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Boston University The Frederick S. Pardee Center
for the Study of the Longer-Range Future



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Abstract

This paper examines the extent to which the emerging world trading regime leaves nations the “policy space” to deploy effective policy for long-run diversification and development and the extent to which there is a convergence of such policy space under global and regional trade regimes. We examine the economic theory of trade and long-run growth and underscore the fact that traditional theories lose luster in the presence of the need for long-run dynamic comparative advantages and when market failures are rife. We then review a “toolbox” of policies that have been deployed by developed and developing countries past and present to kick-start diversity and development with the hope of achieving long-run growth. Next, we examine the extent to which rules under the World Trade Organization (WTO), trade agreements between the European Union (EU) and developing countries, trade agreements between the United States (US) and developing countries, and those among developing countries (South-South, or S-S, agreements) allow for the use of such policies. We demonstrate that there is a great divergence among trade regimes over this question. While S-S agreements provide ample policy space for industrial development, the WTO and EU agreements largely represent the middle of the spectrum in terms of constraining policy space choices. On the far end, opposite S-S agreements, US agreements place considerably more constraints by binding parties both broadly and deeply in their trade commitments.

Development is a long-run process of transforming an economy from concentrated assets based on primary products to a diverse set of assets based on knowledge. This process involves investing in human, physical, and natural capital in manufacturing and services and divesting of rent seeking, commerce, and unsustainable agriculture (Amsden 2001, 2-3). Imbs and Wacziarg (2003) have confirmed that nations that develop follow this trajectory. They find that as nations get richer, sectoral production and employment move from a relatively high concentration to diversity. They find such a process is a long one and that nations do not stabilize their diversity until they reach a mean income of over \$15,000 per capita. For many years it has also been known that as countries diversify they undergo a process of deepening whereby domestic firms improve their internal productive capacities by establishing forward and backward linkages in the economy (Hirschman 1958, Krugman 1995, Amsden 2001).

This paper examines the extent to which the emerging world trading regime leaves nations the “policy space” to deploy effective policy for long-run diversification and development and the extent to which there is a convergence of such policy space under global and regional trade regimes. Part II of the paper examines the economic theory of trade and long-run growth and underscores the fact that traditional theories lose luster in the presence of the need for long-run dynamic comparative advantages and when market failures are rife. We then review a “tool-box” of policies that have been deployed by developed and developing countries past and present to kick-start diversity and development with the hope of achieving long-run growth but also stress that tools alone are not the recipe for development, that “getting the political economy right” is also of vital importance. In Part III we examine the extent to which rules under the World Trade Organization (WTO), trade agreements between the European Union (EU) and developing countries, trade agreements between the United States (US) and developing countries, and those among developing countries (South-South or S-S agreements) allow for the use of such policies. Part IV of the paper summarizes our findings and offers conclusions for policy and future

research. This paper is intended to assist policy-makers as they choose trade partners that affect their ability to design long-run development strategies.

I. TRADE THEORY AND THE LONG RUN

The traditional trade theory that provides the backdrop and justification for the majority of trade treaties is limited in terms of long-run growth for developing countries. Such theories assume a static approach to technological change and assume that there are no market failures among trading partners, two assumptions that do not hold in the developing country context (Caves 2007). This section of the paper provides an overview of trade theory and its limitations and shows how some countries have used various tools to correct for the theoretical limitations identified.

Neo-classical trade theory shows us that liberalizing trade can make all parties better off. The economist David Ricardo showed that because countries face different costs to produce the same product, if each country produces, and then exports, the goods for which it has comparatively lower costs, then all parties benefit. The effects of comparative advantage (as Ricardo's notion became called) on factors of production were developed in the "Heckscher-Ohlin" model. This model assumes that in all countries there is perfect competition, technology is constant and readily available, there is the same mix of goods and services, that factors of production (such as capital and labor) can freely move between industries, and there are no externalities. In other words, this model is "static" and not "dynamic" and there are no market failures.

Within this rubric, the Stolper-Samuelson theorem adds that international trade can fetch a higher price for the products (and hence lead to higher overall welfare) in which a country has a comparative advantage. Foreign direct investment (FDI) (in other words, multinational corporations (MNCs) moving to another country) can contribute to development by increasing employment and by human capital and technological "spillovers" where foreign presence accelerates the introduction of new technology and investment. In theory, the gains from trade accruing to "winning" sectors freed to exploit their comparative advantages have the (Pareto)

possibility to compensate the “losers” of trade liberalization. Moreover, if the net gains from trade are positive, there are more funds available to stimulate growth and protect the environment. In a perfect world then, free trade and increasing exports could indeed be unequivocally beneficial to all parties.

To some, static comparative advantage poses problems for countries who want to sustain long-run growth. Some countries may only have a static comparative advantage in a single commodity where prices are very volatile and where, in the longer run, prices are on the decline relative to industrial goods. What’s more, small initial comparative static advantages among countries in the short run may expand into a growing technology gap between rich and poor nations in the longer run (Lucas 1988, Grossman and Helpman 1991). If the developed world has a static comparative advantage in innovation, it can continually stay ahead by introducing new products, even if the developing world eventually catches up and gains a comparative advantage in low-cost production of each old product over time (Krugman 1979).

If the developed world has a static comparative advantage in innovation, it can continually stay ahead by introducing new products, even if the developing world eventually catches up and gains a comparative advantage in low-cost production of each old product over time.

In the longer run then, what matters most is not static comparative advantage at any one moment in time, but the ongoing pattern of dynamic comparative advantage: the ability to follow one success with another, to build on one industry by launching another, again and again. Since the process of technology develop-

ment is characterized by increasing returns, many models will have multiple equilibria. It is easy to specify a model in which the choice between multiple equilibria is not uniquely determined by history; rather, it becomes possible for public policy to determine which equilibrium will occur (Krugman 1991). If, in such a model, the multiple equilibria include high-tech, high-growth paths as well as traditional,

low-growth futures, then public policy may make all the difference in development.

Neo-classical trade theory also assumes that there are no market failures among trading partners (Caves 2007). However, four key market failures plague nations seeking to catch up to the developed world: coordination failures, information externalities, dynamism and technological change, and human capital formation. Diversification by definition can mean the creation of whole new industries in an economy and sometimes may require linking new industry to necessary intermediate goods markets, labor markets, roads and ports, and final product markets. For 50 years economic theorists have demonstrated how markets fail at “coordinating” these efforts. Coordination failures and the asymmetric distribution of world income have led economists to argue that the nation state should provide “big push” investments to build scale economies and enhance the complementary demand and supply functions of various industries over the long run (Nurkse 1952, Scitovsky 1954, Chang 2002, Rodrik 2007a).

While historically such efforts took the form of large industrial planning efforts and infant industry protection, more recently industrial clustering has taken place where nations focus on the development of specific technologies or sectors in specific geographical regions—especially when facing scale economies. Clustering and export processing zones have been created to attract foreign firms, link them to domestic input providers, and serve as exporting platforms (Amsden 2001, 75). To support these efforts, nations (most successfully in Asia) provide tax breaks and drawbacks to foreign firms but require them to source from domestic firms and transfer technology (Amsden 2001, 88). In tandem, the state provides an educated labor force, public R&D, tariff protection, and subsidized credit to support the domestic firms, and provides export subsidies to the domestic firms until they can produce products at the global technological frontier (Murphy et al. 1989, Amsden 2001, Weiss 2005).

Markets also fail at providing the socially optimal amount of information to producers and consumers—such phenomena are termed “information

externalities.” Technological experimentation through research and development and the inquisitive process of entrepreneurship involve a process of “self-discovery” regarding which economic activities and product lines will be the most appropriate for a domestic economy (Rodrik 2007a, 104–7). These experimenters who tinker with establishing or inventing new technologies to adapt to local conditions provide enormous social value to a national economy but solely bear the course of failure (and success). These entrepreneurs need to be compensated for their experimental nature through subsidization of exports and credit, temporary tariff protection, patent rewards, and marketing support. Without such incentives, entrepreneurs will be more apt to invest in historically profitable industries in the primary product sectors. (Hirschman 1958, Gerschenkron 1966, Krugman 1995).

As hinted earlier, related to coordination failures and information externalities is that trade liberalization and comparative advantage tend to produce static gains but make dynamic gains through technological change more elusive. The static models of the gains from trade suggest that countries such as Brazil should dismantle its industrial sector in favor of specializing in soy and meat production, that India should de-emphasize services and heavy manufacturing in favor of textile and apparel specialization (Ackerman and Gallagher 2008, Anderson et al. 2005). These models, if deployed 20 years ago would have told South Korea and China to focus on rice production. However, following the lead of Japan, the United States, and Europe before them, many nations in East Asia and Latin America fostered more diversified and higher value-added sectors over time (Okimoto 1989, Chang 2002). Thirty-five years ago if South Korea and China had relied on comparative advantage we might not be driving Kias and Hyundais, using Haier appliances or typing on Lenovo laptops.

In enabling the technological capacity of new industries, markets do not give the correct investment signals when there are high and uncertain learning costs and high levels of pecuniary externalities.¹ In other words,

1. Pecuniary externalities affect third parties through prices fluctuations but not necessarily through misallocation of resources.

technological dynamism that leads to diversification is not guaranteed by market reforms alone. For many of the reasons described earlier: weak capital markets, restrictive intellectual property laws, lack of information, and poor coordination, imperfect competition and the need for scale economies, under-investment in technologically dynamic sectors can occur (Arrow 1962, Nelson and Winter 1982, Lall 2005). Historically, to correct for these market failures nations have encouraged joint venturing with technological transfer agreements with foreign firms to learn technological capabilities; in addition they have invested heavily in higher education and publicly funded research and development. What's more, nations have selectively loosened intellectual property rules to allow for learning and supported innovative firms through government procurement, export subsidies, subsidized capital, and tariff protection (Amsden 2001, Lall 2005).

Although mentioned in each of these previous examples, human capital formation is also essential for dynamic economic growth and diversification. Once again, private markets fall short of supplying human capital at a socially optimal level. There are numerous arguments why markets undersupply education and that governments should intervene to increase the supply of educated workers. Basic literacy and education have positive externalities such as improved health and better participation in democratic processes—in other words the social rate of return on education is higher than personal investment. With respect to learning in private firms, firms may under-invest in the training of their workers because of fears of high labor turnover (Rodrik 1992). East Asian tigers—like developed countries before them—spent a great deal of effort providing education and training to their people. This was done by spending a significant amount of funds on education (including providing scholarships to obtain PhDs in developed countries), clustering schools in export processing zones, requiring that foreign firms hire nationals and train them on the job, and subsidizing training programs in domestic firms (Kim and Nelson 2000, Amsden 2001). Table 1 exhibits an illustrative but far from exhaustive list of trade and industrial policies used by East Asian and other developing economies over a 40 year period and the market failures such

policies address. It is this list of policies that will be expanded upon and analyzed in the following section.

Table 1. Tools for Correcting Market Failures

Market Failure	Policy Instrument
Coordination failures	Export subsidies Tariff sequencing Tax drawbacks Clustering Infrastructure provision
Information externalities	Administrative guidance Subsidized credit Tariff sequencing Subsidized entrepreneurship Selective permission for patents
Scale economies/technological dynamism	Tariff sequencing Technology transfer requirements Joint ventures Public research and development Compulsory licensing Selective permission for patents Government procurement ²
Human capital formation	Public education Employment of local personnel Movement of people

Source: Kumar and Gallagher 2007

II. GETTING THE POLITICAL ECONOMY RIGHT

Some countries have been fairly successful at deploying policies to create dynamic comparative advantages and to correct for market failures. In the developing world the recent standouts are Taiwan, South Korea, and more recently China. Table 2 exhibits average annual growth rates in GDP per capita for selected regions of the world from 1960 to 2005.

2. Although countries have used various controls over government procurement to promote local industry, those measures, for purposes of space and time, remain outside the scope of this paper.

Table 2. Growth in GDP Per Capita for Selected Regions, 1960 to 2005

	1960–1980	1980–2005	2000–2005
High Income Countries <i>(for comparison)</i>	5.7	2.1	2.8
East Asia and Pacific	3.5	6.6	7.2
China	3.4	8.6	8.6
Latin America and the Caribbean	2.9	0.5	1.4

Source: World Bank 2008

Today's developing nations look to these success stories as possible models for 21st century policy. East Asia experienced 3.5 percent annual per capita income growth from 1960 to 1980 and 6.6 percent since 1980—one of the most impressive growth trajectories on record. What's more, such growth has also corresponded with reduction in inequality and improvements in many other social indicators. It is beyond the scope of this paper to explain in detail the literature on development in these nations, but experts attribute East Asian growth to four general categories of policies (for useful full-length treatments of development in this region and the use of state policy tools, see World Bank 1993, Wade 2004, Amsden 2001, and Kim and Nelson 2000).

- **Targeted industrial policy** with reciprocal control mechanisms where nations selectively secluded certain industries where they wanted to gain dynamic comparative advantages;
- **Loose intellectual property rules** where nations encouraged learning from foreign nations through government R&D efforts and at times reverse engineering goods from foreign counterparts;
- **The movement of people across borders** for higher education and temporary work. The best students were sent to the US and Europe to earn degrees in science, mathematics, and technology, and then came home to work in targeted industries or government;
- **Investment in human capital and public infrastructure** where governments invested heavily in education and provided infrastructure, such as roads, ports, and so forth.

There is considerable debate regarding the extent to which these policies were the key drivers of growth in some countries. Nevertheless, at this point there is widespread agreement that these policies did have *some* positive effect on economic performance. The debate now centers on what level of effect that was (World Bank 1993). It is not the purpose of this paper to enter that debate. Nor is it the purpose of this paper to judge the value of those policies for development. Rather, based on the evidence that such policies have had some positive effect, this paper examines whether developing countries are still given (or keeping) the choice to deploy them under existing and proposed trade rules.

Whereas the East Asian nations—such as South Korea and Taiwan—managed their integration into the world economy through gradual liberalization and some degree of government involvement, nations in Latin America and the Caribbean (LAC) rapidly liberalized their economies in a short period of time—along the lines currently being advocated in the Doha Round of WTO talks. As we see in Table 2 for LAC, income growth since liberalization began in the 1980s has been barely one percent annually.

Many economists have expressed caution over advising other developing countries to follow the same path as East Asia (Noland and Pack 2003). First, governments can be pathetic in picking “winners” for industrial policy. Many governments have tried to adopt pro-active policies and have failed miserably—in other words meeting market failures with government action often leads to government failure. Governments have been criticized for not being able to pick winning sectors to focus on. Indeed, there are many examples of governments picking “losers.” South Korea and Taiwan are often cited as success stories but Indonesia, Nigeria, and Brazil have had failures that have received relatively less attention in scholarly circles (Burton 1983, Evans 1995). In addition, subsidization and government involvement has been shown to accentuate “rent-seeking” behavior that make it additionally difficult for developing country governments to let go of projects that aren’t going well or that have already reached maturity (Krueger 1996).

Market failures are not always easy to identify and once they are identified it isn’t just a matter of pulling out a policy toolbox, grabbing a tool from one of these lists, and hammering away. Indeed, while there is a strong theoretical justification for pro-active government policy, development success takes

much more than the proper rationale and proper policies. Development success stories from the 20th century all struck a unique blend between state and markets—they got the *political economy* of industrialization right.

These critiques are quite valid. Without the proper political economy conditions, government intervention can create more problems than they correct for. However, the most successful cases in large part circumvented these problems because governments designed policies where state actors were “embedded” in the private sector and where the state enforced discipline on the private sector. We refer to these phenomena as “embedded diagnostics” and “reciprocal control mechanisms.”

In the presence of market failures by definition it is hard for the private sector to interpret the signals and trends it faces in the economy. If firms right in the middle of the marketplace can't always make the best decisions about products and processes, what makes us think that governments can make better decisions (Burton 1983)?

To circumvent the “picking winners” problem, political economists have shown that successful industrializers have had states that were “embedded” in the private sector while maintaining “autonomy” from sectional elite interests seeking rents. State agencies that are charged with correcting market failures have to maintain constant communication and input with the private sector (Evans 1995). Such public–private partnerships help both the private and public sectors “discover” what the most pertinent market failures and other impediments to industrial development are in an economy, and what assets there are in the economy that can be built upon, and to pick activities that will have the largest economy-wide effects (Rodrik 2007a).

Having a good toolkit and embedded autonomy is still not enough. In fact, public–private partnerships could become marriages of corruption and rent-seeking. Successful industrial policy has also tamed the tendency of rent-seeking. In order for this to work, industrial policy has to be coupled with a good deal of discipline and accountability for both private actors and the state. Alice Amsden (2001) has referred to the need for “reciprocal control mechanisms.” A control mechanism is “a set of institutions that disciplines economic behavior based on a feedback of information that has been sensed and assessed” (Amsden 2005). For the East

Asian success stories, the key principle behind their use of control mechanisms was “reciprocity”:

Reciprocity disciplined subsidy recipients and thereby minimized government failures. Subsidies were allocated to make manufacturing profitable—to convert moneylenders into financiers and importers into industrialists—but did not become giveaways. Recipients of subsidies were subjected to monitorable performance standards that were redistributive in nature and result-oriented. The reciprocal control mechanism thus transformed the inefficiency and venality associated with government intervention into collective good (Amsden 2005, 222).

In other words, firms have performance requirements that when they aren't met lead to a termination of supporting benefits by the state. The most successful industrializers were able to abandon projects that were not performing whereas others were perpetuated because bureaucrats became hijacked by business interests who became dependent on the state. Since public policy may make a difference in development, and since it has been used successfully by some developing nations to increase diversification and related growth, it is important to understand the extent to which such policy space exists today.

III. TESTING FOR POLICY SPACE IN THE WTO AND BEYOND

Of the historical tools for diversity and development, which ones remain available under the new global trading regime? Do bilateral and regional agreements further limit policy space for development? This paper examines four trade-related areas (goods, services, investment, and intellectual property) across 13 trade agreements. We compare four US agreements (the North American, Dominican Republic-Central American, US-Chile, and US-Singapore Free Trade Agreements), four EU agreements (the EU-Chile, EU-Mexico, EU-Tunisia, and EU-South Africa agreements), and four South-South agreements (the Southern Cone Common Market, the Andean Community, the China-Chile agreement, and the South Asian Free Trade Agreement) with the WTO trade disciplines to answer the question: to what extent do the various regimes constrain policy space for member nations? In undertaking this analysis, we'll be able to see if there is convergence among the bilateral and regional agreements.³

3. As a caveat before going forward, the agreements within each trade regime are by no means homog-

Table 3. Illustrative Tool Box Flexibilities

Policy Instrument	WTO and Associated Agreements⁴	US Agreements	EU Agreements	South-South Agreements⁵
Tariff sequencing	Y	N	N	Y
Tax export incentives	Y	N	Y	Y
Quantitative restrictions/ import licensing	N	N	N	N
Safeguards for injurious imports ⁶	Y	Y	Y	Y
Control over sensitive services sectors ⁷	Y	Y	Y	Y
Services quotas	N	N	N	Y
Duty of establishment	Y	N	Y	Y
Regulation of services ⁸	Y	Y	Y	Y
Movement of natural persons	Y	N	Y	Y
Public education	Y	Y	Y	Y
Local labor requirements	Y	N	Y	Y
Technology transfer	Y	N	Y	Y
Domestic content ⁹	N	N	N	Y
Foreign exchange restrictions	N	N	N	Y
Infrastructure provision	Y	Y	Y	Y
Administrative guidance	Y	Y	Y	Y
Subsidized credit/entrepreneurship	Y	Y	Y	Y
Early-working permission	Y	N	Y	Y
High disclosure requirements	Y	N	Y	Y
Local production requirements	Y	N	Y	Y
Parallel imports	Y	N	Y ¹⁰	Y

enous. Within each of the principal trade areas, the regimes contain some measure of variation. This paper attempts to draw some generalizations about disciplines under each trade regime. Where the agreements significantly depart from each other, however, the difference is noted.

4. As with all measures under the WTO, even permitted policies are subject to the two pillars of the WTO: non-discrimination and national treatment (GATT Arts. I, III).

5. These South-South arrangements are by far the least uniform. Thus, the designations in this column represent generalizations from the later analysis.

6. Although safeguards are permitted, to some degree, under each agreement, US and S-S agreements impose more stringent requirements on safeguarding nations than the WTO, while the EU agreements contain some more and some less stringent rules.

7. Some amount of control is permitted under all agreements, however the US agreements are the only ones to employ a negative list approach (see section on Services Trade).

8. Here, the key difference is whether the balancing test is self-enforcing, as it is under both US and EU agreements, or dependent on further rulemaking, as in the case of the WTO.

9. This and other policies may be permitted despite violating certain WTO rules if they pass as legitimate public welfare regulations.

10. Although the EU allows some parallel imports, the rules of exhaustion are regional and thus slightly more difficult to comply with than those in the WTO.

Table 3 expands the illustrative list of development policy tools in Table 1 in the first column and then provides an overview of whether such policies are permitted under various trading arrangements. A “Y” signifies that the measure is permitted; an “N” indicates that a measure is not permitted. We go into this table in great detail below, but what stands out from this partial examination is that there is great variation in the amount of policy space available for developing countries. In general, the S-S and US agreements represent opposite ends of the spectrum, whereas the WTO and EU agreements occupy the middle ground.

An inherent flexibility under all trade regimes lies in the dispute settlement system. There exists no overarching global trade police to punish countries for violations. Rather, trade partners must bring suit against each other to enforce the rules of the agreement. Within the WTO, the flexibility is clear: a country may not bring suit under the Dispute Settlement Understanding (DSU) unless the benefits inured to them under the agreement have been “nullified or impaired” by the other country’s actions (Art. 3.8). Even under the EU and US models, however, countries generally will not bring a complaint against a trade partner absent some financial injury, thus leaving very small or poor countries the space to do almost anything permitted by domestic law (EU-Chile Art. 184, EU-Mexico Decision 2/2000 Title VI). Of greater interest here, however, are the true flexibilities in these FTAs—providing countries with legal room to design development policy.

Trade Coverage

Examining trade area coverage provides an initial glance into the trade agreement trends that we discuss more fully in the following sections. Each trade arrangement is unique in its structure and the provisions it contains because the agreements derive from unique negotiations between trading partners. Among the agreements, trade coverage varies widely: from basic agreements effectively regulating only goods trade to complex agreements that cover trade in goods, services, investment, and intellectual property, as well as technical barriers to trade, sanitary and phytosanitary measures,¹¹ labor measures and environmental protection.

US agreements contain, by far, the most comprehensive and uniform trade disciplines. Each US agreement governs goods trade, rules of origin, cus-

11. These include measures pertaining to the health of plant and animal life.

toms regulation, technical barriers to trade, trade remedies, government procurement, investment, cross border trade in services, financial services, telecommunications, intellectual property, transparency and dispute settlement. At least three of the four herein studied contain additional provisions on sanitary and phyto-sanitary measures, temporary entry of business persons, electronic commerce, competition policy, labor, and the environment.

Where trade coverage is concerned, EU-Chile and EU-Mexico contain many of the same trade areas as US agreements. EU-South Africa and EU-Tunisia, on the other hand, begin to resemble much more closely the WTO structure. Neither agreement covers telecommunications, financial services, temporary entry of business persons, or electronic commerce. Nor does either agreement regulate labor and environmental provisions. A closer look at the substantive provisions (discussed in the remainder of the paper) reveals that trade area coverage does not always signify heightened trade commitments.

The South-South agreements look even more skeletal in comparison with the US regimes. The China-Chile Free Trade Agreement (China-Chile) and the South Asian Free Trade Agreement (SAFTA), effectively contain commitments only in the area of goods trade. The Southern Cone Common Market (MERCOSUR) and the Andean Community (CAN) cover as many trade areas as some EU agreements, but, as hinted above, do not necessarily mirror the EU commitments.

Examining trade coverage begins to reveal a pattern among FTAs. While S-S agreements tend to exploit the policy space available under the WTO, US agreements occupy the other end of the spectrum with broad and deep coverage. Meanwhile, the WTO and EU agreements take up the middle ground. In the next pages, the trend emerges more forcefully as we explore the specific trade areas of goods, services, investment, and intellectual property rights.

Goods Trade Policies

Trade in goods constitutes the oldest arena of international trade cooperation and discipline. Within the rules, however, countries have exploited every flexibility they could find to promote growth and development. This section reviews four primary policies affecting goods trade: tariff sequencing, incen-

tives for export, non-tariff barriers, and safeguards. Table 4 provides a summary of our analysis. We show that, in the area of goods trade, agreements between developed and developing countries (North-South or N-S) demonstrate some convergence, imposing harsher disciplines on policy makers than those imposed under the WTO. However, in some key areas, agreements with the EU more closely resemble the WTO disciplines than those of US agreements—hinting that two different North-South models may emerge.

Table 4. Goods Checklist

Policy Instrument	WTO and Associated Agreements	US Agreements	EU Agreements
Tariff sequencing	Y	N	N
Tax drawbacks/deferrals and EPZs	Y	N	Y
Quantitative restrictions/licensing	N	N	N
Safeguards for injurious imports ¹²	Y	Y	Y
Safeguards for shortages ¹³	Y	Y	Y
Safeguards for balance of payments	Y	N	Y

Tariff sequencing Tariff barriers have long been the preferred trade barriers under the WTO and its predecessor and underlying agreement, the General Agreement on Tariffs and Trade (GATT) because they are easy to measure, transparent to apply, and straightforward to liberalize progressively over time. Historically, countries have raised and lowered tariffs in accordance with the perceived needs or demands of domestic industry. By raising tariffs on certain manufactured goods and lowering them on inputs for those goods, for example, some countries have encouraged domestic manufacturers without exposing them to global competition before they're ready (Chang 2002).

Under the WTO and its associated agreements, most countries initially bind rates significantly higher than their applied rates (for example, WTO Chile Tariff Profile).¹⁴ This discrepancy gives them the legal right to raise and lower tariff rates at various times to promote industrial development, subject, of course, to the pillars of the WTO: national treatment and most favored nation (MFN) treatment.

12. As mentioned in note 5, the degree of procedural requirements varies greatly between agreements.

13. Among US and EU disciplines, the rules are not identical across agreements.

14. Take, for example, Chile's tariff profile as provided by the WTO. While the simple average bound is 25.1%, the simple average applied is much lower at 6%. This trend repeats for the countries in this study (WTO Current Schedules).

In regulating tariff rates, US and EU agreement clearly converge. Under both EU and US treaties, countries generally commit to maintaining (by binding) tariff rates at or below¹⁵ the current applied rates—giving little or no room for adjustments upward.¹⁶ Table 5 points out the divergence between tariffs bound under the WTO and those under a North-South regional or bilateral agreement. The table shows that tariffs bound under the regional trade agreements, are largely based on the applied rates¹⁷ in the case of photographic paper in rolls wider than 610 mm.¹⁸ The evidence suggests, then, that countries negotiating with the US or EU bilaterally may have less bargaining power than they do in multilateral negotiations.

Table 5. Illustrative Tariff Comparison: Photographic paper, in rolls wider than 610 mm (%)

Country/Agreement	WTO binding	FTA binding	Alternate FTA binding ¹⁹	MFN applied rate (avg)
Chile	25.0	6.0	6.0	6.0
Mexico	35.0	0.0 ²⁰	0.0	11.5
Costa Rica: DR-CAFTA	45.0	10.0	N/A	9.0
Nicaragua: DR-CAFTA	40.0	5.0	N/A	10.0
Honduras: DR-CAFTA	35.0	10.0	N/A	10.0
Guatemala: DR-CAFTA	45.0	10.0	N/A	10.0
Dominican Republic: DR-CAFTA	35.0	8.0	N/A	8.0
US-Singapore	6.5	0.0	N/A	0.0
EU-Tunisia ²¹	38.0	0.0	N/A	15.0
EU-South Africa ²²	15.0	0.0	N/A	5.0

Source: WTO Current Situation of Schedules and other agreements specified

15. EU agreements also allow for varying transition times to get to the base rate stated in the agreement (for example, EU-Tunisia Schedule).

16. Theoretically, countries choose which sectors to bind and the extent to which they bind them. In that way, even S-S arrangements resemble their N-S counterparts. However, a country's actual ability to bargain in favor of sensitive sectors varies from country to country.

17. That is, the tariff rates already set for that particular country.

18. This trend repeats itself over and over again in the countries' individual tariff schedules. Taking a simple average of the bound rates under the RTAs and comparing it to the simple average of the MFN applied rate across all products would prove this conclusively. Unfortunately, we were unable to find a schedules document that would export to a spreadsheet program and take such averages.

19. This column applies only to Chile and Mexico and represents their commitments under their US agreements.

20. This represents a bound tariff after progressive reduction over seven years.

21. The FTA binding represents a bound tariff after progressive reduction over five years.

22. The FTA binding represents a bound tariff after progressive reduction over five years.

Incentives for export Export incentives constitute another set of policies commonly employed for purposes of development. A country may set up a duty drawback or deferral system to reward companies or industries that export a certain percentage of their products. These programs may be industry or geography-specific.²³ Export incentives can encourage domestic industry to compete on the global scale and, if employed properly, aid in maintaining a healthy trade balance for the country. Unlike tariff regulation, however, EU and US agreements diverge in their treatment of export incentives. While the EU agreements generally take a more permissive stance, US agreements almost universally prohibit, or at least restrict, them.

Since the GATT “does not consider duty and indirect tax exemptions or drawbacks for inputs used for export production at the final stages of fabri-

Export incentives can encourage domestic industry to compete on the global scale and, if deployed properly, aid in maintaining a healthy trade balance for the country...While the EU agreements generally take a more permissive stance, US agreements almost universally prohibit, or at least restrict, them.

cation and at the earlier stages as export subsidies,” it permits countries to impose duty drawbacks or deferrals on condition of export (Rhee 1985, 79).²⁴ EU agreements, like the GATT, do not directly address the use of duty drawbacks, deferrals or export processing zones (EPZs) and, therefore, appear to permit them. Both EU-Chile and EU-Mexico (collectively, the Latin American agreements) prohibit the use of taxation to

protect domestic industry, which could potentially restrict tax-based export incentives (EU-Chile Art. 63, EU-Mexico Decision 2/2000 Art. 13). The agreements with Tunisia and South Africa (collectively, the African agree-

23. The latter, geography-specific drawback or deferral programs, are often called Export Processing Zones (EPZs).

24. As Rhee implies, export subsidies, unlike duty drawbacks and deferrals, are categorically prohibited under each of these regimes (SCM Annex IA, DR-CAFTA Art. 3.14, US-Chile Art. 3.16, NAFTA Art. 705). Mexico’s *maquiladora* program provides a ready example of an export incentive system. Under NAFTA, however, “*maquila* firms were granted a seven-year phase-in period during which they continued to enjoy duty-free importation benefits.” This ended in January 2001, when NAFTA Art. 303 entered into effect (Sargent and Matthews 2001, 1741).

ments), on the other hand, implicitly permit drawbacks by limiting the amounts to that of the original tax (EU-Tunisia Art. 22, EU-S.A. Art. 21).²⁵

By contrast, US agreements almost universally prohibit duty drawbacks or deferrals on condition of certain performance requirements (NAFTA Art. 303, US-Chile Art. 3.8, DR-CAFTA Art. 3.4).²⁶ NAFTA prohibits drawbacks and deferrals provided that goods are “subsequently exported to the territory of another Party, [] used as material in the production of another good that is subsequently exported . . ., or [] substituted by an identical or similar good used as a material in the production of another good that is subsequently exported . . .” in a specified amount. Parties to NAFTA also must not “refund, waive or reduce” specified non-tax duties on condition of export (NAFTA Art. 303). US-Chile and DR-CAFTA differ slightly, in that they proscribe parties from adopting new customs duties waivers, or continuing an existing waiver conditioned on performance requirements. “Performance requirements” under these agreements include export level or percentage requirements, domestic product substitution requirements, domestic goods preference, domestic content requirements, and foreign exchange restrictions (US-Chile Art. 3.24, DR-CAFTA Art. 3.31).²⁷ Thus, US agreements represent a separate model from that of the EU (drawn from the GATT) that more tightly constrains policymakers.²⁸

Non-tariff barriers and restrictions Unlike tariffs, other trade barriers (non-tariff barriers or NTBs) have faced restrictions under almost all modern international trading regimes. Some common NTBs include quantitative restrictions (quotas), import licensing, and import and export price requirements. GATT Article XI prohibits both “instituting” and “maintaining” quantitative restrictions except to prevent or relieve shortages of food

25. This provision seems to be aimed at preventing hidden export subsidies—payments called “drawbacks” or “deferrals” by the government, but which actually exceed the amount of the tax.

26. The one exception here is US-Singapore.

27. This does not include conditions, however, that the good be subsequently exported and other such rules as required under NAFTA Art. 303.1

28. According to Sargent and Matthews, a second aspect of bilateral agreements may lower the ability of a country to create export incentives. Rules of origin, present in all US agreements and most EU agreements, may lower the ability of export-oriented firms to compete with local firms for intra-regional trade since export firms have the propensity to have non-regional inputs (Sargent and Matthews 2001, 1741). This negative externality of the rules of origin may have a lesser effect within EU arrangements since the EU encompasses many countries—creating more regional options for acquiring inputs.

or essential products, to apply local standards for “classification, grading or marketing of commodities in international trade,” or to enforce certain measures governing the domestic production of agricultural or fisheries products. WTO disciplines also make allowances for quotas in the case of a country’s balance of payments difficulties (GATT Art. XII). Furthermore, the WTO treats import licensing schemes as quantitative restrictions, regulating them under the Agreement on Import Licensing (WTO Import Licensing). Finally, Article XI mentions “other measures” that act as a prohibition or restriction on import—potentially leaving room for disputes about non-quota, non-license measures.

Here again, US and EU agreements diverge enough to hint that two different models of NTB disciplines are emerging. EU agreements contain substantially WTO-equivalent language. The Latin American agreements, which are more comprehensive, prohibit quotas, import licensing and “other measures” just as in GATT Art. XI (EU-Chile Art. 76, EU-Mexico Decision 2/2000 Art. 12). The African agreements, on the other hand, prohibit only quotas explicitly (EU-S.A. Art. 19, EU-Tunisia Art. 19).

US agreements also contain WTO-equivalent language, but with an added prohibition on import and export price requirements. Both US-Chile (Art. 3.11(2)) and DR-CAFTA (Art. 3.8(2)) further prohibit import licenses conditioned on performance requirements while also forbidding voluntary export restraints.²⁹ Although slight, the US trend toward deeper trade commitments continues to emerge in NTB disciplines.

Safeguards A final set of goods trade policies aimed at development, safeguards have long been employed by countries facing sudden injurious levels of imports, balance of payments difficulties, and critical food shortages. GATT Articles XII and XIX place some constraints on safeguards by subjecting them to detailed procedural requirements. Safeguard measures under the WTO may include quantitative restrictions, suspending tariff concessions or raising tariff rates (GATT Arts. XII, XIX). The Agreement on Safeguards (Art. 7) further imposes maximum time limits on safeguard

29. DR-CAFTA also expressly incorporates the WTO Agreement on Import Licensing, and imposes an additional notification requirement (Art. 3.9).

measures. First codified within the global trading regime, bilateral and regional agreements have adopted safeguard provisions with similar conditions. EU and US agreements differ, however, in both their treatment of quantitative restrictions and the availability of transitional safeguards.

Like the WTO, EU agreements permit safeguards for injurious imports, balance of payments difficulties and shortages.³⁰ In the Latin American agreements, the EU mirrors GATT Article XII, permitting suspension of tariff concessions, increasing tariff rates and imposing quantitative restrictions as safeguards. At the same time, the agreements are careful to ensure that safeguard measures do not “exceed what is necessary to remedy the difficulties which have arisen” (EU-Chile Art. 92, EU-Mexico Decision 2/2000 Art. 15) and they give priority “to those [measures] which least disturb the functioning of” the agreement as a whole (EU-Tunisia Art. 27).³¹ Despite this caution, the African agreements permit transitional safeguards, which face more relaxed procedural requirements and may be imposed solely to protect infant industry (EU-Tunisia Art. 14; EU-S.A. Art. 25).

US agreements, on the other hand, permit safeguard measures only for injurious import levels and balance of payments difficulties.³² Safeguard measures may include suspending concessions or raising duties *but not* imposing quantitative restrictions. Furthermore, US agreements require that, in the case of injury by imports, the imports not only *cause serious injury or threat thereof* (GATT language), but that they be the *substantial* cause of that injury—a higher legal standard (US-Singapore Art. 7.1; US-Chile Art. 8.1; DR-CAFTA, Art. 8.1; NAFTA Art. 801).³³ Thus, once more, US agreements represent a broader and deeper model of trade commitments.

30. The Latin American agreements allow safeguards in all three of these cases (EU-Chile Arts. 92, 93, 195; EU-Mexico Decision 2/2000 Arts. 15, 16, 21). The African agreements, however, circumscribe the application of safeguards somewhat more (EU-Tunisia Arts. 25-26 (excluding express safeguards for balance of payments); EU-S.A. Arts. 24, 26 (no allowance for goods trade safeguards for balance of payments difficulties or shortages)).

31. The legal standard imposed varies among EU agreements. While the EU-Chile agreement constrains safeguard use to situations where the injured Member has a “substantial interest” in the injured industry (EU-Chile Art. 92), other agreements seem to broaden the scope of the WTO rules and allow safeguards even to protect against “serious deterioration of economic situation” (EU-Tunisia Art. 25).

32. Since the agreements mention nothing about shortages, safeguards to protect against them are presumed prohibited.

33. The only US agreement to take special consideration of developing countries, DR-CAFTA Art. 8.1(4) places limitations on imposing safeguards against developing countries.

Bilateral models and South-South responses Each of these trade regimes has tied policymakers' hands in different ways and to a different extent. The above examples demonstrate conclusively that the global trading regime under the WTO and its associated agreements have, thus far, preserved more policy space in goods trade for developing nations than have most bilateral and regional arrangements—in particular those with the global North. Taking the

The global trading regime under the WTO and its associated agreements have, thus far, preserved more policy space in goods trade for developing nations than have most bilateral and regional arrangements—in particular those with the global North.

analysis further, however, shows that, rather than converge, US and EU agreements have formed two distinct models of trade discipline—the latter allowing more policy flexibility than the former. In addition to these two North-South models, developing countries have established a third option, joining together to form South-South trad-

ing blocs. Several arrangements studied here offer examples of provisions that tend to exploit WTO policy flexibility, leaving open *even more* policy options aimed at diversification and development.

To allow tariff sequencing, both SAFTA and MERCOSUR provide for “sensitive lists” or wholesale exceptions to the general liberalization program (SAFTA Art. 7.3, MERCOSUR Goods, Art. 6). Under SAFTA, even quantitative restrictions need not be eliminated for products on the “sensitive lists” (Art. 7.5). SAFTA also recognizes the special needs of lesser developed countries, allowing “greater flexibility . . . in continuation of quantitative and other restrictions provisionally and without discrimination in critical circumstances by the Least Developed Contracting States” (Art. 11(b)). In addition to permitting tax drawbacks and deferrals, some S-S arrangements, such as China-Chile, exempt all tax issues from coverage by the agreement, leaving contracting states plenty of freedom to use tax incentives for industrial and other development (China-Chile Art. 101).

Notably, these agreements fairly tightly constrain the use of safeguards against fellow developing states. The CAN permits safeguards for injurious imports only when the Trade Liberalization Program causes or threatens

“serious economic damage”—but prohibits them against certain products (Arts. 96, 99). The CAN General Secretariat acts as a gatekeeper, regulating the use of safeguards (Arts. 85, 95). MERCOSUR allows them for injurious imports “only in exceptional cases” and makes no room for safeguards for balance of payments or shortages (MERCOSUR Safeguards Art. 1). SAFTA permits them (except for shortages) but contains a special consideration for Lesser Developed Countries, limiting safeguards against them (Art. 16.8). This provision may hold the key to why South-South arrangements seem to constrain safeguard usage—largely because safeguards would allow more developed members to impose safeguards on the imports of their lesser developed counterparts.

Trade in goods has ceased to be the most important area of trade regulation, however. Global trade disciplines have increased in scope in the past 15 years to impose constraints on services trade regulation, treatment of foreign investment, and intellectual property protection, among others. The following sections explore these trade-related policy areas and the extent to which trade agreements impact policymakers’ decisions today.

Trade in Services

Since the Uruguay Round in 1994, global trade in services has increased dramatically both in quantity and importance. Some of the fastest-growing sectors, like computer-related services, legal, advertising and technical service jobs, other business activities, and research and development grew between 70 and 250 percent from 1994 to 2004. Of 54 bilateral and regional agreements with services trade provisions, only five predate the Uruguay round (Perera 2007, 3). Prior to the Uruguay Round, countries were able to retain control over sensitive sectors, impose quota equivalents for services, require joint ventures from foreign service suppliers, control the establishment of foreign service suppliers, impose safeguards, and employ domestic regulation to control the impact of the services trade.

Today, however, the new global trading regime and bilateral and regional agreements circumscribe their efforts to varying degrees. In many ways, disciplines over trade in services are more uniform among trade agreements than are other areas of trade. Table 6 provides a general picture of where

the three primary regimes studied here converge and diverge. The following discussion explains the practical constraints that services agreements place on policymakers and discusses whether services trade disciplines converge.

Table 6. Services Checklist

Policy Instrument	WTO and Associated Agreements	US Agreements	EU Agreements
Maintaining control over sensitive sectors ³⁴	Y	Y	Y
Services Quotas and Restrictions	N	N	N
Organization type requirements	N	N	N
Duty of establishment	Y	N	Y
Withholding right of establishment	Y	N	N ³⁵
Safeguards	Y	N	N
Freedom to regulate service supply ³⁶	Y	Y	Y
Movement of natural persons	Y	N	Y

Retaining control over sensitive sectors Many countries have desired to maintain control over certain sectors of their services economy. These sectors may include “essential services, network infrastructure services, and financial services” (Oxfam 2008, 2). Theoretically, countries have broad capacity to maintain control over sensitive sectors through the negotiation process. The most significant difference between the agreements, however, lies in the method by which sectors are bound.

The multilateral trading system adopts what has been called a “positive-list approach,” which means that protection is the rule rather than the exception (Marconini 2006, 12). Thus, unless the country places a sector on the list, it can remain unbound. The WTO’s General Agreement on Trade in Services (GATS) Articles IV and XIX also make special allowances for lesser developed countries (LDCs), permitting them to liberalize later. The GATS even defines “public services” so that they are not bound by the rules of the

34. While some amount of control is permitted under all agreements, US agreements employ a negative list rather than the positive list approach of the GATS and EU agreements.

35. Here, the EU agreements could be evolving to look more like US agreements but the rules are not consistent across the four treaties.

36. As mentioned in note 7, the difference here is that the balancing test for regulations is self-enforcing under the EU and US agreements, while enforcement under the WTO requires further rulemaking.

agreement (Art. I:3). Although this method seems broadly permissive, the WTO inherently contains the expectation of full liberalization across sectors (GATS Annex on Art. II Exemptions).

The EU agreements, likewise, have adopted a positive-list approach.³⁷ And like the WTO, with the exception of EU-Tunisia, these agreements call for the eventual elimination of “substantially all remaining discrimination between the parties” in all sectors and all modes of supply (EU-Mexico Decision 2/2001 Art. 7.3; EU-Chile Art. 100; EU-S.A. Art. 30.1). Some EU agreements, represented by the EU-Mexico arrangement, pronounce a standstill on future measures inconsistent with liberalization, and include a most-favored-nation (MFN) provision that prohibits Mexico from deciding “with which regions [it] would like to integrate most or first” (Oxfam 2008, 5; EU-Mexico Decision 2/2001 Arts. 5, 7).

The pivotal difference between the US and the EU models is that US agreements employ a negative list approach—making liberalization, not protection, the rule (Marconini 2006, 12). Practically speaking, this means that countries have to negotiate for every sector they want to protect, making it more negotiation

intensive for nations to maintain control over their sensitive sectors.

At the same time, US agreements also permit countries (theoretically) to make reservations to the MFN principle, to reserve room for future measures that are inconsistent with

the agreement, and to select whole sectors to be untouched (permanently) by the agreement, options which are less available under an EU or WTO framework (Marconini 2006, 8; NAFTA Art. 1206; DR-CAFTA Art. 11.6; US-Chile Art. 11.6; US-Singapore Art. 8.7). What has yet to be

The pivotal difference between the US and the EU models is that US agreements employ a negative list approach—making liberalization, not protection, the rule.

37. Although the four EU agreements studied here contain actual services commitments only to varying degrees, each contains a reference to the positive list approach stated in their negotiating mandate at the very least (EU-Mexico Decision 2/2001 Art. 7.3, EU-Chile Art. 99, EU- S.A. Art. 29.1, EU-Tunisia Art. 32.1).

seen is whether the commitment to complete liberalization will come to completion under any of the EU trading arrangements. If so, developing countries that seek EU trade preferences for the policy flexibility they provide may end up with more policy restrictions than they originally bargained for, 20 or 30 years down the road.

“Non-Tariff Barriers” in services: quota equivalents for services trade

Just as in goods trade, countries have often attempted to protect a domestic services industry or control the behavior of service suppliers by imposing quantitative restrictions on services trade. For the most part, no modern international trade agreement permits these measures. The GATS sets out the template for treatment of services trade in this area. It prohibits service supplier quotas, service transaction or asset restrictions, service output quotas, and service employment limitations in bound sectors.³⁸ These limitations are prohibited whether they come “in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test” (GATS Art. XVI:2).

Modern trade agreements take a largely harmonized approach to services quota regulation. The EU-Latin American agreements employ GATS-identical language when it comes to services quotas (EU-Chile Art. 97; EU-Mexico Decision 2/2001 Art. 4). The African agreements mention no such limitations directly, but the Parties incorporate “strict observance of the [GATS]” (EU-S.A. Art. 29; EU-Tunisia Art. 32.1). With the exception of NAFTA, US agreements also employ GATS language, prohibiting the same behavior with an exception for existing non-conforming measures set out in the schedules (DR-CAFTA Art. 11.4; US-Chile Art. 11.4; US-Singapore Art. 8.5).³⁹ Here, as in the previous section, the distinct binding approaches of the two models make the difference. While under the EU arrangements, only committed sectors are bound by the rules of market access, under US agreements, all are bound except sectors explicitly excluded.

38. This section also prohibits two other measures: requiring a certain organization type for service suppliers and foreign capital participation limits – both of which will be addressed in the coming sections.

39. The exception to many of these rules is NAFTA, since it came about so much earlier—on this subject it states: “The Parties shall periodically, but in any event at least every two years, endeavor to negotiate the liberalization or removal of the quantitative restrictions set out in Annex V pursuant to paragraphs 1 through 3” (NAFTA Art. 1207(4)).

Joint venture requirements Countries have also, historically, controlled the behavior of foreign service suppliers by organization-type requirements and limits on foreign capital participation. This forces foreign services or suppliers to partner with a local company or person, and allows local nationals to control the direction of the company, necessarily transferring some technology and know-how into the domestic economy. Today, however, joint venture requirements, like quotas, are almost universally prohibited under international services agreements.

As above, the GATS provides the textual template for this discipline stating that where market commitments are undertaken member countries may not impose “measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.” It also prohibits placing limits on foreign capital participation (GATS Art. XVI:2(e)-(f)). The EU-Latin American agreements again mimic the GATS disciplines, prohibiting both legal entity requirements and foreign capital restrictions (EU-Chile Art. 97; EU-Mexico Decision 2/2001 Art. 4). The African agreements, as mentioned above, incorporate GATS commitments, but make no additional reference to services organization requirements.

US agreements differ slightly from the EU—in that they *do not* outright prohibit placing limits on foreign capital participation in their services agreements (DR-CAFTA Art. 11.4; US-Chile Art. 11.4; US-Singapore Art. 8.5).⁴⁰ More important, for purposes of this discussion, US agreements regulate foreign capital participation under the investment rather than the services chapters. The investment chapter governs some amount of foreign participation in domestically located firms by forbidding that countries “materially impair” the ability of the investor to exercise control over its investment” (DR-CAFTA Art. 10.10; US-Singapore Art. 15.9; US-Chile Art. 10.10; NAFTA Art. 1107). US agreements also provide a universal right of establishment to firms from partner countries, a discipline discussed in more detail below. Both the “material impairment” provision and the right of establishment would effectively proscribe joint venture requirements. Furthermore, the investment chapter is not sector-specific and therefore binds even more broadly than the US’ negative list approach to service commitments.

40. Once more, NAFTA is the exception to this rule and does not mention either of these disciplines.

Duties and rights of establishment Policies influencing establishment rights represent another area traditionally employed to promote development. Controlling establishment, either by imposing a duty or withholding

Controlling establishment, either by imposing a duty or withholding a right of establishment, allows policymakers to influence who does business in their territory.

a right of establishment, allows policymakers to influence who does business in their territory. By imposing a duty of establishment⁴¹ countries force service suppliers “to establish or maintain a representative office or any form of enterprise, or to be resident in its

territory as a condition for the cross-border supply of a service” (NAFTA Art. 1205). Withholding a “right of establishment,” on the other hand, allows countries to select which service suppliers they want in their territory, and keep out those they do not.

Investment and services agreements rarely regulate the duty of establishment. Neither the GATS nor EU agreements mention such duty. However, if applied to bound sectors, such measures would likely have to be in the schedule for continued liberalization (Marconini 2006, 9). US agreements, on the contrary, expressly forbid parties from imposing such a duty by prohibiting local presence requirements (NAFTA Art. 1205; DR-CAFTA Art. 11.5; US-Chile Art. 11.5; US-Singapore Art. 8.6).⁴²

As for the *right* of establishment, the GATS does not explicitly require that Member countries impose no requirements on the establishment of investments made by a foreign investor (Marconini 2006, 9).⁴³ Yet again, for bound sectors, such measures would likely need to be scheduled for liberalization. Once more, US agreements include as a part of national treatment

⁴¹ Also known as the “right of non-establishment.”

⁴² One author mentions that while the US agreements contain clearer language about the prohibition of duty of establishment clauses, they may not necessarily be “more forceful in actually putting them into effect” (Marconini 2006, 9).

⁴³ Though this may apply more directly to the trade-related investment measures, services and investment are intricately connected and often treated under the same agreement except in US treaties. Furthermore, the Agreement on Trade-Related Investment Measures (TRIMS) makes no mention of rights of establishment for foreign companies either in the text of the agreement or in the Illustrative List of inconsistent measures (TRIMS Annex).

that “[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the *establishment* . . . of investments in its territory” (DR-CAFTA Art. 10.2, emphasis added).

More variation exists among EU treaties. While traditionally, the agreements have not contained a right of establishment, recent agreements have incorporated that right to varying degrees (Oxfam 2008, 3). EU-Chile, for example, contains a separate section (Chapter III) mandating that “with respect to establishment, each Party shall grant to legal and natural persons of the other Party treatment no less favourable than that it accords to its own legal and natural persons performing a like economic activity” (Art. 132). EU-Mexico makes no mention of establishment within the services section, but explicitly mentions the right of establishment for suppliers of *financial* services (EU-Mexico Decision 2/2001 Art. 12). Under the EU-Tunisia agreement, the parties have not yet reached a decision on the matter of establishment, but have agreed to address it in the future (EU-Tunisia Art. 31).⁴⁴ Some evidence suggests, then, that EU disciplines may converge with US commitments in the area of establishment in the future (Oxfam 2008, 3). This trend is not prevalent enough, however, to conclude general convergence in establishment disciplines.

Services safeguards Safeguard regulation arises separately under services trade. In general, most of the permitted safeguard measures for goods involve tariff levels—a measure not directly applicable to services trade. Here, GATS commitments clearly permit more flexibility than bilateral and regional agreements, and the US exceeds both the GATS and the EU in restricting the use of safeguards. GATS Article XII allows “[m]embers [to] adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments.” Furthermore, Article X proposes an Emergency Safeguard Mechanism for situations in which waiting the period required under the general safeguard provisions would cause hardship to the country (though this mechanism has not yet been established).

44. The EU-South Africa agreement uniquely does not even contain an agreement to discuss the issue in the future.

With the exception of EU-Chile, EU agreements generally omit mention of service-related safeguards. The EU-Chile agreement permits parties to “adopt or maintain restrictive measures with regard to trade in goods *and in services* and with regard to payments and capital movements, including those related to direct investment,” but only for balance of payments difficulties” (EU-Chile Art. 195, emphasis added). The US model more uniformly excludes services safeguards, mentioning only suspension of tariff reduction and raising tariff rates (NAFTA Arts. 801, 2104; DR-CAFTA Arts. 8.1, 21.4; US-Chile Arts. 8.1, 23.4; US-Singapore Art. 7.1).

Domestic regulation Possibly one of the most domestically invasive sets of provisions in trade agreements addresses the issues of domestic regulation of service suppliers. Traditionally, domestic regulation remained under the purview of the domestic policymakers. However, with international trading partners concerned that other countries would use regulation to discriminate against their goods and services, the GATS, as well as regional and bilateral agreements, impose some limits on the use of domestic regulation. In this way, the EU and US agreements have converged by employing the GATS standard for legitimate regulation while stepping up the binding nature of that standard.

The GATS spells out the universal standard for balancing legitimate regulation with trade liberalization: that “measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner,” and “that such requirements are, *inter alia*: (a) based on objective and transparent criteria, such as competence and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service” (GATS Art. VI:1, 4). The subtle, but important, difference between the GATS and its bilateral or regional counterparts, however, is that the standard is self-enforcing under the US and some EU agreements. That is, the parties to those treaties must meet those standards or risk violating the agreement. By contrast, the GATS provision acts only as a basis for future rulemaking by the Council for Trade in Services (DR-CAFTA Art. 11.8; US-Chile Art. 11.8; US-Singapore Art. 8.8; NAFTA Art. 1210; EU-Chile Art. 102).⁴⁵

45. Other EU agreements contain more varied language. EU-Mexico, the only other EU agreement here

Human capital development Two key ways that countries have attempted to develop local human capital and promote development generally are through the free movement of persons across borders and heavy investments in public education. The GATS governs the former by scheduling commitments to liberalize migration and immigration. This represents one area that developing countries have traditionally liberalized (rather than protected) in order to promote human capital growth. Ironically, US services agreements permit broad-reaching restrictions on the free movement of persons by simply not covering it within the scope of their services provisions (DR-CAFTA Art. 11.1). EU trade agreements do allow for such commitments, but in most cases, the EU offers in this area are minimal (EU-Chile Art. 95; Oxfam 2008, 5). In the area of public education, on the other hand, countries are generally limited only by their domestic political and economic situations.

South-South responses to bilateral services trade disciplines Across the board, international trading regimes have limited the policy options available to policymakers who could use public policy to promote diversification and growth. Furthermore, diminished differences between the trade agreements could lead to a slight trend in services disciplines convergence, rather than the emergence of two separate bilateral models. Differences still exist, however, as shown by the varying approaches to binding, the unique way that US agreements treat investment disciplines, and the simple fact that US agreements represent a more uniform, comprehensive approach.

Surprisingly, South-South arrangements have done little to either preserve or increase policy space with respect to services measures. Neither China-Chile nor SAFTA includes a section on services, and the CAN, under Secretariat Decision 439, contains only minimal services obligations (CAN Services Arts. 14-16). As a result, these agreements implic-

to contain a substantive services section, contains a much more vague “regulatory carve out” permitting parties to “regulate the supply of services in its territory, in so far as regulations do not discriminate against services and service suppliers of the other Party in comparison to its own like services and service suppliers” (EU-Mexico Decision 2/2001 Art. 8). The EU-South Africa and EU-Tunisia agreements have only a skeletal services section, more of an agreement to agree than a commitment to liberalize services immediately (EU-S.A. Art. 30; EU-Tunisia Art. 31).

itly retain the flexibilities existent under the WTO and GATS but gain nothing in addition. MERCOSUR's Montevideo Protocol, by far the most comprehensive services section, contains largely GATS-equivalent language, especially regarding market access commitments (Art. IV). The CAN allows safeguards in services trade for "serious external financial or balance of payments problems," but does little else to preserve policy flexibility (CAN Services Art. 20).

Trade in services has come to mean, in addition to cross-border trade and movement of people, the supply of services "through commercial presence abroad;" that is, foreign firms setting up shop in a host country (GATS Art. I:2). Although largely treated under services disciplines within the WTO and EU frameworks, the US has set out a new model for these disciplines that much more rigidly constrains the use of domestic measures to control foreign investors and service suppliers. The next section demonstrates the distinct models arising out of international investment regulation and shows how developing countries have protected their ability to regulate in spite of these disciplines.

Investment

Closely related to trade in services—in fact, included within many services trade provisions—is treatment of foreign investment. "Investment" in this case includes both foreign capital and foreign companies. Countries have historically had at their fingertips numerous creatively crafted investment measures aimed to protect domestic industry, preserve their current and capital account balances, create local backward and forward linkages, and otherwise strengthen their economy. Many of them address the treatment of FDI, while some place more direct control over foreign capital by governing foreign portfolio investment (FPI). Table 7 lays out the current availability of these measures under the various trading regimes. In the following section, this paper shows conclusively that the US has established a model of investment agreements distinct from and more restrictive than both the WTO disciplines and the EU agreements.

Table 7. Investment Checklist

Policy Instrument	WTO and Associated Agreements	US Agreements	EU Agreements
Domestic content	N	N	N
Trade balancing	N	N	N
Foreign exchange restrictions	N	N	N
Domestic sales restrictions	N	N	N
Domestic regulations, licensing, certifications ⁴⁶	Y	N ⁴⁷	Y
Local labor requirements	Y	N ⁴⁸	Y
Local management requirements	Y	N	Y
Headquarters/production restrictions	Y	N	Y
Technology transfer	Y	N	Y
Research and development	Y	N	Y
Domestic producer preference	N	N	Y ⁴⁹
Infrastructure provisions	Y	Y	Y
Subsidized credit/entrepreneurship	Y	Y	Y
Administrative guidance	Y	Y	Y
International transfer/payment restrictions	N	N	N

Direct investment protection and promotion Under the WTO disciplines, member countries have much more freedom to regulate foreign direct investors in an effort to promote development and acquire the industrial know-how of the developed world. The Agreement on Trade Related Investment Measures (TRIMS) lays out an illustrative list of prohibited measures in an appended Annex. The Annex provides examples of measures that violate national treatment and the rules against quantitative restrictions: domestic or local content requirements, trade balancing requirements, foreign exchange restrictions, and domestic sale requirements. Under the TRIMS illustrative annex, governments cannot require that investors “purchase or use . . . products of domestic origin or from any domestic source” whether by requiring them to use certain products, or a certain value of local products, or that a certain proportion of local production come from domestic inputs. Governments

46. Some of the provisions may be permitted implicitly or by related provisions or simply by omission.

47. Many of these measures are not permitted under the US rubric, except as a legitimate domestic regulation.

48. For local labor requirements, local management requirements, headquarters restrictions, technology transfer and research and development, a country may not require them as a condition of entry, but may condition receipt of a benefit on them.

49. In EU agreements, these measures may be effectively proscribed by other rules.

also may not require that investors only import a certain volume of their local production based on how much they export or produce locally (Annex:1). Furthermore, developing country governments may not attempt to balance their capital accounts by only allowing foreign investors to acquire foreign exchange through export. Finally, governments may not restrict the amount an investor exports or sells domestically by requiring domestic sale of certain products, or of a certain value of local production, or of a proportion of the value of local production (Annex:2; Correa & Kumar 2003).

Notably absent from this list are numerous other measures historically applied to promote local development, including requirements to employ local labor, incorporate local management, maintain headquarters or production facilities locally, transfer technology developed locally, and undertake research and development locally. Countries may also provide needed infrastructure, subsidized or directed credit in key industries, and administrative guidance to multinational companies seeking to expand in to local markets. Of course, these measures remain subject to the pillars of national treatment and MFN treatment under the WTO, as do all measures of WTO member countries, but none are mentioned expressly in the agreements. In fact, the GATS permits developing countries to attach some conditions to their services liberalization commitments with development in mind (Art. XIX).

EU agreements contain very little on treatment of foreign investors or in-

vestments. Of the agreements studied, only the EU-Chile agreement conveys a general right of establishment for foreign firms (EU-Chile Ch. III).⁵⁰ Thus, the flexibilities existent within the GATS and TRIMS are largely present in EU

In EU agreements, silence, rather than the presence of permissive provisions, preserves flexibility for domestic regulation of foreign enterprises.

agreements as well. Just as EU-Chile grants the right of establishment to foreign investors, it also states that, subject to the rule on national treatment with respect to establishment, “each Party may regulate the establishment of legal and natural persons” (Art. 133). In EU agreements, silence, rather

50. While the other EU agreements incorporate sections titled “Services and Establishment,” as mentioned above, they are largely agreements to agree in the future rather than active commitments between the parties.

than the presence of permissive provisions, preserves flexibility for domestic regulation of foreign enterprises.

Comparatively, US agreements constrain policies toward foreign investors to a much greater degree. US agreements prohibit imposing any performance requirements “in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory.” These prohibited performance requirements include export level requirements, domestic content requirements, local goods or producer preference, trade balancing, foreign exchange restrictions, domestic sales restrictions, and technology transfer requirements. In addition to the above prohibitions, the same provisions prohibit conditioning “the receipt or continued receipt of an advantage” on domestic content of goods, local goods or producer preference, trade balancing requirements, foreign exchange or domestic sales restrictions (NAFTA Art. 1106; DR-CAFTA Art. 10.9; US-Chile Art. 10.9; US-Singapore Art. 15.8).

Some flexibility exists implicitly by noting what is absent from the above list; countries *may* condition receipt of an advantage on export levels, technology transfer, and domestic supply. US treaties also permit countries to condition “the receipt or continued receipt of an advantage . . . on compliance with a requirement to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory” (NAFTA Art. 1106; DR-CAFTA Art. 10.9; US-Chile Art. 10.9; US-Singapore Art. 15.8). Just as under the WTO and EU agreements, countries retain their affirmative rights to provide infrastructure, direct credit, and provide administrative guidance.

Capital controls and transfer restrictions In addition to governing direct investment, countries have employed capital controls or other international transfer or payment restrictions to promote and stabilize development. Under the current trade agreements, however, they may no longer do this. The WTO, EU agreements and US agreements all prohibit international transfer or payment restrictions presumptively (GATS Art. XI; DR-CAFTA Art. 10.8, 11.10; NAFTA Art. 1109; US-Chile Art. 10.8; US-Singapore Art. 8.10, 15.7; EU-Chile Art. 163; EU-Mexico Decision 2/2001 Title III; EU-Tunisia Art.

33; EU-S.A Art. 33).⁵¹ The difference here lies in the exception: both the WTO and EU agreements permit such restrictions only in the case of “serious balance-of-payments and external financial difficulties or threat thereof,” which is the primary purpose for such measures (GATS Art. XII; EU-Chile Arts. 166, 195; EU-Mexico Decision 2/2001 Arts. 30-31; EU-S.A. Arts. 32-34; EU-Tunisia Art. 35). The US model diverges from this by omitting a provision that allows payments and transfers restrictions for balance of payments difficulties. Rather than imposing additional affirmative constraints, US agreements limit policymakers here by omission.

A different model: South-South investment regulation protection

Contrary to the disciplines for services trade, investment provisions in the various trading regimes reveal two distinct models of North-South investment discipline. While the EU, in the main, echoes the commitments of the parties under TRIMS, the US has established a model investment provision that limits the policies available to increase diversity and development. In response to this, some developing countries have created South-South trading relationships that protect regional firms and thus promote regional development.

Investment protection disciplines make up the section that exhibits the greatest divergence between regimes. The WTO lays the ground rules with its illustrative list of prohibited measures. EU-Chile begins to add to WTO commitments with its provision on establishment, but the other EU agreements do not seem to be following suit. US agreements impose many heightened restrictions by prohibiting most performance requirements placed on foreign firms and by not allowing capital controls even for balance of payments difficulties. On the other end of the spectrum, S-S agreements employ investment liberalization within the region to protect countries against foreign investors from outside the region.

Contrary to what one might expect, the investment disciplines under the CAN and MERCOSUR⁵² liberalize extensively while protecting the economic and development interests of the region.⁵³ These agreements both

51. It should be noted that under the EU agreements, Chile reserved a hefty exception for their investment law 600, and Mexico retains an exception for exchange and monetary difficulties in addition to balance of payments.

52. Neither China-Chile nor SAFTA has yet included investment provisions and MERCOSUR has little to add in the way of enhancing policy flexibility.

53. For example, the MERCOSUR Protocol on Investment Promotion and Protection contains the same national treatment standard as that provided under US agreements (Art. 3). Likewise, CAN Decision

echo provisions of N-S agreements and enforce origin and ownership requirements on foreign firms in order for them to qualify for protection under the regime. In CAN Decision 292, for example, companies must be owned at least 60 percent by national investors of two or more Community Members (Art. 1(d)). The same Decision requires that for any country whose investor contributes at least 15 percent of the capital for the enterprise, one of the directors must be a national of that country (Art. 1(e)).

S-S trade agreements exhibit the marriage of substantial liberalization and regional protection. Here, investment liberalization between trading partners has been used both to open up markets and to protect nascent industry. The nature of the trading partner makes a difference, however, as the bargaining and informational asymmetries between developed and developing countries may lead to N-S arrangements placing undesired constraints on policymakers. Beyond investment protection, one more area of “trade-related” disciplines has drawn the attention of international human rights groups and developing nations alike. The following section addresses the fourth and final set of trade disciplines: intellectual property rules (IPRs).

International Intellectual Property Protection

An area at least as highly controversial as investment protection provisions, IPRs have been a primary method by which countries have attempted to walk the fine line between global integration and domestic development. Countries have tried to correct informational asymmetries and create financial incentives for inventors, all the while protecting private property. This balance has become particularly contentious when protecting private property leads to making necessary medicines unavailable to populations most in need (Shadlen 2005, 23). Historically, wealthier countries or knowledge exporters have tended to prioritize incentives for knowledge creation, while poor countries or knowledge importers have prioritized incentives for knowledge dissemination (Shadlen 2005, 6).

Today, however, the global trade regime has placed increasing limits on the ability of developing countries to prioritize such dissemination. In the area of patents, for example, countries have a more difficult time protecting tradi-

292 allows multinational enterprises the right to establish subsidiaries, transfer payments freely, and transfer their domicile freely (Art. 15ff).

tional knowledge of plants and animals, as well as permitting use of the patent application information for related experimentation. Although countries retain some flexibilities to promote local knowledge and address public needs through compulsory licensing and utility models, the trend shows increased protection for inventors and additional constraints on policymakers.

International intellectual property protection rules have come under attack, in part, because of their adverse effect on medicinal availability in the develop-

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ing world. For that reason, the WTO issued the Declaration on the TRIPS Agreement and Public Health (Doha Declaration), which emphasized the importance of developing country concerns about their access to medicines. Despite the controversy, the US has continued to push for stronger

inventor incentives at the expense of policy flexibility. Table 8 provides a broad picture of the policy constraints in this arena and demonstrates how US agreements exceed the rules under other trade regimes.

Table 8. Intellectual Property Checklist

Policy Instrument	WTO and Associated Agreements	US Agreements	EU Agreements
Patent restriction by industry/origin	N	N	N
Limitations on patent terms	N	N	N
Patent refusals/revocations	Y	Y+ ⁵⁴	Y
Limit IP protection for plants/animals	Y	N	Y+
Permit early-working on patented pharmaceuticals	Y	N	Y
Compulsory licensing	Y	Y+	Y
Local production requirement	Y	N	Y
Parallel imports	Y	N	Y+
Limiting patent breadth	Y	Y	Y
Utility models	Y	Y	Y
Narrow patentability requirements	Y	N	Y

54. A [+] sign indicates that the practice is permitted with some procedural requirements in addition to those under TRIPS.

Patent restriction by industry, origin, or duration In this one question, the three regimes under scrutiny concur. Patent restriction by industry, origin, or duration is patently (no pun intended) prohibited under the Agreement on Trade Related Intellectual Property Rights (TRIPS) of the WTO, stating that “patents shall be available for *any* inventions, whether products or processes, *in all fields of technology*, provided that they are new, involve an inventive step and are capable of industrial application” (Art. 27.1). This language is echoed in all US bilateral and regional agreements and likewise incorporated into most EU agreements by reference (NAFTA Art. 1709; DR-CAFTA Art. 15.9; US-Chile Art. 17.9; US-Singapore Art. 16.7; EU-Mexico Decision 2/2001 Art. 36(1)(a); EU-Chile Art. 170(a)(i); EU-S.A. Art. 46).⁵⁵

Further, under TRIPS, all patents must last for 20 years, at a minimum (Art. 33). Regarding the length of the patents, only NAFTA mentions the actual minimum while the rest simply assume a 20-year minimum (Art. 1709(12)). In addition, some agreements restrict a country’s ability to revoke patents where they deem necessary or important. Under TRIPS (and, thus, the EU regime), countries may do so in accordance with their national law, so long as they make judicial review of the administrative decision available (Art. 32). US agreements have added to this that “a patent may be revoked or canceled only on grounds that would have justified a refusal to grant the patent” (DR-CAFTA Art. 15.9(4); US-Chile Art. 17.9(5); US-Singapore Art. 16.7(4); NAFTA Art. 1709.8). The US model once more shows itself distinct by raising the legal standard for patent revocation.

Limited plant and animal protection Patent protection for plants and animals is a relatively new phenomenon. Although plant and animal species are generally found in nature (and therefore not new or innovative), the developed world has sought additional protection for genetically modified plant species—a move that has placed in jeopardy some of the traditional cultural knowledge established by native populations. Under all modern international intellectual property protection regimes, some protection for plant and animal

55. EU-Tunisia constitutes the exception here, where TRIPS is not even mentioned in the section on IPRs.

life is required. TRIPS states that countries may “exclude from patentability . . . plants and animals other than microorganisms.” However they must “provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof” (Art. 27). Although the provision requires some protection, the phrase “effective *sui generis* system” provides for a lot of theoretical flexibility for developing countries to establish their own plant protection systems—a flexibility that many countries have exploited (Shadlen 2005, 13).

Typically, EU agreements do not expand much on the provisions of TRIPS. Instead they mention various international conventions and agreements (including TRIPS) as a part of the requirements for the trade agreement (EU-Mexico Decision 2/2001 Art. 36; EU-Chile Art. 170; EU-S.A. Art. 46; EU-Tunisia Annex 7).⁵⁶ By incorporating TRIPS, EU agreements seem to retain similar flexibilities. One key difference, however, lies in the frequent EU provision requiring that parties accede to the International Convention for the Protection of New Varieties of Plants (UPOV), either from 1978 or 1991.⁵⁷ This represents a slight decrease in policy flexibility by specifying which type of plant protection is acceptable.⁵⁸

Under the US agreements, once more, the disciplines on IPRs are much tighter. All modern agreements required the parties to ratify or accede to the UPOV 1991 (DR-CAFTA Art. 15.1(5); US-Chile Art. 17.1(3); US-Singapore Art. 16.1(2)).⁵⁹ Furthermore, most recent agreements demand that contracting states make every effort to impose a plant patenting system

56. Incorporation of these agreements comes by various means. In some, the parties simply confirm their existing obligations, while, in others, the parties affirmatively undertake to become a party of the convention.

57. The key difference between the 1978 and 1991 conventions is found in the allowance of third parties “to use protected seeds and plants for breeding new varieties.” UPOV 1978 included a farmers exception allowing them to reuse seeds. This exception was eliminated under UPOV 1991, “which provides much stronger rights to breeders” (Shadlen 2005, 13).

58. Under EU-Chile, the parties “continue to ensure an adequate and effective implementation of” UPOV 1978 or UPOV 1991 (Art. 170(a)(v)). EU-Mexico likewise contains the flexibility of choosing UPOV 1978 or UPOV 1991 and states that the parties “confirm the importance they attach to” the convention (EU-Mexico Decision 2/2001 Art. 36(2)). Under EU-South Africa, the parties also “confirm the importance they attach to” UPOV 1978, and Tunisia has committed to accede to UPOV 1991 by the fourth year “after the entry into force of the Agreement” (EU-S.A. Art.46(5)(c); EU-Tunisia Annex 7(1)).

59. Once more, the exception is NAFTA (NAFTA Art. 1701.2).

(DR-CAFTA Art. 15.9(2); US-Chile Art. 17.9(2)). Under US-Singapore, plant patenting is required automatically by excluding the TRIPS provision that allows members to exclude plants from patentability (US-Singapore Art. 16.7(a)).

Permitting use of patent application information Another technique to promote knowledge dissemination employed by some countries is to establish strict information disclosure requirements to make more information readily available to generics producers and domestic inventors trying to build off the patented invention, or to allow some early working on patented pharmaceuticals. TRIPS provides countries with more flexibility than with US agreements in deciding how much information to require (Art. 29). All WTO members must “require that an applicant for a patent shall disclose the invention in a manner sufficiently clear and complete for the invention to be carried out by a person skilled in the art.” Additionally, countries “*may* require the applicant to indicate the best mode for carrying out the invention known to the inventor at the filing date,” thus permitting heightened information requirements (Art. 29.1, emphasis added).

Some US agreements, by contrast, (possibly those where domestic patent regimes do not protect US interests satisfactorily) lower the amount of information that may be demanded. Under DR-CAFTA, for example, parties to the agreement *may not* ask more of the patent applicant than the “information that allows the invention to be made and used by a person skilled in the art, without undue experimentation, as of the filing date” (Art. 15.9(9)).

Early-working or “Bolar” provisions permit “firms to develop, test, and apply for registration of generic versions of patented drugs, to be put on the market once the protected drugs’ patent terms expire” (Shadlen 2005, 19). Under TRIPS early working is permitted so long as it is not used for commercial production or stockpiling purposes.⁶⁰ The actual text states only vaguely that member states must protect data whose origin “involves considerable effort . . . from unfair commercial use” (TRIPS Art. 39.3). EU agreements, for reasons stated previously, incorporate the same legal lan-

60. This standard has been determined by WTO case law and is not necessarily clear from the text of the agreement (Shadlen 2005, 18-19).

guage and, presumably, the same legal standard. The US model, however, more specifically proscribes early-working by protecting submitted data for regulatory approval for five years “against both disclosure and reliance” (DR-CAFTA Art. 15.10(1)). As Shadlen notes, this applies irrespective of patenting, since information protection exists for any product requiring approval before marketing (Shadlen 2005, 19).

Compulsory licensing Governments grant compulsory licenses (CLs) to domestic industry to make and distribute certain patented products, especially pharmaceuticals, without the consent of the patent holder. They grant them largely to access needed technology where the country cannot obtain access through traditionally negotiated licenses (Shadlen 2005, 21). TRIPS permits CLs subject to that procedural requirements within Article 31. Article 31 requires that each license be considered individually, that the proposed user make efforts “to obtain authorization from the right holder on reasonable commercial terms” over a reasonable period of time (except in situations of national emergency), that the scope and duration be limited to a specific purpose, that the use be non-exclusive and non-assignable, that it be for the domestic market of the granting government, and that it be subject to judicial review, among other procedural requirements.

On this point, both EU and US agreements largely incorporate the terms of Article 31. According to some, bilateral and regional agreements often circumscribe the rights of governments to grant compulsory licenses (Shadlen 2005, 24). Evidence of this can be seen in the texts of US agreements stating that the “subject matter of a subsisting patent to support an application for marketing approval or sanitary permit of a pharmaceutical product . . . shall not be made, used or sold in the territory of the Party other than for purposes related to meeting the requirements of such approval” (DR-CAFTA Art. 15.9(5); US-Chile Art. 17.9(4); US-Singapore Art. 16.7(5)). The US-Singapore agreement even says that the subject matter of a patent may only be used to remedy anti-competitive practices, for public non-commercial use or in the case of national emergency, thus restricting the use of CLs further (Art. 16.7(6)).

Additional flexibilities In addition to the above, countries have employed several other measures to encourage national experimentation and

promote development. TRIPS allows countries to require patent owners to produce locally thus encouraging “the transfer of non-codified, tacit knowledge that occurs via the localization of manufacturing operations” (Shadlen 2005, 22). Both Brazil and India have exploited this flexibility as they aim to promote their industrial development. TRIPS also allows countries to determine their own “exhaustion” policies—whether national, regional or international—permitting parallel imports as soon as the patent holder loses exclusive privileges.⁶¹ Governments may further narrow the *interpretation* of the general patentability requirements—that the invention be new, non-obvious, and useful—such that inventors must reach a higher standard to receive a domestic patent (TRIPS Art. 27.1). They may narrow the breadth of the patent so that only a very narrow application is patented, leaving room for creative expansion on existing patents by domestic scientists. Finally, they may establish protection for “utility models,” inventions that may not quite reach the level of patentability but which may provide local residents with incentives for experimentation (Shadlen 2005, 15-16). Since neither patent breadth nor utility models are addressed under TRIPS, countries enjoy the broad freedom to employ them as they like.

Since EU agreements intellectual property provisions only slightly exceed TRIPS disciplines, presumably the same flexibilities exist. What is surprising is that US agreements have little to say on the subjects as well. Governments may interpret “new, non-obvious, and useful” in many ways even under US rules. In addition, neither patent breadth nor utility models have been addressed in US agreements and therefore are fair game for policymakers. A few agreements, however, have begun to infringe on these additional flexibilities. Recent US agreements require a broad interpretation of the term “new,” allowing an invention even 12 months old to qualify for the novelty requirement (DR-CAFTA Art. 15.9(7); US-Chile Art. 17.9(7)). US

61. Carsten Fink explains the difference between exhaustion policies:

“Under a system of national exhaustion, a title holder can prevent parallel importation of his product from a foreign country, where it is sold either by the IPR’s owner himself or by an authorized dealer. In contrast, if rights exhaust internationally, the title-holder loses his exclusive privilege after the first distribution of his product, thus allowing parallel imports from abroad. A hybrid between national and international exhaustion is regional exhaustion, whereby parallel trading is allowed within a particular group of countries but parallel imports from countries outside the region are banned” (Fink 1999, 173).

agreements also effectively prohibit parallel importation due to its national exhaustion policies (Shadlen 2005, 20).

Additional constraints under US agreements US agreements do not stop there; they seek additional protection for intellectual property in a number of other ways. All recent agreements establish mandatory patent term extensions in the case of “unreasonable delays” (US-Chile Art. 17.9(6); DR-CAFTA Art. 15.9(6); US-Singapore Art. 16.7(7)). This phrase contains inherent vagueness that could be interpreted to give transnational companies more leverage against host governments. Several other provisions act to effectively extend the patent term by protecting the information in the patent application as well as the subject matter of the patent. With the exception of NAFTA, US agreements require an additional five years of protection for pharmaceutical safety certification data (US-Chile Art. 17.10(1); DR-CAFTA Art. 15.10(1)(a); US-Singapore Art. 16.8(1)). DR-CAFTA, the most restrictive in terms of patent protection of the US agreements studied, also establishes a five year safe zone for any product patented in another country, allowing notification to the second country within five years (Art. 15.10(1)(b)). Furthermore, US patent term marketing restrictions may create an effective ban on compulsory licensing—though such licenses are internationally recognized—according to some analysts (Art. 15.10(2); Abbott 2004, 14).

South-South responses and the US model Intellectual property protection provides another clear picture of two emerging models of free

Intellectual property protection provides another clear picture of two emerging models of free trade agreements.

trade agreements. While the EU agreements add almost nothing to the commitments within TRIPS, the US demands much more of its partnering nations. By restricting early-working, requiring heightened protection

for plant species, and effectively extending the terms of patent protection through mandatory extensions and data protection, US agreements represent a distinct model of international IPR discipline.

For developing countries, intellectual property rights, as a new area of trade-related issues, has yet to be addressed under many of these agreements as

well. Neither SAFTA nor China-Chile covers IPRs and MERCOSUR has yet to cover patents, the most important of IPRs for purposes of development. The CAN, however, provides a model S-S arrangement that includes intellectual property provisions that promote the interests of the nations in that region. First of all, the CAN expressly protects biological and genetic heritage and traditional knowledge by subjecting patent applications “on the basis of material obtained from that heritage or that knowledge” to international, Andean Community and national law with respect to acquisition of that material (CAN IPRS Art. 3). In addition, the Decision governing IPRs excludes from patentability scientific theories, mathematical methods; living things (whatever the size); literary and artistic works or any other aesthetic creation protected by copyright; plans, rules, and methods for the pursuit of intellectual activities, playing of games, or economic and business activities; computer programs and software, as such; and, methods for presenting information (CAN IPRS Art. 15).

In addition to patenting restrictions, the Decisions of the CAN Secretariat apply an international standard for exhaustion, providing maximum opportunity for parallel imports (CAN IPRS Art. 54; Musungu 2004, 51). Compulsory licensing remains available where there is a failure to exploit (either through manufacture or import), in the case of “public interest, an emergency or national security considerations,” or in order “to correct anti-competitive practices” (CAN IPRS Arts. 61-66). Finally, the IPRS Decision makes explicit room for utility models, which can encourage a lower degree of innovation often “more appropriate for local firms” (CAN IPRS Arts. 81-85; Shadlen 2005, 16).

In this one trade-related area, more than any other, some developing countries are making strides to protect their traditional knowledge and safeguard their public health. This area also provides clear evidence of the emergence of two distinct N-S trade agreement models. While the EU models have exceeded WTO disciplines on a slight scale, the US imposes multiple additional requirements that prioritize property right protection over information dissemination.

IV. SUMMARY AND CONCLUSIONS

The analysis of various types of trade agreements shows that the current global trade regime substantially curtails the ability of countries to maintain control over various policy tools that traditionally have been deployed as part of long-run development paths.⁶² Under the WTO, despite the constraint on policy space, there remains considerable room to maneuver. Countries may legally raise and lower tariffs, provide tax-related export incentives such as drawbacks and deferrals within EPZs, impose performance requirements on investors and service providers, and employ domestic patent laws to prioritize information dissemination over incentives for invention. The WTO also makes room for countries to form bilateral and regional trade agreements under the GATT (Art. XXIV).

Despite wide variation among Article XXIV agreements, policy space under North-South free trade agreements is the most constraining on the traditional industrial development toolkit. Among the countries to form bilateral and regional trade arrangements, the US and the EU are the most influential. Overwhelmingly, among both trade agreements and the global trade regime, the trend heads toward increased liberalization and decreased government intervention in the economy. At the same time, some types of agreements continue to make space for the policies aimed at industrial development, while others push for broader and deeper liberalization. Trade agreements with the EU, for example, retain much of the flexibility under the WTO in the areas of investment and intellectual property, and employ the same positive-list approach as the GATS. By contrast, the US imposes many additional disciplines on its trading partners—expanding patent protection, mandating investment liberalization, and employing a negative-list approach to services bindings. Over the past 15 years, trade regimes have formed around these principles and US trade policy has become more uniform. Meanwhile, EU trade policy varies much more greatly by trading partner, indicating a greater willingness to retain policy flexibility. Provided this trend continues, countries that are still developing in 30 years will have

62. Part of the reason for this is that, with the spread of globalization, no issue is truly “uniquely” domestic. Even though industry standards, licensures, and certifications may be matters of domestic law, they impact foreign companies and, by extension, foreign governments.

more opportunity to creatively use their policy space under an EU agreement than under an agreement with the US.

Many S-S agreements are also established under Article XXIV; yet they often provide the greatest policy space among the agreements studied. This flexibility derives not from lacking affirmative trade disciplines but from using trade liberalization between developing countries to protect industries and promote growth regionally. Investment and intellectual property rules under the CAN provide the clearest example here. The CAN rules of origin establish protection for regional firms against extra-regional companies. In addition, the CAN explicitly protects traditional knowledge, tightens patentability requirements and makes room for local, non-patentable innovation.

Still, some policy space remains under even the most restrictive trading schemes. The self-enforcing nature of dispute resolution, for example, allows smaller countries to undertake virtually any policy that does not economically injure its larger trading partners. Furthermore, to the extent the state is economically capable, it may invest heavily in public education, subsidize credit to certain industries, and build up domestic infrastructure. Using a method employed by developing and developed countries alike, policy makers may also provide administrative guidance—marketing the country, its location, natural resources, and workforce, for example—to investors and traders internationally. This technique may help a country to target an industry that would transfer technology or provide backward and forward linkages in the economy.

This paper is far from the final word on this subject. Indeed, it may perhaps raise more questions than those that are answered. Each subject could be its own separate paper, pursuing in more depth the implied and actual flexibilities inherent in the global trading regime. For that reason, this paper aims only to give an overview of the policies available to countries today, and point out some significant differences between the various types of trade agreements. Going forward, interesting ideas for further research are numerous. A legal analysis of the dispute settlement cases under each regime would shed more light on the extent to which the rules against selective policies have actually been enforced. Political scientists might explore whether

the divergence within international regimes, such as that of the EU-Latin American agreements and the EU-African agreements, is rooted in the geography of the trading partners, their development level, or other factors.

From a policy perspective, it is our hope that negotiators and policymakers who have or are considering crafting longer-run development strategies

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can use this paper as a reference when deciding under which policy regimes such development strategies would be most permissible. Just shy of 60 percent of the people on the planet live in poverty, measured by the World Bank as less than \$2.50 per day. To raise the standard of living for those people, governments seek to put together long-term development strategies that deploy the policy instruments that have proven

successful in other settings. This paper catalogues many of the policies deployed by successful developed and developing countries that over a 35+ year period tripled the average incomes of many countries such as the US, Japan, South Korea, Taiwan, and now China. We show that today, however, poorer nations have a more limited toolkit to engage in long-run development strategies, and that the trade arrangements they form will have an influence on the policies they will have available in the future.

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