

The regulatory framework of Regional Trade Agreements

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Abstract

This paper explores RTAs capacity to regulate supra-nationally the new issues of growing importance for WTO and global trade in general (Standards and Technical regulations, Services, Investment, Public Procurement, Competition, etc)

The objective of the paper is to deepen our understanding of the various issues at stake by identifying the policy questions relevant in the assessment of RTAs regulatory role. By highlighting a number of issues that merit further discussion, it provides the basis for a debate of policy options on regional trade agreements.

The first section of the paper addresses the theoretical question of how to identify the optimal level of regulation and which areas of activity are more likely to benefit from cross-border rules. It also examines the impact of RTAs on regulatory barriers to trade, whether approaches to regulatory barriers differ across regions and what is the relationship between the regional and the multilateral dimension of rules setting (spheres of norms-influence; consequences for the global trading system).

The second section focuses on the experience of RTAs in the regulatory dimension, i.e. what are the regulatory areas mostly concerned by current RTAs' rule-setting activity, with a particular focus on the EU experience.

The third section examines - as case study - the EU-Mediterranean Association Agreements and their impact on regulatory convergence.

The fourth section addresses the new wave of Asian RTAs at the light of the issue of shallow FTAs versus deeper integration.

The conclusions provide suggestions as to a list of policy issues to be addressed, and in so doing they suggest an agenda for future research.

Introduction

In recent years a trend has emerged for regional trade arrangements to go beyond “border measures”, and include elements of “**deep integration**”, i.e. efforts to agree to common disciplines for regulatory regimes, involving different degrees of regulatory intervention covering ‘new subjects’ and other rules and disciplines (services, investment, IPRs, government procurement, competition etc).

This trend is visible in the EU arrangements with associated countries in Central Europe, Mexico and Turkey that increasingly cover services and other regulatory areas. Outside the EU such a trend also concerns Mercosur which has aspirations to become a single market and the NAFTA agreement, as well as the ‘export’ of the NAFTA model in particular by Mexico and Canada in their FTAs with third countries; and now through the Free Trade Area of the Americas negotiating process.

Such a trend is explained by the fact that the simple removal of tariffs while other obstacles remain in place may not be sufficient to fully achieve the potential gains from RTA participation. In particular the **dynamic gains from competition and scale effects** for RTA members might not be achieved unless other factors causing segmentation of markets were removed. All economic impact assessments of existing and potential RTAs tend to agree that these dynamic effects dwarf the purely static ones that result from shallow integration.

A key question is the **relationship between the regional and the multilateral** dimension of rules setting, which appears to be a two-way link. On one side, the existing WTO rules applicable to RTAs in the area of Goods already include **disciplines** on the overall impact of non-tariff measures (“regulations of commerce”) on non-parties and on the need for all RTAs to lead to the internal liberalisation of trade - including through the elimination of non-tariff restrictions - on substantially all trade between the parties. The WTO Committee on Regional Trade Agreements (CRTA) has, however, only made slow progress on this “systemic” aspect of its mandate.

On the other side, as RTA agreements/negotiations increasingly cover a number of areas still under discussions in the WTO or relevant for the new round, they may have implications for the WTO process. RTAs provide an opportunity for countries to **develop rules in areas that are not (yet) covered by WTO disciplines** (e.g. Competition) or to agree among themselves to **apply rules that are “WTO-plus”** (e.g. Services, FDI, Intellectual Property). Regional agreements may therefore prepare the ground for future rule-making within the WTO. At the same time, RTAs carry the risk that they could distract attention from the WTO, if they are perceived as providing an alternative rather than a complement to multilateral rule-making.

Part I: Multi-level governance: some theoretical criteria

In exploring the regulatory role of RTAs, we need first to address the question of **what and how should we regulate beyond the border**. In so doing, we can refer to the theory of public goods, which traditionally conceives national states, their administrative units and relevant groupings (e.g. the EU) as the basic jurisdictions representing the needs and preferences of their citizens, at least for a majority of their populations.

In such a framework, to the extent that provision of local regulations and norms reflect local preferences, they are legitimate and should be respected by foreign producers. In particular, where there are no **cross border effects** (impacting on other jurisdictions' utility) there is no case for attempting to impose domestic norms on other jurisdictions or legislating across borders.

In the area of international trade such analytical framework suggests that the case for harmonisation of norms will depend on whether there are **cross border externalities**, **cross border economies of scale** or whether regulatory norms constitute **obstacles to trade** so large that the benefits of harmonisation outweigh the benefits of purely "local" norms.

In the case cross-border effects are present, the rationale for harmonisation depends crucially on two further factors: the magnitude of **compliance costs and the credibility** of partners or of an international regime. The first factor requires that the benefits of harmonisation must exceed the costs of implementation. The second suggests that if partners are credible then a mutual recognition regime can reduce costs of compliance and is preferred for any given set of benefits. If these two conditions are not met, harmonisation, and a credible monitoring and sanction scheme are preferable options.

Figure 1 presents a simplified decision tree for international regulatory choices, about when to **harmonise**, use **mutual recognition** or least trade distorting **national treatment**¹. Where compliance-costs are higher than benefits of harmonisation, the analysis suggests that 'least trade-distorting', **national treatment**, is likely to be the most effective option for regulation of international commerce. It respects local preferences and imposes the smallest possible cost on foreign producers. This is particularly the case for product standards, while it remains questionable for process and production methods where there are no cross border externalities.

The diagram in figure2 suggests that many stringent conditions must be met for **mutual recognition** to be the recommended instrument/choice for international regulation. It requires regulatory objectives to be equivalent, a precisely predictable regulatory outcome must not be necessary, and trust must be high or policing credible, because of the ambiguity on whether rules accepted as equivalent are actually equivalent. As a consequence, mutual recognition may be better suited for partners in RTAs with effective policing or forms of relatively strong political integration (such as the EU).

Harmonisation also necessitates trust or credible policing, but the agreement of harmonised rules increases credibility and reduces ambiguity, therefore making policing implementation easier. When these conditions are not met, least trade distorting national treatment becomes the recommended outcome.

Overall **compliance costs** (of harmonisation or other cross-border rules) fulfil a decisive function in this analytical framework. When they are high they may preclude global or regional norms even if there is an *a priori* case for such norms. Where compliance costs are low, cross border norms may become feasible. For example if the obstacles to trade created by least trade distorting national treatment determine

¹ The analysis in this section draws largely from the results of a study on Global norms creation and norms competition, prepared for the Trade Directorate General of the European Commission in July 2001 by the University of Sussex.

efficiency and welfare losses that are higher than the compliance costs of adjustment and monitoring, there might still be a case for harmonised global standards.

The conclusion of this analysis is that it is possible to conceive some normative rules that can be applied to identify when and how to set global norms. Any criteria, though, will crucially depend on an **empirical assessment** of quantitative questions concerning:

- * the size of the regulatory obstacles to trade and investment, that -if substantial – can justify harmonisation or other cross-border rules;
- * the relevance of compliance costs as compared to the benefits of international cooperation over the economic or geographic zone of interest;

As the economic literature in this field demonstrates, these assessments are empirically difficult to make.

The above mentioned study done for the European Commission has looked at the problem of quantifying the impact of regulatory barriers in the areas of FDI, competition, environment, social standards, modelling a 40% cut in tariff equivalents of services regulation in a number of scenarios. Its preliminary conclusions indicate that **regulatory barriers are indeed substantial**, and in turn suggests that there are potentially significant benefits from liberalising in areas where regulation is important, above all for **services**.

Moreover, the preliminary quantitative estimates suggest that **multilateral liberalisation – when possible – is always superior to unilateral or regional opening**. This corresponds to the standard view that RTAs are second-best alternatives compared with multilateral opening. And that although there are welfare gains from RTA integration, these gains are dwarfed by the potential of multilateral liberalisation

Part Ib: the impact of regional agreements in the field of regulatory policy.

In exploring RTAs capacity to regulate supra-nationally the new issues of growing importance for WTO and global trade in general, this section examines past experiences and future options with RTAs, assessing the impact of their normative dimension in such areas; the new role of RTAs in creating spheres of norms-influence and its consequences for the global trading system.

Impact of Regional Agreements on regulatory barriers to trade

To assess the effectiveness of RTAs in removing regulatory barriers to trade and in so doing improve market access, it is necessary to begin by discussing the nature of regulatory barriers to trade. It is also important to discuss what might constitute a regional preference in treatment of regulatory barriers to trade; and define a framework for making qualitative assessments of the impact of regional agreements.

Source: D.Evans, P.Holmes, J.Rollo, A.Young, Y.Zahariadis, “Global norms creation and norms competition: a report for the Trade Directorate of the European Commission”, July 2001.



In a recent study for the European Commission² Gary Sampson and Stephen Woolcock develop a methodology based on a comparison of the scope of RTAs regulatory provisions with that of the WTO. If the RTAs examined go further than multilateral rules in terms of commitments or policy area covered, they can be labelled “**WTO-plus**”. That could be taken as an indicator of their effectiveness in opening markets and their contribution to wider liberalisation efforts. This common indicator is used as the standard against which to assess RTAs that have widely different objectives and therefore provisions. Such an assessment of RTAs’ effectiveness needs therefore to be made on a case by case basis.

Figure 2 illustrates this methodology, showing the area of potential impact of RTAs taken into account, their potential market opening effects, and the nature of potential regional preferences related to them. Potential RTA regulatory impact can result from **non-discrimination and national treatment, transparency, “due process” or open decision making, promotion of institutional infrastructure, approximation or compatibility, mutual recognition or equivalence, containing regulatory discretion, effective reviews and remedies, promotion of competitive markets.**

The RTAs examined include the EU and NAFTA, seen as the most important models for dealing with regulatory barriers, the US centred FTAA; the EU-centred EU-Poland Association Agreement, and EU-MEDA agreements; other agreements such as the Chile-Canada Agreement, CER Agreement, EU-Mexico Agreement. The new issues/policy areas covered include technical barriers to trade, public procurement, services and investment.

On the basis of such case studies, the final report finds that the **extent to which regional agreements result in “deeper integration” differs widely**. In particular the extent to which they are WTO-PLUS or not differs greatly, as do the areas where they do - or do not – contain obligations or procedures that go beyond those undertaken at the multilateral level. Therefore there is no straightforward answer to the question whether “new” regional agreements lead to regulatory “deeper integration”. The conclusion depends on a case-by-case examination. Nevertheless, it is possible to conclude that - broadly speaking - **regional agreements have contributed to the removal or reduction of barriers to market access in the new issues areas.**

This result is closely linked to the finding that the impact of regional agreements in the new/regulatory issues has been **generally consistent with the substantive multilateral principles governing regulatory barriers in the WTO**. As the report underlines, most agreements restate the parties’ WTO obligations contained in the various WTO agreements. In this sense, the **WTO rules constitute a floor** that underpins additional commitments in the regional agreements. (In the area of services, additional commitments have been undertaken, and with respect to the TBT and SPS Agreements, processes and institutional arrangements have been developed to improve the degree of transparency of regulations, promote the harmonisation and mutual recognition of standards and generally facilitate trade.)

As for the success or practical **effectiveness** of regional agreements in removing barriers to market access in the field of regulatory policy, any such an assessment needs to take into account not only the stated objectives of the agreements concerned,

² Gary Sampson and Stephen Woolcock, in “Looking at Regional Trade Agreements afresh”, study for the Trade Directorate General of the European Commission, July 2001.

but also how effectively the agreements are **implemented**, and the concrete impact of their procedural provisions in promoting greater regulatory co-operation, approximation or use of the regulatory best practices.

In this respect, the study suggests that **EU agreements with accession states - which are modelled on or apply the full acquis - can be expected to be most effective**. But other EU centred agreements, such as EU-Mexico and the EU Mediterranean agreements analysed later, have a number of areas in which they are unlikely to have much immediate impact. Both NAFTA and the CER include areas in which the regulatory approach they use may be more effective and that notwithstanding the fact that NAFTA tends to adopt a selective approach to removing barriers to market access.

Emerging of competing “regulatory blocks”?

The economic weight of the EU and the US tends to result in the regulatory norms of these two actors becoming the de facto, or – as in the case of the EU accession candidates – de jure requirement for their trading partners. It can be argued that this tendency could have negative implications in the sense that the smaller trading partners of the EU and US may be forced to adopt regulatory norms/practices or standards which are inappropriate for their level of development or which do not reflect their national policy preferences. Nevertheless, evidence from the case studies above considered suggest that **this influence is, on balance, more benign than malign**.

A different question concerns whether there is a general problem of “**regulatory regionalism**” in which the EU and United States develop differing and competing approaches. Here again the judgement varies depending upon the area/issue considered. The lack of agreement across the Atlantic on **food safety and eco-labelling** measures indicate that regulatory approximation within RTAs according to the standards of large countries can have important (negative) systemic implications at the multilateral level. At the same time, the empirical analysis highlights that on many regulatory issues there is a very **broad degree of commonality** between the approaches adopted by the EU and NAFTA. This is not too surprising since their regulatory approaches very often have the same origin, such as in discussions in the OECD, with the principles then being adopted in both multilateral and regional agreements. That largely explains why the EU-Mexico FTA agreement – that can be characterised as a real case of cross regional agreement - did not create insurmountable problems when it came to accommodating the NAFTA with the EU approach.

Consequences for the global trading system

Is the expanding RTAs’ regulatory capacity with regard to the (new) regulatory barriers to trade a “**building**” or a “**stumbling**” block on the road towards multilateral liberalisation?

It has been argued that RTAs provide a ‘**pathfinder role**’ for multilateral liberalisation, by **providing models or promoting the use of regulatory best practice** at the national level, which facilitates enhanced market access or more competition in previously non-competitive markets. It has also been argued that RTAs promote more open market access by helping to implement the principles of open non-discriminatory policies set out in the WTO.

On the other hand it can be argued that RTAs may facilitate the emergence of a form of regulatory regionalism in which countries trading with an RTA are obliged to adopt the regulatory standards of the dominant country in a region or the regional 'acquis'. Such **regulatory regionalism** could undermine the prospects for future multilateral agreements if it leads to the development of competing or incompatible regulatory standards.

On these issues the recent study conducted by Sampson and Woolcock for the European Commission concludes that **RTAs are generally building blocks that facilitate more open markets, promote domestic regulatory reform more effectively than multilateral rules and in some cases go beyond the WTO**, especially with regard to procedures which help implement WTO principles. It estimates that regional agreements have promoted regulatory best practice through their provisions to promote transparency, open decision making and institution building, and these efforts tend to be more effective at the regional level than at the multilateral one.

It concludes that "no convincing evidence was found in the case studies to indicate that we are witnessing a fragmentation of the multilateral rules based trading system as a result of the search for deeper integration in regional agreements. Overall, the obligations in the WTO Agreements are fully acknowledged in the regional agreements, and the procedural measures have the effect of facilitating the implementation of these obligations".

While it is clear that divergent approaches to dealing with new/regulatory policy issues have the potential to result in competing spheres of regulatory influence, the RTAs characterised by deeper integration have proven to be more conducive than impediments towards multilateral rules, when it comes to promoting open markets in sectors characterised by regulatory barriers to trade.

It can be concluded that removing regulatory barriers to trade is not really a question of regionalism versus multilateralism, but **a multi-level process involving sub-national (both public and private), national, regional, plurilateral and multilateral actors and rules**. Rather than asking whether regional agreements are building or stumbling blocks it is therefore necessary to ask what role regional agreements can play in this multi-level process, and how can one ensure that the measures taken at the respective levels are compatible.

This raises the question of how best to structure regional agreements so that they contribute most effectively to this multi-level process. The empirical analysis of RTAs regulatory provisions is the starting point for identifying a series of elements that may be useful in defining a model of '**best practice**' for regional agreements. The mentioned study underlines the role of **procedural** provisions in regional agreements more than the extension of substantive obligations, in extending the regulatory capacity of RTAs in the direction of a more pronounced WTO-plus result. However, the EU approach (Europe Agreements) has tended to include **substantive regulatory obligations**, with undeniable impact.

Figure 2: A general framework for assessing the impact of RTAs on regulatory barriers to trade to the case of TBTs

Area of potential impact of RTAs	Market opening	Nature of potential regional preference
(a) Non-discrimination MFN and National Treatment	framework agreements require non-discrimination in the application of regulatory policies. Coverage may be comprehensive or determined by schedules.	third countries excluded from NT and MFN
(b) Transparency (in substantive provisions)	foreign suppliers need to know what the rules are to comply with them	third parties denied access to information
(c) Due process or open decision making	promotion of best regulatory practice and helps reduce regulatory capture	third country interests excluded from consultation process
(d) Promotion of institutional infrastructure	improved regulatory capabilities or better co-operation between regulators	regional institutions reflect regional preferences
(e) Approximation or compatibility	reduce costs of conformance because regulatory standards are the same	preference for regional standards over international standards
(f) Mutual recognition or equivalence	regulatory barriers are avoided without costly harmonisation	exclusion of third parties from mutual recognition
(g) Containing regulatory discretion	criteria such as ‘least trade restrictive measures’ to limit potential abuse of discretionary power by regulators	retention of discretion in treatment of third country (non-regional) suppliers by regulators
(h) Effective reviews and remedies	rules have no impact unless effectively implemented and enforced	remedies not extended to third countries
(i) Promotion of competitive markets	controls on abuse of market power	criteria other than competition criteria applied to third country firms

Source: Gary Sampson and Stephen Woolcock in “Looking at Regional Trade Agreements afresh”, study for the Trade directorate of the European Commission, July 2001.

Part II: Importance of non-tariff and rules elements of EU RTAs

Regulatory issues are widely seen as the crucial element in “21st century” FTAs. The EU has recently expressed these same views to our MEDA partners, and these same issues are going to be key in important ongoing (Mercosur) and future (ACP-REPA) negotiations.

This section examines past **EU experiences** and future options with RTAs, assessing their normative dimension in those areas that are more frequently covered in current regional agreements.

1.1. Standards, technical regulation and RTAs

Standards and technical regulations help to establish a common trading language, facilitating exchange and guaranteeing quality and they enhance the dissemination of knowledge, technology and business practice.

At the multilateral level, the use of international standards is promoted by the **WTO Agreement on Technical Barriers to Trade**. However, progress may be difficult to achieve in the international context and bilateral or regional initiatives such as RTAs may create a promising driving force. For the area of standards, technical regulations and conformity assessment RTAs may be considered as one possible option to do away with diverging technical rules, standards and costly compliance requirements.

Convergence on common technical rules and standards, and mutual recognition agreements, do not of themselves require an RTA to be beneficial (e.g. the EU-US MRAs). **Regulatory co-operation and mutual recognition** can be of value **even outside the context of the reduction of tariff barriers**. On the other hand, they can form a crucial complement to tariff elimination measures. So it makes good sense to ensure that provisions on standards and conformity assessment form part of any RTA that is negotiated.

Within its own area, and more broadly with the EEA and in negotiation with the Candidate countries, the EU has adopted a system of **mutual recognition** of technical rules in sectors where it has not harmonized them. In other sectors, it has **harmonized** its technical regulations and standards, and made **common conformity assessment rules** with acceptance of products across the whole of the EU (and EEA) single market. While this has not eliminated all the technical obstacles between the EU's Member states, it has set up a regulatory framework that may be said to work in many sectors. Euro-Mediterranean Association Agreements generally promote the use of Community rules (in standardisation, and conformity assessment in particular) and open the possibility of negotiating mutual recognition agreements (MRAs).

Attempts to eliminate some of the barriers arising from mandatory product conformity assessment requirements have been made in **mutual recognition agreements (MRAs)** between the EU and the US, Canada, Switzerland, Japan, Australia, New Zealand and Israel. Such agreements are limited to conformity certification to the other party's rules. The only exception is the recently initialled MRA with the US on equivalence of regulation for the marine equipment sector. The harmonisation of technical rules, or at least, the promotion of good practice in rule-making, has been limited, though efforts are being made to advance the concept in a number of fora, such as ASEM, IMO, and the UN-ECE.

In addition, parallel measures can be agreed. For example, measures can be taken to encourage **exchange of information, consultation** on technical barriers to trade, approximation and simplification of labelling requirements, co-operation on the development of standards, and agreement to base technical requirements of all kinds on international standards, as has been agreed in the FTA between the EU and Mexico. While measures of this kind fall short of actual harmonization, nonetheless they serve to build up confidence and develop an environment that is, over the medium to long term, conducive to the convergence of technical rules.

1.2. Intellectual Property Rights

An adequate level of protection of intellectual property rights plays an increasing role in providing the necessary climate for trade and investment. This was recognised, on the multilateral level, by the adoption of the **WTO TRIPs Agreement** setting minimum standards for the protection of intellectual property rights (covering concrete obligations as well as enforcement).

The EU has, systematically, tried to incorporate provisions on intellectual property rights in its bilateral agreements. These provisions aim at increasing the level of protection of intellectual property rights beyond the minimum standards provided under the WTO TRIPs Agreement.

The concrete provisions agreed between the Community and third countries vary from country to country, but follow a similar pattern: **adoption of the *acquis communautaire*** is required by countries in Central and Eastern Europe; establishment of a '**similar level of protection** compared to that existing in the Community' is required from CIS countries under the respective partnership and co-operation agreements; other third countries, with which recent agreements were concluded, are obliged to provide for a level of protection in line with the '**highest international standards**'. In addition, third countries are required to accede to the major international conventions on intellectual property rights to which they are not yet party.

1.3. Services

In the area of trade in services internal regulations constitute a much more important obstacle than border measures. The provision of services is often highly regulated in the countries and submitted to specific requirements, which usually aim simply at addressing problems of asymmetric information between consumers and providers, thus guaranteeing the quality and security of the service offered, or at ensuring that specific domestic objectives are achieved. However, these regulations may have the result of impeding foreign service suppliers to offer their services in another country. Multilateral liberalisation may involve reaching agreement on politically sensitive issues, such as the modes of supply covered i.e. service providers mobility, or on the introduction of procedures needed to make sure that quality standards are met (e.g. the regulatory framework and qualification pre-requisites). Achieving such agreement may prove relatively easier within a restricted group of RTAs members than in a larger setting.

The **GATS does not reduce Member States ability to regulate services activities** in line with their specific policy objectives, but it calls for the development of a framework to avoid that regulatory measures are used to establish unnecessary obstacles to trade. GATS also encourages its Members to enter into agreements aiming at facilitating the recognition of pre-requisites for the provision of services (article VII). Within the framework of **article V of GATS, regional economic integration agreements** providing for the liberalisation of trade in services favour the establishment of common rules and regulatory framework between its members for the supply of services. Most RTAs have not gone beyond what was achieved in the GATS. The main exceptions are the EU and NAFTA.

At EU level and within the European Economic Area, the establishment of common regulatory frameworks and minimum requirements and the application of the principle of mutual recognition of qualifications have permitted to largely eliminate barriers for provision of services. The agreements signed by the EU with the Candidate Countries cover all sectors and modes of supply and establish a framework for substantive liberalisation. Instead, the FTAs between the EU and Mediterranean countries reaffirm each party obligations under GATS (no GATS-plus measures) and provide for future further widening of the scope of the agreement to cover rights of establishment.

The recent agreement signed with Mexico liberalises progressively trade in services between the parties over and above commitments made under the GATS, and will secure services operators from the EC with an access to the Mexican market which will be equivalent if not superior to that currently enjoyed by operators from Mexico's other preferential partners, in particular the USA and Canada

NAFTA has made substantial progress using a negative list system, so all services sectors are covered unless specifically exempted. In Mercosur, free circulation of services is a long-term objective to be achieved by 2007. Asean members have agreed to full liberalisation in most services by 2020.

1.4. Investment

FDI is an important route through which the economic effects of trade liberalisation and regional integration operate and its potential to contribute significantly to economic growth in both home and host countries is being increasingly recognised. The EU supports the establishment of a **multilateral framework of rules governing international investment**, with the objective of securing a stable and predictable climate for investment world-wide, while preserving the ability of host countries to regulate, in a transparent and non-discriminatory manner, the exercise of economic activity on their territory.

To date little progress has been made in liberalising investment restrictions on a multilateral basis. Agreement could not be reached on a **Multilateral Agreement on Investment (MAI) in the OECD**.

Within most existing RTAs progress has been relatively limited. In Mercosur, for example, Argentina and Brazil still restrict FDI flows. Other RTAs such as NAFTA, GCC and SACU include provisions to liberalise investment.

As far as the EU is concerned, for **pre-entry** (or market access) rights, the EU has a very open regime for access of investors to the European Single Market, with some

horizontal or sectoral exceptions allowing MS to safeguard vital interests, such as national security or public order. The EC Treaty as well as the EEA Agreement grant the right of free establishment inside the EC/EEA for nationals of member States and juridical persons incorporated in a member State (even owned and controlled by third country nationals) when they are doing substantial business in the host State. Agreements which the Community and its member States have with individual third countries (such as the Europe Agreements or the Partnership and Co-operation Agreements) provide for the freedom of Foreign Direct Investment in areas which are open, under the agreements, to establishment. These agreements do not include a “right to invest” in the sense of a pre-entry “national treatment”.

Concerning **post-entry** (or post-establishment) rights and obligations, the EC Treaty and the EEA Agreement provide strong rights for investors to the EC or the EEA and strong obligations on host governments once the investment has been admitted. That includes post-establishment non-discrimination and free transfer rights also vis-à-vis third countries. Europe Agreements, and Partnership and Co-operation Agreements provide for National Treatment and/or MFN for the post-establishment phase as well as the freedom of transfer of investments made and any proceeds thereof.

The case for liberalising international investment within a RTA is strong, as FDI is crucial to fully obtain dynamic gains in RTAs. Agreeing to apply national treatment and rights of establishment for investors helps ensure that the production choices are not distorted and is important for governments seeking to use a RTA as “lock-in” or credibility device.

1.5. Competition policy

Provisions on competition policy may be useful in order to “level the playing field” within a RTA. **Provisions related to competition policy are included in almost every EU Regional Trade Agreement**, with some minor exceptions. However, the level of obligations and the intensity of co-operation envisaged in the different agreements varies widely.

The competition related provisions can be subdivided in **five basic categories**: substantive competition rules proscribing certain practices as incompatible with the proper functioning of the agreement (e.g. prohibitions of concerted practices, abuse of dominant positions, sometimes norms on state aid); provisions for approximation of the third countries’ legislation with EU competition legislation (e.g. on state monopolies; anti-trust legislation); provisions for co-operation in competition law enforcement matters; an obligation to conclude “implementing rules”, and obligations to provide technical assistance on competition policy.

The judgement on the appropriateness of introducing such provisions in a RTA between the EU and a trade partner depends on the specific conditions of the partner considered. For example, where a partner country with whom the EC is about to conclude an RTA does not have in force an appropriate antitrust law and a functioning antitrust authority, an obligation to adopt a national competition law and to enforce it, effectively and in a non-discriminatory manner, could be included in the agreement.

As for obligations to harmonise or approximate domestic legislation with EC rules, the rationale for such a policy is weak outside the pre-accession context. Though there could be a case for countries that are economically very closely linked to the Community.

The consequences of including state aid provisions in bilateral RTAs also raise some concerns, since they may render it difficult to resort to WTO countervailing action.

1.6. Government Procurement

In most countries, purchases by the government (or “Government Procurement”) – not including defence spending - accounts for 10-15% of GDP. As such, if governments permit or require public entities to discriminate in favour of domestic firms when procuring goods and services, trade flows can be significantly affected. To provide a reference benchmark, it can be useful to recall that a recent evaluation of the pattern of purchasing by EU members states’ government entities found that public sector import penetration increased from an estimated 6% in 1987 to some 10% in 1994. Thus 90% of all purchases in the EU continue to be sourced from national firms. It is difficult to provide a quantitative assessment of the impact that procurement agreements have. However, there is evidence to show that significant cost savings for the purchasing entity can result from the introduction of more transparent and open procurement practices. Furthermore, a transparent procurement environment reduces the scope for corruption and, in the longer term, encourages domestic industries to become more competitive.

This wider reality has been recognised by a number of WTO members, leading to the adoption of the **WTO’s Agreement on Government Procurement (GPA)**, to which the EC is a member. For a number of reasons, however, GPA membership – essentially voluntary - is limited almost exclusively to developed countries. Furthermore, many countries use procurement as a means of pursuing other policy objectives, such as social cohesion and maintaining an industrial base. Therefore, progress in this area has been difficult.

Consequently, the **EU has tried to incorporate provisions on government procurement into bilateral agreements**. These provisions aim, on the one hand, to increase certainty and transparency in procurement policies and practices and, on the other, to improve actual market access opportunities for EC companies.

How this is achieved varies between countries. Enlargement candidates are required to adopt the *acquis communautaire* and, in the context of the Partnership and Co-operation Agreements, the CIS have been encouraged to harmonise their systems with that of the Community. With GPA members, the EC seeks to expand on existing market access coverage. With other countries, the EC seeks to agree a set of binding principles which (a) ensure that procurement policies and practices are conducted in a transparent manner, (b) lead to a progressive and mutual opening of procurement markets within an agreed timeframe, and (c) provide for timely and effective challenge procedures. In order to assist countries in implementing these provisions, technical assistance is often provided.

1.7. Rules of origin

Rules of origin in a FTA determine the type of products eligible for preferential tariff treatment. Many countries are members of more than one RTA. These give rise to two kind of problems. First, membership in multiple RTAs can lead to complexity, for example conflicting rules of origin requirements, which can hinder private sector decision making. The application of diverging rules of origin depending on the

partner country generates a supplementary administrative burden and different cost prices for operators who trade under several FTAs. Additionally, the multiplication of different sets of origin rules make customs controls difficult. Secondly, a complex pattern of RTAs can take the form of an “**hub and spoke**” structure. For example, it is possible to argue that the EU network of RTAs places the EU at the hub of agreements with a number of other countries, most of which are not linked to each other through RTAs. That may disincentive economic integration between the partner countries and impact on their economic development by diverting investment towards the hub country, from which firms can reach more markets tariff-free than they can from any other location.

To tackle such problems the EU has defined an harmonised set of origin rules, the so called “standard protocol”, which is gradually being extended to all EC preferential agreements and autonomous regimes, and is a valuable advantage for operators and customs authorities both in the EC and in partner countries. A further advantage is the possibility of regional cumulation between several partner countries which apply identical rules of origin, such as pan-European cumulation, ACP-South Africa cumulation, future Mediterranean cumulation system, etc. **Regional cumulation favours economic co-operation and integration** between the EC and partner countries on the one hand and between partner countries themselves on the other hand.

1.8. Contingent Trade Protection

Most RTAs, including the majority involving the EC, permit the continued use of contingent trade protection mechanisms (eg anti-dumping duties, countervailing duties, safeguard measures) in internal trade between the parties, where appropriate conditions and criteria are met. This is not uncontested in WTO: some WTO Members would argue that for internal liberalisation within an RTA to be effective and genuine, such trade-restrictive measures should not be maintained. However, WTO Members have never been able to reach a common position on this.

Indeed, as individual regional integration agreements evolve, the parties to them may establish common internal regimes, inter alia for **competition policy and state aids**, which finally obviate the need for **anti-dumping and countervailing regimes**. This is a course of evolution which the EC itself has followed and which is not limited solely to the experience of Customs Unions. The Parties to the EEA and ANZCERTA, which are both free trade areas, have also taken steps in this direction.

Concerning the use of **Safeguards**, it would be logical to set tight conditions and criteria for bilateral safeguard action within an RTA, similar to those established for WTO action. The EC has made little use of the bilateral safeguard clauses contained in its own preferential agreements.

Part III

A case study: the EU Mediterranean Association Agreements regulatory convergence

This section overviews the regulatory measures the EU and its Mediterranean partners participating in the Barcelona process have agreed upon in the Association Agreements, in order to help remove barriers to trade and investment.

It provides for a comparative analysis of the content and scope of the current EU-Mediterranean Association agreements, focusing on measures for non-tariff barriers removal, and particularly on the regulatory dimension. Specific attention where appropriate is paid to WTO-plus measures, that is those regulatory measures that go beyond agreed WTO disciplines.

A comparison with the disciplines of the **EU-Mexico FTA** and the **NAFTA agreement** is used as benchmarks to provide further useful insights for future development of the Association Agreements with Mediterranean partners.

The areas of regulatory intervention examined include Services, Investment, Standards, IPR, Government Procurement, Environment, Trade defence instruments, Rules of origin, SPS measures, Competition.

European Union bilateral relations with Mediterranean Partners are currently either governed by first generation agreements, 1970s' Co-operation agreements, or 1990s' Euro-Mediterranean Association agreements. Cyprus, Malta and Turkey are governed by '70ies Association Agreements, providing for the establishment of a customs union on industrial products in two stages. From the three, Turkey is going through the final phase of the customs union with the EC and its Member States.

At present, the EU has concluded six "new generation" agreements with Israel, Morocco, the Palestinian Authority (Interim Agreement), Tunisia, Jordan (signed in 1997 and currently being ratified) and recently Egypt (initialled), and is negotiating three of them (Algeria, Lebanon, Syria). Cyprus, Malta and Turkey benefit from a pre-accession strategy to prepare them for their eventual EU membership.

From the twelve Mediterranean Partners, Cyprus, Egypt, Israel, Jordan, Malta, Morocco, Tunisia and Turkey are Members of the WTO while Algeria and Lebanon have observer status.

The provisions of the Euro-Mediterranean Association agreements governing bilateral relations vary from one Mediterranean Partner to the other but have certain aspects in common, notably a) establishment of WTO-compatible free trade area over a transitional period of up to 12 years; b) provisions relating to intellectual property, services, public procurement, competition rules, state aids and monopolies

The comparative analysis of the content and scope of the regulatory dimension of the current EU-Mediterranean Association Agreements, highlights the following trends.

Services

- The Euro-Mediterranean Association Agreements mostly reaffirm each party obligations under GATS (no GATS-plus measures) and provide for future further widening of the scope of the agreement to cover rights of establishment and supply of services through the establishment of an “economic integration” type of agreement (ex Art. V GATS).
- The EU-Mexico FTA Agreement is more ambitious, covering all four modes of supply and most sectors. It includes a standstill provision and WTO-plus status in all sectors covered. A “rendez-vous” clause allows for further progress in three years time.
- The approach employed by NAFTA towards the liberalisation of services can be described as a GATS-plus initiative. Despite the existence of framework agreements and the use of negative listing NAFTA is still selective in its liberalisation of services.

Investment

- The Euro-Mediterranean Association Agreements open the possibility of some investment liberalisation, but stop short of any substantial commitments. There is therefore ample scope for improvement.
- The EU-Mexico FTA Agreement does not add much to the OECD Codes of liberalisation and to the bilateral agreements on investment protection signed by EU Member States with Mexico.
- NAFTA is very ambitious. Its provisions on investment are very detailed and comprehensive, and represent one of the highest standards of liberalisation in the field of foreign direct investment agreements.

Standards

- Euro-Mediterranean Association Agreements are focused (less in the cases of Egypt and Israel) on the use of Community rules (in standardisation, and conformity assessment in particular) and open the possibility of negotiating MRAs (though to date only Israel has concluded one with the EC).
- The EU-Mexico FTA Agreement confirms right and obligations under the WTO TBT agreement; it calls for enhanced bilateral co-operation and it does not foresees MRAs.
- NAFTA, provides for very detailed provisions, but for very little substance beyond the WTO TBT agreement. In a number of respects it falls short of the WTO TBT agreement itself.

Intellectual and Industrial Property Rights (IPR)

- Euro-Mediterranean Association Agreements provisions on IPR focus on establishing minimum standards for “adequate/suitable and effective protection”, “in line with prevailing/highest international standards”, coupled with reference to a list of international conventions on IPR. Therefore the scope of the obligations depends *inter alia* on whether or not the Euromed partner is already a WTO

member (also bearing in mind that some WTO members have or continue to benefit from specific transitional periods for implementation).

- The EU-Mexico FTA Agreement is a *sui generis* agreement with a country which is member of the WTO and NAFTA. The EU-Mexico agreement does not explicitly contain WTO+ commitments in the domain of IPRs. Nevertheless it creates a binding framework, including the Special Committee for intellectual property matters. In addition, the EU-Mexico text incorporates a list of WIPO conventions which are not covered by NAFTA and are even excluded by its national treatment provision.
- NAFTA IPR provisions cover obligations which are more or less similar to the ones covered by the TRIPs agreement.

Government procurement

- Euro-Mediterranean Association Agreements look for establishing a minimum standard approach for the EUROMED region as a whole. The results are generally less ambitious than the scope of the WTO Government Procurement Agreement (GPA) (in terms of coverage) and in this sense could be defined as “WTO minus”.
- The EU-Mexico FTA Agreement, while following the structure of the GPA, can be characterised as a WTO-minus type of agreement (the sub-central level of government is not covered).
- NAFTA public procurement provisions, as well, can be considered as WTO-minus, (i.e., no coverage of the sub-central government level).

Environment

- Euro-Mediterranean Association Agreements show an evolution over time from rather vague (in policy terms) references to environmental concerns and focus on co-operation in certain specific policy areas, to the objective of sustainable development.
- The EU-Mexico FTA Agreement focuses on co-operation, exchange of information, and experiences. The provision allowing for the conclusion of a sectoral agreement in the field of the environment and natural resources has not been acted upon as yet.
- NAFTA includes extensive environmental provisions, together with dispute settlement mechanisms.

Trade defence instruments

- Regarding anti-dumping in the Euro-Mediterranean Association Agreements, the parties may take measures in accordance with the GATT/WTO, related internal legislation and subject to certain conditions laid down in the Agreements themselves. These latter conditions include the referral of each investigation at initiation stage to the Association Council. Regarding the Agreement recently signed with Egypt the provisions are slightly different and refer only to the taking of measures in accordance with WTO/GATT and related internal legislation.

The AD provisions of the EU - Mexico FTA Agreement are identical to those of the EU - Egypt Association Agreement i.e. measures must be GATT/WTO and related internal legislation compatible (i.e. reaffirmation of WTO commitments).

While NAFTA also allows for the taking of measures between the parties, it has established its own special dispute settlement procedures in the area of anti-dumping.

- On safeguards the texts are also identical in substance across the various Agreements except again for the Agreement with Egypt which, unlike the other refers to the applicability of Article XIX GATT 1994 and the WTO Agreement on Safeguards. However all the Agreements, including Egypt, set out conditions for the referral of the issue to the Association Council with a view to finding a solution. Where a solution is not found in this context the parties can take measures.

Safeguards provisions in EU-Mexico FTA Agreement and NAFTA are more sophisticated.

- On the issue of subsidies, while there are some differences in drafting between the EUROMED Association Agreements, the substance is essentially the same.

Rules of Origin

- The rules of origin in the various EUROMED Association Agreements are different, not only in terms of type of cumulation envisaged, but also in the system of allocating origin and even in the processing rules.
- They are also different and therefore incompatible with the Pan-European system of origin, applicable between the European Union, Switzerland, the EEA, the Central and Eastern European Countries and Turkey.

SPS provisions

- SPS provisions in the Euro-Mediterranean Association Agreements include brief, non-detailed specifications on co-operation in the SPS sector. These agreements do not specifically provide for the possibility of solving explicit trade problems created by SPS measures.
- The SPS provisions established in the EU/Mexico FTA Agreement foresee the possibility of solving trade problems created by SPS measures, on a case by case basis, and by means of a Special Committee. They therefore have a lower level than those integrated in the NAFTA.
- NAFTA has the highest standard on integration of SPS matters.

Competition

- Euro-Mediterranean Association Agreements introduce basic principles on competition, similar to those in the EU legislation, thus incorporating the basic philosophy of eradicating collusive behaviour, the abuse of a dominant market position and competition-distorting state aid. The same is true as for control of the practices of public monopolies and public enterprises.

The implementation of the provisions on collusive behaviour, the abuse of a dominant market position and competition-distorting state aid is in the hands of the Association Council, which will adopt the necessary rules within five years (3 for Israel) of the entry into force of the agreements. So far, no rules have been adopted.

- The EU-Mexico FTA Agreement introduces a Mechanism of Co-operation between the authorities of the Parties with responsibility for the implementation of competition rules, whose aim is to tackle antitrust behaviours that may reduce or eliminate the benefits of the agreement. Such mechanism of cooperation provide the instrument for collaboration in the implementation of the respective competition laws.
- NAFTA requires the adoption by each party of measures “to proscribe anticompetitive business conduct” with each Party also committing to co-operate on a range of issues of competition law enforcement policy. NAFTA also establishes a Working Group on Trade and Competition “to report, and to make recommendations on further work as appropriate”

Summing up, a key element in the EU-Mediterranean Association Agreements is the issue of regulatory approximation, that increasingly emerges as a necessary prerequisite for attaining the objectives set out in the Barcelona Declaration.

As recognised in the 1998 Commission Communication on the Euro-Mediterranean Partnership and the Single Market, **tariff dismantling is only a necessary step in the process of trade liberalisation in the Euro-Mediterranean area.** For goods and services to move freely among the parties addressing trade-impeding regulatory barriers effectively is also essential. Therefore greater convergence/approximation of rules and regulations is needed. In particular, progress towards the (stated) objective of liberalising trade in services and investment, should be accompanied by a common regulatory framework in areas such as competition policy, public procurement, rules of origin, intellectual and industrial property and norms and standards. That will increase the scope for benefiting from a EU-Mediterranean Free Trade Area, *inter alia* contributing to the creation of an area capable of attracting investment.

To this purpose, the current Association Agreements already commit EU Mediterranean partners to a wide regulatory convergence programme with the EU. The question is how coherently and how effectively.

The across the board comparative examination here undertaken of the content and scope of such regulatory commitments highlights some clear trends and leads to the following observations:

1) Among the various Euro-Mediterranean Association Agreements across the board **consistency and coherence** of the provisions covering regulatory issues is lacking, with potential consequences for the long term objective of establishing an Euro-Mediterranean free trade area. That might be explained by political, economic and historical factors (e.g. WTO membership), but also by the fact that these agreements have been negotiated bilaterally and in separate instances, often at years of distance. Examples of large variations include measures on Rules of origin, Services, Public Procurement, Environment, and to a lesser extent SPS, IPR and Trade defence instruments.

2) The **ambition and effectiveness** of the regulatory convergence provisions in bringing about the desired elimination of non-tariff barriers and effective market integration appear often quite modest. In general terms the coverage is limited, with in many cases a hortatory and quite gradual approach (i.e. stating the final objective, but without specific language devoted to the realisation and implementation of such an objective) and the regulatory measures envisaged can be described as just confirming the applicability of existing WTO rules.

3) While comparisons with the EU-Mexico FTA Agreement and with NAFTA is not always appropriate, in many areas regulatory approximation measures in the Euro-Mediterranean Association Agreements **fall short of what achieved in the EU-Mexico FTA Agreement and in NAFTA.**

As far as the Euro-Mediterranean Agreements are concerned, there appears to be, therefore, ample scope for further liberalisation and rule making. This is certainly the case in the area of Services and Investment, Public Procurement, Environment, Rules of Origin, SPS. Within the framework of the current Mediterranean Association Agreements themselves some improvements - for example in the area of Services and Investment (but also Public Procurement) - can be achieved, as a first step, through recommendation of the Association Council. That of course is dependent on maturation of the necessary political will.

Part IV

The new wave of East Asian RTAs: shallow FTAs or deeper integration?

The pursuit of regionalism in East Asia has not been a priority in the past. The sole regional initiative in East Asia up to recently has been ASEAN (Association of South East Asian Nations), which has evolved since its inception in 1967 for the purpose of co-operating on regional security. Tariff reduction under the Common Effective Preferential Tariff (CEPT) scheme began in 1994, leading to the entry into force on 1 January 2003 of the ASEAN FTA (AFTA) for the six original signatories (Brunei, Malaysia, Indonesia, Philippines, Singapore Thailand).

That has recently changed with the announcement of China's agreement with ASEAN in November 2001 to create a common Free Trade Zone within 10 years. Japan has also proposed a Japan-ASEAN Comprehensive Economic Partnership, a broad based bilateral engagement with a political component but without a free trade commitment at this stage. In parallel there are signals that North East Asia is starting to develop its own regional identity, with bilateral or tripartite FTAs being now on political or academic agendas.

Korea began exploratory talks on an FTA with Chile in 1988, and discussions on potential Korean FTAs with Australia, Mexico and Singapore have been reported. Singapore is actively pursuing an FTA policy, having an FTA with New Zealand in effect since 1 January 2001, reaching an Economic Partnership Agreement with Japan signed on 13 January 2002, and currently in negotiations with EFTA, Canada, Mexico, the US and Australia. Thailand has also recently announced its interest in pursuing an FTA with Japan, as well as with China and South Korea.

As discussed above, the European experience of regional agreements points to the conclusion that most successful regional agreements are those where the process of

regional integration has been deep and comprehensive, involving the regulatory integration of domestic markets as well as the simple elimination of tariffs and restrictions applied at the border. This increases the positive impact on competitiveness and welfare over the medium to long term. So, there is a need to tackle non-tariff and regulatory barriers as well as the elimination of tariffs, and consider extending the scope of regional agreements to Services and Investment.

In the East Asia FTAs the first issue is then one of empirical assessment of the size of regulatory obstacles to trade and investment: is it substantial and can it justify harmonisation or other cross-border rules? What is the relevance of compliance costs as compared to the benefits of international cooperation?

Secondly, the EU experience shows that WTO-consistent regional initiatives have their place alongside multilateral liberalisation. The underpinning goals are in many cases the same: progressive trade and investment liberalisation, improved market access and clear international rules. Both can be pursued at the same time and in a fashion that is mutually supportive. The WTO provides the ground rules (the “bedrock”) for international trade in goods, services and the protection of trade-related intellectual property rights, together with a permanent framework for the negotiation of additional liberalisation commitments and stronger or more up-to-date rules among an ever-growing group of countries. RTAs can go further – in terms of greater reciprocal market opening or more ambitious rule making, and more effective promotion of domestic regulatory reform – than is possible in the 142-strong WTO. Regional initiatives have been shown to provide a “pathfinder role” for multilateral liberalisation, by providing models or promoting the use of regulatory best practices at the national level. The question is then how best structure potential regional agreements in East Asia so that they contribute more effectively - and in a WTO consistent way - to this multi-level process of regulatory trade barriers removal.

The growing number of potential preferential agreements among East Asian countries that have been negotiated, proposed, or simply discussed upon over the past couple of years, is finally becoming the object of attention of a growing number of economic studies aiming at quantifying *ex ante* their impact for prospective members and non-members.

The results of these CGE simulations need of course to be taken with some caution. First, it is likely that, at least in some cases, existing levels of protection are underestimated (e.g. for NTBs). Second, there is inherent uncertainty about the parameters, data, and model specifications from which the results are drawn. Models that take into account dynamic mechanisms, to account for the increased capital accumulation and induced productivity increases that result from trade liberalisation, or that account for increased capital mobility, tend to predict larger gains than the more traditional comparative static models. Similarly, models that account for imperfect competition in some sectors have a tendency to produce larger estimates of welfare gains than do models based on the hypothesis of perfectly competitive markets.

That said, it is interesting to consider to what extent the rapidly growing literature on Asian FTA proposals analyses scenarios that go beyond reduction of barriers at the border and into non-tariff barriers (e.g. including national standards, services and foreign investment regulations) and – in this cases - to what extent its findings suggest

that deeper integration scenarios in East Asia would be coupled with more significant economic effects of trade liberalisation than shallow integration.

Hertel, Walmsley and Itakura (2001)³, for example, quantify the dynamic effects of the Japan-Singapore FTA using a recursive CGE model that takes into account the potential impacts on international investment flows. Their results indicate that the effect of such a FTA on investment, capital accumulation and economic growth is significantly higher than in the tariff-only liberalisation scenario, when including services trade liberalisation, harmonisation of standards governing e-commerce and trade facilitation measures through customs automatisation.

Unfortunately, to date most other quantitative studies on Asian FTAs proposals focus more on comparing alternative regional FTAs memberships, rather than assessing the benefits of deeper integration as compared to tariff-only preferential trade liberalisation. Many, nevertheless, try to incorporate a dynamic setting, projecting the effects of economic policy changes to a specified future date, and taking account of changes during the period covered by the simulation in investment, and productivity. These are important modeling steps that can be useful also in properly capturing the impact of the removal of NTBs and in particular of regulatory barriers.

As an example, two recent studies, by Yamazawa (2001) and Scollay and Gilbert (2001), have estimated the potential effect of FTAs in Northeast Asia on welfare, trade, and productivity. Both studies use a computable general equilibrium (CGE) model to analyse the proposed agreement. The focus of the Yamazawa analysis is a Korea-Japan FTA. Scollay and Gilbert provide estimates for a wider number of FTA combinations in the Asia-Pacific region, including a Korea-Japan FTA.

Scollay and Gilbert estimates the effect of tariff-only preferential trade liberalisation using a "static" CGE model: the model accounts for the short run effects of the trade liberalisation and all the initial ripple effects throughout the economies but does not account for any effects of long run increases in productivity due to the trade liberalisation. Overall, these static estimates do not indicate that there is a great deal of benefit to a bilateral FTAs between Japan and Korea limited to tariff elimination, while there are adverse effects on third parties. In contrast, Yamazawa's CGE model, which attempts to go beyond a static model by estimating the effects on trade of long run increases in productivity, predicts that total exports for Korea and Japan would increase by more than 30 percent.

Cheong (2002) applies a CGE model with perfect competition to the Korea-Japan FTA scenario, distinguishing between static and dynamic effects caused by the elimination of trade barriers, the expansion of intra-regional investment and the promotion of competition. When only static effects are considered, the results suggest a Korea-Japan FTA would induce a decline in Korean GDP and welfare. When dynamic effects are factored in, the real GDP and welfare increase substantially.

Nakajima (2002) also applies a CGE model comparing static and dynamic scenarios, focusing in particular on endogenous capital accumulation resulting from intra-regional investment and the promotion of competition. While it finds dynamic effects

³ Most papers cited in this section were presented at the Annual GTAP Conference on Global Economic Analysis in Taipei, in June 2002.

of an FTA to dwarf the potential static economic effects, the FTA scenario considered covers only the elimination of tariff barriers and quantitative restrictions.

Ma and Wang (2002) evaluate the impact of alternative FTA proposals in Asia centred on ASEAN. They consider tariff, non-tariff border measures and services liberalisation, using a dynamic CGE model, with import embodied technology transfer and trade policy induced Total Factor Productivity increases.

Tsutsumi and Kiyota (2002), from the Cabinet Office of the Government of Japan Yokohama National University respectively, evaluate nine RTA scenarios involving Japan, using a CGE model with exogenous (skilled) labour migration and exogenously determined, FDI-led, technological (i.e. productivity) convergence. In this way they aim to account for the impact of factor movements and subsequent effects on competition in the services sector. Each scenario assumes full trade liberalisation, except for agricultural products. The dynamic mechanisms considered in the model bring to large cumulated variations in GDP, much larger than in other CGE models here analysed.

Roland-Host and van der Mensbrugghe (2002) use a dynamic CGE model, with perfect competition and constant returns to scale, to assess a variety of East Asia potential trade regimes, though their FTA scenarios focus on tariff and subsidies elimination only.

Summing up, to date only few quantitative studies of FTA proposals in East Asia address the issue of deeper integration and of its potential economic effects. Nevertheless, the growing development of CGE dynamic models, providing a more sophisticated assessment of investment and productivity effects of trade liberalisation may prelude to the development of further quantitative analysis in this direction.

Invariably, each FTA scenario in East Asia would involve some trade diversion against the excluded countries in the region, or outside the region. So Asian countries should consider the aggregate economic effects in addition to the bilateral ones and should consider whether an FTA with one regional trade partner will alienate other trade partners. East Asia countries need to weigh the benefits derived from closer ties with the costs that could be incurred if the regional arrangements discriminate against other important trading partners and should be especially careful to design future initiatives so that they do not have negative impact on non-parties and complement and support new multilateral trade reforms in the WTO.

Concluding remarks

This paper has explored the issue of RTAs experiences and future options when focusing on their capacity to regulate supra-nationally in the so called “new areas” of growing importance for international trade.

Empirical quantification of the economic impact of RTAs suggests that there are gains from integration but these gains are relatively small, and smaller than those that could be acquired through multilateral liberalisation. Moreover, there is **little evidence that shallow RTAs, such as FTAs in goods only, have a substantial trade impact**. However, deep RTAs like the EU itself or the ones within the EEA or with the

Candidate countries do seem to lead to substantial trade impact. In other cases, results are rather disappointing (Mediterranean) or it is too early to say (Mexico, South Africa).

Indeed, trade in **services and investment** is growing relatively more rapidly and points to a deepening of integration in RTAs between the EU and its trade partners and to the increasing relevance of non-tariff and rules elements in RTAs. This stresses the need to ensure an optimal design for RTAs, both by including crucial non-tariff and rules aspects.

In the analysis above we have seen that **there is no one model for what constitutes deeper integration** in regional trade agreements. Agreements differ considerably in their motivations, and therefore in their scope and level of ambition, in the nature of rights, obligations and processes they contain. Commitments undertaken at the regional level can go beyond those in the WTO Agreements in terms of extending countries' obligations, or including policy areas not covered in the WTO.

There is **no straightforward answer to the question whether “new” regional agreements lead to regulatory “deeper integration”**. The conclusion depends on a case-by-case examination. Nevertheless, while the extent to which regional agreements result in “deeper integration” differs widely, it is clear that regional agreements have generally contributed to the removal or reduction of barriers to market access in the new issues areas.

While it is clear that divergent approaches to dealing with new/regulatory policy issues have the **potential to result in competing spheres of regulatory influence**, the RTAs characterised by deeper integration have proven to be more **building blocks** than stumbling blocks towards multilateral rules, when it comes to promoting open markets in sectors characterised by regulatory barriers to trade.

Removing regulatory barriers to trade is less a question of regionalism versus multilateralism, than a **multi-level process**, involving sub-national, national, regional, plurilateral and multilateral actors and rules. At the same time, sustained lack of progress at the multilateral level might increase the incentives for regional groupings to seek regional trade liberalisation solutions, at the expense of multilateral disciplines. The **best prescription for minimising such a risk would be to press on with MFN liberalisation**.

A key question is what is the **relevance for developing countries** of these results?

Developing countries non-reciprocal access to developed countries market has not been sufficient to ensure that poorer countries share in the wealth being generated by globalisation. RTAs have long been seen as an useful instrument for **supporting developing countries' participation in the international trade system**.

On the basis of economic analysis and historical experience it is often argued that for most developing countries and especially for the poorest ones, a **North-South RTA** with a large industrial country is likely to be superior to a **South-South RTA** among developing countries, provided the right design encourages the necessary domestic reforms. The **EU approach is different, because in most initiatives it promotes a South-South-North model** (Meda, Mercosur, GCC, and now REPAs with ACP countries), which aims at combining the strong points of North-South RTAs (locking in reforms, credibility, good governance, access to large markets, FDI incentives,

technology transfers, etc.) with the positive aspects of South-South agreements (economies of scale, bargaining power, markets large enough to attract FDI, etc).

However, the above analysis indicates that **to ensure a significant economic impact deep regulatory integration is still required** (both South-South and North-South), in other words substantial depth of non-tariff and regulatory aspects (i.e. rules content) and wideness in scope (inclusion of provisions on services, intellectual property and investment) of the RTA. The experience of the EU and Candidates, and the US and Mexico with NAFTA are the most widely cited examples.

This immediately raises the question of which developing partners are willing and, especially, able to embark upon such a complex process, even with strong technical assistance help from a developed partner.

The **costs of adjustment** to trade liberalisation are a significant challenge to developing countries. The inclusion in RTAs of efforts to agree to common disciplines for regulatory regimes exacerbates such a problem. To develop **flanking policies**, such as substantial financial and technical assistance, is therefore paramount to help offset the significant loss of government tariff revenue and increasing opportunity cost of administering RTA rules.

Moreover, **RTAs could be used through their regulatory content to promote sound domestic policies which are essential for development**. The integration of sustainable development into trade policies has also an important regional dimension. RTAs could provide the opportunity to reinforce co-operation on regulatory policies, including on the environmental and social dimensions of sustainable development. This regulatory co-operation should become more important in RTAs, particularly in a North-South context.

Some issues for debate

1) Extent of regulatory convergence through current RTAs:

- Is there one model for what constitutes “deeper integration” in regional trade agreements, or there are a plurality of models?.
- What is the importance in current RTAs of non-tariff or “rules” elements?

2) The economic effects:

- How effective RTAs’ regulatory provisions have been in stimulating trade and investment between members of an RTA? In other words, to what extent RTAs extending to new issues and policy areas result in actual “deeper integration”?
- What is the contribution of RTAs’ normative provisions in promoting (locking in) reforms, and, more generally, sustainable development in their members (particularly in developing countries).

3) Where do we go from here? What policy guidelines can be identified?

- Are recent developments concerning RTAs pointing to the emergence of (competing) “regulatory blocks”, characterised by convergence towards the most developed partner’s regulatory environment within, and divergence without? Or

will this be prevented by the proliferation of cross-linkages (as in NAFTA and EC-Mexico or FTAA and EC-Mercosur, Chile)?

- How do these issues relate to the debate on regulatory convergence through regulatory competition and/or through regulatory harmonisation?
- What is the interaction and eventual degree of interdependence between trade liberalisation and regulatory co-operation at the bilateral and multilateral level? Under which conditions do they reinforce or undermine each other and what can be done to increase the coherence of those policies and to define a proper sequence of interventions?
- What could be done (i.e. how to best structure RTAs) to manage these processes towards regulatory convergence and reduce the risks of trade conflict, while preserving their public policy objectives? In other words, is there a model of “best practice” for RTAs (strengthening procedural provisions; extension of substantive obligations) when extending their regulatory capacity in a direction supportive of multilateral objectives.