The Rush to Regionalism:
Sustainable Development and Regional/Bilateral Approaches to Trade and Investment Liberalization

International Institute for Sustainable Development
Aaron Cosbey

Singapore Institute for International Affairs
Dr. Simon Tay
Dr. Hank Lim
Matthew Walls

November 2004
Published by the International Institute for Sustainable Development
The International Institute for Sustainable Development contributes to sustainable
development by advancing policy recommendations on international trade and investment,
economic policy, climate change, measurement and assessment, and natural
resources management. Through the Internet, we report on international negotiations
and share knowledge gained through collaborative projects with global partners, resulting
in more rigorous research, capacity building in developing countries and better dialogue
between North and South.

IISD’s vision is better living for all—sustainably; its mission is to champion innovation,
enabling societies to live sustainably. IISD receives core operating support from the
Government of Canada, provided through the Canadian International Development
Agency (CIDA) and Environment Canada; and from the Province of Manitoba. The
institute receives project funding from numerous governments inside and outside
Canada, United Nations agencies, foundations and the private sector. IISD is registered
as a charitable organization in Canada and has 501(c)(3) status in the United States.

International Institute for Sustainable Development
161 Portage Avenue East, 6th Floor
Winnipeg, Manitoba
Canada R3B 0Y4
Tel: +1 (204) 958-7700
Fax: +1 (204) 958-7710
E-mail: info@iisd.ca
Web site: http://www.iisd.org/
# Table of Contents

1. **Introduction** ............................................................................................................. 1
2. **Trends in Regionalism** .................................................................................................. 2
3. **A Survey of Actual Practice** ....................................................................................... 5
   3.1 Development aspects of the agreements ................................................................. 6
   3.2 Environmental aspects of the agreements ............................................................... 9
      3.2.1 Environment and sustainable development as objectives of the agreement .......... 9
      3.2.2 Environmental exceptions .................................................................................. 11
      3.2.3 MEAs and trade law .......................................................................................... 12
      3.2.4 Environmental impact assessment ...................................................................... 12
      3.2.5 Regulatory impacts: services and investment ....................................................... 13
      3.2.6 Environmental governance .............................................................................. 16
4. **Issues for Consideration** ............................................................................................. 21
   4.1 Why the rush to regionalism? .................................................................................... 21
      4.1.1 Economic considerations .................................................................................... 22
      4.1.2 Strategic considerations ..................................................................................... 23
   4.2 Does the rush to regionalism undermine the multilateral system? ............................. 25
   4.3 The impacts of level of development on FTA characteristics .................................... 28
      4.3.1 North-North agreements .................................................................................. 28
      4.3.2 North-South agreements .................................................................................. 28
      4.3.3 South-South agreements .................................................................................. 29
   4.4 Regionalism and sustainable development ............................................................... 30
      4.4.1 Economic implications ....................................................................................... 31
      4.4.2 Environment and development implications ....................................................... 33
   4.5 The role of business and the market ......................................................................... 36
5. **Scope for Improvement** .............................................................................................. 37
6. **State of Research** ....................................................................................................... 38
7. **References** .................................................................................................................. 41
1. Introduction

The unmistakable signs of a rush to regionalism in investment and trade agreements are all around us. It seems that not a week goes by that some pair or group of countries do not announce their intent to negotiate a new agreement. This is in stark contrast to the state of affairs ten years ago, when NAFTA was the first North-South free trade agreement (FTA) to be signed, and most of the South-South agreements existed in name only – grand hopes gradually gone flat.

The trend to economic regionalism poses a number of questions from a sustainable development perspective, and the rate of negotiation makes those questions urgent. The most basic is to identify the impetus for the new trend. Why the rush to regional and bilateral agreements? Why now instead of ten years ago? Understanding the underlying dynamic is more than a theoretical promenade. It may, among other things, help us to better understand how to influence the outcomes.

The next set of questions relates to the import of the trend. What exactly does this fundamental shift mean for sustainable development? There are a number of topics subsumed in this broad question:

- What does the trend to regionalism mean for the multilateral trading system? If it implies a weakening of the MTS, what are the development implications for the various groupings of developing countries?
- Beyond the well-worn but important question of trade creation vs. trade diversion, which applies essentially to market access provisions, what are the implications of the rules-based elements of the current crop of agreements (investment, IPRs, competition policy, trade facilitation, etc.)?
- Are countries using FTAs as they were used in the past, to strategically advance their objectives at the multilateral level? This question has specific salience for the new crop of south-south agreements.
- How do the new agreements address the trade-environment relationship? How do they measure up to past practice?
- Are there distinct characteristics to North-North, North-South and South-South agreements?
- Is cooperation on environmental issues better served by a regional focus? If so, are the current agreements (here the scope will include analyzing trade-related environmental side agreements such as the NAAEC) fully exploiting this potential?

This paper aims to set out the issues of importance in addressing the links between sustainable development and the rush to regionalism. It begins by describing the trends in regional agreements. It then surveys current practice, asking how the agreements address a number of key issues of importance to sustainable development, both in the context of economic development and the context of environment. Based on that survey, and a survey of the literature, it then sets out a number of key themes, and asks what we know and do not know about each. The concluding section describes the state of research in relation to these themes.

A note on terminology is needed at the outset. Regional and bilateral trade and investment agreements go by many different names, depending on the analyst. Those who find them a threat to
the multilateral trading system prefer the title Preferential Trade Agreements. Others, primarily the World Bank, prefer Regional Integration Agreements. In this paper we use the term Free Trade Agreements, but do so in the full knowledge that, in the first place, they involve much more than trade in goods or services and that, in the second place, they may not in all cases be forces for unblemished liberalization. Often in the paper we explicitly broaden the definition of FTAs to include bilateral investment treaties (BITs), though the main focus of the analysis is broader trade agreements.

2. Trends in Regionalism

Regionalism in trade and investment agreements has been on a steep rise since the early 1990s. The number of agreements under negotiation or under consideration is for all intents and purposes incalculable, changing on a weekly basis. Of the 273 regional trade agreements that had been notified to the WTO as of December 2003, only 120 pre-date 1995. If planned agreements conclude as planned under WTO notification, the end of 2005 will see almost 300 regional trade agreements in force.¹

Some scholars have identified this recent phenomenon as the “second wave” of regionalism, the first wave having occurred in the 1960s and 1970s. There are some similarities and differences between the two waves. It has been noted that the first wave consisted more of regional trade arrangements, but the second wave has led to a proliferation of bilateral trade agreements. As well, the first wave generated tariff reductions as the main objective of trade agreements but the recent wave of agreements between countries have included areas of economic cooperation beyond tariff reduction and many governments have adopted a multi-tracked approach to trade liberalization. This is best exemplified by the US and South-East Asian strategies of “competitive liberalization” in which regional and bilateral trade negotiations are seen as helping to drive the multilateral agenda with greater effectiveness.

Recent trade agreements have generally been of two kinds, either a straightforward trade agreement or a trade agreement as part of a broader economic partnership agreement involving trade facilitation cooperation, labour and/or environmental cooperation along with a FTA. Often their signatories describe them as “a new benchmark,” “comprehensive,” or “new age.”. These agreements tackle issues—investment, government procurement, environment, competition policy, intellectual property rights—that are still under negotiation at the WTO, or have been dropped from negotiations until after the Doha round.

Since East Asian countries were among the last to pursue bilaterals, only a handful of agreements have been signed there to date. Dozens, however, have been proposed, including one, commonly known as the East Asia FTA, which would encompass North and Southeast Asia and would be one of the largest free trade areas in the world. Among the most significant of those signed, on account of their complexity, depth and the size and development level of the economies involved, are the USSFTA, the ASEAN FTA (AFTA),² the Republic of Korea-Chile FTA, the JSEPA, the ASEAN-

² This November at the 10th ASEAN Summit, ASEAN countries will sign a framework agreement to implement the ASEAN Economic Community (AEC), which will subsume within it AFTA, the ASEAN Agreement on Services
China Comprehensive Economic Partnership Agreement (ACFTA) and the Australia-Thailand Closer Economic Relations FTA (TAFTA).

The US has been energetic in signing bilateral and regional trade agreements in recent years, concluding agreements with Singapore and Chile (2003), and Australia, Bahrain, Morocco and the five Central American states & Dominican Republic (2004). It is currently negotiating with the four Andean nations, and the five countries of the South African Customs Union (SACU) and Panama. It is also pursuing what it calls the Enterprise for ASEAN initiative, aiming to conclude bilateral trade deals with the Association’s ten-members. Similarly it is pursuing a Middle East Free Trade Area Initiative, aiming at bilateral investment treaties and free trade agreements with a number of countries. It has signed Trade and Investment Framework Agreements (TIFAs)—prerequisites to BITs and FTAs—with seven Middle Eastern countries. And it is in negotiations with the 34 countries of the western hemisphere (minus Cuba) on a Free Trade Area of the Americas.

The EU is also pursuing a number of regional initiatives. In 2004 it completed the accession process with 10 new members, is negotiating on four additional candidate countries and is pursuing special integration status for six Balkan states. Under the wider cooperative framework of the “Barcelona Process” it is pursuing a Euro-Mediterranean free trade area by 2010, and has signed bilateral Association Agreements with 11 of the 12 countries involved. Its long-standing preferential relationship with the African and Caribbean countries is currently undergoing a fundamental change with the negotiation of Economic Partnership Agreements with six regions. It is also negotiating a free trade agreement with the six states of the Gulf Cooperation Council, and with the four states of Mercosur – the common market of the Southern Cone.

This frenetic pace of activity is reflected in the rest of the world as well, as countries in South Asia, the Persian Gulf, Latin America and Africa negotiate integration and cooperation agreements or enter into talks aimed at eventually doing so.

Most of these agreements explicitly recognize in their texts GATT Article XXIV and GATS Article V, which are known as the WTO’s preferential trade agreement exception articles. The WTO allows for FTAs provided they meet these three criteria: trade barriers with non-signatories are not raised, the free trade area should be fully established within a reasonable transition period, generally interpreted as no more than ten years, and lastly, the tariffs and regulations should be eliminated for “substantially all sectors.” The latter has been subject to various interpretations, with some debating whether ‘substantial’ should mean sheer trade volume or the most significant traded products. The agreements under discussion lean towards ‘significant;’ by its subjective nature, it allows countries greater freedom for protectionism.

Precedent here is of great importance. Korea, for instance, which has a strong farm lobby, was urged by some of its academics to learn from NAFTA and the EU-Mexico FTAs, the one which excluded (AFAS) and the ASEAN Investment Area (AIA). The AEC was launched at the 2003 ASEAN Summit, as the third pillar in the ASEAN Community. The ASEAN Security Community and ASEAN Socio-cultural Community are the other two pillars.

3 As noted, an agreement with Singapore is already concluded, and Thailand is in negotiations. As of October 2004 the US has completed trade and investment framework agreements (TIFAs)—a prerequisite to a trade agreement—with Indonesia, Philippines, Thailand, Brunei Darussalam and Malaysia.

domestic agricultural support and the other which ended up covering only 64 per cent of EU agricultural goods. In its defense, the EU claimed its FTA met the conditions of Article XXIV since agriculture was a small share of their bilateral trade; Korea in its FTA did the same. It managed to exclude twenty agricultural products, including rice, while postponing negotiation on 337 agricultural tariff lines until after the DDA. Chile, which originally demanded complete agricultural liberalization, in turn asked that refrigerators and washing machines be left off its tariff schedule. Japan, in its negotiations with Mexico, had also been advised to negotiate for the same commitments the EU made in its agriculture and fisheries sectors in the EU-Mexico FTA.

Given that the definition of ‘substantial’ has been stretched and that it has not yet been defined at the WTO level, it is difficult to categorically state that all the agreements under discussion satisfy this criterion. The need for consensus makes this virtually impossible anyhow if it is to discipline any specific agreement some members may have concluded. However, most of the agreements that have been recently signed do not significantly modify the rights and obligations existing under the multilateral system of trade. As shown below, with only a few exceptions the agreements are consistent with the existing WTO rights and obligations. Sectors that are under negotiation, such as agriculture and services, have typically been excluded from discussions, or included but limited to specific goods. And in those sectors that have not yet been discussed at the multilateral level, such as competition policy and investment (with only a weak multilateral agreement), precedents have been set that do not conflict with the WTO agreements, but nevertheless mark a significant break with the status quo.

The path being laid out in East Asia and elsewhere seems to be the one predicted by most economists who have argued that sensitive sectors would be excluded, or left at current WTO bound levels in FTAs, and would hence increase the likelihood of trade diversion. This especially seems the case in the liberalization in agriculture. Subsidies are generally not discussed at all, and the exceptions are telling: the US-Australia FTA, for example, prohibits export subsidies, which neither Party uses, but says nothing about the many other forms of domestic support used extensively by the Parties. As well, the tariff schedules for some products stretch over decades, dropping over time in small increments. In the Thailand-Australia FTA, for instance, Thailand’s dairy sector does not become duty-free until 2025. However, as Thailand is a developing country, this is not a surprise. ASEAN has given its newest members—Cambodia, Laos, Myanmar and Vietnam—tariff deadlines depending upon their entrance date and level of development. The three latter countries will be the last to achieve zero tariff levels, in 2018.

One notable exception, however, is the ASEAN-China Comprehensive Economic Partnership agreement. A framework agreement was signed in November 2003 and negotiations on the goods sector should have been concluded in July 2004 (a notification of extension has been served). This agreement will have an innovative feature similar to special and differential treatment in the WTO. The ‘Early Harvest Schedule’ will give ASEAN’s developing countries preferential access on (mostly) agricultural goods. These countries do not have to reciprocate China’s offer until a future date yet to be negotiated. Most observers believe that this is mostly a political gesture by China to

---

7 Kim, Y-K (2002).
8 Shoji and Hosano (2003).
demonstrate that its economic growth will be beneficial for the region, and to establish itself as the region’s leader.\(^9\)

Other cases, however, tend to prove the rule: both the EU-Mercosur negotiations and the FTAA negotiations are, as of October 2004, faltering badly or stalled, having failed to overcome difficulties related to sensitive issues. In the case of EU-Mercosur these relate almost entirely to market access for Mercosur’s agricultural products. In the case of the FTAA, the problem is again agriculture—including the issue of US market access and domestic support—as well as Brazil’s sensitivity to talks on investment.

Protectionism is not limited to specific sectors but can also be seen at the country level. The more open economies, such as the U.S., Canada and Australia, have signed more comprehensive agreements that go beyond current WTO commitments. Japan and Korea, meanwhile, both known as more protectionist economies, have been very reluctant to agree to deep and broad liberalization cuts in their sensitive sectors. In the JSEPA, Japan achieved very strict rules of origin—60 per cent. It also excluded its construction industry from the government procurement chapter,\(^{10}\) government procurement from its investment chapter, and pushed Singapore to agree that voluntary standards would not be subject to the FTA. And while both Japan and Singapore established a Joint Committee for Mutual Recognition, whose work would be to approve certification bodies, a final clause is included that gives either country the right not to recognize the other country’s standards.\(^{11}\)

### 3. A Survey of Actual Practice

This section will survey a number of existing FTAs, analyzing how they address and effect issues important to environmental protection, and economic and social development in the regions covered. The results of this original survey, coupled with a survey of the literature, will provide a foundation for the next section, which will try to outline the major implications of the rush to regionalism for sustainable development.

The agreements surveyed in this section include:

- Association of South-East Asian Nations (ASEAN)
- ASEAN Free Trade Agreement (AFTA)
- ASEAN-China Comprehensive Economic Partnership Agreement
- ASEAN-Japan CEP
- Australia-Thailand Closer Economic Relations FTA
- Canada-Chile FTA
- Canada-Costa Rica FTA
- Cotonou Partnership Agreement
- Euro-Med Agreements (using Egypt as an example)
- European Union (EU)
- Japan-Singapore Economic Partnership Agreement (JSEPA)
- Korea-Chile FTA

---

\(^{9}\) See for example, Soesastro (2004), Cheow (2004).

\(^{10}\) Construction services are also excluded in the government procurement chapters of the USSFTA.

\(^{11}\) Kim Y-K (2002).
Korea-China FTA  
North American Free Trade Agreement (NAFTA)  
Panama-Taiwan FTA  
Singapore-Australia FTA  
South Asian Free Trade Agreement (SAFTA)  
US-Australia FTA  
US-Bahrain FTA  
US-Central American States (and Dominican Republic) FTA (CAFTA)  
US-Chile FTA  
US-Jordan FTA  
US-Morocco FTA  
US-Singapore FTA (USSFTA)

3.1 Development aspects of the agreements

Section 4, below, will consider the economic impacts of FTAs, revisiting a number of well-worn arguments for and against FTAs in that context. This section will ask how the current crop of FTAs treats a number of issues that are important for countries’ development prospects. Those issues include:

- Investment rules
- Intellectual property rights
- Capital controls
- Trade in services
- Dispute settlement mechanisms
- Institutions of development cooperation

All of these issues tend to be treated differently by the different agreements, in line with the preferences of the Parties. The recent US agreements go well beyond the WTO commitments in the areas of investment, and also in another area of deeper integration: intellectual property rights. On investment, following the precedent set by NAFTA, the US agreements contain binding obligations on non-discriminatory treatment (both pre- and post-establishment), on expropriation, on minimum standards of treatment and on limits to the use of performance requirements. The latter obligation is the only one contained in the WTO’s TRIMS Agreement. Also, in another development pioneered by NAFTA, the agreements contain a mechanism whereby investors may directly impel a state to enter into arbitration where a breach of obligations is alleged. As the next section describes, the majority of modern FTAs follow this pattern of going beyond the WTO rules on investment.

On intellectual property rights, all the US agreements starting with NAFTA create a wide range of WTO-plus obligations. The final provisions vary from agreement to agreement. For example the USSFTA (Art. 16.8), like the US agreements that come after it, protects the safety testing data from pharmaceuticals (whether patented or not) for five years, in effect meaning generic drugs produced during that time must do their own testing before gaining approval. Given the costs of safety testing, this is a significant requirement, and in effect grants a five year protection from generic competition that is not granted in TRIPs. The US-Morocco FTA (Art. 15.9.2) contains obligations to register patents on existing drugs if “new use” for those drugs is found. This practice, called “evergreening,” is used by patent holders to extend the life of their patent protection beyond that
available under TRIPS. Practically all of the modern US FTAs go beyond TRIPS in curtailing the ability of the Parties to deny patents on certain inventions.\textsuperscript{12} TRIPS Art. 27.3(b) allows WTO members to exclude from patentability plants and animals other than microorganisms, provided some \textit{sui generis} system of plant protection is used. This flexibility does not exist in any of the post-NAFTA US agreements. A full analysis of the TRIPS-plus elements in the modern US FTAs is beyond the scope of this paper, but the impact on development of these provisions might be substantial. In the area of patents on pharmaceuticals, for example, the effect is to restrict the possibility of generic competition to patented pharmaceuticals, raising the price of drugs above what it would otherwise be.

On the issue of investment-related capital transfers, some of the US agreements also go beyond existing obligations. In the USSFTA and the US-Chile FTA, for example, there are very limited grounds on which the Parties may restrict the investment-related capital transfers. It has been argued that such restrictions are in fact economically valuable tools in the event of balance of payments crises such as the Asian crisis of 1997.\textsuperscript{13}

Non-US agreements also go beyond the WTO rights and obligations in key areas, but not with as great a frequency. IPR protection, in particular, is not as stringent in most non-US agreements. JSEPA, Korea-China and ASEAN all offer nothing concrete in excess of existing WTO commitments in this area. All, however, offer more in the way of investment protection, adopting an investor-state dispute settlement mechanism and other provisions not found in the WTO TRIMS Agreement.\textsuperscript{14} Further, Korea-China goes beyond the WTO agreements with a detailed chapter on government procurement that lays down non-discrimination and national treatment as core principles.

The US and Canadian FTAs, in contrast, have made extensive commitments in both investment and IPRs that go beyond WTO rules, though they build upon, or reproduce, NAFTA and prior US FTA commitments.\textsuperscript{15} It is in these sectors that the agreements most diverge from current multilateral obligations. This does not imply they are necessarily WTO-inconsistent; rather, they are usually more comprehensive than current WTO benchmarks.

In services, for instance, the U.S. agreements and a few others have noticeably switched from the GATS’ positive list format to a negative list, with the final effect of making the obligations more comprehensive. This was used in all the post-NAFTA FTAs signed by the US, and has also been adopted in the Singapore-Australia FTA and the Korea-Chile FTA, though not in AFTA or the JSEPA. The U.S. has also opted for a negative list in government procurement. At the same time, however, these new commitments, while they abide by the MFN and national treatment principles, do not always match the principles embodied in documents like the Doha Ministerial Declaration.

The dispute settlement mechanisms established by the FTAs have largely been of two kinds. ASEAN, as a regional association that will eventually resemble a Common Market (minus a shared

\textsuperscript{12} For an overview of the TRIPs-Plus phenomenon, see Drahos (2001).
\textsuperscript{13} See a survey of evidence in Economist (2003).
\textsuperscript{14} ASEAN’s investor-state DSM is not found in the 1998 Framework ASEAN Investment Agreement, but rather in its predecessor, the 1987 Agreement for the Promotion and Protection of Investments, which is still in force.
\textsuperscript{15} Of course, bilateral investment treaties, no matter who the signatory, go beyond WTO commitments almost by definition.
tariff rate), recently signed an agreement to establish a single, elaborate DSM that will be divided into several institutions, a legal unit, a consultation unit similar to the EU’s SOLVIT,\(^\text{16}\) a consultation board and an ‘Enhanced DSM’ modeled on the WTO’s Dispute Settlement Body.\(^\text{17}\) The DSM would treat all disputes, whether they involve goods, services or investment. The Enhanced DSM will be responsible for adjudicating investor-state disputes, but ASEAN members have the option to pursue other venues such as the International Centre for the Settlement of Investment Disputes. The text of the ASEAN-China FTA framework agreement suggests it will likely adopt a similar structure.

In the other bilaterals, the DSM comprises an investor-state DSM and an ‘additional DSM’ for other disputes. In all instances, this is a three-member tribunal. Each party can choose one panelist, and the third, who chairs the tribunal, must be one that both sides agree upon. The modern US FTAs require that the submissions to the tribunal and tribunal sessions be open to the public. The tribunals also may accept third party submissions, whereas other agreements only give tribunals the authority to seek third party submissions at their own choosing.

Many agreements also establish institutions aimed at fostering development, or building capacity. NAFTA established a bank to finance environmental infrastructure projects in the US-Mexico border region, particularly in the area of waste water treatment, drinking water and hazardous waste (but largely utilizing existing funds). It also established a Border Environmental Cooperation Commission (BECC) to participate in identifying priority activities. Also established at the time NAFTA entered into force was an environmental commission (described in greater detail in the next section) dedicated to building capacity for environmental management in the NAFTA countries.

The EU represents a special case because of its emphasis on integration. It has the ability to create binding law through its own institutions. The EU has created a wide variety of mechanisms to promote development within the EU and in other countries. The European Investment Bank is an institution owned by the EU member states that disburses more than all multilateral development banks put together. Among the most direct programs are the “structural funds” under which the Union effects transfers from rich to poorer members, in an effort to foster regional development. The 2000 – 2006 budget for these funds is set at 195 billion Euros, or one third of the EU budget. The Euro-Med Agreements are similarly endowed with a fund (MEDA) supporting the reform of economic and social structures in the Mediterranean countries. It has a budget of 5.35 billion Euros in the 2000 – 2006 period. The Cotonou Partnership Agreement covers more than seventy African, Caribbean and Pacific (ACP) countries and has a development assistance budget of 15.2 billion Euros in the same period. The EU-Chile Association Agreement, on the other hand—perhaps because Chile is not a neighbour or former colony—does not seem to go beyond being a FTA – there is no program of collaboration on par with the Euro-Med program.

ASEAN runs a development program, the Initiative for ASEAN Integration (IAI), which helps the new members – Cambodia, Laos, Myanmar and Vietnam – build their transportation, energy and communication infrastructure, train civil servants and government officials, and accelerate trade facilitation. However, as they did with AFTA, ASEAN countries have failed to follow through on all their commitments, either for lack of political will or financial resources. Only 20 per cent of the IAI

\(^{16}\) SOLVIT is an EU-run on-line forum for the resolution of citizens’ and business’ disputes arising from the EU’s Internal Market Law. It is an alternative to formal dispute settlement mechanisms.

\(^{17}\) Recommendations of the High-Level Task Force. ASEAN Secretariat. http://www.aseansec.org/hltf.htm
initiatives have received funding; ASEAN recently announced that it had only 35 per cent to fund the new ASEAN Economic Community.\textsuperscript{18}

The ASEAN-China FTA and the ASEAN-Japan CEP, while still just framework agreements, will establish initiatives to build infrastructure and capacity in ASEAN’s developing countries. These initiatives will target energy, transportation, human resource, tourism, environment and information technology sectors, and offer training to help officials implement and enforce the FTA commitments. Bilateral agreements, such as the Korea-Chile and the Australia-Thailand FTAs, establish committees under specific sectors, such as standards or sanitary and phytosanitary measures, who will have the roles of monitoring the agreement’s implementation and allocating resources to be used to build capacity or share best practices.

3.2 Environmental aspects of the agreements

The various regional and bilateral FTAs display a wide variety of approaches to environmental cooperation and promotion of environmental integrity. In some ways they do not differ significantly from the approaches used in trade rules at the multilateral level. In other ways they differ markedly. As a rule there is no single approach used by regional and bilateral FTAs and one would not expect there to be, given the various groupings of parties with diverse levels of development, comparative advantage, history and culture, regulatory approaches, domestic policies and institutions, environmental consciousness and other determining characteristics. This diversity makes FTAs a good laboratory for approaches to foster sustainable development through trade.

This section surveys the various mechanisms found in a wide variety of agreements. The areas explored are as follows:

- Environment and sustainable development as the objectives of the agreement;
- Environmental exceptions in the agreement;
- MEAs and trade law;
- Environmental impact assessment;
- Regulatory impacts in the area of services and investment;
- Environmental governance: institutions created within and outside the agreements for environmental cooperation and protection.

The results of this survey and the analysis in the preceding section will be used in the following section as the basis for an analysis of the implications of regionalism in trade and investment for sustainable development.

3.2.1 Environment and sustainable development as objectives of the agreement.

Mann and Porter (2003) argue strongly that the WTO has now incorporated sustainable development as an explicit objective, in large part relying on the preambular language of the Marrakech Treaties and paragraph 6 of the Doha Declaration. Such language has taken on a new power following its use by the WTO Appellate Body in US - Shrimp-Turtle, which made it the foundation of a watershed interpretation of GATT law.\textsuperscript{19} That said, such language is not binding on

\textsuperscript{18} ASEAN (2004); Manila Times (2004).
\textsuperscript{19} WTO (1998).
the signatories in the same way as the operative provisions. And most FTAs lack such references in the body of the agreements, where the objectives are spelled out – a location that would carry greater weight. The most one can say is that preambular language may be used in the context of a dispute to guide the panelists in interpreting the agreements. It is also a rough guide to the sentiments of the drafters and provides legitimacy to interventions that seek explicitly to promote sustainable development.

Many regional and bilateral FTAs have preambular language on environment or sustainable development. NAFTA’s preamble specifies that the Parties are resolved to “promote sustainable development” and “strengthen the development and enforcement of environmental laws and regulations.” All subsequent agreements signed by the US and Canada have similar preambular provisions, though the wording changes slightly from agreement to agreement. The US-Australian FTA, for example, has the Parties resolving to implement the agreement “in a manner consistent with their commitment to high labour standards, sustainable development, and environmental protection.”

Free trade agreements signed by the EU also incorporate such objectives. The EU-Chile FTA, for example, explicitly mentions “sustainable development and environmental protection requirements.” The Euro-Med agreements follow a different path, referring only to social and economic development in the preamble. Title V of the EU-Egypt Agreement, however, is devoted to Economic Cooperation, and includes numerous promises of environmental capacity building. Its aims explicitly include “[supporting] Egypt’s own efforts to achieve sustainable development and social development.” So while there is no overall preambular reference, sustainable development objectives are central to the agreement. As has been noted, this commitment is backed up with substantial financial resources.

Four of East Asia’s FTAs – the USSFTA, the Korea-Chile FTA, the Panama-Taiwan FTA and the Singapore-EFTA FTA – include preambular language similar to the preamble in the Agreement Establishing the WTO, in effect affirming that economic growth should be carried out in a manner consistent with sustainable development. The USSFTA expands upon this by declaring that sustainable development can be achieved through an open and non-discriminatory trading system. ASEAN, in other treaties such as the Yangon Declaration on Sustainable Development, the Kuala Lumpur Accord on Development and Environment or ASEAN Vision 2020, includes language to the same effect. The Japan-Vietnam bilateral investment treaty (BIT)—a type of agreement often criticized as being too narrowly focused on economic objectives (Cosbey et al. (2004), Peterson (2004))—includes in its preamble: “Recognizing that these objectives can be achieved without relaxing health, safety and environmental measures of general application … ”

Mercosur’s treaty establishing the common market (Treaty of Asunción) asserts that integration “is a vital prerequisite for accelerating [the process] of economic development with social justice,” and that “this objective must be achieved by making optimum use of available resources, preserving the environment, …”

---

20 EFTA is the European Free Trade Association, which includes Switzerland, Liechtenstein, Iceland and Norway.
21 ASEAN (2003a).
22 ASEAN (1990).
23 ASEAN (1997).
The ECOWAS Treaty has no such language, referring only to economic and social development. The SAFTA too refers only to commercial objectives in its preamble and objectives.

The Cotonou Partnership Agreement (CPA) sets the stage for a series of inter-regional negotiations, known as Economic Partnership Agreements (EPAs) that are due to be undertaken in the coming years. Reflecting the fact that the EU itself has sustainable development as a binding objective in an operational Article of its underlying treaties, the CPA affirms the goals of sustainable development in explicit terms. It remains to be seen how this will be translated into the text of the EPAs themselves.

### 3.2.2 Environmental exceptions

The GATT, the GATS and other bodies of WTO law have general exceptions that might include exceptions for environmental measures. In GATT, for example, there is an exception for measures necessary to protect human, animal or plant life or health (Art. XX (b)), and another for measures relating to the conservation of exhaustible natural resources (Art. XX (g)). These have been viewed as “environmental” exceptions but both have been interpreted in fairly narrow fashion by GATT and WTO panels. Recent cases, however, have somewhat broadened the scope.  

Many Regional and bilateral FTAs also contain such language, but a number go further to confirm that the Parties understand that such language actually refers to environmental measures – something not obvious and formerly contentious in the WTO context. NAFTA, for example, in a set of exceptions applicable to most of the agreement (with the notable exception of the investment chapter), incorporates GATT Article XX, and notes that the parties understand that Art. XX(b) covers environmental measures, and that Art. XX (g) applies to measures related to the conservation of living exhaustible natural resources. NAFTA’s “children” – all the subsequent agreements signed by Canada and the US—also have these qualifications.

It is interesting to note that Mexico, after signing an agreement with such GATT-plus language in the North American context, reverted to a simple reference to the GATT text in its FTA with Chile, and then to a GATT-minus formulation in its agreements with the European Community. In the latter agreement GATT Art. XX(b) is reproduced, but without specifying that it covers environmental measures, and Art. XX(g) is left out completely. Chile, which also penned GATT-plus obligations separately with Canada and the US, incorporates both the GATT exceptions in its agreement with the EU, but without the NAFTA-type environmental elaborations.

Most of the Asian agreements have provisions similar to GATT’s Article XX, many simply reproducing them in total (though the SAFTA leaves out Art. XX(g)). Only two go further than the GATT language. The USSFTA, as noted above, follows the other children of NAFTA in clarifying the Parties’ understanding that environmental measures and living exhaustible resources are covered. And the Republic of Korea-Chile FTA’s chapter on investment contains a general exception (Article 10.18) that provides that nothing in the rest of the Chapter should be seen as preventing a Party from taking measures to “ensure that an investment activity in its territory is undertaken in a manner sensitive to environmental concerns.” This provision is qualified, however by a demand that such measures be “otherwise consistent with [Chapter 10],” raising doubts about its final value. The

---

25 Mexico’s dislike of GATT Art. XX(g) may stem from its seminal trade-environment dispute with the US: US-Tuna-Dolphin.
USSFTA, Korea-Chile and Panama-Taiwan FTAs do not establish an equivalent GATT Article XX (g) to cover services.

The Euro-Med Agreements also have general exceptions. The EU-Egypt Agreement elaborates a GATT-like general exception (Art. 26) to cover “the protection of health and life of humans, animals or plants,” but does not mention the exhaustible natural resources provisions of the GATT (Art. XX(g)). That provision is still in force, of course, between the EU and Egypt as WTO members. Art. 26 does, however, provide for very broad grounds for exception, including “public morality, public policy or public security.” And it does away with the problematic GATT term “necessary,” asking only that any measure be “justified on grounds of” such bases.

ECOWAS does not set out general exceptions, but neither is it structured to imply the kind of commitments that would demand such exceptions. It basically sets out a framework for future liberalization. Mercosur, similarly, has no such exceptions. Both agreements aspire to become common markets, where the movement of goods and services is free, and where a certain degree of harmonization of environmental measures is likely to occur. As such, there is perhaps little need for an exception allowing certain bases for restricting that movement.

3.2.3. MEAs and trade law

NAFTA, in an illustration of the fact that regional agreements can move beyond impasses at the multilateral level, incorporates specific language on the relationship between its provisions and those of various multilateral environmental agreements (MEAs). NAFTA’s Art. 104 allows that in the event of any conflict between NAFTA law and the obligations of specific trade-related MEAs (Basel Convention, CITES and the Montreal Protocol), the latter shall prevail, provided that the least trade-restrictive measure available is chosen to comply with those obligations.

This particular innovation has not been taken up in many other agreements (presumably in part because it reflects the narrow base of MEAs accepted by the US). Two FTAs subsequently signed by Canada do have such language: Canada-Chile and Canada-Cost Rica. Mexico’s subsequent agreement with Chile reproduces this text, but it appears in none of Mexico’s other FTAs since NAFTA. Subsequent US agreements either do not mention MEAs, or affirm their importance and agree to wait on the results of the WTO Doha Round negotiations on the relationship between trade and MEA rules (the latter are USSFTA, US-Chile FTA, US-CAFTA).

3.2.4. Environmental impact assessment

A limited number of FTAs have been subject to environmental impact assessments before approval. NAFTA was the first, and Canada and the US now are required by law to subject FTAs to such assessments, involving the preparation of a draft assessment, an extensive round of public comment, and the finalization of the assessment. The US negotiators typically require negotiating partners also to undertake environmental reviews of trade agreements, and such reviews have been conducted by a number of countries since the US Executive Order 13141 made such review standard practice in the US.26

26 The obligations contained in the Executive Order were later enshrined in the temporary permission granted the US Executive to negotiate trade and investment treaties: The 2002 Trade Act.
Notably, the trade partners who have done assessments for negotiations with the United States and Canada have not seen fit to conduct these exercises in other FTAs. After doing so for the US and, in the case of Singapore, for Canada, neither Thailand nor Singapore conducted an EIA for its FTAs with Australia. This suggests that developing countries are performing EIAs only at the behest of foreign countries. Singapore, for instance, has tried to persuade Korea in their FTA discussions that an EIA is not needed because Singapore’s environmental regime can deal with all potential impacts.27

The European Union is also committed to undertaking what it calls Sustainability Impact Assessment (SIA) of trade agreements. Past or ongoing exercises include assessments of: the EU-Chile FTA; the WTO’s Doha Development Round; the Economic Partnership Agreements within the CPA; the Agreements with the Cooperative Council for the Arab States of the Gulf, and the EU-Mercosur FTA (currently in abeyance). Notably, there was no SIA of the accession of the new EC member states (which do, however, adopt the entire body of EU law and policy with respect to the environment and sustainable development so such an assessment would have been equivalent to the process that continues within the framework of the so-called Gothenburg Process on sustainable development). Neither do there seem to be plans to conduct SIAs of the Euro-Med Associate Agreements. These exercises are far more in depth and wide-ranging than those conducted in North America. For one thing, they consider environmental impacts beyond the borders of the EU – an inherently difficult prospect. For another, their scope is sustainable development writ broadly, as opposed to environment.

The Doha Ministerial Declaration “takes note” in paragraph 6 of the commitment by certain WTO members to undertake environmental impact assessments of their trade agreements but makes no active recommendation.

3.2.5. Regulatory impacts: services and investment

While the first generation of environmental concerns with trade agreements tended to centre on scale, structural and direct impacts (see OECD, 1994), some of the most contentious of the new issues deal with regulatory impacts of parts of these agreements that do not deal with trade in goods, and the risk that they will impinge on domestic policy space to regulate in the public interest. Cosbey et al. (2004) lay out in detail the potential problems associated with investment agreements, whether as bilateral treaties or as rules embedded in wider trade agreements. UNDP (2003) details the risks of regulatory impact in the area of services negotiations. How do the various regional and bilateral FTAs measure up in this regard?

On the issue of services trade, the most prominent controversy stems from the provisions related to domestic regulation. In the GATS (Article 6.4) there is a requirement that domestic regulations applicable to services be “no more burdensome than necessary.”28 A similar necessity test has been used in GATT dispute settlement proceedings with a very narrow interpretation: necessary equates to the option that is least trade restrictive. Given that services can comprise a number of sectors of broad public interest, such as health, education, and water distribution & treatment, critics worry

28 The regulations in question are broadly defined: measures relating to qualification requirements and procedures, technical standards and licensing requirements. Note that it is still under negotiation whether Article 6(4) applies to all services, or only to those under which a country has undertaken specific commitments.
that this provision will subject a number of non-commercial policy goals (such as environment and human health and safety) to the primacy of commercial objectives.\(^{29}\) It may, for example, be seen as more burdensome than necessary to cap medical fees for service in a mixed private/public health care system. A number of less trade-restricting alternatives exist to ensure affordability of services: medical voucher systems, medical “account” systems, increasing social welfare payments, and so on.

A number of FTAs simply reaffirm the GATS commitments by reference (the Canada-Costa Rica FTA, the ASEAN Framework Agreement on Services and the Euro-Med Agreements), meaning the necessity test is applicable as between them. Others go further to replicate the GATS language, as in US FTAs with CAFTA, Chile and Australia, Canada-Cost Rica and the JSEPA.\(^{30}\) Some treaties, such as NAFTA and Mercosur (which predate the GATS language) and the Korea-Chile and Panama-Taiwan FTAs, while they deal with services do not deal with domestic regulation. Thailand-Australia, though it incorporates other GATS commitments explicitly, avoids including this language. Canada-Chile incorporates the test, but only with respect to licensing and certification, rather than with respect to all domestic regulation – a significant narrowing that would allow the parties more policy space. Of course, even where the GATS test is absent in a FTA, if the Parties are WTO members they are bound by the GATS commitments, including the obligation set out in Art. 6.4.

On the issue of investment, NAFTA began a trend followed by almost all subsequent regional and bilateral FTAs to include investment provisions in the body of the agreement. NAFTA was also the first trade agreement to contain a mechanism that allows for firms to directly compel states to enter into arbitration over alleged breaches of investment-related obligations, following the practice of a large number of bilateral investment treaties (BITs). This mechanism was slightly modified for the US-Chile FTA, and is replicated in the USSFTA. The Korea-Chile, Panama-Taiwan, Canada-Chile and Thailand-Australia FTAs, as well as the JSEPA, also establish the same kind of investor-state arbitration mechanism. So does Mercosur’s Protocol of Colonia for the Promotion and Reciprocal Protection of Investments, adopted almost simultaneously with NAFTA.\(^{31}\)

Only a few modern FTAs buck this trend. The Mercosur Protocol envisages an investor-initiated process that is then conducted by the governments concerned, effectively putting limits on the ability of investors to initiate disputes where their governments are in substantial disagreement.

The EU-Chile FTA also breaks the modern mold, providing only for state-state arbitration and a panel drawn from a standing roster of arbitrators. It addresses only the establishment phase of investment and includes a provision affirming the parties’ right to regulate. It relegates the post-investment process to BITs that may be concluded between Chile and individual EU Member states.\(^{32}\) ECOWAS and SAFTA have no such system, nor any specific provisions for investor

\(^{29}\) See Grieshaber-Otto and Sinclair (2004).

\(^{30}\) In the Canada-Chile FTA the measures in question are limited to those with respect to licensing and certification only. Technical standards are not covered.

\(^{31}\) This Protocol has not come into effect, and seems unlikely to do so any time soon. See da Motta Viega (2004).

\(^{32}\) This is because the EC does not have authority to negotiate international investment treaties. The EU-Chile agreement was thus a different sort of animal from the standard BIT –more of a framework agreement. This may account for the lack of an investor-state DSM.
protection. Other than the US-Jordan FTA, the US-Australia FTA is the first post-NAFTA US FTA without such a mechanism.\footnote{Australia argued successfully that its regime for managing investment, including the judiciary, was of sterling enough character to obviate the need for such provisions. The result is a disparaging comment on the institutions found in the other post-NAFTA US FTA partners.}

A recent innovation in this regard has been the accommodation in FTAs for the possible creation of an appellate body for investment arbitration (something that critics have long called for). The US-Chile FTA, for example, in Annex 10-H, states:

“Within three years after the date of entry into force of this Agreement, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 10.25 in arbitrations commenced after they establish the appellate body or similar mechanism.”

Similar text appears in the US-Morocco FTA. The USSFTA and US-CAFTA, by contrast, make provision for the possible establishment of a \textit{multilateral} procedure of appeal applicable as between the Parties. Provision for appellate mechanisms is an interesting demonstration of the ability of regional agreements to build on the lessons of experience, to innovate. This ability is limited, of course, by the number of possible future FTAs to be drafted, since there are only a few examples of experience-based innovation within existing agreements.

In many treaties investment is carved out as not covered by the general exceptions (modelled after GATT Art. XX) described above. The investment provisions in NAFTA, for example, are not subject to the general exceptions, and neither are the investment provisions in a number of subsequent US and Canadian-based treaties such as USSFTA, US-Chile FTA, US-CAFTA, Canada-Chile. The same pattern is followed by a number of other agreements such as Korea-Chile and Panama-Taiwan FTAs. In all these cases there is, however, a limited application of GATT Articles XX(b) and (g) (specifying coverage of living exhaustible resources, but not explicitly of environmental measures) with respect to performance requirements.\footnote{The Canada Chile Agreement contains these exceptions, but only for measures not inconsistent with the rest of the chapter – a provision empty of much legal value.} The Japan-Singapore New Age Economic Partnership Agreement is exceptional in applying both types of exceptions to all investment measures – not just performance requirements (Art. 83).

One of the most contentious issues in the area of investment is the definition of indirect expropriation. If loosely defined, its scope could encompass regulatory measures that deprive investors of expected profits -- even if the measures in question are non-discriminatory, of general application, and serve a public purpose such as protection of environment or human health (see Mann (2004)). In such cases, governments would be forced to pay reparations to affected firms, in effect chilling further regulation, and certainly dampening the ability of governments to experiment with different regulatory models. That is, developing countries in particular need flexibility to experiment with different types of regulatory frameworks, as many of them are only now in the process of developing such systems. If GATS-led privatization and liberalization are found to have undesirable impacts—for example by limiting the ability of governments to have fee schedules that subsidize provision of health care and education to the poor—then going back to a different system would likely trigger prohibitively high payouts to the established private service providers.
represents an infringement on the fundamental sovereign right of governments to regulate in the public interest.

Though these risks have been known for some time, as a result of the NAFTA experience (see Mann, 2001), only a few of the new bilateral treaties or wider trade agreements explicitly denies such a basis for claims of expropriation.\(^{35}\) These are the modern US treaties: US-Chile, USSFTA, US-Morocco and USCAFTA. The most recent Canadian model BIT also has this language, and it is expected that future treaties such as the Canada-Central American Four and Canada-Singapore FTAs will contain such qualifications.

### 3.2.6. Environmental governance

Environmental governance in the context of regional and bilateral FTAs refers to the mechanisms used to encourage upward harmonization of standards, to deal with environment-related disputes, to ensure enforcement of environmental laws, to foster environmental cooperation on matters of shared concern, and to foster environment-related capacity building. The various regional and bilateral FTAs offer a wide spectrum of approaches to these challenges.

NAFTA pioneered environmental and labour side agreements as mechanisms for dealing with environmental issues. The North American Agreement on Environmental Cooperation (NAAEC) created a Commission (the North American Commission on Environmental Cooperation, or NACEC) with a funded Secretariat appointed by the Council (the three Environment Ministers), and two public advisory groups. It works to coordinate environmental policies and practices among the three countries—particularly on issues of shared interest such as management of chemicals, environmental reporting and migratory species—raise environmental standards, and build capacity for environmental management. It allows for citizens to submit claims alleging government failure to enforce existing environmental laws which, if found by the Secretariat to be well grounded, lead to the compilation of a factual record – a sort of “name and shame” device. This mechanism has been well used over NAFTA’s 10-year history, in ways that frequently manage to embarrass the Parties (Raustialla (2003), Markell (2003)). As such it is perhaps not surprising that there has been almost no replication of this mechanism in other FTAs.

The NACEC is mandated to assist NAFTA officials in matters relating to trade and the environment, but the formal mechanism for doing so was never exercised until some nine years into the life of the agreement. Even now that some meetings have begun to be held, NAFTA’s trade officials are not overly receptive to the input of their environmental counterparts.

The NAAEC has arguably been successful in quiet, unremarkable ways – harmonizing North American environmental reporting, for example, and compiling and standardizing databases of environmental information and environmental law across the three countries.\(^{36}\) It has strong programs on conservation of biodiversity, on pollutants and health—including work on sound management of chemicals and hazardous waste—and law and policy. It also does strong analytical

\(^{35}\) Even so the denial is not complete. The wording is typically as follows: “Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations.” (emphasis added)

\(^{36}\) For assessments of this work, see Johnson et al. (2004), Block (2003).
work on the linkages between trade and environment. These collaborative environmental efforts are arguably a greater legacy than the NACEC’s record of fostering enforcement of existing domestic environmental standards, and may in fact have helped foster the upward harmonization of standards that is one of the aims of the NAAEC.\footnote{For example, Mexico’s recently announced (Oct. 8 2004) plan to phase out the use of Lindane, a persistent organic pollutant, was strongly linked to the work of the NACEC, and will take place under a NACEC framework: a North American Regional Action Plan on Lindane. Mexico’s phase-out of DDT has been a model for the rest of Latin American policy makers.}

In addition two of the NAFTA parties (the US and Mexico) established a Border Environmental Cooperation Commission (BECC) and a North American Development Bank (NadBank) to address a range of environmental issues along the US-Mexican border that were widely perceived as being trade-related. The effectiveness of these mechanisms is difficult to assess since they also involved the reassignment of existing bodies and funds.

NAFTA also contains a hortatory obligation not to waive or derogate from domestic health, safety or environmental standards in order to attract investment. If a Party believes another party has done so, it can initiate consultations, but these simply lead to a joint effort to reconcile. The mechanism is rather weak, and has never been used.

As well there is in NAAEC a party-party mechanism (Part V) that can be used where one party alleges a persistent pattern of failure to enforce another party’s environmental law. Since its establishment it never has been used; it is unlikely that any party would want to start a stone-throwing melee, given that to some extent they all live in glass houses.

Canada has, in all its subsequent FTAs, included labour and environmental side agreements, but with some modifications. In Canada-Chile, the institutions are almost carbon copies of those found in NAFTA.\footnote{This is a product of the fact that at the time Chile hoped to accede to NAFTA, or negotiate a US-Chile FTA, in short order.} The Citizens’ submission process, though, has been poorly exercised. In seven years it has seen only four submissions, all from Chileans complaining about Chilean non-enforcement of domestic laws. In two cases the Joint Submission Committee found no need for a factual record, in one case it found the guidelines for submission not followed, and in one case it recommended the preparation of a factual record but the Parties, who have the final say, decided not to prepare one.\footnote{This compares with over 50 submissions disputes under NAFTA’s citizen submission process in its first ten years, 10 of which led to the preparation of factual records.}

However, the dynamics in a bilateral agreement will obviously differ from those in an agreement involving three parties. In a bilateral agreement, one party will find itself subject to a complaint and the other can hardly force its consideration; in a trilateral agreement, there are two unaffected parties who have a majority in situations where voting is required. There is also the issue of shared environmental resources to be considered, which motivated some of the institutions created in the NAFTA context but is a lesser consideration in the Canada-Chile context.

The environmental cooperative activities, in such areas as environmental health and enforcement matters, are well-intentioned but poorly funded. The 2003-2005 budget for such activities consists of USD 56,000 per year. For what the comparison is worth, the NACEC’s budget in 2003 was roughly USD 12 million.
The subsequent Canada-Costa Rica side agreement on environment is much weaker. It establishes no institutions (there are two national contact points instead of a Secretariat). The citizens’ submission process has evolved into a process where a citizen may ask a question of his or her own government on enforcement matters and be given a public reply – an extremely weak facility. Cooperation activities aimed at capacity building are ongoing, but are funded at similar levels to those under Canada-Chile, amounting to one or two workshops per year on matters of interest. The same approach is likely to be adopted again in Canada’s pending agreement with the other four Central American states.

The US post-NAFTA FTAs also show signs of retreat from the NAFTA model. Beginning with US-Jordan (which does not follow exactly this model, but which pioneered the approach) and used in every subsequent agreement without fail, the standard model creates an environmental council (or promises to do so) charged with meeting once a year, and pledges to pursue collaboration on a number of environmental fronts. There is no side agreement, but the chapters on environment and dispute settlement provide for the possibility of state-to-state dispute settlement over failure to effectively enforce environmental standards in a manner affecting trade between the Parties. The operative commitment on which this facility is based is:

“A Party shall not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties, after the date of entry into force of this Agreement.”

This paragraph is followed by one recognizing that Parties will often exercise discretion in enforcement matters for legitimate reasons. A special dispute resolution procedure is provided for disputes arising under the environmental or labour commitments. If a Party breaches the basic obligation, it must pay a fine into a fund to be used for environmental initiatives in the non-complying state. The agreements taking this approach are, in chronological order, US FTAs with: Singapore, Chile, Australia, Bahrain, CAFTA and Morocco.

It is worth noting that such Party-Party mechanisms may never actually be exercised. It was noted above that Part V of the NAAEC has never been invoked, for example, and it would be surprising to see them much used in any of the new agreements. It is likely that no Party feels secure enough about its own environmental record to be comfortable in publicly attacking that of another. It may also be that no Party has yet felt the benefits would outweigh the costs of such a politically divisive dispute.

The more interesting question is whether there will be any exercise of the commitments in those agreements for environmental cooperation and capacity building. The rather disappointing experience of the Canadian approach is discussed above. As a case study of the US approach, take the USSFTA – the first of the new generation of agreements. The Agreement’s environment chapter mentions that the two countries will sign a Memorandum of Intent on Environmental Cooperation and the Environment. This would oblige both countries to engage in environmental cooperation activities such as information-sharing and improving environmental enforcement. The activities are meant to strengthen their “capacity to protect the environment and promote sustainable development,” and improve their overall environmental “performance.” No deadline is set in the
agreement, and it is questionable whether a memorandum will be drawn up anytime soon. It is uncertain where the funds for the activities will come from.\(^{40}\)

The USSFTA also contains a provision to create an environmental subcommittee upon the request of either party. Its meetings would bring together environment officials from both governments to discuss any issues pertaining to the environmental chapter. In addition, one of these meetings must be open to the public. Unlike the NACEC established by NAFTA, though, the subcommittee has no independent budget, mandate or secretariat.

The USSFTA is the only East Asian FTA to include a mechanism to enforce environmental governance or to cooperate on environmental activities. The framework agreements of the China-ASEAN FTA and the Japan-ASEAN FTA mention the possibility of co-operating on environmental projects. The Thailand-Australia, Panama-Taiwan and Korea-Chile FTAs include commitments to provide technical assistance in other fields, such as standardization, SPS measures and customs, but not the environment.

ASEAN is distinct in the East Asia region for the extent of its environmental cooperation activities. Under the auspices of the Bureau for Resources Development, work on the environment is organized according to action plans and supervised by the ASEAN Environmental Ministers, who meet yearly. ASEAN currently has five working groups for MEAs: nature conservation and biodiversity, sustainable cities, the marine and coastal environment, and water resources management. Little effort has been made to tie the bureau’s work on the environment with the Bureau of Economic Integration, which oversees trade policies. The secretariat did create an environmental economics working group in 1994 but disbanded it four years later. The ASEAN Senior Officials on the Environment coordinated with the ASEAN Senior Economic Officials when drafting the ASEAN Agreement on Transboundary Haze Pollution in 2002. But ASEAN does not yet seem prepared to make these meetings a regular occurrence, nor to make environmental governance a legally-binding feature of trade agreements. The farthest it has gone is to include in the preamble to the declaration of the ASEAN Community\(^{41}\) that ASEAN would be “guided” by the ASEAN Vision 2020 and the Hanoi Plan of Action, both of which affirm ASEAN’s commitment to creating environmentally sustainable societies.\(^{42}\)

Despite this reticence, environmental cooperation has been extensive. The ASEAN Regional Center on Biodiversity Conservation is in its fifth year of operation. The ASEAN Specialized Meteorological Centre was recently set up, and work is being done to implement the Regional Haze Action Plan (RHAP). Environmental education is one of ASEAN’s highest priorities, and the Secretariat is also conducting a feasibility study to establish a center for environmentally sound technologies. By the end of 2004 the Senior Environmental Ministers (SEM) is supposed to complete a framework agreement on biological and genetic resources. The Association has agreed to create a US$10 million ASEAN environment fund, and is working on a best practices list to promote environmentally sustainable cities.

\(^{40}\) TEPAC (2003).

\(^{41}\) ASEAN (2003b)

\(^{42}\) ASEAN (1997): “We envision a clean and green ASEAN with fully established mechanism for sustainable development to ensure the protection of the region’s environment, the sustainability of its natural resources, and the high quality of life of its peoples.”
On environmental cooperation, the Euro-Med Agreements have good language. Chapter 44 of the Agreement with Egypt (Environment) promises cooperation aimed at preventing deterioration of the environment, controlling pollution and ensuring the rational use of natural resources, with a view to ensuring sustainable development. It lists a number of areas of cooperation, but does not actually establish any institutions to backstop those initiatives. There is a facility for financing of reforms and cooperation in the Mediterranean area under the Euro-Med frameworks for collaboration—the MEDA—but the 2005 - 2006 program has nothing on environment. EU-Chile has no specific provisions for environmental cooperation.

EU “inter-regional” agreements, Mercosur and the Euro-Med agreements, are designed as agreements for political cooperation, in which trade is a subordinated concern. They are structured as agreements between the EU and its Member states on one side and negotiated by the foreign affairs departments rather than the trade negotiators, who deal only with the trade sections. The result is paradoxical, because in a structure that should accommodate intensive environmental cooperation even the provisions found in many “pure” trade agreements do not occur. The reasons may actually be in part bureaucratic: in most European countries both trade and international environmental negotiations are conducted by specialized departments, with not much more than pro forma participation of the foreign affairs agencies—which consequently have weak institutional capability for dealing with these issues. While trade negotiators form part of the core negotiating group for the inter-regional agreements, those responsible for international environmental processes typically do not.

Mercosur in 2001 signed a “Framework Agreement on the Environment in Mercosur,” aimed at fostering sustainable development and protecting the environment in the Mercosur countries. Chapter 3, on Environmental Cooperation, lists 14 types of environmental cooperation to be pursued, including fostering harmonization of national environmental standards, sharing information on environmental emergencies and promoting research into clean technology.

The Agreement only entered into force in June 2004, three years after its signing – a symptom of the intense politics of its negotiation. So it is too early to assess the reality behind the promises. It should be noted that there has been ongoing work on environmental matters in the Mercosur since 1995, under the auspices of the Sub-Working Group Six (Environment) and before that since 1992 in the context of special meetings on environment. The work program focuses on the areas of:

- Eliminating environmental non-tariff barriers within Mercosur;
- Creating a bloc-wide system of environmental information;
- Guidelines for environmental emergencies;
- Work on competitiveness and environmental cost internalization;
- Work on international environmental standards such as ISO 14000;
- Sectoral work, such as on illegal trade in timber;
- Creating a Mercosur system of ecolabelling.

This section of the paper has uncovered a rich variety of approaches to addressing environmental issues in regional and bilateral trade agreements. These will serve as a basis for the analytical approach in the section that follows. That section will address key questions about the implications of regionalism in trade and investment for sustainable development.
4. Issues for Consideration

This section will outline the major questions that must be addressed if we are to understand the sustainable development implications of regionalism in trade and investment policy. The choice of issues and the discussion of each is founded on the previous section’s survey of actual practice, as well as on an extensive review of the literature. On some issues there is a wealth of published literature; on others the crop is much more meagre. The concluding section will try to assess the state of research with respect to the questions raised here.

4.1. Why the rush to regionalism?

There are as many different rationales for negotiating FTAs as there are countries doing so. At a general level the rush we are now witnessing owes much to the change in philosophy of many developing countries, after the failure of the protectionist import-substitution models of the late twentieth century. The success of the “Asian tigers” in developing their economies using a judicious mix of market intervention and export promotion has lent a new legitimacy to the policies of liberalization and economic integration.  

But the intensification of negotiation we now see has much of the flavour of a process that is feeding on itself, tending to exponential growth, and there may be some credibility to the assertions of Bhagwati (2002) that we are witnessing a drive to not be left out of the widening phenomenon of regional and bilateral integration. Baldwin (1995) makes the argument that FTA negotiations react to one another in a widening domino effect. Since FTAs disadvantage non-members, every time one is signed there is pressure from non-member exporters to engage in integration of their own, bringing the economic and political balance back further in their favour.

It is instructive in any particular case to look at the economic composition of the FTA partners, asking whether they are complementary or competitors. The former types of arrangements tend to be founded on economic considerations, and the latter on strategic. The agreements of East Asia are a mixed bag in this regard. The ASEAN-China FTA agreement is an example of an FTA with competitive partners. Although China’s imports from the region have grown in recent years and continue to grow, ASEAN’s developing countries compete for the same foreign export markets as China and both regions share similar comparative advantages. The FTA has been interpreted by ASEAN countries in political terms foremost, and then in economic terms. AFTA is a combination of competitive and complementary economies. The Agreement, along with the future ASEAN Economic Community (AEC), is meant to capitalize on the growing network of MNCs located throughout Southeast Asia, and to create economies of scale that could match China or India’s.

---

43 Though Rodrik (2001) argues strongly that current models of liberalization do not in fact mimic the conditions that led to growth in the Asian tigers, pointing out that those models tend to rule out the kind of market intervention practiced there, instead trusting (in his view, erroneously) that unassisted open economies will lead to development.

44 China imported US$4.5 billion worth of goods from ASEAN in 1993. By 2000, it had risen to US$35 billion, though it fell to US$19.5 billion in 2002. ASEAN Trade Data, ASEAN Secretariat.


At the same time, there is a wide variety of factors leading to the rush to regionalism in any particular case. The analysis that follows separates them into driving forces based on economic and strategic considerations.

4.1.1. Economic considerations

One of the foremost reasons for regional or bilateral integration is to effectively create larger markets (through lowering of tariff and non-tariff barriers) to take advantages of economies of scale in the production of goods and services, and the increased opportunities for productive investment.47 But this motivation is actually a stronger rationale for multilateral trading arrangements than for regional or bilateral arrangements, since the bigger the liberalized market the better. We need to search for other complementary reasons to explain the explosion of regional negotiations.

One primary motivation is that FTAs offer more and better liberalization than is easily available at the multilateral level. Thus, for example, Mexico’s desire to sign NAFTA was premised on the ability of its firms to sell into a much larger US market, to an extent not possible under multilateral arrangements. The willingness of a host of partners to cement deals with larger economies is premised on the same sorts of motivations. There is in fact strong empirical evidence to demonstrate that flows of FDI are influenced by the size of the regionally integrated market, presumably seeking economies of scale.48

For developing countries, signing North-South agreements can also be motivated by a desire to lock in reforms that increase their credibility as hosts for foreign direct investment and technology transfer.49 It is seen, this argument goes, as a seal of approval for the governments involved to have concluded negotiations that involve strong reforms of domestic institutions (as in the area of IPRs), the opening up of protected service sectors and the willingness to sign on to strong investor protections.

For their part, many developed countries are keen to lock in reforms of developing country markets in areas of deeper integration. Thus, for example, we see a slew of US FTAs incorporating WTO-plus elements in the areas of investment and intellectual property rights, given the US’ prominent position as an exporter of capital and technology.50 This motivation has a strategic side as well, considered in greater depth below: it is often impossible to achieve this kind of commitment to reform at the multilateral level.

The motivation for regional negotiations can also be reactive. A large part of the drive to create the ASEAN Economic Community was a response to the growth in economic strength of China and India as competitors.51 A regionally integrated South-East Asia would be able to keep more of its

47 Berthelon (2004) and others have found that FTAs that significantly enlarged the market resulted in significant economic growth,
48 Schiff and Winters (2003), Lederman et al. (2003).
49 Whalley (1998) argues that this was a prime motivation for Mexico in negotiating the NAFTA. Tornell and Esquivel (1997) call it a “commitment effect.” This sort of locking in is seen as particularly important in countries where there is a strong likelihood that future regimes will be less enamoured of neo-liberal open-market policies.
50 Vivas-Eugui (2003) surveys this trend in the Latin American context. See also Drahos (2001).
51 ASEAN (2003b).
own manufacturing and export base, and decrease the tendency for investment to flow to the Chinese and Indian giants.

Finally, bilateral or regional agreements can also give a country a foothold, an entry point, in a region of export interest. This, for example, was a large part of the motivation for the US and Canada to seek negotiations with Singapore, and for Korea in signing an agreement with Chile.\(^{52}\)

Of course, the different motivations for regionalism cannot be isolated and must be seen as part of a larger picture that almost always also involves non-economic considerations, often subsumed under the term “economic integration,” implying a degree of harmonization of policies. For example, the process that led to the creation of the European Union began with a desire on the part of France and Germany to end rivalry and future potential conflicts but ultimately extended to almost all areas of public policy. These types of motivations are considered below.

### 4.1.2. Strategic considerations

We have already noted, above, that one strategic consideration is the fear of being left out of the expanding phenomenon of regional integration. Thus, Canada (at the time bound to the US by a bilateral FTA) was adamant that the US include it in its free trade talks with Mexico, not wanting to be left out of the continental integration process. Similarly, the move by Japan to begin signing FTAs in the region has been strongly impelled by a fear of loss of influence. So the ASEAN-Japan agreement was very much a reaction to the ASEAN-China negotiations.\(^{53}\)

Another oft-cited strategic motivation is the slow pace at which liberalization is proceeding at the multilateral level.\(^{54}\) Related to this is the fact that negotiations and administrative arrangements are much easier, more flexible, at the bilateral or regional level than they are in the WTO with its almost 150 members. As such, regional forums are able to tackle agreements on issues not covered, or very minimally covered by WTO law, and on which no multilateral agreement can be soon expected.

The impetus for bilateral FTAs in Singapore—the most active signer of such deals in Asia—is based on the fact that East Asian regionalism is characterized by diversity and heterogeneity with respect to the stage of economic development. Therefore, it would not be easy to conclude an integrated region-wide FTA, and bilateral FTAs are expected to provide the necessary impetus for trade and investment liberalization in East Asia.\(^{55}\)

The US openly stated its intent to pursue a bilateral and regional strategy of liberalization after the failure of the WTO’s Cancun Ministerial meeting in 2003 (though it was already doing so before that date).\(^{56}\) This motivation has two related elements. First, there is the obvious intent to pursue at the

\(^{52}\) See comments made by US Trade Representative Robert Zoellick on the USTR website (http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Section_Index.html). For Chile, see Kim S-Y (2002).

\(^{53}\) Lim (2004a).


\(^{55}\) Elek (2003), Scollay (2003).

\(^{56}\) Zoellick (2003a).
bilateral level reforms that cannot be achieved at the multilateral level. For example, the widespread inclusion of certain investment provisions in modern FTAs is in part a reaction to the refusal of a number of countries to countenance investment negotiations in the WTO. Second, there is the desire to use bilateral and regional negotiations as a tool to push greater efforts at the multilateral level — the so-called “competitive liberalization” strategy. So, for example, when the energies of the Uruguay Round negotiations were flagging, the US declared its intent to push for greater liberalization in the APEC forum, hoping to achieve progress there that could then be used to prod the WTO negotiations. The US move to negotiate agreements with several G20 countries after Cancun — where the G20 had, in its view, stymied progress — was a clear attack on the integrity of the bloc it saw as frustrating the Doha Round negotiations.

Another major strategic motivation for FTAs is to cement security and political relations between partners. So, for example, the EU’s Euro-Med process is based on the understanding that a prosperous and integrated Mediterranean is in the strategic interests of the European states. Similarly the China-ASEAN negotiations, from the Chinese perspective, are an effort to assert greater influence in the region, and help cement its emerging role as a regional leader.

In a related vein, FTAs may also be concluded in an effort to stabilize potentially antagonistic relations. China, Japan and Korea are engaging in such a process with the ASEAN+3 initiatives, where the rise of China and the traditional economic and political rivalry between China and Japan also increased the need for a regional framework to minimize and stabilize the negative effects of potential conflicts between East Asia’s two largest powers. Similarly, the US-Middle Eastern free trade negotiations are clearly motivated (on the US side) by a desire to bring peace and stability through prosperity and greater US influence in a relatively hostile region of key geopolitical interest.

FTAs may also be seen as a way to increase sovereign power through agglomeration, in a time when the forces of globalization tend to erode the sovereign ability of any individual country to manage its own affairs. In that sense, the proliferation of regional and bilateral FTAs in East Asia can be explained in part as a response to the Asian Financial crisis in 1997. This unexpected financial and

57 See Zoellick (2002).
58 Bergsten (2004), in the context of the subsequent round of WTO negotiations, argues that, “APEC should actively pursue the FTAAP idea. It offers the best prospects of any available strategy for catalyzing a successful outcome of the Doha Round and thus revitalizing the World Trade Organization (WTO).”
60 The 1995 Barcelona Declaration that initiated the Euro-Med process stresses the “strategic importance of the Mediterranean,” and the “privileged nature of the links forged by neighbourhood and community.” It also affirms that “the general objective of turning the Mediterranean basin into an area of dialogue, exchange and cooperation guaranteeing peace, stability and prosperity requires a strengthening of democracy and respect for human rights, sustainable and balanced economic and social development, measures to combat poverty and promotion of greater understanding between cultures.” See Youngs (2002).
61 Lim (2003).
63 Mansfield and Pevehouse (2000) find that the effect works best between countries that actually expand trade, but that even at low levels of trade there is an impact.
65 Zoellick (2003b).
66 Gavin and van Langenhove (2003)
economic meltdown contributed to a regional sense of insecurity and vulnerability in many Asian countries.

The Euro-Med agreements are driven by what seems to be a broad spectrum of economic and political goals. The Associate agreements with the EU are only one part of a larger process that also envisions a Mediterranean FTA and, as part of the “Barcelona Process,” aims to “establish a common Euro-Mediterranean area of peace and stability based on fundamental principles including respect for human rights and democracy.” Clearly the EU sees the wellbeing of its Southern neighbours as important to its own wellbeing, and is willing to invest the necessary resources to help make them good neighbours.

A regional trade agreement, particularly if it encompasses a number of smaller powers, may afford increased bargaining power in multilateral trade negotiations by giving them a combined voice. Note that this rationale for FTAs would predict the need to counter-balance that newly-created power through the establishment of other FTAs in other parts of the world.

Finally, there may be a desire by smaller economies to bring the rule of law to their larger trading partners – what has been called the safe-haven concern, wherein a trade agreement acts as insurance against future protectionism in large export markets. This was a prime motivation for Canada in negotiating FTAs with the US, with whom it had a number of high profile running battles on trade issues without recourse to adequate mechanisms of dispute settlement.

4.2. Does the rush to regionalism undermine the multilateral system?

The rush to regionalism gives rise immediately to the question: does regionalism in trade and investment reinforce or undermine progress at the multilateral level? To use Bhagwati’s terms: are FTAs building blocks or stumbling blocks for free trade? This section considers this question, without considering the merits or drawbacks of the results for sustainable development. Section 4.4 goes into further detail on this question, asking what it means for sustainable development that the multilateral system be eroded or shored up by FTAs, as the case may be. In the end this is the key issue; this section starts with no assumptions about the desirability of a strong multilateral system of trade rules.

Section 3, above, describes the ways in which WTO rules interact with FTAs. They are allowed under GATT Art. XXIV, provided they meet three criteria: trade barriers with non-signatories should not be raised, the free trade area should be established within a transition period of no more than ten years, and the trade rules and regulations should be eliminated for “substantially all sectors.” We noted above that interpreting the last of these criteria has been done creatively, depending on the circumstances.

---

68 Chang and Winters (2002) find this may be a significant effect in the Mercosur context. In the SAARC context, see The Daily Star (2004).
69 This motivation is argued by Whalley and Hamilton (1996).
70 See Ostry (2000).
The broad purpose of the WTO criteria, which have never yet been successfully exercised to find any particular agreement in breach of the rules, is basic: to preserve the sacrosanct principle of most-favoured nation (MFN), one of the cornerstones of the multilateral system. That is, if a FTA is created, it should do minimal damage to the interests of other WTO members. In fact, to go further, many hope that FTAs will foster greater progress at the multilateral level. In East Asia, bilateral and sub-regional FTAs are being promoted on the assumption that they will produce a process of “competitive liberalization”. It is proposed that the separate agreements can become building blocks towards regional and ultimately global free and open trade. While this may indeed be the case, some analysts are concerned that many East Asian countries do not have a clear idea about the dynamics of regional trade and investment liberalization, nor of the risk of trade fragmentation resulting from the un-coordinated processes.\(^72\) Even with the agreements that link them it is a rather complicated matter.

By their basic nature FTAs are a violation of the MFN principle; they treat parties more favourably than non-parties. The concern here is that widespread coverage of FTAs will change the nature of multilateral negotiations. The calculus of benefits from negotiations must take into account the fact that concessions offered will not necessarily constitute MFN treatment. Other things being equal, the biggest losers from this new dynamic are those involved in the fewest FTAs.

It has also been argued that FTAs create disincentives for multilateral liberalization, since those FTA parties that enjoy preferential access to large markets (such as Mexico to the US, and Chile to the EU) will resist any liberalization that erodes their edge over competitor nations.\(^73\) On the other hand, such an effect is to some extent offset by those countries excluded from existing agreements, who will push for greater multilateral efforts at liberalization (and/or seek to become FTA members).

The arguments are more or less straightforward in the area of tariff protection. It becomes more complex as we consider elements of deeper integration, such as technical barriers to trade, sanitary and phytosanitary protection measures, competition law, intellectual property protection and regulation of investment. It is in the first instance somewhat more difficult to determine what is WTO-plus in these areas. But the major challenge is to determine the implications of variance from the WTO rules. That is, it is easy to see that lower tariffs convey an advantage to FTA parties vis-à-vis the rest of the world, but what is the ultimate impact of an FTA mandating stronger laws to protect intellectual property?\(^74\)

Beyond the MFN impacts, there are other questions about elements of deeper integration in FTAs. Rules that differ from those agreed at the multilateral level might have any or all of several types of impact.

They might frustrate progress at the multilateral level by locking in agreement to respect regulatory differences. In the context of food safety and ecolabelling rules, regional agreements tend to more easily bow to the desires of the Parties for autonomy on regulatory frameworks.\(^75\) Differences go

\(^{72}\) Soesastro (2003).
\(^{73}\) See, for example, Krishna (1998).
\(^{74}\) This raises the important issues whether identical levels of protection of intellectual property are actually appropriate for countries at different levels of development; an issue the WTO has difficulty addressing.
\(^{75}\) Isaac (2003)
beyond standards to fundamental approaches to regulation, using as an example the transatlantic
differences in approach to precaution. Such respect, however, is more difficult to conceive at the
multilateral level, and therefore it has been argued that “regional rules reinforce national regulatory
autonomy … and ultimately become a stumbling block to the multilateral system.”\textsuperscript{76} OECD (2003)
finds potential for this sort of dynamic in the regional approaches to competition policy and
contingency protection.

In a similar vein, the existence of rules at the regional level can frustrate the ability of countries to
multilaterally agree to improved approaches. In the area of investment there are so many BITs in
force with problematic language on expropriation, for example, that the task of reforming them
through a more carefully thought-out multilateral agreement becomes almost impossible.\textsuperscript{77} If none
of them existed, it might be possible to negotiate a better approach, but as it is their existence can be
used by those resistant to change as a shield from reform efforts. It is likely that if the recent US
FTAs had existed prior to Doha, it would have been much more difficult to draft the landmark
Doha Declaration on TRIPS and Public Health. Those agreements contain language that runs
counter to the Declaration’s objectives, and their existence might have tipped the scales against
progress in what was, to the last hour, a hard-fought battle.

Closely related is the problem that regional rules may adopt provisions existing at the multilateral
level, which then makes reform of the multilateral rules much more difficult. For example, the
previous section documented a trend in recent agreements to adopt a clause on domestic regulation
of services, declaring that any such regulations be “no more burdensome than necessary.” Many
regard this language as problematic, in that it may unduly restrict policy space.\textsuperscript{78} But its reproduction
in a wide number of FTAs since its adoption at the multilateral level helps “freeze in” that approach,
insulating it from the possibility of multilateral reform. Of course, the relationship between the
multilateral and the bilateral/regional is further complicated by the prospect that a definitive
interpretation of that language at the multilateral level will influence how it is interpreted at the
bilateral/regional levels as well.

On the positive side, regional approaches that go beyond the multilateral rules might in fact pioneer
new approaches that can then be the basis for progress at the multilateral level. The APEC
approach to liberalizing trade in environmental goods and services, for example, has served as the
basis for debates in the WTO context (used as an alternative to the approach promulgated by the
OECD).\textsuperscript{79} A number of the environmental WTO-plus elements described in the previous section
might eventually fall into this category. Tay (2004), in the specific context of trade-environment
talks, argues that given the stalled progress at the international level on those issues, the policy
innovation that can take place at the regional and bilateral levels is healthy, and may feed workable
precedents back into a debate at the multilateral level. Heydon (2003) also argues that such a
dynamic is possible under the right circumstances.

In the final analysis, the impact of regional approaches that go beyond the WTO will rest on a
somewhat subjective analysis of the approach in question. If we believe that the necessity test for
domestic regulation is a bad idea, then we will argue that its inclusion in a number of FTAs will

\textsuperscript{76} Ibid, p. 243.
\textsuperscript{77} Peterson (2004)
\textsuperscript{78} UNDP (2003), Howse and Tuerk (2003).
\textsuperscript{79} See WTO (2003b).
frustrate progress in reform at the multilateral level. Similarly, the investment provisions found in so many BITs only constitute a problem for the multilateral system if we find them to be inadequate or inappropriate. This sort of analysis—which is not entirely subjective, since empirical evidence can tell us whether an approach works or does not, given agreed objectives—will in the end differentiate a “pioneering approach,” offering a model for multilateral emulation, from one that “frustrates progress.”

A final consideration is that any given country has only a finite amount of capacity to negotiate. This capacity vests not only in having enough capable negotiators to cover the bilateral meetings, but also in having adequate analytical power, political energy and mechanisms of consultation to determine what negotiating positions might be in the national interest. In those countries with scant capacity of this sort, it tends to be a zero-sum game: negotiations at the regional level mean fewer resources to devote to multilateral negotiations, and vice versa. Widespread regional negotiations of the sort we are now seeing will surely make multilateral negotiations proceed more slowly. Alternatively, if the pace of negotiations is not easily slowed, overstretched capacity might mean some countries are not getting the best deal they could from a given set of negotiations.

4.3. The impacts of level of development on FTA characteristics

It should be clear by this point in the analysis that FTAs are far from homogeneous, and defy general description. One useful way to group them is to analyze the common features of FTAs conducted as between partners of various levels of development. This section briefly summarizes what can be said about North-North agreements, South-South agreements, and those conducted between partners from both the North and the South.

4.3.1. North-North agreements

FTAs among northern parties tend to involve deep liberalization, extending beyond tariff cuts to also broach areas of deeper integration. The Canada-US Free Trade Agreement, for example, pioneered deeper integration in the area of services, investment and IPRs.80

As the previous section showed, they also tend to involve significant provisions on the environment. The European Union, while not a typical FTA, goes far beyond any other international institution in its ability to legislate environmental rules and to ensure their enforcement. It can deploy large resources to support its priorities. It has articulated key principles such as precaution and subsidiarity in a legally binding manner, and has created a number of international institutions of environmental governance.81 Such provisions tend to arise from a desire to promote integration and from competitiveness concerns: the fear that in a non-harmonized setting there would be a damaging race to the regulatory bottom.

4.3.2. North-South agreements

FTAs between developed and developing countries have several distinct characteristics. Many of those features stem from the overriding desire of the Southern partner to secure market access in the markets of the Northern partner. The literature shows that the creation of a larger integrated

---

80 See Ostry (2000).
market is a clear potential win for the smaller player in such agreements, leading to increased investment and exports.\textsuperscript{82}

The question is: what do developing countries surrender in exchange for those potential benefits? In the area of environment, the answer is clear, as shown in section 3: they accede to the priorities of the Northern partner. Thus, US FTA partners accede to the demand by the US to perform an environmental impact assessment (or environmental review, in the US’ terminology), as did Singapore. But Singapore, like the other US PFTA partners, obviously did not do so out of a conviction of the value of the exercise, since it did not perform a similar analysis for subsequent FTAs. The same holds true of the side agreements on environment and labour attached by the US and Canada to NAFTA at the last minute, and accepted over Mexico’s apoplectic objections. And it even holds for the “GATT-plus” language interpreting environmental exceptions, found in agreements signed by Mexico and Chile with North American partners.

Similarly, we have seen a raft of FTAs of a David-and-Goliath character where the weaker partner accepts strong obligations in areas of deeper integration. Vivas-Eugui (2003) documents the GATT-Plus character of commitments made in US FTA negotiations in the western hemisphere. The World Bank (2004) does the same for North-South agreements in the areas of services and investment. Peterson (2004) argues that the expropriation commitments in modern FTAs could well preclude allowing developing countries to introduce public solutions in areas such as child care and health insurance.

It is worth bearing in mind the analysis of the preceding section, where it was argued that such GATT-plus commitments in the areas of deeper integration might be a force either undermining or driving progress at the multilateral level. The effects discussed in that section are most likely to occur as a result of North-South agreements, where at the end of the day the approaches preferred by the Northern partner tend to emerge unscathed by the negotiation process.

North-South agreements are also most likely to include provisions providing for technical assistance and capacity building. Section 3 catalogued a number of these sorts of provisions. There is a strong element of this in the Euro-Med agreements, with powerful budgets to back it up, in areas ranging from environmental protection to investment promotion. NAFTA also has a significant element of this sort of exercise built into the side agreement on environment – the North American Agreement on Environmental Cooperation. Subsequent US and Canadian FTAs also contain similar provisions, but with much weaker institutional structures and practically no budget. The underlying causes and implications of this tendency are discussed further in Section 4.4.

4.3.3. South-South agreements

The liberalization involved in South-South agreements is of a different character. It tends to focus on market access, on tariff barriers and to a lesser extent non-tariff barriers.\textsuperscript{83} And it tends to pass over elements of deeper integration such as investment and intellectual property rights. World Bank (2004:36) argues that, for many South-South agreements, “the drive for economic integration begins with political objectives.”

\textsuperscript{82} Schiff and Winters (2003)
\textsuperscript{83} Kamal and Imai (2003) show this to be true in the South-East Asian context.
South-South liberalization tends to be more shallow, even in the area of liberalizing trade in goods. It allows for more exceptions, more scope for government intervention. Thus, for example, Indonesia has submitted nearly 400 categories of sensitive and highly sensitive goods to be excluded from the scope of liberalization under the ASEAN-China free trade deal. And South-South agreements tend to have more restrictive rules of origin, meaning a greater likelihood of trade diversion.

There are, however, a number of agreements that defy that generalization, involving deeper integration among developing countries, such as the customs union exercises ongoing in Mercosur, ECOWAS, SACU and the Andean Community. ASEAN as well has a number of well-developed institutions of policy coordination (discussed in Section 3), in areas ranging from the environment to regional peace and stability.

In the area of environment, the South-South agreements take a different approach than those followed by other agreements. The focus is not so much on warding off the pollution haven effect, embodied in Northern agreements by means of complex obligations to enforce existing environmental regulations. Rather, the focus seems to be on addressing environmental problems of shared interest. So, for example, in Mercosur there are programs to establish a Mercosur-wide ecolabelling system, in large part aimed at garnering market share among green consumers in export markets. Mercosur countries are also in the process of developing a region-wide system of environmental information. Similarly, the ASEAN countries responded to the issue of haze pollution by devising collaborative approaches.

South-South agreements may go beyond WTO law in areas of shared interest, pursuing Southern priorities in ways that would be difficult to do at the multilateral level. For example, the Andean Community has pioneered an approach to intellectual property rights protection that respects the objectives of the Convention on Biological Diversity, and protects traditional knowledge. SAFTA pays disproportionate attention to the question of special and differential treatment, and even agrees to create a mechanism to compensate least-developed contracting states for loss of tariff revenue from trade liberalization. The WTO system has to date proven incapable of a similar level of development on these issues.

### 4.4. Regionalism and sustainable development

What does the rush to regionalism mean for sustainable development? It was argued above that this question—not the question of whether the multilateral system is under siege—is the proper focus of our attention. Where the regional/bilateral agreements differ from the multilateral system, is that good or bad for economic, social and environmental progress, both at the regional and global levels? This section starts to analyze the themes that must be more fully addressed if we are to adequately answer this question. It focuses first on economic implications of the rush to regionalism, and then on the development and environmental implications.

---

84 Though note that World Bank (2004) finds that South-South agreements have made significant improvements in this regard since the early 1990s.
85 Estevadeordal and Suoruminen (2004)
4.4.1. Economic implications

There is an ongoing debate on whether trade and investment liberalization in fact contribute to economic growth, and moreover whether growth, if created, leads to poverty alleviation, reduced inequity or other elements of sustainable development.\(^{87}\) A resolution to this debate is beyond the scope of this paper. In fact, the contribution of this paper will be to add more layers of uncertainty to the mix. If free trade is good in any of the ways suggested above, are FTAs therefore good in the same ways? And if free trade alone is not sufficient to advance countries in the areas of growth and development, does it contribute to strengthening those institutions and policies that comprise a sufficiency?

The first question takes us to the well-worn battleground of trade creation versus trade diversion. Viner (1950) wrote the classic piece on this subject, arguing that FTAs might reduce the welfare of non-parties, and even of the parties themselves, by causing FTA consumers (either final consumers or producers consuming inputs) to switch from buying efficiently produced non-FTA partner goods to those produced less efficiently by FTA partners. This switch would occur if the differential between the internal and external tariff barriers were high enough to make the inefficient FTA goods sell more cheaply. Strict rules of origin can also have the effect of tariff barriers, as can non-tariff barriers imposed externally but resolved among FTA parties. All can cause less efficiently-produced goods from within the FTA to replace non-FTA imports. In a much-cited study, Yeats (1998) found evidence of trade diversion within the Mercosur. A meta-analysis by World Bank (2004) found that of 19 FTAs examined, 10 seemed to create net trade diversion.

But trade diversion is not automatic, even in theory. In the case of the ASEAN Free Trade Area (AFTA), for example, the effect is much less likely; ASEAN economies as a rule are quite open and the margin of preference between AFTA tariffs and MFN tariffs is not large.\(^{88}\)

As Schiff and Winters (2003) note, where there is trade diversion the smaller country in a FTA may end up better off; the benefits of increased exports to the larger partner may outweigh the losses incurred by sourcing inefficiently produced goods. But if our focus is sustainable development impacts, it must be kept in mind that these national benefits would come at the expense of global wellbeing.

It should also be noted that we are seeing a rise in “hub-and-spoke” FTA arrangements, with the US and the EU signing large numbers of bilaterals.\(^{89}\) While this may bring benefits to the hubs, the spokes, particularly if restrictive rules of origin are used in the bilaterals, will not be as well off.\(^{90}\) This dynamic is a strong argument in favour of multilateral, rather than regional or bilateral, approaches.

More recently it has been argued that Viner’s analysis is too static, and does not take into account the dynamic links between FTAs and structural economic reform, dynamic medium/long-term effects on productivity, learning from exporting, or the longer-term impacts of locking in reforms. The debate on both sides is summarized well by Devlin and French-Davis (1999). Increased

\(^{87}\) For an analytical survey of the literature, see Cosbey (2004).
\(^{88}\) Lim (2004c).
\(^{90}\) Wonnacott (1996)
productivity may be the result of technology transfer and spillovers from investment diverted from non-parties (or even from the higher-cost FTA partner(s)). Any such increases in productivity among the parties would be counted as benefits, against the losses created through trade diversion. At a global level, of course, the gain here is not clear; any increased productivity would have to be greater than that hypothetically achieved by the alternative: investment in non-FTA countries.

Schiff and Winters (2003) and World Bank (2004), surveying the literature, find evidence that liberalization can bring significant benefits—particularly multilateral liberalization, and particularly in the services sector, but also to a lesser extent in the area of trade in goods. Both stress, however, that not all liberalization will do so, even disregarding the question of trade diversion. The economic benefits derived from liberalization, they note, have been shown to depend on a number of factors not related to the existence of a FTA: shared borders and culture, macroeconomic stability, the strength of domestic institutions and infrastructure, the readiness of exporters and the size of the market created by integration. Noting the pre-eminent importance of this last factor, Schiff and Winters argue that South-South agreements will lead to far fewer benefits than will North-South agreements.

The example of AFTA demonstrates how domestic economic and political institutions can influence the gains from a trade agreement. So far the net effect of AFTA has been negligible, with many ASEAN economies losing their competitive advantage against China and other rapidly developing economies since the Asian financial crisis in 1997. Limited by meager financial resources—a problem aggravated by the Asian financial crisis—some ASEAN countries were unable to implement the reforms required by the agreement, and in some instances backed out of their commitments. Moreover, liberalization in ASEAN countries has often not been followed by the necessary domestic de-regulation and re-structuring of the real and financial sectors. Financial and banking de-regulations and increasing labour productivity, infrastructural investment, transparency and efficiency in public institutions have not kept pace with the rate of trade and investment liberalization. As long as there is such a gap, ASEAN countries will not be able to take advantage of AFTA and other regional and bilateral FTAs and the widening opportunities offered by ever-widening and intensifying globalization process.

Specific examples of this include Indonesia, which suffered the worst of all Asian countries after the crisis. The country was slow to liberalize its banking and financial sectors. This was partly due to the corruption that pervaded the political system, as well as the enormous political changes precipitated by the financial crisis, which saw the end of the Suharto regime. The lack of transparency in government and the country’s weak judiciary also dampened investor confidence and hence reduced the momentum for reform. In Malaysia, the government’s longstanding protection of its automotive industry has continued despite AFTA. In 1998, Malaysia requested ASEAN to amend the AFTA agreement so that it could postpone the liberalization of its auto sector. Malaysia was given an extension of five years; now that that its postponed deadline is about to expire in 2005, it intends to increase its excise duties on imported vehicles to replace the tariff reduction. The Philippines government, pushed by its strong agricultural and manufacturing lobbies, has also

91 See Lim (2004b). Intra-regional trade as a percentage of total trade has remained flat since the entry into force of AFTA. But note that both intra-regional trade per unit of GDP and extra-regional trade per unit of GDP have increased strongly since AFTA’s entry into force (World Bank 2004: 59).
93 Ibid.
missed deadlines for opening up several sectors, and actually reversed its mandated lowering of tariffs on petrochemicals.

This is not to deny the reforms that have taken place, however, as many countries, notably Singapore, Thailand and Malaysia, have implemented changes to government institutions, such as the Government-Linked Corporations in Singapore and Malaysia’s Khazanah Nasional. Indonesia’s IBRA (Indonesian Bank Restructuring Agency) made enough progress that it fulfilled its mandate and was disbanded in late 2003. In recognition of the challenges that liberalization imposes, ASEAN’s newest members, Cambodia, Laos, Myanmar and Vietnam, have been given delayed liberalization schedules and some preferential tariffs from ASEAN’s older members.

In the NAFTA context, Lederman et al. (2003) use world-wide data in a rigorous analysis to explain the inflow of FDI to Mexico. Post-NAFTA Mexico exceeded predicted levels of FDI, but by the late 1990s levels of FDI had dropped to below what the model predicted. They speculate as to the cause, noting that institutional and policy reform in Mexico lagged behind that of a number of other competitors for FDI, including the EU’s accession candidates.

Rodrik (2001), Hoekman (2002) and others (though arguing from a multilateral perspective) share the focus on ancillary factors as key in ensuring gains from liberalization. Without the necessary infrastructure, strong institutions and a supporting policy environment, the opportunities offered by liberalization are just that: opportunities. Exploiting those opportunities is the real challenge. Lederman et al. (2003:301), speaking in the context of the investment effects of FTAs, concur: “Unstable countries with low productivity, distorted policies and weak institutions are unlikely to draw much FDI benefit from joining a [regional integration agreement]. … Ultimately, FTAs are neither necessary nor sufficient for countries to attract increased FDI inflows.” The World Bank (2004) makes the same case, also in the context of investment.

This brings us to the second question, posed above: if other elements are needed in order for FTAs to contribute to sustainable development, do FTAs at least make achieving those elements easier? Before addressing that question, we first examine the environment and development impacts of FTAs.

4.4.2. Environment and development implications

One of the key features of bilateral/regional approaches to liberalization is the ability at that level to accomplish what cannot be accomplished at the multilateral level.

Environmental protection often requires regional cooperation, as with the problems encountered by states that share river basins, that border common seas, that co-host migratory species or that have shared air quality concerns. And close neighbours are more keenly interested in regional development concerns than are other states. Regional or bilateral cooperation on trade matters, by creating the foundation of institutional cooperation, yields an opportunity to make related progress on such issues of shared environment and development concern, as with the establishment of NAFTA’s side agreements on environment and labour, Mercosur’s efforts to create an environmental information system, the work of ASEAN on haze pollution or the FTAA’s parallel efforts on non-trade issues such as democracy and education under the Summit of the Americas process. This type of regional action on environmental matters follows the principle of subsidiarity, which says that the appropriate level of action for any problem is the lowest level that includes all
affected. Many environmental problems need engagement of regional groupings, or of two countries.

Regional approaches to both environmental and development cooperation can be more tailored than what is easily possible at the multilateral level. For example, in the SAFTA there is special provision for the possible graduation of the Maldives from least-developed country status. The Andean Community’s common law on the protection of intellectual property rights includes pioneering provisions to safeguard traditional knowledge and biodiversity – concerns acute to the region, but not of the same priority to other countries. Regional level agreements in general have greater flexibility to craft solutions that satisfy their parties’ needs, and provide the institutional basis to make further progress as other needs become obvious.

North-South agreements have particular characteristics that make them interesting. They usually involve the Northern partner requesting environment and capacity building institutions within, or associated with, the agreement (See section 3). Few of these agreements have enough history to allow conclusions on whether the requirements have had lasting impacts on the Southern partners’ priorities. It was noted above that US FTA partners, required to perform environmental reviews of the US agreements, have not undertaken similar exercises in subsequent negotiations. NAFTA may be the only North-South agreement with enough history to provide guidance on this question. And in some respects the influence of US and Canadian priorities on Mexico seem to have had some positive effects. Within the framework of work under the environmental side agreement, Mexico has taken important steps in the areas of pollutant release inventories and persistent organic pollutants. As well, in the ten years of NAFTA Mexico’s environmental and development NGO community has blossomed into a significant force in the public’s consciousness (though one could also attribute this to the considerable environmental damage and poor working conditions being fostered by the US border region industries). The most interesting conclusion related to NAFTA is that while industry has cleaned up its production processes overall, the increased scale of economic activity has overwhelmed any such environmental benefits.

The EU also has a long enough history to support analysis, though any analysis of the EU ends up classifying it as a special case. The benefits in terms of economic development for countries such as Portugal, Greece and Ireland are indisputable, however and are at least in part a result of deliberate development policies including substantial transfer payments. And there is no doubt about the prospective benefits for the newly acceded countries in terms of environmental management, since all EU members must adhere to the Community body of law.

It is noteworthy that the most successful examples of trade-agreement related capacity building and environment and development cooperation occur within agreements among close neighbours. So, for example, the Canada-Costa Rica provisions on capacity building and environmental cooperation

---

94 Decision 486 of the Cartagena Agreement, which came into effect December 1 2002. The law was intended to bring the Andean countries into compliance with the WTO’s TRIPS Agreement.
95 Winfield (2003).
97 Bradley (1999).
sound good, but in reality have produced very little in the way of concrete results. NAFTA, on the other hand, has been more positive.\textsuperscript{98}

In part this may be due to budget problems (which may in turn be related back to the practical irrelevance and politically low priority of such activities among distant states). In those examples where there has been substantial budget outlay, there have unsurprisingly been significant results, as in NAFTA, ASEAN, the Euro-Med agreements and so on.

It is also noteworthy that the work on environmental cooperation related to trade agreements is more effectively focused on strictly environmental issues, as opposed to a focus on ameliorating the environmental effects of liberalized trade and investment. That is, to use the NAFTA example, the objectives of the environmental side agreement include a strong mandate to prevent or resolve environment-related trade disputes and to consider the environmental effects of NAFTA, but the results of the work in this area have been meagre.\textsuperscript{99} The real success of the side agreement has been in the areas of environmental cooperation on themes with little direct relationship to trade, such as migratory species, sound management of chemicals and environmental health.\textsuperscript{100} Similarly, in ASEAN, while the work of the environment Ministers has been fruitful, cooperation and joint work between those Ministers and the Senior Economic Officials has been practically non-existent.

On the other hand, there is certainly value to strengthening the institutions of environmental management, not least in that it gives countries a stronger ability to manage any environmental impacts of trade liberalization.\textsuperscript{101} In that context, it is worth asking whether the approach of recent US agreements, which build in legalistic regimes to ensure compliance with existing environmental law, are more effective than the approach used by Canada and others: a deliberate attempt to build capacity for environmental management. The experience of NAFTA—where we have yet to see a Party-to-Party dispute over non-enforcement, but we do see results from the collaborative efforts of the side agreement—seem to suggest that they are not. But more research is clearly needed in this area.

North-South agreements can also have interesting features in areas of sustainable development beyond the environmental. For example, the FTAA negotiations are occurring in the wider framework of the Summit of the Americas process – a process that aims to work toward progress in areas such as education, human rights, corruption, security, justice systems, democracy and so on. The 2001 Quebec City Summit produced a formal democracy clause, making participation in the FTAA subject to a requirement of basic democracy. The EU (a North-North agreement, but one that was at the time contemplating expansion into Eastern Europe) has a similar clause.

And the negotiations surrounding trade agreements can occasion pressure on issues such as labour and human rights. The US’ periodic renewal of Permanent Normal Trade Relation status with China, for example, has become a focal point for US pressure on such issues. And the negotiations

\textsuperscript{98} For an evaluation of the NAFTA’s programs, see Johnson et al. (2003).
\textsuperscript{99} Ibid.
\textsuperscript{100} Ibid. See also Block (2003).
\textsuperscript{101} Given the obvious value of this type of institutional strengthening, it seems particularly important to ensure that deep integration efforts do not unduly frustrate the ability of governments to regulate in the public interest in areas of environment and public health and safety. See Cosbey et al. (2004) for a summary of the concerns from an investment perspective. On services, see Grieshaber-Otto and Sinclair (2004), and on IPRs, see Médecins Sans Frontières (2004).
between the US and Colombia have provided an opportunity for the US to exert pressure on the
Colombian government to address the wholesale killing of union leaders by paramilitaries.\footnote{See Forero (2004).} These sorts of opportunities tend to be one-shot affairs, though; after the agreement is signed there is normally no venue for discussion of, or further pressure on, such issues.

### 4.5. The role of business and the market

What is the potential role of the private sector in the use of FTAs to promote sustainable development? In the final event, it is private investors primarily who will be fostering the kinds of changes that must be made if we are to transform existing economic structures into something closer to a sustainable engine of development.

In the first place, it is imperative that the private sector understand the new rules of the game that exist in the context of FTAs. That is, it will be difficult for entrepreneurs to take advantage of new economic opportunities if they do not know that they exist. It is incumbent on governments to inform private sector actors of both the risks and opportunities that are part of any FTA package.

Timeliness is important here. Many FTAs have long lead times for liberalization commitments that will be painful to particular sectors of the economy. These are fine if they are well used, to warn affected parties and to implement strategies that will minimize the costs of transformation (particularly on the poor). But too often they are not.

It was noted above that the rush to regionalism may be producing a “spaghetti bowl” of criss-crossing FTAs, many of which have differing tariff schedules, rules of origin, regulatory commitments and other commitments related to non-tariff barriers.\footnote{The term and the argument come from Bhagwati, Krishna and Panagariya (1999).} The expanding number of FTAs can become in itself a barrier to exporters if it increases the cost of knowing the rules of play, not to mention the costs of changing production and process methods to meet differing export market requirements.\footnote{Heydon (2003).}

There is a robust literature on the environmental and economic impacts of foreign investors (or, more accurately, of their investments). The question most often asked is whether foreign investors generate better or worse results (variably defined) for a given country than do domestic investors. Given the commitments in the recent crop of FTAs to liberalize investment regimes, it is worth pursuing this question in greater depth. Cosbey and Mann (2004) in a survey of the literature find that BITs by themselves seem to have no discernable effect on FDI flows,\footnote{See Hallward-Driemeier (2003), UNCTAD (1998).} and therefore little in the way of associated environmental or economic impacts, though they may constrict policy space in some worrying ways.\footnote{See Muchlinski (2004).} On the other hand, they find some preliminary evidence that investment provisions contained in a wider free trade package might indeed have some effect on FDI flows, though they are unable to apportion the causation between the presence of investment rules and the liberalization of trade in goods (which, \textit{inter alia}, creates a larger market to which investors are drawn).

---

\footnote{See Forero (2004).}
\footnote{The term and the argument come from Bhagwati, Krishna and Panagariya (1999).}
\footnote{Heydon (2003).}
\footnote{See Hallward-Driemeier (2003), UNCTAD (1998).}
\footnote{See also Muchlinski (2004).}
While there is a growing interest in what some call corporate social responsibility, there has as yet been no experimentation in the FTAs with provisions that attempt to ensure that the quality (as opposed to the quantity) of incoming investment is in line with national interests from a sustainable development perspective. Voluntary codes exist, such as the OECD’s guidelines for Multinational Enterprises, most recently revised in 2000. And there has been some speculative work on what an international investment agreement might look like if it were to incorporate more binding sustainable development commitments. But such provisions have not yet found their way into hard law.

5. Scope for Improvement

What is the scope for improving FTAs from a sustainable development perspective, based on the analysis presented above? This section briefly touches on some of the most promising avenues.

An overarching need, before this question can be adequately answered, is for more complete knowledge of what agreements are currently being negotiated or planned, and what elements they contain. In this regard, it is important to note that practically none of the current or historical negotiations have released draft text to the public for comment and input. Until such time as this problem is rectified, it is difficult to talk about improving FTAs, since experience has shown that any substantial changes are extremely difficult to effect after the negotiations are completed.

One area of obvious need is for more robust efforts at capacity building in North-South agreements. Even where there is good language to this effect in most agreements, limited budgets usually give the lie to the expressions of good intent. It was argued above that if the desire is for environmental compliance, or the avoidance of pollution havens, it may make more sense to invest in building enforcement capacity than, absent that capacity, to construct elaborate mechanisms to compel enforcement.

Establishing regional or bilateral mechanisms of environmental cooperation also seems to be a step in the right direction. It was noted above, however, that these mechanisms may be most useful where the parties share borders and common environmental concerns. Thus, many South-South agreements have begun to work on environmental cooperation under institutions put in place as part of a wider integration process.

There are few FTAs that aim to build capacity in areas related to economic and social development. This is striking, given the wide agreement in the literature that strong domestic policies and institutions are critical for exploiting the opportunities created by liberalization agreements. There is good language in some of the EU agreements on this subject, and it will be worth watching the Euro-Med initiative and others to draw out lessons that might in time emerge.

As to the economic impacts of a FTA, the studies surveyed for this paper seem in basic agreement that there is no automatic link between a FTA and increased prosperity however defined. The key at

---

107 See, for example, IISD (2004)
108 On this point see UNCTAD (2001).
109 The Free Trade Area of the Americas negotiations remain the sole exception to this rule.
110 Mercosur and ASEAN were discussed above as good examples.
the domestic level seems to be strong institutions of governance and economic stability. Also key is the elaboration and implementation of the agreement itself. Several factors emerge as common themes to guide policy makers:

- A small differential between MFN tariffs and FTA tariffs will create less chance of trade diversion. In that context, non-tariff barriers such as strict rules of origin, and carved-out sectors of interest, have the same effects as high general MFN tariffs.
- Hub-and-spoke arrangements, while good for the hub, tend to be less so for the spokes.
- Southern countries may reap more economic benefits in partnering with Northern; the rule of thumb is the larger the integrated market, the better.
- Agreements should cover the broadest number of areas possible, rather than being specifically tailored to particular sets of interest.
- They should contain specific provisions which ensure that the benefits are subsequently extended on a MFN basis;
- They should aim to harmonize and adopt common rules of origin methods that are simple, liberal and transparent.

6. State of Research

The issues analyzed in the previous two sections span the range from conventional, on which the existing research is in an overwhelming abundance, to unconventional, on which in many cases the research is quite thin. This concluding section of the scoping paper will try to assess the state of the research on the various topics examined, and make some suggestions for future research.

On the question of why the rush to regionalism, there is, as seen in Section 4, a wealth of speculation. Most of those who write on the issues of regional agreements have their pet theories and it is likely that most have at least some element of the whole truth in them. Presumably an overall answer would come from the aggregation and synthesis of a host of answers at the level of particular agreements. Not only is there no such synthesis, but there are very few focused analyses of the underlying causes of specific agreements to synthesize. Indeed, none are referenced in this paper, though there are references to a large number of theories expressed in the context of broader theses. This may be because this question is not one easily amenable to empirical research, as it involves understanding motivations that are both political and economic, and because the motivations in each particular context may differ widely. In any case, there is a clear need here for more research, combining economic and political science analysis.

It can be argued that answering this question is less urgent than addressing some of the other questions raised below; the rush to regionalism is on and dissecting its causes, some might argue, is less important than understanding its implications. This is true only to the extent that those implications do not leave us wanting to alter the current rush in some way. If they do, on the other hand, understanding what fuels it will be important.

The question of whether FTAs are stumbling blocks or building blocks for the multilateral system is perhaps the most thoroughly analyzed of any in this paper. Some surveys and syntheses of the arguments on either side were presented in Section 4. However, the research in this area is not comprehensive by any means. While the question has been well addressed in the context of tariff preferences and selected non-tariff barriers (such as rules of origin), it has been only marginally
covered in the context of deeper integration, which is the most dynamic area of negotiation. That is, we have very little analysis telling us what the impacts might be on the multilateral system of rules at the FTA level that differ from WTO norms in the areas of investment, intellectual property rights, technical barriers to trade, etc. Indeed, we were able to cite only a handful of studies even cataloguing those differences, and only two of these went further to consider the multilateral implications. Yet our scoping of the issues identified some urgent questions in this area: will the proliferation of such provisions make it easier or harder to get agreement on them at the multilateral level? What does this mean for the prospect of the multilateral negotiations addressing common problems in the FTA provisions, or vice versa?

On the differing characteristics of FTA between North-North, North-South and South-South partners, there is not much literature. Only a couple of studies asked this question in any detail. Of course, there are a wide number of studies looking at the characteristics of particular agreements, or even groups of agreements. But comparative analysis across the different types is scarce. Given the wave of new South-South and North-South agreements, this seems a critical research need, and part of the more general need for basic information on the nature and implications of existing and proposed agreements. Given the recent nature of the rush to regionalism, and since the speed at which new agreements are being proposed and negotiated in some cases compares favourably with the time it takes a peer-reviewed article to come to publication, this research shortcoming is not surprising.

On the economic implications for sustainable development of the rush to regionalism, there were several questions raised. First, the question of trade diversion by FTAs is an extremely well-worn research path, with the first definitive work on the subject delivered in 1950. For all that, however, it is not yet a settled question. Second, on the need for good domestic institutions and policies as a prerequisite to the economic gains from liberalization, there has also been a sizable body of work, though on the whole much more recent. Section 4 cited a number of works on both these questions.

On the environment and development implications for sustainable development of the rush to regionalism, there has been less analysis. There has been a good deal of work on the impacts of the NAFTA and EU programs for regional development and capacity building. In the NAFTA context there has been good work on the effectiveness of the provisions for environmental cooperation. But there are few other agreements with such provisions that have either taken the provisions seriously or have enough history from which to draw lessons. Steenblik and Tébar-Less (2003) did a comparative analysis of the environmental provisions in FTAs existing at the time, but an updated and more in-depth analysis would be useful. And this paper found no comparative analysis across agreements of the non-trade components associated with FTAs: the commitments to cooperation, capacity building, institutional strengthening, etc.

This latter research gap is important from a sustainable development perspective, and its identification demonstrates the value of a sustainable development approach to the issues. While trade agreements are ostensibly about trade and investment, their objectives often run much more broadly (see Section 3.2.1), and we have catalogued a number of approaches to operationalizing

---

111 Sampson and Woolcock (2003) and OECD (2003). The latter, however, is a particularly good analysis.
113 For example, in the South-East Asian context see Kamal and Imai (2003), Chaturvedi (2003).
those broad objectives. But, while the literature is replete with assessments of FTAs in achieving their economic objectives, it is strikingly void of analysis of the objectives related to what Ostry (2000) calls community-building or cooperation. Not only are these typically important sustainable development objectives in their own right, related to environmental cooperation, capacity building, institution building, regional cooperation on social objectives, and so on. They are also in many cases prerequisites to the gains from the very liberalization agreements that they accompany (both economic gains and broader social welfare gains). As such, the lack of analysis of the widely varying approaches and their effectiveness is a critical research gap.

On the role of business and the market in the use of FTAs to promote sustainable development, section 4 posed two main questions: first, what is the impact on business of the “spaghetti bowl” phenomenon of criss-crossing rules and regulations? This paper turned up very little research of this type, though it found repeated references to the problem. It may be that the phenomenon is too new, or too obvious to be found worthy of empirical analysis. But as always, grounding the argument in real-life cases is preferable; if the problem is real, research makes it more forceful; if it is not, then the myth can be debunked.

The second question was how FDI responds to investment rules, both in the context of bilateral investment treaties and in the context of embedded investment rules in FTAs. At the time of this writing there were only two studies that looked at the BITs, though there were several more in the process of publication. Given the number of BITs being signed on a regular basis, this question is important, particularly since the early evidence seems to indicate no FDI benefits to signatories, but several palpable downside risks.

On the question of embedded investment rules in FTAs, as distinct from BITs, there was only one study that tried to make the distinction. There are, however, a very healthy number of studies looking at Mexican FDI and its relationship to NAFTA, and these in fact adequately cover the latter question without bothering to make the explicit distinction. Several were cited in section 4, as was a survey of the literature on this question.

This section has focused on the gaps in literature on the questions outlined in section 4 of the paper. An overarching need, not captured by this approach, is for better information on what agreements have been signed, what agreements are being negotiated, and what they contain. This is a particularly difficult prospect for agreements under negotiation, the FTAA being the only negotiation to date to publicly release draft negotiating text. The speed at which the terrain changes in this area militates against conventional publication of such information – it would be out of date by the time it was disseminated. There are several good websites that act as repositories of treaty texts on a regional basis (mostly covering the Western Hemisphere), but there is no full coverage of this type. This type of access is the most basic research need in the area of regional agreements and sustainable development.

---

115 Cosbey and Mann (2004).
7. References


Berthelon, Matias. 2004. Growth Effects of Regional Integration Agreements. Processed bg to wb 2004


Regulation’ on Postal and Other Public Services. Ottawa: Canadian Centre for Policy Alternatives.


for Grabs.” Canada Watch, Vol. 9, Nos. 1-2, pp. 3-6.

Isaac, Grant E., 2003. “Food Safety and Eco-Labelling Regulations: A Case of Transatlantic Regulatory
Regionalism?” in Gary P. Sampson and Stephen Woolcock (eds.), Regionalism, Multilateralism, and

the Ten-year Review and Assessment Committee to the Council of the Commission for Environmental
Cooperation. Montreal: CEC.

285.

Kim, Sunyoung, 2002. “A Strategy for the Successful Conclusion of the South Korea-Chile Free Trade
Agreement.” Master’s Project, Monterrey Institute of International Studies.

Kim, Yee-Kyoung, 2002. “Assessment of Japan-Singapore FTA focusing on eliminating trade barriers of


Lederman, Daniel, William F. Maloney and Luis Serven, 2003. Lessons from NAFTA for Latin America and

submitted to Keizai Koho Center (Keidanren), April.


Lim, Hank and Matthew Walls, 2004b. “ASEAN Economic Community: Promises and Potential
Roadblocks,” Japanese External Trade Organization.

__________, 2005. “ASEAN after AFTA: What’s Next?” Dialogue+Cooperation,


