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Multilateralizing ‘Deep Regional Integration’: A Developing Country Perspective*

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Introduction

Regional trade agreements continue to proliferate. Always a central element of the trade policy strategy of European countries, regionalism has now become the dominant form of international cooperation on trade policy for virtually all the members of the WTO, developed and developing. The proliferation of preferential trade agreements has been accompanied by high growth rates in world trade, reflecting not just preferential liberalization, but more important, steadily declining barriers to trade generally. Applied most-favored-nation tariffs of OECD countries average less than [5] percent. Excluding agricultural products, the uniform tariff equivalent of trade policies of OECD members is [...] percent (Kee, Nicita and Olarreaga, 2006). For the developing countries, the subject matter of this paper, applied MFN tariffs have also been reduced substantially, with the median average overall trade restrictiveness index being 7.5% for the 57 countries for which data are available in 2005 compared with 12.3% 10 years earlier.

This reduction in external, MFN, protection reflects mostly unilateral, autonomous actions by governments (Martin and Messerlin, 2007). But participation in PTAs has also played a role. In the case of Latin America, for example, recent research by Estevadeordal, Freund and Ornelas (2007) concludes that the preferential tariff reduction following PTA formation promotes subsequent external tariff reduction for those PTAs that do not involve the formation of a customs union.¹ Rigorous empirical research on the relationship between preferential and MFN tariffs over time is sparse as a result of data constraints. As is well known, in theory PTAs can be building or stumbling blocs. What is incontrovertible is that the level of MFN trade barriers has been falling steadily in recent decades.

From welfare perspective what matters is not only the applied MFN level of protection but the extent of discrimination in the treatment of alternative sources of supply of a given good or service. The lower are MFN tariffs *and* the less there is discrimination, the better off is the world as a whole. An important function of the WTO is to encourage members to reduce external levels of protection through recurring multilateral trade negotiations (MTNs), in the process also reducing the extent of discrimination that is created by PTAs. Although the WTO also has rules on the design and implementation of PTAs, these have never been enforced. In practice, MTNs are the primary mechanism through which WTO members address the trade diverting effects of PTAs.

¹ Bohara, Gawande and Sanguinetti (2004), focusing on the impact of preferential trade flows from Brazil to Argentina, find that greater imports from Brazil led to lower MFN tariffs in Argentina, especially in sectors where trade diversion occurred as a result of Mercosur.

In addition to MTNs, other forces may also ‘multilateralize regionalism’. These are of interest as alternative possible routes through which the objective of a multilateral, non-discriminatory, trade regime might emerge from a sequence that includes regional/bilateral (i.e. discriminatory) agreements. The original conception in Baldwin (2006) was applied to straightforward barriers to goods trade, emphasizing in particular the costs associated with the enforcement of discriminatory free trade such as rules of origin. This paper considers whether the concept of multilateralizing regionalism is applicable to ‘deep integration’ – areas of domestic and regulatory policy where the objective is not (primarily) to discriminate against foreign or among foreign suppliers of a good or service. It does so by asking whether PTAs have so far shown signs of such multilateralization and discussing what might be done to encourage greater ‘multilateral’ outcomes.

So-called “deep integration” has become increasingly important to PTAs over the last decade and a half. It covers provisions dealing with product and market regulation (e.g., standards and competition policies, labor, the environment) and property rights (protection of intellectual property, other intangible assets as well as physical and financial investments). Such ‘regulatory’ policies are especially important for services industries, which have become more prominent in PTA negotiations as result of the increasing tradability of services and the inclusion of investment policies in bilateral and regional talks.

One factor should make multilateralisation via regionalism easier for services and regulations than for goods and traditional trade barriers. In many cases regulation is quite naturally applied in a non-discriminatory fashion, treating domestic and all overseas suppliers or firms equally – where ‘domesticity’ is defined more frequently in terms of location of production rather than ownership. This is quite different from tariffs and NTBs affecting trade in goods, where domestic/foreign and intra-foreign discrimination is the objective. From the perspective of achieving regulatory objectives, nationality often will (and certainly should) not matter. But even if regulation applies to all sources of supply, it can still have the effect of segmenting markets and reducing competition. The multilateral challenge is to get countries in PTAs to adopt regulations and reforms that enhance the contestability of the relevant markets, independent of the nationality of producers and suppliers.

If liberalization– defined as taking actions to enhance the contestability of a market – is more likely to be multilateral (nondiscriminatory) for regulations than for merchandise trade barriers, it is, equally, less likely to come about at all. This is because it is inherently more far-reaching and because it is simultaneously necessary and very difficult to distinguish between regulations that are genuinely needed for the achievement of domestic objectives

and those that are oriented towards segmenting markets and protecting domestic incumbents. In practice it is certainly not necessarily the case that regulations are applied on a nationality blind basis – insofar as protectionism is an objective of policymakers, regulation can be (and is) used to achieve this. One reason is that the legitimate, non-protectionist class of regulation frequently requires acquiescence of domestic firms if it is to be implemented effectively and almost always entails consulting those firms about any reforms. With the complex and subtle nature of many regulations, incumbents will have a great deal of influence over regulatory structures and details and may even have veto power over policy makers.

For cooperation on product market regulation and domestic policies in PTAs (“deep integration”) one can envisage three different processes of multilateralization. First, *hegemonic multilateralization*: a hegemonic economic power is essentially able to impose its own model (or at least a model consistent with its own stand) on its partners, not necessarily coercively but by the force of its market size. As different partners adopt the hegemon’s approach over their own local one, a degree of multilateralism is achieved. And it is possible that as the partners enter further bilateral or regional arrangements with other partners the model is extended. Unlike in Baldwin’s goods cases, the deep hegemonic route is generally implemented as the bilateral agreements are signed rather than afterwards. Although the accretion of users of a particular regulatory model may increase the chances of that model being adopted globally, we do not yet have any examples of such progress. However, as Schiff and Winters (2003) observed, the accretion of two different groups of supporters around two different models – say a US and a EU model – could make the final multilateral step (harmonization or recognition of equivalence) less rather than more likely. Moreover, intuitively, it might not even be multilateralizing, in the sense of decreasing the average degree of discrimination or difference in treatment across the world.²

Hegemonic multilateralisation refers not to discrimination across sources of supply by a single market but to the degree of harmonization of standards and regulations across markets. If a high degree of similarity or consistency is achieved, goods and services designed for one market can be sold elsewhere, greatly increasing the contestability of markets. Examples of the hegemonic model abound in ‘deep integration’. The USA requires partners in Bilateral Investment Treaties (BITs) to conform to a nearly identical template and imposes its own intellectual property (IP) protection provisions in its PTAs – World Bank

² As Winters (1999) discusses, multilateralism is actually rather hard to pin down precisely and a world divided into two very different camps may involve more frictions and discrimination than one in which many standards are used each slightly different from another.

(2005). These rules are applied by partners to all sources of investment or intellectual property; they may have displaced discriminatory regimes but even if not, their uniformity across countries eases the regulatory burden on firms looking to invest or use IP. Another example is the EU's strictures on the use of genetically modified organisms (GMOs): these mean that African countries wishing to export to the EU are effectively obliged to adopt the same policy stance. The same is true of any mandatory product standard that differs from that applying in other markets. In such cases the potential for bifurcation in the world economy seems evident, suggesting that harmonization is one thing but that harmonization around appropriate rules is quite another.

The second route to multilateralism that we identify is a *convergence route*. This operates within a regional arrangement where the erosion of barriers to trade increases the pressure to harmonize regulations because they start to have greater impact on trade patterns, competitiveness and profitability. This is essentially the "competition between rules" that featured in the EU's Single Market Programme, which applies equally to goods and services. It depended, in the former case, not only on the removal of traditional barriers to intra-EU trade (tariffs, quotas, etc.) but on the aggressive policy of the Commission and ECJ towards other limitations on the freedom of movement of goods such as product standards. In services the political sensitivity of this route is evident in the constrained liberalization of cross-border services espoused by the recent Services Directive in the EU and the difficulties that have affected efforts by the EU and the US to make progress in moving towards accepting each other's regulatory norms for specific goods and services as being effectively 'equivalent'.³

The third route to multilateralism is that identified by Baldwin – what we might term a *political evolution route* – whereby changes in the political weight of different parties or in the relative importance of different costs change the political economy so that groups that once sought to segment markets now seek to integrate them. One difference is that, compared with restrictions on goods trade, regulations are complex and require greater complicity from the relevant industry. The strong position of incumbents makes liberalization more difficult; in particular, it is difficult to envisage incumbents in a sector seeking the liberalization of that sector. The hope, as in goods, is that downstream (using) sectors can generate enough pressure.

The plan of the paper is as follows. In Section 1 we briefly summarize some of the "stylized facts" regarding coverage, content and implementation of PTAs outside the

³ E.g., the lack of success under the Transatlantic Economic Partnership to agree on mutual recognition of

traditional arena of goods trade policy. Section 2 tries to interpret the evidence, asking why deep integration is so difficult. It discusses the political economy and also a case study of the temporary movement of labor – mode 4 of the GATS. Section 3 discusses what might be done to encourage multilateralizing cooperation on behind the border policies. Section 4 concludes.

1. ‘Beyond the Border’ Cooperation in PTAs

Numerous countries have sought to increase competition on domestic markets by going beyond the liberalization of tariffs and quotas applied at the border and liberalizing FDI, opening access to foreign competition in backbone services sectors such as transport and telecommunications, and taking action to constrain the market segmenting effects of regulatory policies. Because inefficient regulation generates costs for buyers of the affected goods and services, and because regulation is often an instrument used to pursue so-called non-economic – as opposed to sectoral – objectives, unilateral reform incentives may be larger than for trade in goods and be less susceptible to roll-back, reducing the need to use international commitment mechanisms such as trade agreements. For example, allowing high cost, low quality services to dominate on a market will be detrimental to almost everyone in an economy, with large users having strong incentives to push for measures – such as deregulation, privatization, and liberalization – that generate more competition in the provision of these upstream suppliers of inputs (Hoekman and Messerlin, 2000).

Although numerous pro-competitive reforms have been implemented across the world, there is substantial evidence that barriers to trade and investment remain prevalent in most countries, and that there is substantial scope for governments to reduce the trade-restricting (and cost-raising) effects of domestic regulation. The consensus view is that the tariff equivalents of the trade restricting effects of domestic policies are a (large) multiple of the prevailing border tariffs today. Studies that use available information on prevailing policies conclude that further services liberalization would have much greater positive effects on national welfare than the removal of trade barriers – see e.g., Konan and Maskus (2006) on Tunisia and Jensen, Rutherford and Tarr (2006) on Russia. Instead of the “standard” 1 percent increase in welfare from goods liberalization, introducing greater competition on services markets raises the gains to the 5-10 percent range or more. These large effects of services liberalization reflect both the importance of services in the economy and the extent

to which many of them continue to be protected.

Research on the potential gains from further regulatory reform and harmonization/mutual recognition initiatives in the EU and the US also illustrates that in principle there is a significant incentive to pursue such reform. Kox and Lejour (2006) note that policy heterogeneity generates trade and investment costs for EU firms doing business in other EU countries. Complying with idiosyncratic national regulations generates fixed market-entry costs for each export market. Using a gravity regression including an indicator for bilateral policy heterogeneity based on an OECD dataset of product market regulation, they find a strong negative impact of policy heterogeneity costs on intra-EU trade and FDI. Removal of these costs could increase intra-EU services trade by 30-60% and FDI by 18-36%. OECD (2005) estimates that greater convergence in regulatory regimes and removal of policy barriers to entry could raise per capita GDP by over 3 percent in the EU and US.

Thus, there are potentially large gains from measures aimed at reducing the prevalence and costs of differences in regulation, as well as policies that simply prevent access to specific markets. The key questions are whether progress can be facilitated through *bilateral* or *regional* cooperation, and, whether such cooperation would result in a ‘multilateral’ outcome – i.e., a nondiscriminatory and reasonably uniform one. Whether this is feasible will depend on what the precise nature of an agreement is – e.g., recognition of qualifications or home country licensing and regulatory supervision can only be extended to other countries if they satisfy the substantive requirements (minimum standards).

What follows focuses on the major ‘behind-the-border’ policies that tend to be covered by PTAs: standards, services, investment, competition policy, IPRs, and enforcement provisions. Given the plethora of PTAs in force and under negotiation, we will limit our discussion to some of the ‘stylized facts’ that can be distilled from the major ‘types’ of recent PTAs. These can be classified on various dimensions. Our focus here will be on those negotiated by the US (the ‘NAFTA-type’), by the EU, and those involving other countries.

Standards and technical regulations

Technical product standards, sanitary and phytosanitary measures, professional qualifications and the processes and procedures that are used to certify products and service providers can have the effect of needlessly restraining trade. They are therefore subject to disciplines in both the WTO and many PTAs. In contrast to tariffs and quotas, the objective underlying mandatory standards is generally not to provide protection for domestic producers of goods or services, although standards can have that effect.

Two approaches can be taken to reducing the costs for producers (and consumers) associated with differences in standards for the same/similar products across markets: harmonization and (mutual) recognition. Harmonization in turn can be ‘hegemonic’ – reflecting convergence to the norms prevailing in the largest market – or ‘cooperative’ – reflecting the joint development and adoption of a specific norm. International standards, the adoption of which is encouraged by WTO rules in this area, are an example of the latter. In practice, firms have strong incentives to produce to the standards that prevail in large markets so as to realize economies of scale.

Greater acceptance of the principle of mutual recognition – agreement that regulatory standards in an area are essentially or substantively equivalent – could do much to enhance the contestability of markets and reduce compliance costs by eliminating duplicative and redundant requirements. Achieving progress on this front requires mutual trust and understanding of regulatory systems. A precondition is not just agreement on the equivalence or adequacy of the substantive norms that apply in each market, but also that these norms are enforced.

MRAs don’t *require* a PTA. Many MRAs and MRA discussions have taken place without the countries involved having a bilateral trade agreement. This was the case, for example, with the MRAs negotiated between the EU and the US in the second half of the 1990s.⁴ One reason was that the negotiations involved the relevant national regulatory agencies, as well as representatives from the industries concerned (under the auspices of the Transatlantic Business Dialogue (see e.g., Devereaux, Lawrence and Watkins, 2006).

In an assessment of the coverage and approaches taken in PTAs with respect to standards, Piermartini and Budetta (2006) conclude that the majority of PTAs extant have provisions that conform to those found in the WTO: calling for transparency in the process of setting and enforcing standards, and encouraging mutual recognition. There is little evidence explicit harmonization – not surprising, given that EU efforts to harmonize standards were a failure and led to the shift to the mutual recognition principle – see, for example, Pelkmans (2001).

An example of *de facto* hegemonic harmonization is in the use of the ‘precautionary principle’ by the EU in setting standards. Precaution is clearly central to the EU approach to standardization, but it is not something that can be – or is – imposed on their partners

⁴ The agreements cover bilateral inspection, testing, and certification for a variety of traded products, including medical devices, pharmaceuticals, recreational craft, telecommunications, electromagnetic compatibility (EMC) services, and electrical equipment.

explicitly. De facto, however, the strong risk aversion that characterizes EU policy does impose constraints on partners as they are precluded from using technologies that are not accepted in the EU – GMOs for example – for fear of spillovers to the EU. This constraint is an actually an MFN one, for it applies to anyone who wishes to export to the EU, but it bites most strongly on PTA partners because they have invested most in such exporting.

Outside the EU and EEA members, few PTAs appear to have made much progress through the vehicle of mutual recognition. Although MRAs can of course have discriminatory effects on those that are not members, few MRAs have in fact been concluded under PTA auspices.⁵ Pelkmans (2007) argues that this is not surprising since MRAs require considerable trust and sophistication to be feasible. Provisions calling for recognition and acceptance of equivalence of standards are strongest in US PTAs. In general, the prospects of recognition may be improved by the fact that many PTAs establish institutions that facilitate communication between national standards setting bodies. A number of PTAs also put in place measures to encourage recognition of conformity assessment and certification bodies. The latter is a particular focus of US PTAs. Although the US tends to have the strongest provisions on recognition and acceptance of the equivalence of conformity assessment mechanisms, the US PTAs do not seek to impose US norms per se.

From a multilateralizing perspective it does not appear that PTA provisions in this area have major potential downsides – the approaches taken are consistent with those called for in the relevant WTO agreements. As mentioned, most PTAs do not appear to go beyond WTO disciplines in this area. Piermartini and Budetta (2006) note that a number of PTAs establish regional bodies to deal with standards issues, and many – in particular those involving the US (and Mexico) – call for actions and specific bodies to increase the transparency of standards setting and enforcement.

Services policies

Most preferential trade agreements negotiated since the early 1990s include provisions on services. Although many early PTAs did (and do) not go much beyond the GATS, more recent vintage agreements often have a higher level of ambition, although none come close to the EU. A recent assessment by Roy, Marchetti and Lim (2006) concludes many of the trade agreements reported to the WTO since 2000 have a sectoral coverage that greatly exceeds the commitments the countries involved made in the GATS (Table 1). This applies both to the

⁵ Chen and Mattoo (2006) find that MRAs promote trade of covered and excluded countries. Baller (2007) confirms these results.

existing GATS commitments and the offers that were on the table in the Doha round as of mid 2006 when the talks were suspended. Roy et al. also conclude, however, that the substantive disciplines (rules) that are included in many of the agreements are similar to those in the GATS, i.e., the depth of the associated commitments often does go much beyond what PTA members committed to under the WTO.

Many agreements generally do entail some additional liberalization and commitments – e.g., the EU-Chile agreement goes further than the GATS by locking in some liberalization of telecommunications and maritime services (Ullrich, 2004), and the DR-CAFTA requires Costa Rica to open further its telecommunications and insurance industries – but the ‘additionality’ is usually limited.⁶ An in-depth analysis of services liberalization in PTAs in Asia by Fink and Molinuevo (2007) finds that there is great variance across PTAs in terms of coverage of services and the depth of commitments, with more commitments made in sectors where countries have also made more extensive commitments in the GATS. Sensitive sectors such as health, transport and financial services as well as the movement of service suppliers (mode 4) tend to be subject to the fewest commitments. In areas where there are no WTO disciplines, there tend not to be PTA rules either—e.g., safeguards, subsidies, or procurement. The same is true as regards domestic regulation, with only one PTA establishing an across-the-board necessity test.⁷

An important conclusion by Fink and Molinuevo (2007) is that the rules of origin that are contained in the PTAs are mostly liberal, in that PTA benefits extend to nonmember firms that are established (have a commercial presence) and substantial business operations in a PTA member. With the exception of the EU and a small number of agreements between high-income countries (e.g., Australia-New Zealand), most PTAs have not achieved much in terms of actual *additional* liberalization.

⁶ Houde, Kolse-Patil and Miroudot (2007) examine 20 PTAs and conclude all are WTO-plus. They also point out that bilateral reciprocity is stronger than in GATS in that as developing country PTA members (not surprisingly) make the greatest number of additional commitments relative to those made under the GATS.

⁷ This is contained in the Trans-Pacific Economic Partnership Agreement, between Brunei, Chile, New Zealand and Singapore.

Table 1: Selected Post-2000 Preferential Trade Agreements that include Services

PTA	Entry into Force	Date of Signature	WTO Notification	Negative or Positive List?	GATS-type Market Access Obligation for Mode 3?
New Zealand – Singapore	Jan. 2001	Nov. 2000	Sept. 2001	Positive List	Yes
EFTA – Mexico	Jul. 2001	Nov. 2000	Aug. 2001	Positive List	Yes
EC – Mexico	Mar. 2001	Oct. 2000	June 2002	Positive List	Yes
Chile – Costa Rica	Feb. 2002	Oct. 1999	May 2002	Negative List	No (nor for mode 1)
Japan – Singapore	Nov. 2002	Jan. 2002	Nov. 2002	Positive List (Japan used negative list for mode 3 NT).	Yes
Singapore – Australia	Jul. 2003	Feb. 2003	Oct. 2003	Negative List	Yes
US – Chile	Jan. 2004	June 2003	Dec. 2003	Negative List	Yes
US – Singapore	Jan. 2004	May 2003	Dec. 2003	Negative List	Yes
Chile – El Salvador	June 2002	Oct. 1999	Mar. 2004	Negative List	No (nor for mode 1)
Republic of Korea – Chile	April 2004	Feb. 2003	April 2004	Negative List	No (nor for mode 1)
EC-Chile	Mar. 2005	Nov. 2002	Nov. 2005	Positive List	Yes
EFTA – Singapore	Jan. 2003	June 2002	Jan. 2003	Positive List	Yes
China – HKC	Jan. 2004	Sep. 2003	Jan. 2004	Positive List (for China)	Yes
China – Macao China	Jan. 2004	Oct. 2003	Jan. 2004	Positive List (for China)	Yes
EFTA – Chile	Dec. 2004	June 2003	Dec. 2004	Positive List	Yes
US – Australia	Jan. 2005	Aug. 2004	Dec. 2004	Negative List	Yes
Thailand – Australia	Jan. 2005	Jul. 2004	Jan. 2005	Positive List	Yes
Panama – El Salvador	April 2003	March 2002	April 2005	Negative List	No (neither for mode 1)
Japan – Mexico	April 2005	Sep. 2004	April 2005	Negative List	No (neither for mode 1)
US – Bahrain	Aug. 2006	Sep. 2004	-----	Negative List	Yes
US – Oman	-----	Jan. 2006	-----	Negative List	Yes
US – CA + DR	Mar. 2006	Aug. 2005	Mar. 2006	Negative List	Yes
US – Morocco	Jan. 2006	June 2004	Jan. 2006	Negative List	Yes
US – Peru	-----	April 2006	-----	Negative List	Yes
Japan – Malaysia	-----	Dec. 2005	-----	Positive List	Yes
Korea – Singapore	Mar. 2006	Aug. 2005	Feb. 2006	Negative List	No
US – Colombia	-----	Feb. 2006 (conclusion of negotiations)	-----	Negative List	Yes
Singapore – India	-----	June 2005	-----	Positive List	Yes

Source: Roy, Marchetti and Lim (2006).

The difficulty experienced by the EU to fully liberalize intra-EU services trade and create a single market for services illustrates that in practice it is not straightforward to achieve liberalization through regional cooperation, even where there is a strong political commitment and common institutions that have a mandate to pursue integration of markets. Progress towards a single market in services across the EU has encountered strong opposition when attempting to remove limitations on cross-border trade and the temporary movement of personnel. Although the EC Treaty guarantees the freedom to provide services and the freedom of movement of workers between all EU countries, many governments have been unwilling to accept ‘home country regulation’. A 1996 Directive on “The Posting of Workers in the Framework of the Provision of Services” (96/71/EC) clarified that EU states must apply any minimum terms and conditions of employment to workers from another EU member posted temporarily by their employer to work in that state. The January 2004 draft Services Directive sought to go beyond this by requiring that sector-specific regulations of EU member states be non-discriminatory, objectively justified on the grounds of public interest, and proportionate. Many EU members opposed the associated ‘competition in regulation’ and the Directive that was eventually adopted allows countries to retain a number of policies that segment EU services markets

As is true of the recent PTAs in Asia and elsewhere, there is close correlation between sectors and policies where the EU members have agreed on internal liberalization and the extent of external liberalization and commitments in the GATS. Thus, the average pre-Doha level of specific commitments on market access and national treatment for the EU-15 was 46 percent, a fairly high number compared to other WTO members.⁸ The highest level of commitment was in modes 2 (consumption abroad) and 3 (commercial presence); by far the fewest commitments were made for mode 4 (temporary movement of natural persons supplying services): 3.5 percent. The same pattern continues to prevail for the EU offer in the Doha Round (Table 2). Not surprisingly, the EU’s external trade policy reflects the constraints it confronts in achieving a fully integrated internal market for services.

⁸ This index is a weighted average measure of the depth of the commitments on national treatment and market access, the maximum – no limitations and no exceptions – being 100.

Table 2: EU-15 coverage of GATS services commitments (%)

Mode of supply	Pre-Doha	April 2003 offer	Difference (% points)
Mode 1	50.5	57.2	6.7
Mode 2	66.9	88.2	21.3
Mode 3	63.0	82.9	19.9
Mode 4	3.5	4.5	1.0
Total	46.0	58.2	12.2

Source: Hoekman, Mattoo and Sapir (2007).

Investment policies

An increasing number of PTAs include investment provisions. In the case of US agreements these take the form of specific chapters, modeled on the NAFTA. These provide for national treatment and MFN, ban TRIMs, guarantee capital transfers and include provisions requiring compensation in cases of expropriation. Extensive dispute settlement provisions, including investor-state arbitration are a core part of these agreements. These PTAs generally subsume and go beyond pre-existing BITs. They include *broad definitions of investment*, including not only FDI, but also portfolio flows, debt instruments and intangible assets such as intellectual property (Hoekman and Newfarmer, 2005). The treatment of *investment* and capital flows in EU agreements tends to be less extensive than in US agreements. For example, the EU-Mexico agreement simply states that the existing restrictions on investment will be progressively eliminated and no new restrictions adopted, without specifying particular sectors or setting a timeline for liberalization. The language in the EU-Chile agreement is even more general, calling for “free movement of capital relating to direct investments made in accordance with the laws of the host country.”

[Assess whether provisions extend only to members of the PTA/BIT or to all investors? If the latter they are very multilateralizing – but if the former potentially restrictive.]

Competition policies

Competition policy (defined here as disciplines on the behavior of firms and the ability of governments to provide financial assistance to firms) has played an important role in only few PTAs. The EU is of course the ‘gold standard’ in terms of the extent and reach of the

constraints that are imposed on Member states regarding policies that may have an impact on intra-regional trade. Disciplines are imposed on state aids (subsidies), monopolies, government procurement practices, and competition policy. The various disciplines are enforced by supranational bodies (the European Commission and the European Court of Justice) as well as by national institutions. These various competition provisions were considered necessary in order to achieve the objective of creating an integrated European market. Thus, the primary focus is to discipline measures (public and private) that may segment national markets or distort trade. The disciplines benefit any potential competitor – even one from outside the Union - so competition policy is potentially multilateralizing; however, given that external suppliers are subject to the anti-dumping regime, which is essentially designed to reduce competition, at least some of the multilateral benefits are eroded in practice.

Another PTA with far-reaching cooperation on competition policy is the Closer Economic Relations agreement between Australia and New Zealand, under which it was agreed that nationals of one state could be made the subject of an enquiry by the competition authorities of the other state and be required to respond to requests for information. Antitrust legislation in both countries was amended to extend its scope to encompass the behavior of firms located in either market; Courts were empowered to sit and serve orders in the other country; and judgments are enforceable in both countries. However, the application of antitrust remedies remains strictly national.

Many – indeed, most – of the more recently negotiated PTAs have provisions on competition law. Most of these PTAs do not come even close to the depth of cooperation found in the EU/EEA or between Australia and New Zealand. This is the case even for EU PTAs, where competition provisions figure most prominently. Given the importance of common competition disciplines in the realization and functioning of the EU it is not surprising that competition policy also figures on the agenda of EU PTAs. For example, the Association agreements with Mediterranean countries require them to adopt – after a transition period – EU rules relating to agreements between firms restricting competition, abuse of dominant position, the behavior of public undertakings (state-owned firms) and competition-distorting state aids that have an effect on trade. However, these provisions are best regarded as of a best endeavors nature. The type of cooperation that is called for

is limited to consultation and weak forms of comity. Most US PTAs do not contain disciplines on competition law and those that do have language on this subject explicitly exempt the relevant provisions from the dispute settlement mechanisms established to enforce the PTA. Such carve-outs also apply in EU PTAs – this is the case for example in the EU-Chile PTA – and most Latin American PTAs (Sokol, 2007).

The EU is the outlier on the competition policy front in that, given the vigor with which it is pursued in bilateral relations, one might conclude that there is some hegemonic intent/hope in terms of the coverage, scope and style of competition policies. However, there is not much evidence of hard law here, although in truth it is hard to detect exactly what is going on in most PTAs. Also, of course, the constitutional discussions over a new EU Treaty in mid-2007 suggested that perhaps the EU was falling out of love with competition policy – at French insistence the promotion of competition was removed as a constitutional objective of the European Union.

IPRs

There are significant differences across PTAs as regards the coverage of IPRs. With the exception of US agreements, most PTAs do not go beyond the substantive provisions of the WTO. The US is the major outlier. It includes IPRs in the definition of assets covered by the investment chapter of a PTA, and has negotiated TRIPS+ disciplines (see Fink and Reichenmiller, 2005). Access to investor-State arbitration under the PTA's investment provisions is considerably more powerful than the state-to-state provisions found in the WTO and EU PTAs. In the case of IPRs, US PTAs clearly involve an effort by the hegemon to impose its standards in the form of legally binding, enforceable norms, and to do so in a way that protects everyone's IP. The EU tends to be much less prescriptive in this area, although some observers note that the EU may begin to use PTAs as a vehicle to impose its preferred approach to the definition and protection of geographical indications – especially if multilateral agreement cannot be obtained.⁹

⁹ The EU and US have agreed to cooperate in the enforcement of IPRs in third countries, including agreement to make IPR enforcement a key focus in trade capacity building technical assistance to third countries and improving coordination of their efforts in this area with a view to avoiding duplication. See US Government, 2006.

Implementation, enforcement and dispute settlement

Signing a PTA is one thing, but implementing it and then enforcing its provisions are quite another. Unfortunately these are extremely difficult to pin down. One might detect implementation in terms of legal statute, but quite often the PTA clauses do not require changes in statutes so much as lower level regulations, which are very hard to identify. Enforcement is even harder to see; something might be inferred from enforcement activity, but not too much is known about this even in the best-documented PTAs. Possibly, the dispute settlement provisions of the PTAs are therefore the main source of information we have at our disposal.

By a long way, the US PTAs are the most far reaching in terms of dispute settlement, not surprisingly in the areas where there are strong lobbies in the US—first and foremost IPRs and investment protection, but also in areas such as product standards and conformity assessment. The latter is actually rather asymmetric: thus in the CAFTA, signatories are subject to disciplines that enhance the likelihood that *US certification* of goods is accepted as equivalent, but there is not a similar language on US acceptance of their certification. This is hegemonic multilateralisation given that US standards are applied by other countries too. The seriousness of US implementation is reflected not just in terms of formal, binding dispute settlement – a NAFTA+ model (see below)—but also in terms of calling for – and setting up – bodies to monitor implementation. Thus, the US seems to take implementation of agreed conditions in a PTA more seriously than others. For example, the USTR website has documents on FTA compliance by partners and the US PTAs call for and have established performance benchmarks and contact points through which interested parties (citizens) can raise perceived instances of non-compliance.¹⁰ The corollary of the focus on enforcement by the US is the care with which subjects where it does not want to be bound – e.g., antitrust – are carved-out from dispute settlement. An example is the US-Chile PTA. None of this exists with the EU's or Asian PTAs, where diplomatic and political processes predominate, although there are some hints of it in the

¹⁰ A noteworthy feature of recent US PTAs is that dispute settlement makes provision for compensation payments in lieu of implementation (or retaliation). In US-Chile, in the case of non-implementation of a panel finding, if the losing party offers to pay 50% of the damage caused. It appears this is open ended, as the text speaks of annual payments. This PTA also provides for monetary fines of up to \$15 million per year in case of violation of labor/environmental provisions. Proceeds go into a fund earmarked for labor/green initiatives.

Latin American agreements. The latter probably represents evidence of multilateralisation as Mexico sought to use the models that it had adopted under NAFTA with its other partners and so on to their partners.

2. Interpreting Experience

This section asks why we see so little progress on deep integration in PTAs, relative to both the status quo and the WTO? It considers first the political economy of liberalization in the ‘deep integration’ field: it is very complex even for the modalities (PTA and multilateral talks) we have at present and seems to offer no obvious means for evolving spontaneously from a discriminatory to a multilateral form. Second, we offer a case study of the liberalization of the temporary movement of labor – mode 4 of the GATS – in which specific features of this very important area are examined. Again, while there are some grounds for expecting that movement will be liberalized eventually – this will be unilaterally and bilaterally rather than multilaterally.

Why so little?

A number of factors combine to make deep integration more complex and demanding than that of the goods sector. These reasons affect progress in the multilateral system as well as regionally, but arguably they impinge more heavily on the latter.

As far as services liberalization is concerned, one relevant consideration is that for large services firms that operate globally – most of them European or American – the costs of meeting prevailing regulatory requirements can be met relatively easily by hiring locally certified professionals, which is something they would do anyway for good business reasons. The firms that are most affected by regulatory differences are the smaller ones, but their characteristics – small, dispersed, etc. – and the high degree of uncertainty they confront regarding likely benefits of international expansion make it difficult to organization effective lobbying for overseas market access. Equally, the greater cost of going global makes their existing national markets more important and so increases the benefits of resisting liberalization at home. Given the important role of incumbent firms in the regulation of many sectors, this imbalance gives a strong bias towards inward looking policy.

Another factor that will affect the power of bilateral cooperation to support national regulatory reform is that, while dealing with regulatory costs (and reducing the associated rents where these exist) will be good for consumers in the PTA, it may not do much to increase trade. Instead, the main effect may be to foster domestic entry into the markets concerned. In the case of many services, not only are there transactions costs associated with international competition, but the need to employ local labor and other factors of production in order to sell services – many of which remain difficult to trade via mode 1 – may imply that foreign firms will not have that much of an advantage over domestic firms in newly opened market segments. This will reduce the incentive for service firms to lobby for/support bilateral opening/cooperation. Such considerations may help to explain the limited progress that has been made to date in the EU-US transatlantic context in regulatory cooperation and mutual recognition of standards and professional qualifications.

A third possible factor is much of the intersection of what needs to be done and what looks politically feasible is very small. In the case of merchandise trade all WTO members have clear interests in improving access to export markets. Some countries are more diversified than others and all have differential specific interests – but all countries are exporters of goods that are subject to trade barriers in partner country markets. Thus they have exporters that see potential benefits from reciprocal negotiations on tariffs affecting merchandise trade. The same is true for the rules of origin created by the proliferation of PTAs—these basically become another form of tariff barrier into PTA markets (the upper bound of any rule of origin is the MFN tariff).

Interests are less symmetric when it comes to services, investment, competition and IPR policies. In the case of services, while many developing countries are significant exporters, the key sectors are often those in which the relevant policies are under the control of the government as opposed to trading partners – i.e. in which there is relatively little to be gained internationally. The most important is tourism, where the export revenue generated depends primarily on measures that the destination country puts in place itself. As far as cross-border trade in services via telecommunications networks is concerned (mode 1 GATS), developing countries have export interests, but this channel for trade is usually not constrained by policy in the importing country (at least at present),

e.g. business process outsourcing, call centers, etc. The one mode where developing countries confront particularly high barriers and that is therefore of great relevance to potential exporters is the temporary cross-border movement of service providers (natural persons) – mode 4. However, this is politically extremely sensitive and insofar as exporters perceive little promise of progress, they will invest little in lobbying.

Turning to investment (FDI in services and goods sectors), few developing countries have significant “offensive” interests – i.e. they do not have indigenous multinational service providers seeking better access to foreign markets. FDI is primarily of interest to firms based in high-income countries and large emerging economies. Likewise competition policy in their markets is unlikely to do much for small exporting firms from developing countries, as opposed to action on anti-dumping policies, which the developed countries have striven to keep in an entirely separate box in the negotiations. And most developing countries have little ability to generate internationalizable intellectual property or to influence standards much.

Regulatory cooperation that takes the form of recognition agreements implies that firms that have established in a market that is covered by the agreement will be able to contest the other market(s) more easily, whatever their “nationality”. That is, firms from third parties that have established a commercial presence in a PTA member – and thus have satisfied the regulatory requirements prevailing in the host market – will also benefit. This will not necessarily be true for cross-border trade, as home-country regulation by third countries may not be accepted as equivalent by regulators in the markets that have recognition agreements. This implies that recognition agreements may generate a bias towards FDI as the channel through which to contest large PTA markets. Insofar as firms in small countries (developing economies) cannot engage in FDI because the associated fixed costs are too high, they will not be able to benefit from a MRA between their trading partners.

All told, then, much of the deep integration agenda seems either of little interest or beyond the reach of developing country trade negotiators. To the extent that it will make progress it will require domestic constituencies to emerge to control domestic regulation and PTAs will contribute mainly via these.

Of course, governments and communities may want to see more investment

flowing into the country, including in services, to help create new employment opportunities. They may also support cooperation on standards and competition law. But, this will be as guardians of the general welfare not as sectoral champions.

Finally, the characteristics of regulation complicate liberalization. Barriers to trade in goods apply at the border and are visible. In the case of regulation, trade is restricted by a mix of explicit discrimination against foreign providers and domestic policies that may result in *de facto* discrimination. The prevalence of regulation to address market failures due to asymmetric information, imperfect competition and network externalities greatly complicates international cooperation and integration efforts. Regulators may be concerned (for good or bad reasons) that trade liberalization will impede their ability to enforce domestic regulatory standards. Trade will bring with it regulatory competition if services suppliers from abroad are subject only to the norms and standards that apply in their home markets. A critical – and difficult – question is how to differentiate between legitimate concerns relating to quality and performance, and regulatory requirements that simply constitute barriers to entry, creating rents for incumbents by raising prices. In practice these are matters that can only be clarified through repeated exchanges and interactions, informed by analysis.

In addition to concerns about the ability to enforce national regulatory standards, in developing countries liberalization may raise an additional regulation-related issue: achieving social equity objectives. The impacts of more competitive market structures following liberalization on access to services by poorer households in developing countries have been mixed. In cases like mobile telecommunications, a positive relationship has been observed in many developing countries because initial conditions were bad – few households had access. However, in other areas, like financial services, unless improved regulatory measures are put in place, liberalization may have an adverse effect on access to credit for rural areas and the poor. Putting in place mechanisms to ensure better access to services post-liberalization is important from an equity perspective. It is also important from a political economy perspective to bolster support for implementing efficiency enhancing policy reforms and sustaining them over time. Absent actions to address regulatory weaknesses, countries may not be in a position to

fully realize the potential benefits of trade reforms in services.¹¹

It is very difficult to design rules in a way that clearly separates or distinguishes between measures that are protectionist and measures that have good domestic efficiency or social equity rationales. Regulators may therefore be concerned that PTA negotiating dynamics could adversely affect their ability to design and implement regulatory norms that maximize national welfare. Given these political constraints the prospect of deep integration spontaneously multilateralizing seems rather weak.

Liberalizing the temporary movement of labor – mode 4 of the GATS:

The area that is probably of greatest aggregate interest to developing countries in direct welfare terms is to achieve progress on the temporary movement of labor (TML) – covered by mode 4 of the GATS. It is simultaneously undoubtedly the most sensitive politically. To date progress in this area has been dominated by regional and bilateral approaches (TML), but it is formally part of the multilateral system via Mode 4 of the GATS. While much of the story is *sui generis*, it does help to shed light on the process of ‘deep integration’ in general and the prospects for multilateralizing regional agreements¹². Our conclusion is that, while it is possible that experience with bilateral TML agreements will provide sufficient business enthusiasm and popular political comfort to permit an extension to multilateral forms, it is by no means inevitable.

Oye (1992) argued that regionalism could play a major role in liberalization when issues were too sensitive or too complex for multilateral processes to work. Using the 1930s as his principal example, he argued that the economic stakes were so high and suspicions so great that only the high degree of internalization provided by regional approaches could overcome political resistance to liberalizing trade. In the event the regionalism of the USA’s Reciprocal Trade Agreements Act was multilateralized after the Second World War and so this process proved quite benign for goods trade. Can we expect the same for mode 4 of services trade or migration more generally?

¹¹ Goods policy is also prone to distributional arguments – for example the desire to subsidize food or energy prices – and to maintain tariffs on outputs produced by poor farmers (special products in the Doha agricultural negotiation). These arguments have gradually given way under analysis and as we argue below their service equivalents are equally open to refutation.

¹² Mode 4 agreements are restricted to mobility to provide services, but the discussion that follows covers all temporary labor agreements.

The argument hinges around the fact that mode 4 involves people rather than things – people whose behavior and welfare have to be considered in one form or another even after they have entered a country, and whose behavior and welfare impinges on those of domestic residents in a much more basic way than does the origin of the goods and services they consume. Is this additional dimension entailed in labor movement compared with goods and other forms of services trade an insurmountable barrier or one that in time might be eroded? To answer this we contrast various bilateral labor agreements with the multilateral norm as embodied in Mode 4 of the GATS.

The architecture of the GATS contains several features that lie uneasily with policy-making in the field of migration. First, GATS Mode 4 is explicitly stated to be only about trade and not about migration. We have written this several times ourselves, but suspect that merely reiterating it in a louder voice is not winning the argument. Electorates, politicians and immigration bureaucracies in host countries all perceive TML as raising issues such as national security, access to national or local public goods and acceptance of civic duties, and seem set to resist trade-type concessions until they are addressed. In source countries concerns are sometimes voiced about exploitation and the conditions under which workers serve. GATS provides no instruments for dealing with these non-trade dimensions and indeed few ways of even bringing the competent authorities together.

Second, the GATS views TML solely as a matter of reciprocal market access – the host (‘importing’) nation relaxes its restrictions on entry in return for reciprocal market access concessions from its partner in the same or a different market. But while some labor does move both ways across many borders, the flows are usually very far from balanced, so there is no real equivalent to the intra-industry trade or even the primaries-for-manufacturing trades found for goods. Within a TML negotiation, there is at present nothing that a source (exporting) country can do to encourage its destination partner to lower access barriers to particular classes of labor – e.g. there is no GATS provision for it to make binding commitments to, say, validate migrants’ qualifications, provide security vetting or guarantee re-admission for returnees. The best one can foresee under present rules is swapping concessions on skilled labor market access in developing countries for those on unskilled labor access in developed countries, but this is a huge

political challenge given their very different political interests and sectors of work within each economy. Thus beyond this one possibility we will need to invent some new GATS modalities if the will to multilateralize TML suddenly arises.

Third, GATS calls for bindings – all-but-permanent commitments to market opening backed up by an effective enforcement mechanism. Conditional opening – conditional on the state of the labor market, on experience with previous groups of migrants, on political peace or on national security considerations – is not accommodated except via tacit commitments to renegotiate or turn a blind eye to infringements. Thus there is no way that source countries can share the risks that hosts perceive and thus help them along the way to making concessions.

Fourth, GATS is color/race/culture blind, but most societies have quite strong views about who belongs and who does not. For example, European countries are generally more open to residents of their former colonies and most countries favor neighbors over more distant partners. We do not advocate discrimination even *ex ante*, and certainly not *ex post*, but one has to be realistic about the ways in which societies define themselves. In addition ‘regionalism as diplomacy’ is probably stronger for TML than for goods trade: migration looks like an even stronger tool for influencing or trying to stabilize small countries in one’s sphere of influence than does preferential trade. Thus, for example, New Zealand has specific labor schemes for workers from the Pacific islands, with which it identifies closely. For both reasons the GATS’ MFN clause presents peculiar difficulties for TML.

The absence of modalities for cooperation in the GATS contrasts strongly with the large number of bilateral labor arrangements that exist on TML. These typically involve negotiation of a good deal of action by the source country in return for the grant of a quota of places for temporary emigrants from the country alone. The sort of elements that enter such a deal are that the developed partner: (i) accepts a quota of less-skilled or semi-skilled workers to specific segments of its labor market (but often with some rights to change employer), with the overall quota having some flexibility with respect to an economics needs test or an objective measure of labor market conditions; (ii) offers guarantees about the welfare of workers while abroad; and (iii) makes some commitment to encourage the return of workers at the end of their TML period.

In return the developing partner offers some of the following:

- a. security clearance or details and documentation on its nationals;
- b. some validation and possibly management of their qualifications;
- c. a commitment to accept its nationals back at the end of their TML period, (or before if conditions were breached) even if they no longer hold the appropriate documentation;
- d. facilities for recruitment in-country;
- e. pre-migration training courses for potential migrants and
- f. enhanced efforts to prevent migrants from absconding into undocumented migration - e.g. limiting the number of family members eligible for migration, coordinating social pressure or migrants to return by agreeing that if there is significant failure, future quotas may be reduced.

The important point about these actions is that they are at least to some extent unmonitorable by the developed partner – (a) and (b) are, for example, expressly aimed at reducing the need for developed partner monitoring, while (f) is unmeasurable. For this reason they depend on mutual trust between the partners and thus are likely to be feasible only for a subset of partners, at least at first.

Beyond this skeleton, there would still be myriad details to negotiate – e.g. the transferability of health and pension rights, and whether or not to withhold part of their payment until the workers exit – and then administer. Again these are much more feasible, and possibly only feasible at all, in the context of bilateral or regional agreements.

Experience suggests that business finds immigrant labor a considerable boon, so as long as the labor market remains quite buoyant, one can expect there to be pressure to maintain and probably extend access. For example, farms in the south of the USA are quite clear how much they depend on undocumented labor from Mexico and beyond, and in Germany business was an advocate for the guest worker schemes in the 1960s and 70s. It is true that firms prefer to keep the same workers if they can – or to have them back season after season – so their support for temporary mobility is qualified, but overall access to any labor would probably be the priority. Thus the question of multilateralizing bilateral labor agreements depends on other players – governments, labor organizations

and society at large. From the contrast drawn above we would conclude that these groups are unlikely to see much benefit in meeting the demand for labor by extending the number of countries that are covered by an agreement rather than increasing the quotas or stay durations for the subset already favored. Moreover, any lessons learned from dealing with one set of labor partners will quite easily be dismissed as not being of relevance to relations with another set. Thus while immigration numbers might be allowed to increase (which is far from certain) it may not multilateralize.

The apparent advantages of bilateral over multilateral TML agreements are a major challenge for the multilateral trading system and its advocates like us. The defense that regionalism is just the first step towards multilateralism is attractive, but in our judgment it is not yet sufficiently well established in this area to be plausible. The necessary steps for such an evolution to occur are that the GATS find a means to allow source countries to make binding commitments on their side of the TML process and that their capacity to honor these commitments be boosted by technical assistance and other means. Once experience with bilaterals has defined developed countries' requirements of their partners in a fairly objective way, it might be possible to commit that *any* developing country that could meet those parameters would be eligible for a TML quota of 'a standard' kind. The parallel would not be MFN so much as the mutual recognition component of the WTO Agreements on technical barriers and SPS.

In truth, however, such steps will be far from sufficient: the arguments presented above about cultural affinities and potential assimilation will remain to be solved. But if the GATS permitted discrimination in one area of the WTO's business, might this not undermine the case for multilateralism in other areas? To us this would be a major cost. Thus one might be better off recognizing that treating TML as a purely trade issue is not wholly convincing intellectually and is proving largely ineffective practically. With its deep implications for national policy and identity, TML is perhaps not yet ripe for multilateralism; or rather multilateralism is not yet ripe for it.

The MFN obligation in the GATS applies to all services trade whether scheduled or not (unless a measure has been explicitly excepted from MFN, and even that is time-limited). Thus there is some chance that bilateral labor mobility arrangements, except those forming part of a fully-blown preferential arrangement, could be challenged and

possibly ruled WTO-inconsistent. That would be a major strain for the system as a whole. Some commentators have argued that because the issues are so sensitive and so case-specific progress will be possible only bilaterally; hence, they say, we should bow to the inevitable and let the GATS recognize bilateral deals. We agree that for many years most temporary mobility deals will be bilateral, but would rather leave them out of the GATS than dilute the fundamental non-discrimination principle of the WTO. Thus while there is clearly a case for ensuring that bilateral deals on mode 4 cannot be taken to the dispute settlement procedure, we would not recognize them formally under the GATS and would certainly not allow them to be scheduled or enforced via its procedures. Bilateralism is likely to create friction in temporary mobility and there is a case for keeping that friction out of the WTO.

3. Where to from here? Options to encourage welfare-enhancing multilateralization

This section contains a brief discussion of what makes sense in multilateralisation from an economic development perspective, followed by some thoughts on how to help to bring it about. While there is some scope for PTAs to develop in multilateral directions in areas of ‘deep integration’ we argue that there is need for some caution about the destination and a strong case for helping the journey along through conscious intervention.

The objective

Simple multilateralization is fine from a welfare perspective for trade in goods: free trade is first best. This is not necessarily the case for services or regulation. Regulation is not, *per se*, a “bad”, although it can be bad. The implication is that we cannot just engage in the reciprocal mechanics of “liberalization” defined as the removal of any policies that business argues restricts entry or raises their operating costs. One needs to weigh the relative benefits of regulation in solving market failures and improving competition against the costs and restraints they imply for business. The trade-off will vary from sector to sector - one size does not fit all. It may also be affected by the geographical coverage and the credibility of the regulation, both issues on which PTAs and multilateral agreements may have an impact.

One rationale for deep integration may be to internalize pecuniary spillovers—e.g., reflecting tax or incentive competition to attract FDI, generally a beggar-thy-neighbor policy that ultimately primarily benefits multinationals. Developing countries therefore have an incentive to push for international disciplines on incentive policies. PTAs represent one potential vehicle for doing so and multilateral agreements would do also. From a development perspective, the extension of PTAs to regulatory issues can be beneficial if it improves policy quality and/or credibility, thereby reducing risk premia and helping to attract investment. Regional cooperation may be more effective in this regard than multilateral, for partners may be more similar (e.g. have common legal or administrative systems) than the world as a whole. North–South PTAs also tend to be associated with deeper transfers of finance and knowledge (technical assistance), potentially helping to reduce implementation and adjustment costs. Proponents of deep integration in North-South agreements also argue that binding disciplines in areas such as competition and investment policy is critical to integrate markets and that it is easier to envisage enforcement among small groups than among large, for which it faces classic public goods problems – see Schiff and Winters (2003), although note also the reservation there that such benefits are far from automatic. They have to be consciously sought and designed.

Given the large asymmetries in size and power, the challenge for small and poor countries is to ensure that any negotiated outcome is in their interest. Such countries have very little scope to use their trade policies as an instrument to induce other countries to open up their markets. An implication is that quid pro quo “payments” for preferential market access are likely to be sought in areas such as regulatory regimes, investment policy, etc. It is at this point that the suitability of adopted policies arises. The regulatory standards that are written into trade agreements generally start from the status quo prevailing in OECD countries, so that the lion’s share of associated implementation costs—but presumably also the benefits—lies with developing country signatories. From a development perspective the acid test is whether proposed or negotiated rules in regulatory areas will improve the business environment, lower costs and/or help achieve domestic non-economic objectives *in the developing country*. Credibility of the wrong policy is not an aid to development.

For non-participants (excluded countries), the key concern is whether deeper integration among PTA members has negative implications for them. Ideally, the objective here from a multilateralization perspective is to satisfy the equivalent of the Pareto criterion: gains from deeper integration of PTA members should not lower welfare in other developing countries. From a development perspective the issue therefore is not only to maximize the potential payoffs of deeper integration for developing country members of PTAs, but to maximize the prospects that such integration be ‘multilateralized’ and thus benefits non-member developing countries as well.

The means

Clearly the discrimination in trade caused by the preferential access that PTA members grant to each other’s markets is a negative for the rest of the world and may be detrimental to some PTA members. The issues here are very well known, as are the means through which such downsides can be attenuated. Trade diversion may generate incentives for PTA members to lower MFN barriers as well – viz. e.g., Estevadeordal, Freund and Ornelas (2007)—and, more generally, the WTO offers the instrument of MTNs through which to negotiate lower MFN barriers.

What might be done to address the potential negative effects of deep integration on developing country PTA members and the rest of the world? Realization of the first objective noted above – ensuring that deep integration benefits developing country PTA members – arguably requires that the specifics of regulation and cooperation reflect national circumstances. Regulatory standards and institutions need to be tailored to national circumstances to be effective and attain the desired objective. An increasing body of evidence has shown that a “one size fits all” approach – including international “best practice” norms – may not be appropriate. For example, Barth, Caprio and Levine (2006), in a comprehensive cross-country assessment of the impact of the Basel Committee's standards for bank regulation, conclude that there is no evidence that any single set of “best practices” is appropriate for promoting well-functioning banks. They argue that a high degree of country specificity may be needed, rather than simply adopting international norms “off the shelf.”

This suggests that what may be most appropriate from an economic welfare

(development) perspective is to create a framework for assisting governments to identify ‘good policies’, not a system that is premised on harmonization or convergence. An important corollary of such an approach must be ‘restraint’ on the part of large, industrialized partner countries and accountability for performance and outcomes. PTAs could help by creating/supporting institutional mechanisms to increase the transparency of policies and their effects (outcomes) through common (joint) monitoring and analysis. Creating a focal point for *constructive*, as opposed to adversarial, interactions between governments on the competitive (market segmenting) effects of regulation (or a lack of regulation) and the costs and benefits (incidence) of specific reforms could do much to mobilize the needed support by constituencies in developing country PTA members. [This argument seems to suggest that PTAs will not generalize easily to multilateral forms, which so far have been rather adversarial in the trade domain.]

Such an approach to deeper integration would benefit from expanded development assistance to help put in place and improve nondiscriminatory regulation in developing countries. Much effort is already being put into technical assistance to help countries expand trade capacity. From a multilateral perspective a key concern and constraint that should be imposed on such aid is to promote policies that are nondiscriminatory in intent and effect.

The proposed approach is not that different from that being pursued in the context of EU-US bilateral cooperation on regulatory matters (in the context of transatlantic dialogue), APEC and the European Neighborhood Policy. The latter offers neighboring countries the opportunity for, but does not impose, the adoption of elements of the EU *Acquis*. In the bilateral EU-US context, the Framework for Advancing Transatlantic Economic Integration stresses dialogue, learning and soft forms of cooperation: the establishment of joint mechanisms and processes to assess the impact of regulatory regimes and to enhance timely access to information on proposed regulations, and a Transatlantic Economic Council to guide the process and review progress.¹³

An obvious question then is why deep integration of this type might benefit from

¹³ However, only a number of issues relating to financial markets are mentioned as a “lighthouse priority project” in the EU-US 2007 Summit: accounting standards (‘mutual recognition’ of US GAAP and the IFRS to allow firms to dispense with expensive reconciliation of reports), auditor oversight, reinsurance regulation, and mutual recognition in the field of securities regulation (“where appropriate”).

being pursued through the institutional apparatus of a PTA. If the focus is on the implementation of nondiscriminatory regulatory improvements and cooperation, there is no prima facie case to pursue this through a PTA. In practice, as mentioned above and as discussed at greater length in Schiff and Winters (2003) ‘deep integration’ has often been pursued through other forms of cooperation.

‘Soft law’ cooperation to put in place efficient regulation to address market failures and attain noneconomic objectives while seeking to reduce duplication and transactions costs for firms operating in different countries will not do much to remove regulatory barriers that are explicitly aimed at protecting national industries. Trade agreements and the reciprocity that drives them can be an effective means of negotiating away such restrictions, while still ensuring that non-protectionist national regulatory objectives are satisfied. Realization of the latter may be a precondition for liberalization in the sense of allowing foreign firms to contest a market (say in services), providing a rationale for pursuing regulatory cooperation in the context of a PTA that includes binding market access commitments and disciplines such as the national treatment rule.

Efforts to ensure that PTA-based regulatory cooperation benefits – and is seen to benefit – members may also help realize the second objective: multilateralization. This may arise if it enhances prospects for the nondiscriminatory application of reforms where this is technically feasible. However, prospects for – the likelihood of – such multilateralization depend very much on political economy forces that prevail in the PTA context. Constituencies that perceive benefits from deeper integration may perceive less “need” to discriminate against non-PTA members insofar as the costs of reform have already been incurred. Conversely, they may perceive a greater interest to keep non-PTA firms out of ‘their’ markets. This suggests that a key input into greater multilateralization is documenting there are significant net benefits from doing so. This in turn suggests a need to do much more to monitor and analyze the effects of deep integration initiatives.

What role for the WTO? Transparency!

As is painfully obvious from this paper, rather little is known (or at least publicly available) about what is actually being done by PTAs. To what extent are provisions implemented? Is deeper integration implemented in a discriminatory way in areas where

this is not necessary in principle? What are the effects of specific instances of deeper integration? What are the estimated costs and benefits? What is the incidence of these effects?

The WTO could be a much more effective focal point for information on these types of questions. The absence of comprehensive information on implementation of PTAs greatly impedes analysis of their effects, in turn attenuating the accountability of governments that have negotiated them. A concerted effort by the major protagonists involved in PTAs – starting with the EU and US – to agree to regular in-depth scrutiny of PTAs and to finance the required data collection effort would do much to remove the uncertainty that currently affects efforts to assess the extent and impacts of PTA-based deeper integration efforts.

[Relate this to/discuss new WTO mandate on surveillance of PTAs]

Reforms require domestic constituencies to implement and sustain them – comprehensive data on the implementation of policies will allow think tanks, NGOs, industries, and researchers assess and analyze the effects of PTAs. While ideally pursued through the WTO, the collection, compilation and analysis of the required information should involve research and public interest bodies in the PTA members. These bodies can do much to help shed light and build consensus for better policies.

Concluding Remarks

[To be added]

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