PART I

Introduction

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Introduction

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The modern history of the world trading system, and in particular international trade agreements, is evidenced by shifts among bilateralism, regionalism and multilateralism. In the late nineteenth century and early twentieth century, bilateralism was clearly dominant. Trade agreements were negotiated on a bilateral basis between individual countries. In the 1860s and 1870s, England initiated much of this activity, pushing its trading partners to sign trade agreements that reciprocally lowered tariff rates. In the 1930s, it was the United States (US) that made a big push in this area, through its Reciprocal Trade Agreements programme, although a number of other countries were also active in negotiating bilateral agreements to lower tariff rates.

However, immediately after World War II, multilateralism and regionalism replaced bilateralism as the dominant approach. From the late 1940s to the mid-1990s, multilateralism grew in strength as more and more nations joined the GATT or its successor, the WTO. The GATT, which began with 23 countries, unquestionably came to dominate the world trading scene. It did not, however, completely replace regional and bilateral trade agreements. Regionalism remained a competing model, as nations in Europe, North America, South America and elsewhere all formed trading blocs during this period. East Asia was the only region to eschew regionalism, while Western Europe was the clear leader in terms of both the timing and the scope of its economic integration, with other regions following behind. Bilateralism, on the other hand, diminished considerably during this period. Such agreements were extremely rare, and where they did exist could usually be explained mostly by political, rather than economic, factors.

In recent years, though, bilateralism has returned with a vengeance. The initial return to bilateralism can be traced to the breakup of the Soviet Union and collapse of Communism in the early 1990s. The newly formed nations, along with several Eastern European economies in transition from a centrally planned to a market-based economy, led a mini-revival of bilateralism in the mid- to late 1990s. Bilateralism, however, only significantly gained momentum following the failed WTO negotiations at the 1999 Seattle Ministerial Conference. Prior to 1999, it was rare for the major trading powers to negotiate and sign bilateral trade agreements. Following the failed Ministerial, all major trading nations (including the East Asian nations) almost immediately launched multiple negotiations. A large number of

such agreements have now been negotiated and signed, and many more are currently being negotiated. The rapid increase in the total number of agreements has created a competitive process among nations, with all of the major trading powers pushing hard to conclude these agreements so as not to lose particular markets to their competitors.

In addition to bilateral agreements, there are also a growing number of what could be termed 'loose' regional trade agreements. These are concluded among several countries in the same 'region', with the term region more loosely defined than in previous eras. These agreements are, in essence, plurilateral agreements among countries which may or may not be in somewhat close proximity to each other, but do not necessarily include all countries from that area. For example, the North American Free Trade Agreement (NAFTA), a more traditional RTA, was signed in 1993 by Canada, the US and Mexico: three contiguous countries of North America. By contrast, in 2006 the Central America–Dominican Republic–United States Free Trade Agreement (CAFTA–DR–US) was signed by the US, a few Central American countries, and the Dominican Republic. All are in the same general region, but there are many other countries within that region which were not included. On the other hand, the Trans-Pacific Strategic Economic Partnership Agreement (P4) between Brunei, Chile, New Zealand and Singapore cannot be said to even remotely resemble nations in close proximity to one another (although admittedly all members are linked by the Pacific Ocean).

The result of the proliferation of these agreements is that today's international trade rules now consist of a number of instruments. At the forefront, there is the multilateral WTO Agreement, which includes 151 countries or customs territories. In addition, there are the traditional regional trading blocs, each with their own agreements, some of which provide for deep integration or customs unions among the member countries. Then, there is the complex web of bilateral trade agreements between individual countries. Finally, there are a growing number of 'loose' regional agreements. All of these agreements – over 300 in total – exist together, creating a mish-mash of overlapping, supporting, and possibly conflicting, obligations.

Perhaps even more importantly than the sheer quantity of trade agreements are their scope and coverage. While the nineteenth and early twentieth century bilateral agreements were often narrowly focused on reducing tariffs, the more recent ones contain obligations that are wide-ranging and controversial, from investment provisions to intellectual property rights affecting access to medicines to protections for labour/human rights and the environment. While the full impact that these agreements will have on domestic policy-making is uncertain, it is clear that a number of agreements are going beyond the coverage of the WTO as well as the regional and bilateral agreements negotiated prior to 1999 and reaching a new level of international policy-making.

Before turning to the structure of this volume, it is worth noting an important definitional point: What should this recent wave of agreements be called? Above, we

have referred to 'bilateral trade agreements' and 'loose' 'regional trade agreements'. Most often, these agreements are referred to as 'free trade' agreements, and, in fact, many of the agreements have 'free trade' in the title (although others use more general terms such as 'economic partnership' agreements). Some commentators have also taken to referring to the collection of bilateral and regional trade agreements as 'preferential trade agreements'.

The term 'free trade agreements' (FTAs) has advantages in that it is the most commonly used term and is the term used in many agreements. On the negative side, it excludes customs unions, which these agreements sometimes are, and it perhaps puts the agreements in an overly positive, not to mention inaccurate, light. For instance, it could be argued that favouring certain countries in trade relations, as these agreements do, is not 'free trade' at all, but rather discriminatory trade. Moreover, the vast majority of these agreements do not actually create 'free' trade between partner countries. For these reasons, the term 'preferential trade agreements' (PTAs) was created. The term PTAs is not used as often, and is not used in any of the agreements themselves. On the other hand, it is a common term for these agreements, and it is arguably more accurate in describing what these agreements do (they establish preferences for some countries over others in trade relations). The term PTAs also has the advantage in that it can include both free trade agreements and customs unions. In a sense, bilateral and regional trade agreements, as we have titled the book, is the most all encompassing and accurate term. But it is wordy, and does not have an acronym that is commonly recognised (i.e., few people will be used to seeing the term BRTA). As a result, we preferred the use of the term PTA throughout this collection, but have given the authors the freedom to vary their terminology as they see fit. We do not intend there to be any negative connotations with the choice or use of any of the terms.

The structure of the book

The spread of PTAs raises a number of interesting questions in terms of politics, international relations, international law, economics and global governance:

- What are the reasons for the recent interest in and growth of these agreements?
- How do the benefits of bilateral trade liberalisation compare with those of multilateral trade liberalisation?
- How do these new agreements relate to existing multilateral and regional trade agreements, and to international law more generally?
- What is the substantive scope of these agreements? That is, what policies do they promote and what obligations do they contain?
- How are these agreements negotiated among the various governments, and what is the role of non-state actors who have an interest in the agreements?

This book attempts to provide some preliminary answers to these questions. We say 'preliminary' because the development of these agreements is still ongoing. The end does not appear to be in sight yet, especially as the Doha Round continues on (and on) with no set timetable for completion. Thus, the analysis offered here is necessarily limited to what has occurred so far.

The book is structured as follows. Parts II and III will put these issues in context by providing some general background on the economics, politics, international relations and international law aspects of PTAs. For instance, Part II contains a chapter by Pravin Krishna of Johns Hopkins University, School of Advanced International Studies, evaluating the economics of PTAs. More specifically, Professor Krishna expands upon existing literature to find that the welfare effects of PTAs are ambiguous at best. The chapter also provides, *inter alia*, an interesting analysis on the design of PTAs with welfare-improving effects. Part II also contains a chapter on the political and international relations considerations of PTAs. Written by Olivier Cattaneo of the International Trade Department at the World Bank, the chapter asks the question 'Why do countries conclude PTAs?' and provides a unique assessment of both the historical and present situation, ultimately concluding that the political economy of PTAs revolves more around politics than economics. The final chapter is a practical analysis of some of the differences between bilateral PTAs and multi-party ones. In the chapter, David Evans of the New Zealand Ministry of Foreign Affairs and Trade, demonstrates how the 'new generation' of plurilateral PTAs are a break from traditional bilateral PTAs and offer some challenging procedural and substantive issues, such as how are such agreements to be negotiated and structured to meet the needs (and ambitions) of all parties.

Part III tries to situate PTAs in the larger context in which they exist. There are two aspects to this: (1) How do PTAs fit with the WTO, which prohibits discrimination among WTO Members but has an exception for free trade agreements and customs unions? and (2) How do PTAs fit within international law more generally? Part III begins with a chapter by Andrew Mitchell of the University of Melbourne, Faculty of Law, and Nicholas Lockhart of the law firm of Sidley Austin, examining the nature of the exception for PTAs under WTO rules. It outlines, in substantial detail, the conditions of the exception and concludes with an assessment of the likelihood of legal challenge to a PTA if it did not meet all of the conditions of the exception. Chapter 6, by Andrew Mitchell and Tania Voon, also of the University of Melbourne, Faculty of Law, provides a comprehensive analysis of the under-explored and often murky relationship of PTAs to international law. More specifically, Mitchell and Voon provide examples of difficult and unsettled issues surrounding the overlap between PTAs and public international law, including the particularly thorny issues of conflicting norms between two treaties/agreements and multiple dispute settlement systems that are capable of hearing the same dispute.

Part IV provides a detailed look at specific subject areas that are part of PTAs. In essence, this part offers a comparison across the various agreements, examining the

scope of the law that is being created in seven important policy areas. First, Timothy Josling of Stanford University, Food Research Institute, analyses the contentious area of agriculture with reference to historical data as well as differences between bilateral and regional PTAs. Next, Federico Ortino of King's College London provides a review of services in the multilateral forum before comprehensively detailing how certain PTAs are creating GATS-Plus obligations. Joshua Meltzer from the Australia Department of Foreign Affairs and Trade then contributes a thorough and detailed chapter on investment and focuses on both the wide-ranging obligations undertaken in the area as well as those areas which have caused much disagreement and dispute. Arwel Davies of Swansea University, Faculty of Law, next provides a chapter on government procurement which illustrates how many agreements are hesitant to move substantially beyond the WTO model. Michael Handler of the University of New South Wales, Faculty of Law and Bryan Mercurio of The Chinese University of Hong Kong, Faculty of Law, provide a chapter on intellectual property which looks at three TRIPS-Plus areas of intellectual property: copyright, geographical indications and patents. Lorand Bartels of Cambridge University then analyses the inclusion of social issues, such as labour, environment and human rights, into PTAs. Finally, Simon Lester of WorldTradeLaw.net and Victoria Donaldson of the WTO Secretariat conclude with a detailed review of various dispute settlement provisions in PTAs, finding a general, but not perfect, correlation to the WTO model set out in the Dispute Settlement Understanding.

The companion volume to this book (to be published later) will be made up of case studies of various PTAs. At this stage, we are not offering a complete set of case studies of all PTAs. Rather, we have tried to select a group that includes a good sampling in terms of countries and regions covered, and also a sampling of agreements that address key issues (such as intellectual property and agriculture). Authored by leading scholars, practitioners and governmental officials, each case study provides a comprehensive review of particular agreements. The first case study, authored by Andrew Mitchell and Tania Voon, is the Australia–United States Free Trade Agreement (AUSFTA). Mauricio Salas, of the law firm Facio & Caňas in San Jose, Costa Rica, next reviews the CAFTA–DR–US. Bradly Condon of the Instituto Tecnológico Autónomo de México (ITAM) then provides a review of the European Union–Mexico Economic Partnership, Political Co-ordination and Co-operation Agreement. The Mexico–Japan Economic Partnership Agreement is then reviewed by Bryan Mercurio before Jason Kearns of the US House of Representatives, Committee on Ways and Means outlines the United States–Morocco Free Trade Agreement. Peter Draper and Nkululeko Khumal, both of the South African Institute of International Affairs, then review the EFTA–SACU before Luz Sosa of the General Directorate for International Economic Affairs (Chile) outlines the China–Chile Free Trade Agreement. The book concludes with a review of the China-ASEAN Free Trade Agreement, authored by Jiangyu Wang of the Chinese University of Hong Kong, Faculty of Law.

In later editions of the book, we plan to supplement this work by providing case studies of additional agreements, eventually compiling a comprehensive resource providing case studies of as many PTAs as is practicable. Such a resource should be useful in a number of ways. For example, each study can serve as an in-depth study of a particular PTA. Moreover, the group of case studies can be used to compare and contrast the coverage of different PTAs, or to examine the PTAs signed by a particular country.

As mentioned above, the expansion of PTAs as a key part of the world trading system is a fairly recent development. As things continue to evolve, we will expand this study through future editions. For the chapters covering specific substantive areas, we will update these to take into account new agreements as they are signed. In addition, as noted, we will add more case studies with each new edition. In this way, we hope this book and its future editions will serve as a comprehensive and essential resource for understanding the role of PTAs in the international trade regime.

PART II

Economics and politics of PTAs

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The economics of PTAs

PRAVIN KRISHNA*

I. Introduction

Strongly influenced by the perception that restricted commerce and preferences in trade relations had contributed to the economic depression of the 1930s and the subsequent outbreak of war, the discussions leading to the General Agreement on Tariffs and Trade (GATT) in 1947 were driven by the desire to create an international economic order based on a liberal and non-discriminatory multilateral trade system. Enshrined in Article I of the GATT, the principle of non-discrimination (commonly referred to as the most-favoured-nation or MFN clause) precludes member countries from discriminating against imports based upon the country of origin. However, in an important exception to this central prescript, the GATT, through its Article XXIV, permits its members to enter into preferential trade agreements (PTAs), provided these preferences are complete. In so doing, it sanctions the formation of Free Trade Areas (FTAs), whose members are obligated to eliminate internal import barriers, and Customs Unions (CUs), whose members additionally agree on a common external tariff against imports from non-members. Additional derogations to the principle of non-discrimination now include the enabling clause, which allows tariff preferences to be granted to developing countries (in accordance with the generalised system of preferences) and permits preferential trade among developing countries.

Such PTAs are now in vogue. Even as multilateral approaches to trade liberalisation – through negotiations organised by the GATT/WTO – have made substantial progress in reducing international barriers to trade, GATT/WTO-sanctioned PTAs have rapidly increased in number in recent years. Among the more prominent existing PTAs are the North American Free Trade Agreement (NAFTA), the European Economic Community (EEC), both formed under Article XXIV, and the MERCOSUR (the CU between the Argentine Republic, Brazil, Paraguay, and Uruguay), formed under the Enabling Clause. All in all, hundreds of PTAs are

* This chapter draws substantially on my earlier research, particularly my works of 2004 and 2005 (cited below).

currently in existence, with nearly every member country of the WTO belonging to at least one PTA.[1]

That a country liberalising its trade preferentially against select partners is doing something distinct from multilateral liberalisation (where it eliminates tariffs against all imports regardless of country of origin) should be easy to see. What this implies for the liberalising country is a little more difficult to understand. Even a good half century after the economic implications of trade preferences were first articulated by Viner,[2] the differences between preferential and multilateral liberalisation (or free trade areas versus free trade) remain a nuance that most policy analysts (and occasionally even distinguished economists) appear to miss.

It is with a discussion of these issues concerning the distinction between preferential and non-discriminatory trade liberalisation that we begin the analytical section of this chapter, which is intended as a brief and accessible primer on the economics of PTAs. Specifically, Section II develops the classic analysis of Viner and demonstrates the generally ambiguous welfare effects of preferential trade liberalisation. Section III discusses the role geographic proximity ('regionalism') may play in this discussion. Section IV discusses the design of welfare-improving preferential trade agreements. Section V reviews GATT/WTO regulations concerning PTA formation and asks how the existing provisions compare with the welfare improving designs for PTAs described in Section IV. Section VI concludes.

II. Welfare analysis

A. Trade creation and trade diversion

Does preferential trade liberalisation in favour of particular trading partners have the same welfare consequences as non-discriminatory trade liberalisation in favour of all imports? Does a simple proportion of the welfare benefits of non-discriminatory free trade accrue with preferential liberalisation?

A thorough answer to these questions would require the reader to take a deep plunge into the abstruse world of the second-best (whose existence and complexities were, indeed, first discovered and developed by analysts working on the economics of PTAs). But the idea may be introduced in a rudimentary fashion using the following 'textbook' representation of Viner's analysis: Consider the case of two countries, A and B, and the rest of the world W. A is our 'home' country. A produces a good and trades it for the exports of its trading partners B and W. Both B and W are assumed to export the same good and offer it to A at a fixed (but different) price. Initially, imports from B and W are subject to non-discriminatory trade restrictions: tariffs against B and W are equal. Imagine now that A eliminates its tariffs against B while maintaining its tariffs

1 For a listing of all bilateral and regional trade agreements notified to the WTO, see www.worldtradelaw.net/fta/ftadatabase/ftas.asp.

2 Jacob Viner, *The Customs Unions Issue* (New York: Carnegie Endowment for International Peace, 1950).