal hearings shall be open for the public and pleadings, memorials, briefs, minutes, transcripts, awards and decisions of the tribunal shall be made publicly available to the extent that they don't reveal sensitive information. In the same vein, US agreements allow *amicus curia* submissions in the case of disputes. Whether such provisions are an advantage or disadvantage of course depends on the perspective one

[38] Note, however, that a party to EFTA agreements cannot block state-to-state tribunals.
[39] In Swiss BITs, it was not until 1990 that the issue of consent of the state parties to arbitration has been expressly addressed but not always guaranteed (Liebeskind, 2002).

takes. On the one hand, increased transparency and third-party access to disputes may help to increase the democratic legitimacy of dispute settlement procedures, but on the other hand public and political pressure might undermine a rules-based and predictable arbitration mechanism (UNCTAD, 2007). One could further argue that non-participation of third countries in dispute settlement can be an advantage for the investor to the extent that such participation may otherwise slow down and/or increase the cost of arbitration procedures. It should be noted that while Swiss BITs do not feature transparency provisions, matters arising from such treaties are routinely discussed in the federal Parliament.

In sum, except for the EC agreements, all PTAs with investment coverage offer investors the choice of investor-to-state dispute settlement under ICSID or *ad hoc* processes using – in most cases -UNCITRAL rules.

In contrast to US agreements, disputes arising from national treatment and MFN commitments for commercial presence cannot be taken to international investor-to-state arbitration under the EFTA agreements.

EFTA agreements require consent by the disputing parties – though only in the case of pre-establishment disputes for the Korea agreement – and Swiss investors are thus not guaranteed access to international third-party arbitration if host states refuse. Again, this is in contrast with US agreements with EFTA's PTA partners. These latter agreements also include transparency provisions and allow for consolidation of disputes, which is not the case under EFTA agreements.

Table V.1 Investment and commercial presence: definitions and relationship

Agreement	Definition of investment	Definition of commercial presence in services chapter	Relationship between investment in services and horizontal investment disciplines
Japan-Malaysia	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Service chapter prevails in case of inconsistencies with the investment chapter's obligations on NT, MFN, and performance requirements.
Japan-Mexico	Asset based– closed list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
Japan-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Relationship not expressly defined. Singapore has scheduled a reservation giving precedence to the services disciplines in case of inconsistencies with investment chapter's obligation on NT and performance requirements.
TAFTA	FDI as defined by IMF.	GATS definition of commercial presence.	One single schedule of commitments for services and investment.
EC-Chile	Direct investment incl. branches	GATS definition of commercial presence. Ownership or control not necessary.	Services chapter solely governs commercial presence.
Draft EC mandate for EC-ASEAN[1]	Builds on GATS provisions of commercial presence and extends them to investors in non-services sectors. Ownership or control not necessary.		One single schedule of commitments for services and investment.
EFTA-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	The investment chapter's NT and MFN obligations do not apply to commercial presence in any service sector.
EFTA-Korea	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	The investment chapter's NT and MFN obligations do not apply to commercial presence in sectors covered by the services chapter.
Trans-Pacific SEP	Investment chapter still under negotiation.	GATS definition of commercial presence. Ownership or control not necessary.	No investment disciplines yet, only services disciplines apply
New Zealand – Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence. Ownership or control not necessary.	The investment chapter's NT and MFN obligations do not apply to commercial presence as governed by services chapter.
Chile – Korea	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
Korea – Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
India – Singapore	Asset based– open list: Includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Service chapter prevails in case of inconsistencies.
AIA/AFAS	Asset based– open list. Excludes portfolio investment.	Not explicitly defined, but implicitly follows GATS.	Does not apply to investment in services.
US-Korea draft	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence for financial services.	Investment disciplines apply.
US-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
US-Thailand[2]	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	No draft available.	National treatment provision in investment chapter does not apply to services. Service chapter prevails in case of inconsistencies.
ACCEC draft	Investment chapter still under negotiation.	GATS definition of commercial presence.	No investment disciplines yet, only services disciplines apply

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.2 Rules of origin/denial of benefits[1]

Agreement	Natural persons		Juridical persons		
	Extended to domestic nationals (or 'citizens')	**Extended to permanent residents**	**Limited to domestically owned or controlled service suppliers/investors**	**Extended to judicial persons constituted under domestic laws and having substantial business operations in the domestic territory**	**Other provisions**
Japan-Malaysia	Yes	No (Japan) Yes (Malaysia)	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply. Investment chapter does not extend benefits to branches of enterprises of third states.
Japan-Mexico	Yes	No	No	Yes	Parties can deny FTA benefits to investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.
Japan-Singapore	Yes	No (Japan) Yes (Singapore)	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)
TAFTA	Yes	No	Yes (for services and main investment disciplines)	Yes (for investment chapter)	
EC-Chile	Yes	No	No	Yes	
Draft EC mandate for EC-ASEAN[2]	Yes	No	No	Yes	Benefits also extended to juridical persons with substantial business operations (*'possesses a real and continuous link')* in the territory of any party.
EFTA-Singapore	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)
EFTA-Korea	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any WTO-member, if service supplier is owned or controlled by person of a party (services chapter only).
Trans-Pacific SEP[3]		Yes	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only).
New Zealand – Singapore	Yes	Not automatically.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only). No substantial business operations test in investment chapter.
Chile – Korea	Yes	Yes	No	Yes	Parties can deny FTA benefits to investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply (investment chapter only).
Korea – Singapore	Yes	Yes	No	Yes	
India – Singapore	Yes	Yes	Yes (for services supplied through commercial presence and investment disciplines)	Yes (for services supplied cross border and through consumption abroad)	Benefits can be denied if the juridical person is owned or controlled by persons of the denying party (only for modes 1 and 2 in services).
AFAS/AIA	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only). Investment chapter allows for cumulated equity calculations.
US-Korea draft	Yes	No	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain normal economic relations or where certain trade sanctions apply.
US-Singapore	Yes	No	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.
ACCEC draft[3]	Yes	No	Yes (for commercial presence)	Yes	

1: No draft available for the US-Thailand agreement. 2: Excl. Myanmar, Laos and Cambodia. 3: Only for services (investment chapter not finalized).

Table V.3 Treatment of investment

	Establishment				Post-establishment			
	NT		MFN		NT		MFN	
	positive list	negative list	positive list	negative list	positive list	negative list	positive list	negative list
Japan-Malaysia		+		+ (not vis-à-vis ASEAN members for Malaysia)		+		+ (not vis-à-vis ASEAN members for Malaysia)
Japan-Mexico		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements))
Japan-Singapore		+		Request		+		Request
TAFTA	+			+		+		+
EC-Chile ***(does not replace BITs)***	+		No MFN clause or request		+		No MFN clause or request	
Draft EC mandate for EC-ASEAN[1] ***(does not replace BITs)***	+			+ (REIO-like clause)	+			+ (REIO-like clause)
EFTA-Singapore		+		+ (REIO clause)		+		+ (REIO clause)
EFTA-Korea *(replaces and suspends Swiss BIT)*		+		+ (REIO clause)		+		+ (REIO clause)
Trans-Pacific SEP	No investment disciplines yet.							
New Zealand – Singapore		+		+		+		+
Chile – Korea *(replaces and suspends BIT)*		+		+ (REIO clause)		+		+ (REIO clause)
Korea – Singapore		+		Request		+		Request
India – Singapore	+ India	+ Singapore		Request	+			Request
AIA ***(does not replace BITs)***		+		+ (intra-regional)		+		+ (intra-regional)
US-Korea Draft		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
US-Singapore		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
US-Thailand[2]		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
ACCEC draft	Investment chapter under negotiation. No draft available.							

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.4 Treatment of services[1]

Agreement	Establishment						Post-establishment					
	Market access		NT		MFN		Market Access		NT		MFN	
	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list
Japan-Malaysia	+		+			+ (not binding for preferences under other PTIA)	+		+			+ (not binding for preferences under other PTIA)
Japan-Mexico				+		+ (not past agreements, and 3 sectors in future agreements)				+		+ (not past agreements, and 3 sectors in future agreements)
Japan-Singapore	+		+			Request	+		+			Request
TAFTA	+		+			Request	+		+			Request
EC-Chile	+		+		No MFN clause or request		+		+		No MFN clause or request	
Draft EC mandate for EC-ASEAN[2]	+		+			+ (REIO-like clause)	+		+			+ (REIO-like clause)
EFTA-Singapore	+		+			+ (REIO clause)	+		+			+ (REIO clause)
EFTA-Korea	+		+			+ (REIO clause)	+		+			+ (REIO clause)
Trans-Pacific SEP		+		+		+ (not past agreements, and 3 sectors in future agreements for Chile, New Zealand and Singapore)		+		+		+ (not past agreements, and 3 sectors in future agreements for Chile, New Zealand and Singapore)
New Zealand – Singapore	+		+		No MFN clause or request				+		No MFN clause or request	
Chile – Korea				+		Request				+		Request
Korea – Singapore		+ (not mode 3)		+ (not financial services)		Request	+	+ (not mode 3)		+ (not financial services)		Request
India – Singapore	+		+			Request	+		+			Request
AFAS	+		+			+ (intra-regional)	+		+			+ (intra-regional)
US-Korea draft		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)
US-Singapore		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)
ACCEC draft	+		+			+ (intra-regional)	+		+			+ (intra-regional)

1: No draft available for the US-Thailand agreement. 2: Excl. Myanmar, Laos and Cambodia.

Table V.5 Specifications in treatment standards

Agreement	NT				MFN				NT/MFN to other party's:		NT/MFN to other party's:	
	Services treatment to 'like':		Investment treatment to 'like':		Services treatment to 'like':		Investment treatment to 'like':					
	Circum-stances	Service suppliers/ services	Circum-stances	Investors/ investments	Circum-stances	Service suppliers/ services	Circum-stances	Investors/ investments	Service suppliers	Service suppliers and services	Investors	Investors and investments
Japan-Malaysia		+	+			+	+			+		+
Japan-Mexico	+		+		+					+		+
Japan-Singapore		+	+			+ (request)	+ (request)			+		+
TAFTA		+	+			+ (request)	+			+		+
EC-Chile		+	+ (*'economic activity'*)		No MFN clause or request					+	*'legal or natural persons'*	
Draft EC mandate for EC-ASEAN[1]	Like investors (incl. service suppliers) and 'all measures affecting establishment'[2]				Like investors (incl. service suppliers) and 'all measures affecting establishment'							*'investors'* and *'all measures affecting establishment'*
EFTA-Singapore		+	+ (*'situa-tions'*)			+	+ (*'situa-tions'*)			+		+
EFTA-Korea		+	No reference to factual comparisons			+	No reference to factual comparisons			+		+
Trans-Pacific SEP	+		No investment disciplines yet.		+		No investment disciplines yet.			+	No investment disciplines yet.	
New Zealand – Singapore		+	+ (*'situa-tions'*)		No MFN clause or request		+ (*'situa-tions'*)			+		+
Chile – Korea	+		+		Do not mention factual comparison in request		+			+		+
Korea – Singapore	+		+		Do not mention factual comparison in requests					+		+
India – Singapore		+	+		Do not mention factual comparison in requests					+		+
AFAS/ ASEAN	*'discriminatory measures'*			+		+		+		+		+
US-Korea draft	+		+		+		+		+			+
US-Singapore	+		+		+		+		+			+
US-Thailand[3]	No draft available		+		No draft available		+		No draft available			+
ACCEC draft		+	No investment disciplines yet.			+	No investment disciplines yet.			+	No investment disciplines yet.	

1: Excl. Myanmar, Laos and Cambodia. 2: The definition of establishment can be found in footnote 3 of the analysis. 3: US proposal

Table V.6 Investment protection and dispute settlement

Agreement	Umbrella clause	Transfers	Standard of treatment/ Fair and equitable	Compen-sation	Expropriation		Dispute settlement		Scope of application of investment protection disciplines to goods and services
					Direct	Indirect	State-state	Investor-state	
Japan-Malaysia		+	+	+	+	+	+	+	All protections apply.
Japan-Mexico		+	+	+	+	+	+	+	All protections apply.
Japan-Singapore		+		+	+	+	+	+	All protections apply.
TAFTA		+	+	+	+	+	+	+ (Post-establishment only)	Protection applies to commercial presence.
EC-Chile		+	References to BITs				+		Protection applies to free transfers.
Draft EC mandate for EC-ASEAN[1]	?	?	References to BITs				+		Protection applies to free transfers.
EFTA-Singapore	+	+	+	+	+	'de facto'	+	+	Protection applies to commercial presence.
EFTA-Korea *(replaces and suspends Swiss BIT)*	+	+	+	+	+	+	+	+	Protection applies to commercial presence.
Trans-Pacific SEP	No investment disciplines yet.								
New Zealand – Singapore		NT and MFN		NT and MFN			+	+	Protection applies to commercial presence.
Chile – Korea *(replaces and suspends BIT)*		+	+	+	+	+	+	+	All protections apply.
Korea – Singapore		+	+	+	+	+	+	+	All protections apply.
India – Singapore		+		+	+	+	+	+ (Not for NT or post-establishment)	The services chapter incorporates selected protections of the investment chapter to be applied to commercial presence. The protection of the investment chapter applies to other investments.
AIA *(does not replace BITs)*		+	+	+	+	+	+	+ (Post-establishment only)	Protection applies to investment in services.
US-Korea draft		+	+	+	+	+	+	+	Protection applies to commercial presence.
US-Singapore		+	+	+	+	+	+	+	Protection applies to commercial presence.
US-Thailand[2]		+	+	+	+	+	+	+	Protection applies to commercial presence.
ACCEC	No investment disciplines yet.								

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.7 EFTA vs. US agreements with Singapore and Korea

			SINGAPORE		KOREA	
			EFTA	**US**	**EFTA**	**US (draft)**
Definition of investment			Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.
Definition of commercial presence in services chapter			GATS definition of commercial presence	Investment in services covered by investment chapter	GATS definition of commercial presence	Investment in non-financial services covered by investment chapter. GATS definition of commercial presence for investment in financial services.
Relationship between investment in services and horizontal investment disciplines			The investment chapter's NT and MFN obligations do not apply to commercial presence in any service sector.	Investment disciplines apply.	The investment chapter's NT and MFN obligations do not apply to commercial presence in sectors covered by the services chapter.	Investment disciplines apply for non-financial services.
Rules of origin for natural persons	**Extended to domestic nationals (or 'citizens')**		Yes	Yes	Yes	Yes
	Extended to permanent residents		Yes for investors. Only for services if the importing party grants substantially the same treatment to permanent residents as to nationals in respect of measures affecting services trade	No	Yes for investors. Only for services if the importing party grants substantially the same treatment to permanent residents as to nationals in respect of measures affecting services trade	No
Rules of origin for juridical persons	**Limited to domestically owned or controlled service suppliers/investors**		No	No	No	No
	Extended to judicial persons constituted under domestic laws and having substantial business operations in the domestic territory		Yes	Yes	Yes	Yes
	Other provisions		Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.	Benefits also extended to juridical persons with substantial business operations in the territory of any WTO-member, if service supplier is owned or controlled by person of a party (services chapter only).	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain normal economic relations or where certain trade sanctions apply.
Treatment pre- and post-establishment for investment	**NT**		Negative list for investors and investments in like situations	Negative list for investors and investments in like circumstances	Negative list for investors and investments with no factual comparison	Negative list for investors and investments in like circumstances
	MFN		Negative list for investors and investments in like situations but with REIO clause	Negative list for investors and investments in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.	Negative list for investors and investments with no factual comparison but with REIO clause	Negative list for investors and investments in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.
Treatment pre- and post-establishment for services	**Market access**		Positive list	Negative list (don't mention foreign equity restrictions)	Incorporates article XVI of GATS; i.e. positive list	Negative list (don't mention foreign equity restrictions)
	NT		Positive list for like services and service suppliers	Negative list (not for mode 1 in financial services) for service suppliers in like circumstances	Incorporates article XVII of GATS; i.e. positive list for like services and service suppliers	Negative list (not for mode 1 in financial services) for service suppliers in like circumstances
	MFN		Negative list for like services and service suppliers but with REIO clause.	Negative list for service suppliers in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.	Negative list for like services and service suppliers but with REIO clause.	Negative list for service suppliers in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.
Umbrella clause			Yes	No	Yes	No
Transfers			Yes	Yes	Yes	Yes
Standard of treatment/ fair & equitable			Yes	Yes but similar to customary international law	Yes	Yes but similar to customary international law
Compensation			Yes (not specified in detail)	Yes	Yes	Yes
Expropriation			Direct and de facto	Direct and indirect	Direct and indirect	Direct and indirect
Investor–to-state dispute settlement			ICSID or UNCITRAL rules with no automatic consent.	ICSID, UNCITRAL or other institutions/rules with automatic consent for the first two. Allows for consolidation and includes transparency provisions.	ICSID or UNCITRAL rules with no automatic consent for pre-establishment disputes.	ICSID, UNCITRAL or other institutions/rules with automatic consent for the first two. Allows for consolidation and includes transparency provisions.
Protection applies to investment in services			Yes	Yes	Yes	Yes

VI. Assessing the effects of de jure trade and investment integration

Key issues addressed:

- De jure integration in Asia: impacts on third country trade performance
- De jure integration in Asia: impacts on third country FDI performance
- The influence of investment rule-making on induced FDI flows

As discussed in Section II of this study, regional economic integration can be regarded as a process driven via the marketplace or by the effects of legally binding agreements entered into by governments. Market-driven integration is facilitated by the private sector and technological developments, whereas rule-driven integration is facilitated by legal instruments. In recent years, the latter have typically taken the form of international trade and investment treaties. The two processes are of course complementary, but the distinction is nonetheless useful for detecting the main forces driving Asian integration and their implications for third country multinationals.

In what follows, the study reviews the overall empirical evidence on the importance of rules and agreements in the context of Asian integration of trade and FDI flows. While there is little doubt that Asian integration has long been market driven, this dynamic is currently undergoing significant change. Since Asia's interest in bilateral and regional trade and investment agreements is a rather recent phenomenon, we have to rely - to a certain extent - on experiences with non-Asian preferential trade and investment agreements in order to gauge the likely outcome of this process and its potential implications for Swiss investors in the region.

VI.1 The rise of preferential trade and investment agreements and their likely impacts

The general consensus iin policy research circles is that the process of economic integration in Asia has so far been driven primarily by economic forces due to the FDI-induced integration of production networks, as well as by the impetus flowing endogenously from continued region-wide growth which, *ceteris paribus,* naturally increases trade and investment activity at the regional level (Dobson and Yue, 1997; Kimura and Ando, 2003; Damuri et al., 2006). ADB (2002a) thus find that, while PTAs have the potential to increase intra-regional trade and investment flows - as observed most markedly in the case of the EU and NAFTA - their impact on the Asia-Pacific region has to date been small.

However, this dynamic might very well be changing. Asian countries have increasingly turned towards far-reaching bilateral PTAs rather than the 'open regionalism' pursued by ASEAN and APEC in the past (Scollay, 2004; ADB, 2006). In particular, Japan, India, South Korea, Singapore and Thailand have all been active in trying to facilitate economic integration – and to some extent countenance the rise of China - through negotiations of formal trade agreements featuring comprehensive disciplines on investment on a bilateral or regional basis. The same countries have also been active signatories of bilateral investment treaties, both within and outside the region, as the scale of their own FDI outflows has grown.

Likely impact on trade flows

Based on what we know about PTAs in general, the rush towards regional and bilateral integration could have important implications for the future of trade and investment flows in Asia. In a recent 'meta-analysis' of all relevant econometric studies of preferential trade agreements, the World Bank (2005) found that regional/bilateral trade increases as a result. Such an outcome is confirmed by general equilibrium simulations (e.g. Krueger, 1999) and there is thus clear evidence that PTAs contribute to the increased regionalisation of world trade patterns (Pelagidis & Papasotirou, 2002).

The more interesting question for Switzerland, though, is whether increased intra-regional trade comes at the expense of third country suppliers. Athukorala (2006a) finds that even though there has been a rapid expansion of components trade within AFTA, this has been complemented by increased trade in final goods with countries outside the region.[40] Furthermore, as noted above - and also pointed out by Dobson and Yue (1997) and more recently by Kawai (2007) - increased regionalisation in Asia is offset by continued dependence on non-Asian markets and MNEs. The end result is that even as the Asian region continues to experience greater integration, its dependence on the global economy continues to constrain inward-looking policy choices.

Will the recent shift towards PTAs change such a pattern? When compiling all the regression estimates of authoritative studies, the World Bank (2005) is unable to reach any definitive conclusions as to whether PTAs are in fact trade- or FDI-diverting *per se*. It seems that some

[40] Production-sharing leads to massive double counting of published trade data as goods cross multiple borders in the course of their production. If not controlled for, this will overestimate the importance of intra-regional trade, and underestimate the importance of extra-regional trade and thus generate misleading inferences as to regional integration trends in trade (Athukorala, 2003; Athukorala and Yamashita, 2006).

agreements can induce such effects are while others do not. The devil, as always, lies in the details of individual agreements. So what, then, may explain some of the variations observed?

First, PTAs that are open to trade with third countries and cover practically all economic sectors are typically found to be less trade-diverting on average. Too high external tariff barriers relative to preferential tariffs and too many exceptions will lead to trade diversion and thus likely hurt third-country suppliers. Also, since East Asia continues to rely significantly on *extra*-regional trade for its growth dynamism, trade diversion would hurt Asian countries themselves (Athukorala and Yamashita, 2006).

Until recently, the tendency had been towards declining margins of regional preference – i.e. the difference between the average MFN and preferential tariffs – for ASEAN members, indicating that trade liberalization conducted multilaterally was moving faster than that conducted along regional lines (Ando and Kimura, 2003; Damuri et al., 2006).

The recent acceleration of tariff cuts under AFTA, the proliferation of preferential trade agreements and the continued negotiated gridlock in Geneva, suggest however that the relationship described above has been somewhat reversed over the course of the Doha Round. At the same time, it must be emphasized that third country traders and investors such as Switzerland have benefited from the continued commitment of Asian countries to liberalize their trade and investment regimes, as well as their regulatory regimes in services, on an autonomous basis. Simply put, third countries have often enjoyed *de facto* MFN treatment in their trade and investment relations with Asian countries. To date, there is very limited evidence of trade and investment policy backtracking in Asia, such that the wedge between actual (applied) and bound policies and measures and the fact that third countries are not direct beneficiaries of the protective properties of policy bindings have not proven unduly problematic.

Many of the recent or currently negotiated Asian PTAs focus on economy-wide liberalisation rather than creating 'carve-outs' to serve particular rent-seeking sectors and interests (ADB, 2006; Plummer, 2006). For this reason, Frankel (1997), Fink and Primo Braga (1999), Li (2000), Clark and Tavares (2000), Gilbert, Scollay and Bora (2001), and Soloaga and Winters (1999) all find that AFTA has been more trade creating than diverting. Also, recently concluded negotiations over an ASEAN-China PTA, while initially limited to goods trade (a services complement has since been added), liberalises 98% of all tariff lines and includes trade in agricultural products which can help create momentum for further agricultural liberalization in the Asia-Pacific region (Cheong and Kwon, 2005; Feridhanusetyawan, 2005).

There are of course important exceptions to the trends depicted above. Some of the recent PTAs of Thailand and a number of agreements entered into by India appear to have been driven more by mercantilistic than liberal ideals and feature highly selective preferential tariff dismantling rather than comprehensive liberalisation, ultimately calling into question their WTO compatibility (Sally, 2006). Nonetheless, most Asian PTAs – both those in existence today and those under negotiation – tend to be liberal in character and maintain relatively small margins of preference for regional producers (ADB, 2006; Plummer, 2006; Kawai, 2007; see Box VI.1).

An important question of course is whether such a benign policy environment will continue to define the norm or whether the region's recent conversion to PTA-centric forms of integration will raise new hurdles for third countries. The latter

Box VI.1 ***Tariff reduction in selected Asian PTAs***

AFTA*:* Negative list approach, 0 percent target. The CEPT scheme allows countries to maintain temporary exclusions, sensitive products list and general exclusion lists. Commodities are phased into inclusion gradually, and there is a longer timeframe for the CLMV countries. ASEAN6 reached 0-5 % tariff in 2003 and Vietnam in 2006. Lao PDR and Myanmar are to do so in 2008, and Cambodia in 2010.

Japan-Singapore*:* Positive list approach. Tariffs on Singapore's imports from Japan will be 0% immediately. Complete tariff elimination in Japan with 10-year transition period. Japan maintains some exceptions, including meat and meat products, fruit and vegetables, dairy products, and cane and beet sugar.

ASEAN-China**:** Negative list approach. Under the normal track, tariffs will be eliminated by 2010 for ASEAN6. Under the sensitive track, tariff reductions will start in 2012, to reach 0-5 percent tariff levels by 2018. ASEAN4/CLMV countries are given five more years to follow a similar tariff reduction scheme. Tariffs on goods under the Early Harvest Program, which includes agricultural products (Chapters 01 to 08 of the HS code), will be reduced to zero for ASEAN6 and China.

ASEAN-India: Positive list approach. Progressive elimination of tariffs in substantially all trade in goods. Under the normal track, tariffs will be reduced or eliminated by 2011 for India, Brunei, Indonesia, Malaysia, Singapore and Thailand, and by 2016 for other ASEAN members. Specific treatment is foreseen for sensitive products. The early harvest program follows a positive list approach.

Source: Feridhanusetyawan, 2005

Box VI.2 *Rules of origin in AFTA and the Japan-Singapore PTA*

AFTA: Rules of origin are relatively simple and liberal. A product has to satisfy 40 percent of its content originating from any member states. Cumulative rules of origin state that inputs for finished products eligible for preferential treatment in other member states shall be considered as originating in the member state where working or processing of the finished product has taken place, provided that the aggregate ASEAN content of the final products is not less than 40 percent.

Japan-Singapore: Rules of origin are less liberal and rather complex. Liberal rules of origin typically apply a general rule that the local content of the product has to be at 40–50 percent. In the Japan-Singapore agreement, rules of origin are product specific, or the originating content must be no less than 60 percent of the total value of the materials. The material must undergo the final production process in the territory of either party. Simple cutting, mixing, and packaging are not considered sufficient transformation for rules of origin. Origin can accumulate bilaterally.

Source: Feridhanusetyawan 2005

question arguably assumes heightened importance as the European Union – Switzerland's most important trading partner and a key competitor in world markets– engages anew in preferential trade and investment negotiations, including with key partners in Asia (e.g. India and ASEAN).

A second source of potential variance in the effects of PTAs relates to the design of rules of origin. Lacking a harmonized global rule of origin regime, PTAs with too strict or complex rules of origin have been shown to exert trade-diverting effects that can nullify or impair some of the new trade opportunities a PTA is supposed to create (Panagariya, 1998). One study has shown that the origin rules found in the NAFTA was equivalent to an added tariff of 4.3 percent (Estevadeordal and Suominen, 2004). It is therefore unfortunate that Asian PTAs have so far failed to adopt simple and transparent rules of origin for trade in goods.[41] This is notably the case of an otherwise 'benign' agreement such as that between Japan and Singapore (see Box VI.2 above).

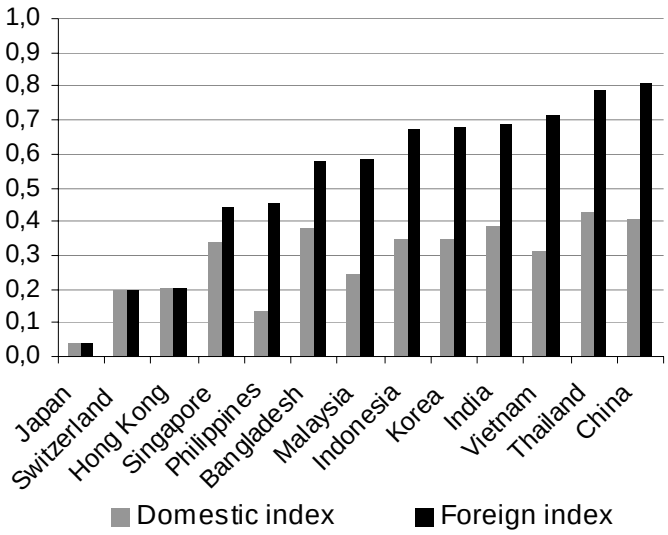
Moreover, even though AFTA rules of origin are relatively simple, the Asian Development Bank (2006) finds that one of the reasons why the promotion of intra-regional trade in AFTA has not fulfilled its full potential relates to the costs of complying with regional rules of origin, especially when compared to the relatively small margins of preference granted by AFTA tariff concessions. It seems that only multinationals in very high-tariff sectors such as automobiles have found it worthwhile to go through the bureaucratic procedures of obtaining an AFTA rule of origin certificate. Cuyvers *et al.* (2005), Plummer (2006) and Baldwin (2006) all note that one of the great challenges, for both Asian and non-Asian countries, is to

[41] In contrast, rules of origin as applied for services and investment in the Asian region are fairly liberal. These are analysed in the chapter on key investment provisions in Asian PTAs.

prevent Asian PTAs from creating a 'noodle bowl' of criss-crossing rules which would increase the cost of trade within the Asian sub-region. If this is not done, many firms will find it cheaper simply to pay the MFN duty rather than complying with complex rules with fewer new trade opportunities the likely result.

Another important characteristic that can help to minimize the potentially adverse impact of PTAs on third country producers is to have them integrate 'deeper' and 'wider' than is possible at the multilateral level: i.e. address more sectors, liberalize more comprehensively and address a wider set of regulatory impediments to trade and investment. Even if tariffs are fully removed, the business environment in Asia is still far from borderless (Ando and Kimura, 2003). Technical barriers accompanying inspection procedures for exports and imports are for instance prevalent (Wakasugi, 2007). Moreover, it is most likely in non-goods trade that the greatest benefits can accrue from integration via PTAs. For instance, trade in many key service sectors – such as telecommunications (see Figure VI.1 below) is still restricted by excessive or discriminatory regulation. This can be problematic for service sector MNEs, but also for firms in manufacturing and in other sectors that are connected to production networks throughout the region.

Figure VI.1 Trade restrictiveness index for telecommunications services, 2001



Notes: Index takes values 0 to 1, where high values indicate substantial restrictions on establishment and conducting ongoing operations. The foreign index covers discriminatory and non-discriminatory restrictions, the domestic index covers non-discriminatory restrictions.
Source: Productivity Commission (2001)

As discussed above, one of the basic pillars of regional and international regional and international production sharing is low trade facilitation and service link costs. Gains from

services liberalisation in Asia (and elsewhere) have generally been found to exceed those from goods liberalisation by significant margins, up to a factor of five according to one study (Robinson et al., 1999). Dee and Hanslow (2000) find that APEC countries could realise gains of US$110 billion from liberalising services trade, and that China alone could benefit by as much as US$70 billion by removing its stringent service sector restrictions. Chadha (2000), Brown et al (1996), Chada et al (2001), Benjamin and Diao (2000) come to similar results. (see Box VI.3).

Even though the largest economic gains from services liberalisation come from non-preferential market opening, PTAs can be useful tools for moving forward in what are often politically sensitive areas (McKibbin and Wilcoxen, 1996; OECD, 2004).

To convey the sense of the shared will to engage in economic cooperation beyond the reciprocal exchange of market access commitments, the newer generation of preferential trade agreements in Asia, such as those agreed between Singapore and Japan, ASEAN and China, ASEAN and Japan, as well as the India-ASEAN agreement, all explicitly use the term "comprehensive economic partnership" (CEP) rather than "free trade agreement" (Feridhanusetyawan, 2005).

In services, Asian PTAs typically adopt a GATS+ approach, whether in terms of agreed rules or (especially) negotiated market opening commitments (Roy, Marchetti and Lim, 2006; Fink and Molinuevo, 2007). Many such agreements also feature cooperative initiatives relating to the movement of natural persons, including in the realm of mutual recognition agreements in regulated professions (UNCTAD, 2007).

Box VI.3 *Studies on protectionism in selected service areas*

Finance and banking: Claessens and Glaessner (1998), Mattoo (1998), and Mcguire and Schuele (2000) all find – with different methodologies – that Asian economies are more restrictive and discriminatory than North American and European countries. Kalirajan et al (2000) find price impacts of non-prudential restrictions on foreign banks to be highest in Indonesia, the Philippines, Malaysia, Singapore, Korea and Thailand. Hong Kong has very low non-prudential regulations on foreign banks.

Distribution: Kalirajan (2001) finds that the most restricted markets are India, Indonesia, Korea, Malaysia, Philippines and Thailand. It is important to note, though, that significant unilateral liberalisation has taken place in Asia in the last few years, little of which is however bound in PTAs.

Professional services: Nguyen-Hong (2000) find that professional services are most restricted against foreigners in Indonesia, Malaysia and the Philippines all having nationality and residency requirements for the delivery of professional services.

Telecoms: Warren (2001) finds that the highest barriers in the Asian region are found in India, Indonesia, Korea and Thailand. These countries have major limitations on FDI in fixed network and mobile phone services (see also figure 13). Again, this is a sector that continues to witness autonomous (but typically unbound) market opening.

Laos, Vietnam, Japan, Singapore and Korea have all made notable commitments on services trade and investment in their PTAs. On the other hand, countries like Thailand, Malaysia and Indonesia have tended to schedule very limited commitments over and above those taken in the Uruguay Round (with the obvious exception of AFAS for intra-ASEAN trade and investment in services). In the goods area, the Singapore-Japan agreement is a prime example of a PTA that – apart from its chapters on investment and services - goes far 'behind the border' in addressing infrastructure and rules, costumes procedures and a variety of other indirect measures affecting trade flows. Such advances have prompted Hertel *et al*. (2001) to conclude that the so-called 'new-age' agreement between Singapore and Japan would not likely be trade-diverting overall; i.e. third countries would not lose out.[42] The rise of bilateralism in Asia has, with few exceptions, generally been characterised as a 'WTO-plus' process, which, *ceteris paribus,* should help create a better institutional setting for markets to function across borders and should therefore stimulate greater trade among partners, including third countries.

Likely impact on investment flows

Chase (2003) notes that bilateral or regional integration should be of particular interest to multinationals, since proximity has obvious benefits for firms spreading production across borders. Unfortunately, studies investigating the effect of PTAs on investment flows are relatively few. Stein and Duade (2001), Yeyati et al. (2003), and Medvedev (2006) find that PTAs do increase intra-bloc investment. Similarly, a recent study by the OECD (2007) finds that PTAs with comprehensive investment provisions exert a strongly positive impact on induced FDI flows among partner countries. Such results would appear to indicate that the recent surge in Asian PTAs should increase investment flows among Asian countries. This is particularly the case since the most substantial impact on FDI seems to occur when PTAs coincide with domestic liberalization and concerted efforts at macroeconomic stabilization among member countries. These are precisely the conditions obtaining in Asia in recent years (Blomström and Kokko, 1997; 2001; Graham and Wada, 2000).

Once again, the interesting question for third countries is whether PTA-driven integration is due to investment diversion or creation? Some evidence suggests that investment diversion is a genuine concern under some PTAs, with adverse third country effects. The World Bank

[42] Such a result, however, is based on *ex ante* calculations and not the actual effects of the agreement.

(2000) finds that FDI declined in EFTA members following the phase-in of the EU Internal Market Program (IMP) and did not recover until the establishment of the EEA. In addition, Luis and Lederman (2005) show that NAFTA resulted in diversion of FDI from other countries in Latin America, as Mexico's share of US-sourced investment remained stable throughout the 1990s while the share of other countries declined.

The evidence for PTA-induced investment diversion is not clear cut, however. Echoing the more recent findings of the OECD, Adams *et al*. (2003) and Dee and Gali (2003) show that strong investment provisions in PTAs have a net investment creation effect. Kimura and Ando (2003; 2005) note that; i) the generally low margins of preference among Asian countries will tend to mitigate biases against foreign firms, and ii) the existence of sophisticated production and distribution networks encouraging activities of *all* MNEs in East Asia will mean less of an asymmetric impact of PTAs and could thus be in the interest of MNEs in the region.

'New age' agreements promote economic ties through various investment facilitation activities, some of which also benefit third country MNEs. As discussed above, the framework agreement of the ASEAN Investment Area and the Singapore-Japan agreement both foresee information sharing, simplification and transparency of procedures and rules, etc. Such provisions stand to benefit not only PTA members but also non-Asian MNEs investing in Asian markets as they enhance service links between production networks (Thorbecke and Yoshitomi, 2006). Te Velde and Bezemer (2004) thus find that membership of a PTA can lead to further *extra*-regional FDI inflows, i.e. the increased opportunities for investment among partner countries also stimulate FDI from third countries. This is confirmed in the case of MERCOSUR, where most of new FDI came from outside the PTA (Chudnovsky and López, 2001) as well as of the Canada-United States FTA (subsequently NAFTA), where FDI to Canada from Europe increased much more than that from the US (Globerman, 2002).

VI.2 (How) do bilateral investment treaties work?

Bilateral investment treaties (BITs) are another legal instrument used to promote economic integration. The aim of host countries in signing BITs is to enhance the investment climate (i.e. serve a "signalling" function vis-à-vis foreign investors) and attract more FDI by granting strong protection rights against discriminatory (investment liberalization) or confiscatory (investment protection) state conduct.

Most Asian countries have signed numerous BITs. China has for instance signed BITs with over 100 countries and Korea and Malaysia with more than 60 each. Most such agreements are North-South in character and involve treaties entered into between Asian and home countries from the OECD area, but intra-Asian BITs are also becoming increasingly common.

With 111 such agreements - some of which have yet to enter into force - Switzerland has the second largest network of BITs in the world after Germany, covering around 44 % of total Swiss outward investment stock (OECD, 2005a). Switzerland is currently re-negotiating its network of BITs based on its 1995 BIT model.

Switzerland has concluded BITs with the vast majority of countries in Asia (excluding the EFTA-ASEAN PTA that features an investment chapter and to which Switzerland is party (See Box VI.4). Swiss BITs with Asian countries address matters of investment protection and feature post-establishment treatment provisions. Such treaties thus follow the 'European' BIT-model – as opposed to the more encompassing North American model – and include no commitments on investment liberalisation. Most-favoured-nation treatment is included in most treaties. National treatment, on the other hand, is rarely included in Asian BITs, and when it is, derogations are typically allowed. In the Swiss agreement with Indonesia, for instance, derogations from the national treatment principle are allowed by the Indonesian state if based on developmental considerations. Differences also exist relating to the settlement of disputes between investors and host states (Liebeskind, 2002). Not all Swiss BITs allow for investor-to-state dispute settlement. Box VI.5 highlights recent investment disputes involving Asian countries.

Box VI.4 *Swiss BITs with Asian countries*

Partner:	Signature	In force
Cambodia	12-Oct-96	28-Mar-00
Vietnam	3-Jul-92	3-Dec-92
Laos	4-Dec-96	4-Dec-96
Thailand	17-Nov-97	21-Jul-99
Philippines	31-Mar-97	23-Apr-99
India	4-Apr-97	16-Feb-00
Pakistan	11-Jul-95	6-May-97
Sri Lanka	23-Sept-81	12-Feb-82
China	12-Nov-86	18-Mar-87
Hong Kong	22-Sep-94	22-Oct-94
Singapore	6-Mar-78	3-May-78
Singap-EFTA	26-Jun-02	1-Jan-03
Malaysia	1-Mar-78	9-Jun-78
Indonesia	6-Jun-74	9-Apr-76
South Korea	15-Dec-05	1-Sept-06
North Korea	14-Dec-98	15-Nov-00
Mongolia	29-Jan-07	9-Sept-99

Notes: The Korea-BIT is replaced by the EFTA (minus Norway)-Korea investment agreement.

Source: UNCTAD online investment treaty database; see also: www.seco.admin.ch/themen/00513/00594/index.html

In theory, BITs can be an important instrument in promoting FDI to Asia from multinationals headquartered in OECD countries and in enhancing host countries' investment regimes.

Box VI.5 Recent investment-treaty disputes with Asian countries

1) SGS Société Générale de Surveillance S.A. (Switzerland) v. Republic of the Philippines

ICSID arbitration with stakes at around $170,000,000. Tribunal was registered June 6th 2002 and constituted September 8th 2002.The Philippines awarded SGS, a Swiss business group a contract to provide comprehensive import supervision for goods prior to shipment to the Philippines and specialized services to assist in improving the customs clearance and control processes. Part of the service was undertaken overseas. A dispute arose between SGS and the Philippines concerning alleged breaches of the services contract. SGS submitted certain monetary claims to the Philippines which were subject to various attempts for amicable settlement before submitting the dispute to arbitration. SGS invoked the provisions of the Swiss-Indonesia 1997 BIT. However, on January 29th 2004 the tribunal held the contractual claims to be inadmissible because of the claimant's failure to pursue the exclusive dispute resolution procedure specified by the contract.

See: www.bg-consulting.com/docs/icsid_042004.pdf, www.worldbank.org/icsid/cases/SGSvPhil-final.pdf

2) Fraport AG Frankfurt Airport Services Worldwide (Germany) v. Republic of the Philippines

ICSID arbitration with stakes at around $500,000,000. Tribunal was registered October 9th 2003 and constituted Feb 11th 2004. A consortium including Fraport won a concession to build and operate a new terminal at Manila's Aquino International Airport. The Supreme Court of the Philippines voided the contract in May 2003, citing administrative irregularities. Claimant says it was stripped of its investment because a new government came into power. Fraport is pursuing BIT arbitration, and its consortium, PIATCO, is pursuing contract arbitration. Case is pending.

See: www.americanlawyer.com/focuseurope/treaty0605.html

3) ABN AMRO Bank N.V. (The Netherlands), ANZEF Limited (U.K.), BNP Paribas (France), Crédit Lyonnais S.A. (France), Erste Bank der Oesterreichischen Sparkassen AG (Austria), Standard Chartered Bank (U.K.), Credit Suisse First Boston (Switzerland) v. Republic of India

Ad hoc arbitration with stakes at around $290,000,000 launched December 10th 2004. One of several BIT disputes flowing from the Dabhol power project in Mumbai. The firms allege that the Government of India failed to protect their loans in the Dabhol project after the plants closure in 2001, and is liable for damages under investment treaties concluded by India with the UK, Austria, France, the Netherlands and Switzerland. The US Government and the Overseas Private Investment Corporation have also mounted an arbitration under the terms of a 1997 US-India Investment Incentive Agreement. This state-to-state arbitration parallels a pair of ongoing investor-to-state arbitrations launched by General Electric and Bechtel (the majority shareholders in the Dabhol project), as well as an unclear number of commercial arbitrations proceeding under the terms of the Dabhol project contracts. The seven arbitrations initiated by the European banks are arbitrated under the UNCITRAL rules of arbitration.

See: www.iisd.org/pdf/2004/investment_investsd_dec17_2004.pdf, www.opic.gov/foia/awards/GOI110804.pdf, http://in.news.yahoo.com/041210/137/2ie3i.html

However, empirical studies devoted to the subject matter conclude that BITs exert an indeterminate influence on investment flows between signatories. Hallward-Driemeier (2003), Tobin and Rose-Ackerman (2004) and Yackee (2006) find either no or (somewhat counter-intuitively) even a negative impact of BITs on induced FDI flows. In contrast, Neumayer and Spess (2005), Salacuse and Sullivan (2004) and Banga (2003; 2006) find strong and positive associations between the number of BITs a country has signed and its FDI inflows. However,

association is different from causation, and Aisbett (2007) shows that these latter studies fail to take into account that BIT signatories tend to experience large FDI inflows *before* signing the agreement, and that there is no marginal effect of BITs by themselves after they have been signed. Moreover, BITs do not seem to 'substitute' for property-rights - as Neumayer and Spess (2005) claim; i.e. investors do not regard BITs as a sufficient safeguard against a general disrespect of property rights by host governments. This does not rule out, however, that investors value the usefulness of BITs when deciding where to invest, particularly as confidence in the robustness of investor-state arbitration procedures increases in the context of heightened judicial activism.

Secondly, BITs should not be seen in isolation of broader integrating trends. One recent study suggests that BITs might influence investment behaviour when complemented by an investor-friendly political and economic environment (Tobin and Rose-Ackerman, 2006).

Thirdly, there is scant evidence on whether BITs matter more for FDI flows in certain sectors than in others (in either manufacturing or services), or for some types of investments rather than others (i.e. resource- vs. efficiency- vs. market-seeking FDI. Expropriation risks are typically greatest in natural resource industries for instance, such that BITs may have a particularly useful role to play in such sectors despite their more marginal use in other areas (Aisbett, 2007). Finally, it is still unsure whether BITs with pre-establishment rights, such as those negotiated by Canada and the United States, exert greater impacts on investment flows relative to agreements limited to post-establishment rights. In any event, the empirical evidence currently available suggests that BITs do not on the whole exert determinative impacts on the investment decisions of multinational firms.

VII. Concluding remarks

When assessing the growth of Asia's trade and the respective roles of policy, technology, and markets in influencing patterns of regional integration, a key conclusion that emerges is that technological change, markets, and the private sector, particularly multinational firms (hence FDI), have been crucial in deepening integration. To date, empirical studies suggest that bilateral and regional trade and investment agreements have had only a limited impact on Asia's integration process, the most significant liberalization efforts having been unilateral in character.

Outside the arena of formal trade and investment agreements, a number of important factors have been driving trade and FDI activity in Asia. Increasing trade integration within East and Southeast Asia has been closely associated with changes in industrial organization and the spread of international production sharing, or the fragmentation of vertically integrated supply chains. The attractiveness of East and Southeast Asia as production and investment platforms has been enhanced by a variety of measures that reduce the frictions and costs of trade, such as investments in ports and other infrastructure, the establishment of special economic zones and bonded industrial warehouses, and duty drawback schemes. These arrangements have allowed investors, both domestic and foreign, to take advantage of economies of scope and specialization. The above trends have resulted in burgeoning cross-border trade in manufactured parts and components and in the assembly of final goods, while also casting new light on the economy-wide importance of enhancing the quality of key infrastructure and business services that play a central trade- and FDI-facilitating role.

Assessing the impact that preferential trade agreements (PTAs) have had in promoting regional trade and investment patterns remains an arduous task, not least because Asian countries are such recent converts to the practice of discriminatory trade and investment agreements. Yet there can be little doubt that integration is on the move, and intra-regional trade and investment in developing Asia has grown at a faster pace than the rate of growth of world trade in recent years. But in addition to the factors cited above, rising intra-regional trade shares have also been a direct consequence of fast regional economic growth itself. Other things being equal, trade among countries that are growing fast will tend to rise more quickly than trade among countries where growth is slower. The Asian Development Bank recently noted that, while at a worldwide level PTAs have probably increased trade, their impact on the Asia and Pacific region has been quite small. For instance, the ADB estimates that intra-bloc trade within the Association of Southeast Asian Nations (ASEAN) Free Trade

Area (AFTA) would appear to be no larger than it would be without the agreement (ADB, 2002a).

There are, however, unmistakable signs that the dynamics of Asian integration are changing, not least because of the protracted difficulties encountered in multilateral trade negotiations but also in light of the emergence of – and concomitant competitive threats and opportunities from - China and India as regional giants.

Countries in Asia and in other regions are increasingly experimenting with preferential trade agreements, most often on a bilateral basis. Such a trend is today on a strong upswing throughout Asia and increasingly spans several regions. Indeed, Asia's "noodle bowl" is not only expanding, but is increasingly involved with complex agreements in other parts of the world. Such cross-regional agreements are driven by a variety of concerns such as energy security, access to minerals and other natural resources. They also represent efforts by Asian countries to "lock in" reforms by making them part of a formal trade treaty with a major developed country or region. Many such agreements are also motivated by political considerations, as countries seek to cement diplomatic alliances by providing economic benefits to partners.

The proliferation of preferential trade and investment agreements is a very recent phenomenon in developing Asia. Before 1995, only three of them involved developing member countries of the Asian Development Bank as notified to the WTO. By 2006, a total of 36 agreements had been formally notified to the WTO. The region is currently the theatre of more than 40 ongoing PTA negotiations, a hyperactivity that knows no equivalent elsewhere in the world. Asian PTAs range from minimalist agreements that simply exchange partial tariff preferences or extend tariff concessions from more to less developed countries to "full-blown" agreements that reach well behind border management issues. The latter agreements are becoming increasingly common. Agreements notified under the enabling clause (between developing countries) tend to be less comprehensive than agreements notified under GATT Article XXIV. In recent years, full-blown PTAs tend to extend coverage to services, which must be notified separately under GATS Article V. Increasingly, preferential trade agreements go beyond countries' WTO commitments and also address new issues such as investment, competition policy, as well as labour and environmental issues.

As Asia's preferential trade and investment agreements are still for the most part at an early stage, this obviously complicates attempts at assessing their effects empirically and assigning structural influences to their core provisions. Yet during the time that they are

implemented, such agreements will begin to impact on both regional and global trade and investment flows. Accordingly, it is important that preferential trade and investment liberalisation be conducted in such a way that supports, rather than inhibits, the openness that has so far been a defining characteristic of Asia's trade expansion and integration into world markets and the ability of third country traders and investors – including from Switzerland - to take part in, benefit from and contribute to such growth.

The trend towards PTAs involving developing countries in Asia cannot readily be described as an overt desire to create an Asian trade bloc to compete with the EU or North America. Asia's dependence on the markets of the two other blocks – Europe and North America - remains of paramount importance, all the more so as producers in the region – which remains on the whole generally open towards foreign direct investment - are tightly connected in global and regional supply chains that require an open trade and investment regime to thrive. The need for such openness extends to the underlying services infrastructure in the region, without which cross-border trade cannot durably prosper and for which unilateral liberalization and non-trade-centric forms of regulatory and infrastructural cooperation remain important driving forces.[43] Solace can moreover be taken from the outward orientation of Asian PTAs. This is most patently the case of East Asia, a region that encompasses some of the world's major trading powers (China, Japan, Korea), and where two thirds of existing PTAs and fully 85% of agreements currently under negotiation involve countries or regional groupings outside the region.

Though this study concludes that the effects of regionalism in Asia have so far proven fairly benign for third country investors and service suppliers, such developments cannot however be discounted as risk-free. This is all the more given the novel character of Asian PTAs. Such risks include those, common to all integration processes predicated on discriminatory access, that a proliferation of PTAs may entail in terms of possible trade and investment diversion effects. A related danger is that growing recourse to bilateralism could polarize trade and FDI opportunities, favouring large trading "hubs" at the expense of more isolated, weaker trading "spokes." Additional risks relate to the transaction costs, pressures for protectionist capture and greater overall complexity in the business environment that a multiplicity of overlapping disciplines, particularly rules of origin for goods and services (Mode 3) trade, can pose to third country traders and investors.

[43] One example is the creation of trade-facilitating corridors – in road, rail and inland waterway transport – currently being developed in several parts of Asia.

Care must thus be taken to ensure that the rise of PTAs, in Asia and elsewhere, remain (as has largely been the case to date in the region), building blocks for the WTO and for multilateral engagement more broadly rather than stumbling blocks. It is indeed likely that stronger multilateral disciplines will be needed to generate “best practice” PTAs and ensure that their systemic downsides are properly mitigated. The adoption and effective implementation of some basic principles over and above the Doha Round’s timid (yet useful) advances on enhanced transparency and multilateral surveillance, would indeed help to minimize the potential damage from PTAs while also allowing for properly designed agreements to lead to trade and investment creation and efficient behind-the-border reforms. Box VII.1 highlights the key elements of best practice PTAs that Swiss businesses, both traders and investors, and policy-makers should be advocating (and monitoring) in Asia and elsewhere, and for which new (notably for investment) or strengthened existing disciplines (on rules of origin, services, and preferential trade agreements) may be needed in the WTO.

Box VII.1 Towards ‘best practice’ preferential trade and investment liberalization

Preferential trade agreements should ensure:

- Wide coverage of goods with few exclusions. Agriculture and manufacturing tariffs and non-tariff barriers should be eliminated on a clear and fast timetable.
- Wide coverage of services and coverage of all modes of service delivery.
- Mutual recognition and convergence/greater cooperation in matters of domestic regulation as a trade-facilitating complement to market access commitments in goods and services trade.
- Symmetrical and simple rules of origin based on a positive standard or test. They should have transparent and consistent implementing regulations (e.g., accounting practices, paperwork for certification of origin) that are chosen at the minimum level needed to prevent trade deflection.
- Adoption of a liberal, substantial business operation, test as a rule of origin for services and investment, so as to allow established third country service suppliers and investors to compete and take advantage of opportunities within an integrating area.
- Even-handed and transparent customs procedures. Valuation should be transparent, offering few or no chances for corruption (use of electronic data interchange).
- Enforcement of intellectual property rights in a non-discriminatory manner. This should be consistent with the World Trade Organization (WTO) Agreement on Trade-Related Intellectual Property Rights, reinforcing international conventions on copyrights, patents, etc.
- National treatment embodied in foreign direct investment regulations and investment provisions. Any performance requirements should be based on a "negative-list" approach and should provide protection in law for foreign investors to prevent expropriation or unwarranted actions against such investors' interests.
- Establishment of dispute-settlement provisions, to adjudicate conflicts in a timely and fair fashion by using objective panels of experts. Antidumping findings should be subject to review by such panels with proceedings held in a fair and transparent manner.
- Open competition and non-discrimination among members for government procurement and as little discrimination against non-members as possible.

- Transparent and non-discriminatory competition laws and regulations. To the extent possible, they should be harmonized among members once tariff-free trade has been achieved so as to eliminate use of antidumping (as distinct from antimonopoly) measures.
- Clear and simple codes that guide technical barriers to trade, such as product standards and phyto-sanitary standards to protect public health and safety (based on the WTO agreements on standards). Likewise, agreements that cover environmental and labour standards should embrace the rights of partners to establish and implement their own laws and regulations in conformity with existing international obligations in the areas of environmental protection and labour rights and conditions.

Source: Adapted from Plummer (2006) in ADB (2006).

Beyond ensuring that bilateral agreements are designed to mitigate trade and investment diversion problems, it bears recalling that preferential liberalisation may provide a springboard for "deeper integration," either through measures that go beyond World Trade Organization (WTO) agreements or through reductions in behind-the-border barriers. To the extent that PTAs can help achieve such objectives, the gains from preferential liberalization may well mitigate and possibly offset any losses entailed by discriminatory market-opening. Bilateral and regional compacts that help to reduce trade transaction costs, liberalize cross-border investment and promote regulatory convergence and cooperation may indeed afford opportunities for sizable income gains, including on the part of third country investors and service providers.

The trends depicted in this study raise important challenges for Swiss policy-makers and the country's business community. Though likely less pronounced than in goods (manufacturing) trade, progress is being registered in opening up Asia's services markets to greater competition via trade and investment agreements – both internally among Asian nations, and particularly within ASEAN, as well as through formal agreements reached with parties outside of Asia, especially agreements with the United States, Japan, Australia and New Zealand.

To date, the trend towards deeper Asian integration in the fields of services and investment has generally proven benign for third country traders and investors, owing to the adoption of liberal rules of origin governing the participation of third country investors (Mode 3) in services markets, reliance on unilateral market opening in services trade and investment and the continued outward-orientation of Asian countries' trade and investment regimes even as intra-regional trade and investment ties are rising noticeably.

There is little doubt however that some recent PTAs, notably those entered into by several Asian countries with the United States and (to a lesser extent) Japan, place the latter countries' service suppliers and investors in a privileged position in Asian markets across several modes of supply and service sectors of priority interest to Switzerland. In some sectors, the degree of access achieved and the quality of the rules agreed (especially on investment) appear qualitatively superior to those enjoyed by Swiss operators under the two agreements which Switzerland, as an EFTA member country, has completed to date in the region (with Singapore and Korea).

The scope for reassessing Switzerland's negotiating priorities and the substantive elements of its approaches to rule-making in services and (especially) investment may also be heightened by recent neighbourhood considerations, notably the decision of the European Union – Switzerland's most important trading partner and home to many Swiss firms' - large and small - main competitors in world markets, to renounce its DDA-induced moratorium on PTA activity and enter into an ambitious set of preferential trade negotiations with key partners in Asia (India, Korea, ASEAN). One the central aims of the EU will be to secure high levels of market access and WTO+ rule-making outcomes in services, investment and related regulatory issues in key emerging country markets and regions. Such a major policy development is one to which Switzerland, either on its own (bilaterally) or through EFTA, may wish to respond by deepening and better serving its already important existing ties in the world's fastest growing region by contemplating its own expanded network of preferential trade and investment agreements. In so doing, Switzerland might wish to deepen the regional (preferential) dimension of its existing trade policy arsenal, thereby complementing first-best efforts at non-discriminatory market opening in the World Trade Organization.

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APPENDIX 1: Towards an EU–ASEAN PTA

On April, 23rd 2007, member states of the EU mandated the European Commission to negotiate a PTA with the ASEAN countries, as well as with Korea and India. This decision was taken following a long period where resistance for bilateral integration with ASEAN countries was strong, mainly for political economy considerations. This appendix the possibility of an EU– ASEAN PTA by applying a political economy analysis examining EU considerations for such an agreement, followed by a more detailed discussion of the feasibility and benefits of such an agreement and its likely substantive content.

(i) Political Economy Considerations

Broadly speaking, seven main issues can be seen as underlying prospects for a EU– ASEAN PTA. First, the EU had long been among the strongest advocates of multilateral liberalisation through the WTO, in effect adopting a moratorium on new PTAs during the course of the Doha Round. This policy, which was championed by the former Commission, and notably by its Trade Commissioner Pascal Lamy, has been increasingly questioned under the current Commission, in large measure as frustration over the prospects of completing an ambitious Doha Round has mounted.

Second, in connection with frustration from liberalisation at the multilateral level, the EU has not been indifferent towards the surge in preferential trade and investment agreements concluded of late, particularly in the fast-growing Asia region. The rise in bilateral and regional deals conducted by ASEAN members, as well as by other main trading partners, such as the US, China, India, Japan and Australia, has led to growing concerns within EU business and governmental circles that EU competitiveness is being eroded and that these agreements were adversely affecting the EU. The fear of a loss of competitiveness vis-à-vis the US and China has also been one of the main drivers behind the Lisbon Strategy and to a large extent is a recurring issue in EU internal discourse.

Third, EU frustration over the expected outcome of the DDA concerns not only the level of liberalisation to be achieved but also likely rulemaking advances. It is already obvious that a WTO deal will not include some of the main areas of importance for the EU. Two notable examples are the area of services, where the GATS' built-in agenda had yielded no tangible results so far, and the Singapore Issues (trade facilitation, transparency in government procurement, investment and competition). The latter were a priority for the EU, and yet were sacrificed at the WTO's Cancun Ministerial. The EU's reluctant decision to abandon negotiations on the Singapore Issues and to remove them from the DDA's Single Undertaking has exacted a high price in the minds of some Member states and the Commission, a price that is widely believed to have been inadequately matched by some of the EU's key trading partners. At the same time, experience gained in other PTAs reinforces the view that WTO+ progress on these (and other) issues can readily be achieved outside the multilateral system..

Taken together, these first three issues contributed to a gradual shift in the EU position, where it now believes that a PTA with ASEAN countries and other key traders in the Asian region (India and Korea notably) would compensate for some of the lost benefits from a weaker (or non-existent) WTO deal, and may even lead to an improved outcome.

Furthermore, the above considerations lead to another, fourth, issue concerning the optimal negotiation strategy for the EU in the WTO. From a tactical point of view, such a policy

change can be regarded as a signalling game with other key countries in the WTO. When the EU insisted in the past on a multilateral deal, it was a hostage, under the WTO's Single Undertaking. to a veto by other trading partners, who could also extract bigger concessions from it. By signalling that there is an alternative to a negotiated WTO agreement, the EU can soften the demands of other trade parties, who are likely to lose significantly from a failed DDA. Finally, the PTA approach also expands the EU's bargaining power position with individual countries. It is clear that any agreement with ASEAN members will include provisions and chapters concerning services, investment, intellectual property rights and other areas, which these countries might otherwise oppose or show greater reluctance towards in the WTO arena.

Fifth, it is apparent that the EU's policy shift towards preferentialism was being considered for several years, particularly as several studies and business lobbies contributed to pushing EU trade policy in such a direction. However, the institutional setting of decision-making in the EU, coupled with the 2004 enlargement to 10 new Member States (now already 12 with the 2007 enlargement) imposed a number of policy constraints. The newly enlarged EU has highlighted the growing divergence of trade interests among member states with differentiated economic structures.

Sixth, the EU's existing network of preferential agreements cover almost all of Europe, the ACP countries, the Middle East and some countries in Latin America (Mexico and Chile and ongoing negotiations with Mercosur), with Asia the only region with which the EU had yet to reach any PTA. A PTA with ASEAN would thus help to remedy the gap in the geography of EU preferential trade ties. It would also match the EU's preference to negotiate regional trade agreements over bilateral ones, though the latter route is being pursued in the case of India and Korea.

Finally, the EU has shown some reluctance to negotiate bilaterally with ASEAN due to the human rights and political situation in Myanmar. These have been and are still areas of major contention for the EU. In April 2007, the EU renewed its sanctions against the military regime of Myanmar. It is possible that the Myanmar issue may yet prove to be a stumbling bloc in negotiations with ASEAN, such that the EU may need to consider a bilateral approach with individual ASEAN countries and still receive the benefits from agreements that ASEAN has concluded with other third country partners.

(ii) Projected benefits and side effects

An EU – ASEAN FTA is projected to impact the EU, ASEAN and third countries in both positive and negative ways, generating both static and dynamic effects. Overall, on the basis of a report made by a joint qualitative and quantitative assessment group of ASEAN countries and the EU[44], an EU – ASEAN FTA is projected to yield wide economic and strategic benefits to the parties of such an agreement. The following is a summary of results of this report, with some reference to possible impacts on Switzerland:

Trade in manufactured goods – trade in the goods area is generally less hampered by traditional trade barriers, such as tariffs, and does not constitute the most significant obstacle to trade between the EU and ASEAN. However, gains can be made from the liberalisation of several sensitive products where tariff peaks apply, such as in agriculture or the automotive sector. The reciprocal liberalisation of agricultural trade between the EU and ASEAN could

[44] See Hedi Bchir and Fouquin (2005). The cost-benefit analysis for ASEAN is not covered in this document, but is a part of the assessment report. The report tested various scenarios, including dismantlement of tariffs on goods with or without the exclusion of sensitive products, liberalisation of the services sector, as well as a scenario where the other PTAs being negotiated by ASEAN and the EU are concluded with third parties.

generate trade diversion effects on Switzerland, although the importance of farm trade between ASEAN and Switzerland remains relatively modest. The highest level of trade protection in the EU-ASEAN area is associated with non-tariff barriers. These affect both parties, but are most evident for ASEAN exports to the EU. Such NTBs take the form of onerous technical standards and regulatory requirements (particularly, environment and food safety standards) that entail high costs for ASEAN producers, as well as tariff quotas for specific sensitive agricultural products. From a practical point of view, benefits are projected to result from the establishment of common disciplines on technical barriers to trade (TBT), sanitary and phyto-sanitary (SPS) standards, as well as through the advent of less stringent rules of origin.

Trade in services - the main benefit for the EU is expected to accrue from the liberalisation of trade in services. In this area, benefits would flow from the abolition of numerous trade and investment restrictions and burdensome regulatory requirements. A PTA including services (and investment) is widely expected to improve on the probable outcome of the DDA. It is estimated for instance that the liberalisation of business services could result in a 29% increase in EU exports to ASEAN (€7.9 billion), and generate an 80% increase in ASEAN exports to the EU (€14 billion). An EU-ASEAN agreement on services trade could be detrimental to Switzerland, depending on both the nature and extent of liberalisation in specific sectors and horizontal issues.

Because Swiss laws and regulations are already largely EU compliant in the services field, and because Swiss service providers tend to be more competitive than most of their ASEAN counterparts, the risk of trade diversion does not so much lie in the EU market as in key ASEAN markets of interest to Swiss investors. Such effects could however be mitigated if a prospective EU-ASEAN PTA featured a liberal rule of origin/denial of benefits clause with regard to Mode 3.

Trade and investment – current trade and investment relations between ASEAN and the EU are asymmetrical. It follows from the analysis that in several industries and sectors there remains considerable scope for trade and investment complementarities. For the EU, these exist in knowledge-based services, where a comparative advantage clearly prevails, while for ASEAN such complementarities arise mainly in manufacturing. For the EU, the main obstacles to trade and investment within ASEAN countries arise in the services sector, particularly via foreign ownership limitations as well as in state subsidies and support directed to several manufacturing industries. Inter-regional FDI flows are generally expected to benefit strongly from a prospective PTA.

Differentiated benefits and scope – given the economic and development diversity that prevails within ASEAN, whose memberships features countries at polar extremes of the income/per capita GDP ladder, an EU-ASEAN PTA would quite clearly yield differentiated benefits. Heterogeneity within ASEAN need not be an obstacle to a PTA and could allow for differentiated levels of ambition, coverage and depth of liberalisation across various issue areas in line with the variable geometry that both the EU and ASEAN have practiced in various policy domains.

Strategic benefits – A PTA would extend the commercial reach of EU suppliers in ASEAN markets, the only region of the world (as part of Asia in general) not currently covered by EU preferential trade agreements. Such an outcome is likely to be enhanced by the natural play of markets and the expected continued strong growth in the region. Moreover, a PTA would help establish and promote a more stable, visible and predictable environment for investment and the enforcement of intellectual property rights, a major offensive export interest for the EU (and Switzerland). It would also decrease or attenuate the scope for trade- and investment-diversion effects on the EU likely to result from existing and future PTAs negotiated between ASEAN countries (both as a block and as individual countries) with third

countries in Asia or beyond. The latter consideration is of potentially high significance for Switzerland, given the scope and coverage of ASEAN PTAs. For ASEAN countries, engagement with the EU is a major element in its competitive strategy towards China and India. A PTA would most likely provide a boost to FDI inflows and may act as an external lever in pursuing needed structural reforms. From a development standpoint, a PTA may lead to some (marginal) preference erosion under the current GSP and EBA schemes with the least advanced ASEAN counties. The extent of such erosion is not clear, since EBA preferential treatment is underused, owing primarily to complex rules of origin in EU sensitive products such as textiles and clothing. A relaxation of such rules would greatly enhance the developmental benefits of the PTA for ASEAN, particularly the CLMV countries.

(iii) Elements of an EU - ASEAN PTA[45]

The EU view of a FTA with ASEAN is of a comprehensive agreement, based on ambitious coverage and extensive liberalisation. Such an agreement will prioritise market access for goods and services, and will include provisions on regulatory transparency, standards and conformity assessment, sanitary and phyto-sanitary rules, intellectual property rights, investment, trade facilitation and customs, public procurement, trade and competition, including state aids, as well as provisions on co-operation on trade and sustainable development, including both environmental and social elements.

1. The **trade in goods** package would be based on the symmetrical liberalisation of trade over a period of 10 years, allowing flexibility of transition periods for different ASEAN members. Sensitive products would be treated via special provisions, such as differentiated transition periods. The scope of liberalisation is to include substantially all trade, yet as in other cases there is no interpretation of what substantial liberalisation stands for (the EU practice is 90%). Although clear asymmetry exists between the EU and ASEAN countries insofar as development is concerned, such asymmetry is not addressed in terms of the scope and coverage of liberalisation, other than flexibility of transition periods (10 years). Other issues to be addressed with regard to trade in goods will include rules of origin, financial responsibility clauses concerning errors in the application of rules of origin and anti-circumvention measures. Provisions on standards and conformity assessment aim to go beyond WTO provisions and to include the adoption of recognised international standards, the streamlining of testing requirements in priority areas, as well as regulatory convergence and cooperation measures.

2. **Non-Tariff Barriers** - The liberalisation of trade in goods would also include restrictions on the use of non-tariff barriers (NTBs), other than those justified by general exceptions, intertwined with provisions and procedures to ensure their elimination. It should be noted that there appears to be a logical gap between the EU's intention to comprehensively eliminate "un-justified" NTBs, and the formula suggested by the Commission to negotiate the abolition of NTBs on a request-offer formula basis.

3. Disciplines on **sanitary and phyto-sanitary measures** would be based on WTO provisions, and in particular would address the issue of transparency and the establishment of a mechanism for the recognition of equivalence. Such a mechanism would include prelisting of food-producing establishments, and aim at the recognition of the disease-free health status of the EU and ASEAN countries. While allowing for minimal border checks, the PTA would apply the principle of regionalisation for both animal and plant diseases. It would also include animal welfare within its scope.

[45] Based on the Draft EU-ASEAN FTA Negotiating Directive.

4. **Anti-dumping and countervailing measures** would aim at WTO+ treatment by including EU rules, such as use of a public interest test, adoption of a lesser-duty rule and additional consultations.

5. **Services and investment** constitute a priority for the EU in the PTA, and are to be treated under the same framework. Although liberalisation would be in accordance with Article V of the GATS, and thus not excluding a-priori any sector or mode of supply, the EU is reluctant to negotiate the liberalisation of national maritime cabotage, domestic and international air services (with minor exclusions), as well as audio-visual services. The Commission's negotiating leeway in health and education services, two areas of likely ASEAN interest, is somewhat unclear. Although the prospective agreement's negotiating modality has yet to be specified, it appears likely that commitments would follow a GATS-like positive/hybrid list approach, though Commission have expressed interest embedding provisions similar to those found in recent Japanese PTAs with ASEAN members that aim at locking in the regulatory status quo in voluntarily scheduled sectors.

6. **Government procurement** constitutes an additional priority area for the EU in ASEAN countries, all the more so as most of its Members (with the exception of Singapore, Cambodia and Vietnam) are parties to the WTO's plurilateral GPA while other ASEAN members have long maintained discriminatory procurement regimes as key elements of industrial and SME policy. The EU objective is to encourage the progressive liberalisation of government procurement markets at the national and sub-national levels. Such liberalisation would aim at greater market access based on non-discrimination and transparency measures.
7. **Trade and competition** provisions would include provisions aimed at defining and restricting the scope of anti-competitive behaviour. More specifically, the PTA would aim to develop rules on restrictive business practices, vertical restraints, abuse of dominance, mergers and state aids.

8. Rules on **intellectual property rights** in the PTA would extend the disciplines already covered under existing multilateral agreements (so-called TRIPs+ provisions that are commonly found in US PTAs). However, the EU would also intend to include specific rules on geographical indications and their recognition, protection and enforcement.

9. **Other provisions** in the proposed PTA would include trade facilitation, trade and sustainable development issues including the liberalisation of environmental goods, services and technology, and measures concerning regulatory transparency.

10. Promoting **regulatory convergence** with the EU is an important goal for the EU. In such a case, third countries, like Switzerland, that are already in compliance with most EU regulatory regimes, can be expected to enjoy positive spillover effects from ASEAN countries' greater regulatory alignment with EU standards and regulations.

APPENDIX 2: Definition of machinery parts and components

HS classifications: 840140, 840290, 840390, 840490, 840590, 8406, 8407, 8408, 8409, 8410, 8411, 8412, 8413, 8414, 841520, 841590, 8416, 8417, 841891, 841899, 841990, 842123, 842129, 842131, 842191, 842199, 842290, 842390, 842490, 8431, 843290, 843390, 843490, 843590, 843680, 843691, 843699, 843790, 843890, 843991, 843999, 844090, 844190, 844240, 844250, 844390, 8448, 845090, 845190, 845240, 845290, 845390, 845490, 845590, 8466, 846791, 846792, 846799, 846890, 8473, 847490, 847590, 847690, 847790, 847890, 847990, 8481, 8482, 8483, 8484, 8485, 8503, 850490, 8505, 850690, 8507, 850990, 851090, 8511, 8512, 851390, 851490, 851590, 851690, 851790, 8518, 8522, 8529, 853090, 8531, 8532, 8533, 8534, 8535, 8536, 8537, 8538, 8539, 8540, 8541, 8542, 854390, 8544, 8545, 8546, 8547, 8548, 8607, 8707, 8708, 870990, 8714, 871690, 8803, 8805, 9001, 9002, 9003, 900590, 900691, 900699, 900791, 900792, 900890, 900999, 901090, 901190, 901290, 9013, 9014, 901590, 901790, 902490, 902590, 902690, 902790, 902890, 902990, 903090, 903190, 903290, 9033, 9110, 9111, 9112, 9113, 9114, 9209.

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