

Trade and Investment Rule-making

THE ROLE OF REGIONAL AND
BILATERAL AGREEMENTS



EDITED BY STEPHEN WOOLCOCK

Trade and investment rule-making: The role of regional and bilateral agreements

Edited by Stephen Woolcock



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1

Introduction

Stephen Woolcock

Introduction

The two major trends in the international economy in the 1990s have been globalization and regionalism, and much has been written on both. The interaction between the two has, however, not yet been subject to a great deal of research. This volume aims to rectify this by looking at the interaction between regional and other levels of rule-making in the international trade and investment regimes.

Much of the work on regional or preferential agreements has tended to avoid discussion of the detail of rule-making or deeper integration. Models of trade creation and trade diversion are based on tariff preferences, other tangible forms of protection or elements of regional or preferential agreements that are reasonably easy to quantify, such as commitments on services. Although there has been an assumption in the economics literature that deeper integration is likely to be less discriminatory than tariffs, there has been little detailed study of the impact of deeper integration at the regional level on the multilateral trading regime. A number of contributions have pointed to the costs of a “spaghetti bowl” of different preferential rules and how these might be seen as “stumbling blocks rather than building blocks” for the wider multilateral system. But the spaghetti bowl analogy was drawn from observation of one area of rule-making, that of preferential rules of origin, and one cannot conclude that all rule-making at the regional level has the same effects. Finally, there are often only very general references to the

linkage between regional and multilateral negotiations, along the lines of the growth of regional agreements following problems in multilateral negotiations, or the threat of regional initiatives being used to pressurize negotiating partners in multilateral negotiations to make concessions.¹

Rule-making may not be a major issue in the Doha Development Agenda (DDA), but it continues to be important in regional and bilateral agreements. It is therefore especially important to look at the interaction between the multilateral level of the WTO and other levels of rule-making. This volume contributes to a better understanding of the issues by looking in detail at the interaction between the regional and other levels of rule-making in a range of policy areas. The volume adopts a horizontal approach in order to be able to analyse the interaction between different agreements. Consideration of past rule-making also enables an assessment of the interaction over a period since the formation of GATT, although for reasons of space this historical treatment is not extensive. The case studies have been chosen to include policy areas important for agricultural trade (agricultural rules such as sanitary and phytosanitary (SPS) measures), for trade in manufactures (rules of origin and public procurement) and for “new” trade issues such as services, intellectual property rights and investment. The selection of case studies also covers cases in which there are few or only partial multilateral rules within the WTO (preferential rules of origin and investment); cases in which there are rules but these are not applied by all WTO members (telecommunications services and public procurement); and cases in which there are strong WTO rules (intellectual property and SPS measures).

This introductory chapter sets out three broad assumptions about the nature of the international trade and investment regimes on which the work is based. First, rule-making is central to the international system and is likely to become more important in the future. Second, rules are – and have always been – the product of a multilevel process. And third, how these levels interact will be of central importance to the future of international trade and investment regimes.

The chapter then offers an analytical framework for assessing the impact of regional/bilateral initiatives and the interaction between levels. This framework essentially breaks down rule-making into component elements. This facilitates an assessment of the impact of RTAs, how agreements on different levels interact and a comparison on the dominant models of RTAs or FTAs, such as those promoted by the United States, the European Union and other “hubs”. This framework provides an opportunity for developing some straightforward hypotheses regarding the interaction between levels of rule-making. For example, greater coverage at the regional or bilateral level is likely to constitute a preference, but

one that is subject to erosion as the coverage of multilateral rules increases. Transparency rules at the regional level are unlikely to cause difficulties and will tend to promote best (or at least better) regulatory practice that will tend to be non-discriminatory. Substantive rules at the regional or bilateral level that go beyond agreed international rules can be beneficial in that they extend the reach of rules that make trade and investment more predictable and thus reduce frictional and other costs. But substantive rules that go beyond existing agreed international norms, such as the WTO rules, can also result in incompatible rules in different regions and therefore need to be looked at more carefully. More efficient enforcement provisions at the regional or bilateral level create no difficulties if there is broad compatibility between the regional and multilateral (or plurilateral) rules. Difficulties may arise, however, when regional or bilateral enforcement results in interpretations of general norms that diverge from those of the WTO or other global bodies. The typical elements common to all rule-making and their potential impact are discussed below in more detail.

The horizontal case studies that follow this chapter illustrate the complex nature of the interaction between different layers of rule-making. These cannot be easily summarized in general conclusions. In some cases there is evidence of a synergy between RTAs/FTAs and other levels of rule-making; in some cases there are signs of divergence between the dominant regional/bilateral approaches that could result in some difficulties ensuring compatibility between bilateral or regional rule-making and multilateral rule-making. Three broad conclusions do, however, emerge from the case studies.

- The interaction between levels of rule-making is an important factor shaping policy outcomes and therefore one that must be considered alongside interest groups, institutional structures and ideas when seeking to explain the evolution of trade and investment policies.
- During the “second phase” of regionalism, namely the phase stretching from roughly the early to mid-1990s until the early 2000s, the interaction between regional and multilateral initiatives and agreements was positive in the sense that the two were synergistic or complementary. But developments since the early 2000s raise some doubt as to whether this will continue to be the case.
- There are important differences between the approaches of the major rule-making “hubs” (i.e. the United States and the European Union) to regional or bilateral agreements, in terms of both the general policy objectives pursued, a point that has been made clear in the existing literature on FTAs, and the detail of rule-making that can have profound implications for future trade and investment.

Rule-making and market access are inextricably linked

Trade policy is often conveniently divided between market access issues and rules. This occurs in negotiations such as the DDA, but also in analysis. Market access tends to be about numbers (i.e. tariff levels and bindings, or sectors covered by GATS commitments), with reciprocity driving negotiations. The quantification possible in market access studies also facilitates the use of trade models to estimate the impact of policy options. Rule-making is less amenable to quantification. The impact of any agreement on rules is therefore harder to assess, and changes are likely to provoke significant opposition from domestic interests resistant to a change in the regulatory *status quo*. Negotiating rules also tends to involve more actors, which makes for greater complexity. For developing countries with limited research and negotiating capacity, it has often been easier to reject negotiations on rules issues rather than risk getting involved. The ease of quantifying tariffs and other border measures also leads to arguments favouring liberalization of the remaining tariffs or obvious barriers to trade over negotiations on rules. In short, there are a number of factors favouring leaving rule-making aside and concentrating on further liberalization of market access.

But the distinction between market access and rules is largely artificial. Rules and market access are closely related. For years efforts have been made to establish a framework of rules for technical barriers to trade because non-discrimination/national treatment has proved to be ineffective in removing these barriers to market access. The controversy surrounding trade in products deriving from genetically modified crops illustrates how market access and rule-making are inextricably linked and, as chapter 4 shows, that differences in domestic regulation or rules create major problems for trade. Regulation/rules is *the* issue in market access for investors and cross-border services trade, as illustrated in the cases of telecommunications services (chap. 6) and investment (chap. 8).

The potential for rule-making to influence trade has been present at least since the establishment of GATT. For example, the obligation to provide national treatment under article III of GATT has always had the potential to limit national policy autonomy with regard to how the rules were applied. But until the 1980s there was no political consensus in GATT on the vigorous enforcement of national treatment that encroached into national regulatory sovereignty. More effective enforcement of obligations in the WTO's Dispute Settlement Understanding (DSU) and equivalent regional provisions have, however, brought home the reality of the trading system's intrusive nature.

Rule-making has always been a multilevel process

Rule-making in trade and investment has always occurred on different levels. Whilst GATT 1948 is assumed to be “multilateral”, it was in fact drawn up by only 32 countries under the dominant influence of the United States, which saw to it that US domestic preferences and approaches to regulating markets shaped GATT, even though concessions were made to its negotiating partners. During the 1950s, and especially during the 1960s and 1970s, the plurilateral Organization for Economic Cooperation and Development (OECD) played a leading role in developing agreed models for rule-making. These models were then subsequently introduced into GATT, as shown in the case of public procurement (see chap. 5), but also services and intellectual property rights (chaps. 6 and 7). Efforts to “multilateralize” rules developed at the plurilateral or regional level have not always been successful. Consider, for example, the case of investment, where the North American Free Trade Agreement (NAFTA) combined OECD rules on investment liberalization with investment protection rules from bilateral investment treaties (BITs) in a comprehensive model for investment rules that the United States then sought to “multilateralize” through the Multilateral Agreement on Investment (see chap. 8).

There is thus nothing new in rules being devised or evolving from a multilevel process. What is new is the emergence of the regional level as one of the most important, and the decline in the role of the OECD as a forum for rule-making (as opposed to policy-related research). This multilevel nature of trade and investment policy has been recognized in policy circles. For example, the OECD Ministerial Declaration of 2001 called for efforts to ensure that regional and multilateral regimes are complements and not substitutes for one another, and the Doha Declaration called for work to ensure that regional agreements and multilateral approaches are compatible.

How levels of rule-making interact is now a central concern

Looking through the literature on trade and regional agreements one finds repeated references to the links between regional and multilateral negotiations, but of a very general nature. For example, the Kennedy administration is seen as having pressed for a new round of GATT negotiations in the early 1960s in order to limit trade diversion resulting from the creation of the EEC. When Bill Brock, the US Special Trade Representative, came back from the 1982 GATT Ministerial Meeting frustrated at

the lack of progress, he is reported to have made the strategic decision to press ahead with bilateral/regional negotiations. It has also been argued that NAFTA and the APEC summit in early 1993 were used by the United States to bring pressure on its trading partners to make concessions in the Uruguay Round. The more pronounced articulation of the US policy of “competitive liberalization” (in which regional/bilateral liberalization is to “compete” with multilateral liberalization in the WTO) was seen as a consequence of the failure of the Cancun WTO Ministerial in September 2003.

But these references to strategic linkage between the levels of negotiation or rule-making do not provide us with much of a sense of how the different levels really interact. What is needed, and what this volume addresses, is detailed work on the interaction in each element of rule-making in each policy area. As the regional level assumes a more important role in the multilevel process of trade and investment policy, it is especially important to understand how regional agreements interact with other levels.

Existing research on the impact of RTAs

The increase in numbers of regional or bilateral trade agreements has led to an outpouring of material on the subject. This research has focused on the motivations behind regional agreements and their impact on the multilateral system, but there is little work that has looked at the detail of the interaction between regional agreements and other levels of rule-making.

The work on the motivations behind RTAs or bilateral agreements invariably concludes that there are multiple motivations including foreign/security policy considerations, market access or heading off trade diversion, locking in domestic reforms, “hedging” against uncertainty in multilateral negotiations, attracting foreign direct investment or setting norms and standards for trade and investment (Schott, 2004; World Bank, 2005).

There is a vast literature, build on Vinerian customs union theory, on how regional agreements affect patterns of trade and investment.² This can be divided into work limited to the static effects of regional agreements and that which seeks to assess the dynamic effects. In terms of the static effects there are no unambiguous results on whether regional agreements are, in general, trade-creating or trade-diverting. As Viner (1950) envisaged, they can be both. Generally speaking there tend to be small net trade-creation effects from RTAs, which has raised questions as to why there has been support for such agreements. The “standard discussion of RTAs proceeds as if tariffs were the only barrier” to trade

(Winters, 1999: 7). This may have been a reasonable approximation for what was going on in the RTAs between developed countries up to the 1980s (although this is debatable). It is perhaps still a reasonable approximation for FTAs among developing countries today. But regional or bilateral agreements that involve developed economies, including of course North-South RTAs, will contain a greater or lesser degree of deeper integration or measures that seek to address “non-trade” issues or regulatory barriers to trade.

Deep integration

The static gains from deep integration emanate from the reductions in costs, including cost reductions due to the creation of common rules. In most cases of deep integration within a region, both producers or service providers in the region and suppliers outside benefit, but the degree to which each benefits will vary. For example, if different national technical regulations exist and are harmonized within an RTA this reduces costs for suppliers within the region, because they can supply the whole market using one “pattern” rather than having to comply with a number of differing national regulations. Third-country suppliers will also benefit for the same reason. But the harmonized regional regulation may be more stringent or tougher than at least some of the previous national regulations. When this occurs one could say there is an effect equivalent to trade diversion.³ Regional or bilateral rule-making can be seen as promoting greater predictability and therefore positive even when smaller countries are “obliged” to accept the rules of a dominant “hub”. But the balance of benefits will depend on whether the rules are appropriate to all parties or are simply those dictated by the dominant hub. When rules diverge from agreed international rules they are also less likely to be of benefit, because of the risk of divergent sets of regional rules, or regulatory regionalism (van Scherpenberg, 1998; Isaac in this volume).

In principle if the regulatory barriers addressed by deep integration entail expenditure of real resources (i.e. in compliance with different regulatory norms or standards) rather than the creation of rents, then reducing the barriers saves resources and can be beneficial even if there is some trade distortion (Winters, 1996: 7). “Overall therefore, discriminatory deep integration seems unlikely to be harmful except in the opportunity cost sense of forgoing the greater gains from non-discriminatory integration” (Winters, 1996: 7). The work that has been done on the impact of rule-making, such as in services, tends to confirm that preferences are less evident and may even be impracticable to implement in some cases (Mattoo and Fink, 2002). In general, however, there has been little empirical work done on the effects of deeper integration agreements and

little that has assessed the more systemic or dynamic effects of divergent or competitive approaches to deep integration that could result in “regulatory regionalism”.

Systemic effects

There have been studies of the systemic effect of preferential trade agreements, but like those concerned with the static effects, these have been based on the creation and progressive extension of customs unions and FTAs based on a form of optimal tariff argument (Krugman, 1991). Krugman’s model suggested that if regional integration advanced to the extent that there were three regional blocs, this would be the worst case for world welfare. Various other writers developed the Krugman approach with somewhat differing results (for a summary see Winters, 1996), but the value of these models does not always match their elegance.

Some more elaborate models of “bloc formation” usefully include assessments of the effects of asymmetric bloc size, which is clearly a factor in some of the North-South RTAs that include rule-making. According to such models a regional bloc gains when it attracts members from other continents, because the trade benefits of boosting demand for the bloc’s comparative advantage goods outweigh trade diversion, even if the enlarged bloc does not increase its tariff on other countries. Frankel, Stein and Wei (1995) argue that a continent can increase its welfare by integrating when other continents stick with MFN. Alternatively smaller countries sign up to regional blocs as an “insurance premium” (i.e. to ensure market access), which has negative systemic effects as these countries are then less concerned about multilateralism. Arguably the larger the bloc the greater the incentive to defect, but the threat of retaliation or the effectiveness of multilateral discipline over preferential agreements, which is currently weak in the WTO, will influence the likelihood of countries opting for regional agreements.

More recently the World Bank (2005) has simulated the effects on developing countries of concluding regional/bilateral agreements with the major WTO members. This suggests that there may well be short-term gains in terms of attracting foreign direct investment and guaranteeing access to the market of the “hub”, but that in the long term developing countries are likely to be worse off.

These models are inevitably based on a number of limiting assumptions. For a start they assume unitary rational actors (in national governments) that are able to assess the costs and benefits of any policy choices, such as the costs of trade diversion against the gains from regional preferences. None of the economic models developed to date has been able

to come to more than ambiguous answers to such questions. Second, the models are invariably based on tariffs only and do not say much about the systemic impact of RTAs in the field of regulatory policies/barriers to trade. Third, the models largely discount the role of institutions. This means that the models cannot take account of any regulatory harmonization or regulatory emulation/competition (which is clearly happening to some degree in the multilateral system). Finally, the models are, understandably, based on the impact on economic welfare. Regulatory policies are generally based on a broader range of criteria including, for example, consumer protection, environmental sustainability or prudential security.

Political economy models

There are a number of “political economy” models based on the effects of pressure groups and voters on trade policy options. In these, regional agreements are formed when producers believe they will gain from trade diversion and utility-maximizing governments (seeking reelection or party funding) oblige (Grossman and Helpman, 1994). In other words, “good” politics dictates that regional agreements are more likely to be supported the greater the trade diversion (Krishna, 1999). These political economy approaches, like the optimal-tariff-based approaches, use highly stylized models of reality. They are based on the assumption that governments are clear on how to maximize their political utility and their decisions are essentially based on the balance between sector interests. They do not appear to account for the role of precedent or emulation in policy-making, which the cases discussed in this chapter all suggest plays a role. It is, of course, quite possible that the sector composition of preferences, and in particular the exclusion of specific sensitive sectors from tariff liberalization, are amenable to such interest-based explanations while rule-making aspects of RTAs are more complex.

Such rational-choice-based political economy models also fail to take account of path dependency or policy emulation. Therefore they cannot offer much guidance on whether, for example, the creation of a regional investment regime is a contribution to a wider multilateral agreement on investment or not. Political economy models developed with RTAs in mind, such as Baldwin’s (1996) domino model, appear to have more to offer. Baldwin’s model of RTA enlargement, which draws on European experience, argues that the shock of deeper integration creates pressure to join the bloc from producers and investors in neighbouring non-members. Without equal access to the bloc such producers will be at a disadvantage compared to producers and investors inside. As the bloc enlarges the costs of non-participation become greater as more and more markets are affected; enlargement only stops when the remaining

neighbouring countries face sufficiently high political objections to accession (Baldwin, 1996). This approach appears more applicable to a scenario in which deeper integration widens to include new countries, and could be seen as a driver for regulatory regionalism.

Bhagwati (1999) also addresses the path-dependency question by asking whether preferential trade agreements “provide an impetus for – or detract from – the worldwide non-discriminatory freeing of trade”. In this discussion he assumes that the “path” takes the form of the progressive enlargement of preferential trade agreements. Apart from the fact that the model is again based on progressive tariff liberalization, it also ignores the possibility of a multilateral regime emerging as a result of the emulation of rules or norms. The case of investment, discussed in chapter 8, shows how NAFTA-type rules for investment are being emulated in other regions. In other words, it does not readily fit with our hypothesis that postulates a rather more complicated, multilevel process of regime formation. Of more value for rule-making is Bhagwati’s (1994) discussion of sequential negotiations in which a selfish hegemon negotiates first with smaller and weaker neighbours in order to provide an incentive for others to negotiate and/or set a precedent for wider trade regimes.

In summary, there are a number of general shortcomings in much of the existing literature in terms of its applicability to the interaction between levels of rule-making in international trade and investment. First, it tends to use models developed from first principles with only very generalized references to the substantive provisions of regional agreements. Winters (1996: 50), in his summary of the models, suggests that given the difficulties with the existing models there is a need to consider actual cases. But the discussion of cases in much of the more theoretical literature is at a high level of generality and in most cases still fails to address the detailed substance of agreements. Bhagwati’s (1994) concept of the spaghetti bowl effect of regional agreements begins to address the question of compatibility of different regulatory norms, but this is based on an observation of preferential rules of origin and is not necessarily applicable to other areas of rule-making.

The issue of legal compatibility

Studies have also addressed the relationship between regional agreements and the multilateral trade rules in terms of the compatibility of regional/bilateral agreements with the letter of GATT article XXIV and GATS article V, the enabling clauses that provide exceptions for regional agreements between developing countries and the work of the WTO’s Committee on Regional Trade Agreements (CRTA). Assessing the compati-

bility of RTAs with the WTO provisions has been an important aspect of WTO work (WTO, 1995). But the work of the CRTA has been encumbered by a lack of progress towards agreed interpretations of the WTO provisions on what is substantially all trade under GATT article XXIV and article V of GATS.⁴ Negotiations in the WTO on definitions of substantially all trade have focused on the coverage of agreements in terms of tariff lines or sectors. In terms of the coverage of rule-making in RTAs, the question is to what extent article XXIV 8(a)(i) that requires the removal of “other regulatory restrictions to commerce” applies to deeper integration or rule-making provisions?⁵ A second area of contention is the treatment of regulatory barriers in terms of the requirement that the “general incidence of protection” in the form of duties or “other regulation of commerce” should not be greater after the creation of an RTA than it was for the constituent countries before the RTA was formed. Whilst there has been some clarification of the treatment of tariff protection under this provision in the 1994 Understanding on the Interpretation of Article XXIV, the treatment of “other regulatory restrictions to commerce” remains very unclear. For example, if country A has a higher SPS standard than its RTA partner, country B, and the RTA common standards are harmonized up to this level, does this mean that third-country suppliers will face a higher incidence of “protection” in country B, or does the existence of a single standard for the whole RTA mean that the cost of compliance for third-country suppliers is lower, so the general incidence of protection is lower? How could one go about measuring these compensatory effects?⁶

There is a continuing debate on how the provisions of the WTO might be revised in order to make them more effective and operational in their coverage of RTAs (Trachtmann, 2002). But this has concentrated on sector coverage only. In the future it will be necessary to have some operational criteria to apply article XXIV to rule-making. But before this can happen it is necessary to develop some means of assessing the impact of regional rule-making on the WTO. This in turn requires an analytical framework to facilitate an assessment of the compatibility of RTAs with multilateral rules and thus criteria for the application of article XXIV.

An analytical framework

From the sections above it follows that there is a need for more work on the substance of the regional agreements themselves. In order to be able to compare the provisions of various regional agreements and assess how they affect other levels of rule-making, it is helpful to break down rule-making into its component elements. This can then provide the basis for

comparison and the possible development of criteria for assessing the impact of such agreements and whether they are compatible with the long-term health of the multilateral trading system.

The analytical framework presented in summary form in table 1.1 builds on earlier work and distinguishes between the key elements in any rule-making provisions (Woolcock, 2005). With some exceptions this can be applied to any area of rule-making. For example, when coverage goes beyond that of the WTO, such as in the use of generalized negative listing in sector schedules, or when subcentral government or secondary instruments are covered at the regional level, a preference is created analogous to a tariff preference. In terms of principles a regional agreement that offers national treatment only to signatories clearly also creates a preference.

Regional transparency requirements, on the one hand, tend not to represent much of a preference as the information is likely to be made available to all parties. Transparency rules will also tend to promote good regulatory practice, which is likely to mean more regulation based on clear criteria and non-discrimination. On the other hand, where transparency rules in an RTA include “due process” commitments only *vis-à-vis* regional partners, as is the case in most RTAs apart from NAFTA, one could say there is a degree of preference.

Substantive rules such as full or partial harmonization or mutual recognition help reduce or remove regulatory barriers to market access, but, as noted above, can result in higher regional regulatory standards. Even then common regional rules may have a range of benefits for signatories and third parties. Much will depend on the details of the specific case. An important factor in assessing the impact of substantive rules will be whether regional rules are based on agreed international standards, such as in the case of RTA provisions on telecommunications that tend to use the WTO’s 1997 Telecommunications Reference Paper (see chap. 6), or whether they seek to change or reinterpret existing rules, as is in part the case with SPS rules (see chap. 3) and IPR rules (see chap. 7). The degree of preference with mutual recognition depends on whether agreements are open – in other words whether mutual recognition is also available to bodies or sectors in third countries that meet the same requirements as the signatories to any mutual recognition agreement.

There are often rules on cooperation. General wording and an overarching RTA committee as the forum are unlikely to have much impact, but sector or policy-level cooperative machinery tends to include exchange of expertise and more resources. This can in turn help to establish or strengthen regulatory capacity or promote regulatory emulation, which can be important in spreading rules, especially in agreements between developed and developing countries.

As with market access commitments, rule-making generally also provides for a regulatory safeguard that allows regulators discretionary powers or the right to regulate to defend “legitimate” policy objectives. Some systems of rules then seek to limit the scope for such discretion by requiring discriminatory measures to be proportionate, or the use of “least trade-distorting measures” to satisfy the legitimate policy objective. If regional regulatory safeguards provide less scope for discretion than the WTO then the agreement could be said to go beyond the WTO. The issue then becomes whether these tighter rules apply only to signatories to the RTA or to all parties. If greater discretion is possible *vis-à-vis* third parties then a form of discrimination or preference is established.

Rules mean little unless they are enforced, and all trade and investment agreements contain some degree of ambiguity that requires interpretation. Dispute settlement provisions, review procedures and the scope for non-state actors to bring cases of non-compliance are therefore important elements in rule-making. For example, some RTAs offer investor-state-type dispute settlement rules that go beyond the WTO, and some offer extensive access to review procedures for legal persons. More effective enforcement at the regional level can promote market opening and better regulatory practice. Regional interpretations of rules may, however, set precedents for wider multilateral rules and thus challenge WTO rules.

By breaking down rule-making into the elements illustrated above it is therefore possible to assess how rule-making initiatives at the regional level interact with other levels. The framework also facilitates a comparison between regional rules and between RTAs and established international regimes, such as in particular with WTO rules. The framework therefore provides a point of reference for assessing the impact of RTAs that may be useful in policy prescription (see chap. 9).

Who shapes rule-making?

As noted above, RTAs are initiated for a combination of different reasons, which cannot be discussed in detail here. Very often foreign policy interests lie behind the launching of an agreement, such as in the case of the EuroMed association agreements or the US-Israel FTA. Other times commercial interests wishing to gain a competitive advantage or to neutralize an advantaged gained by competitors will make a strong business case for an RTA, such as in the case of the EU-Mexico agreement in order to neutralize the disadvantageous position of EU business interests *vis-à-vis* US competitors in Mexico.

Table 1.1 An analytical framework for assessing RTAs

Element of rule	Typical provisions	Likely impact	Typical WTO provision	Degree of preference
Coverage	(a) Sector schedules (b) Type of entity subject covered (c) Central, state, local, independent regulator or private entities (d) Regulatory instruments covered	More extensive coverage implies greater “liberalization”	Generally a positive list approach Limited to coverage of central government as a rule Legislation as a rule with some secondary instruments	Third parties do not benefit from WTO-plus coverage Analogous to tariff preference
Principles	(a) National treatment (b) MFN status	Precludes discrimination against foreign suppliers No discrimination between third-party suppliers	WTO embodies national treatment and MFN principles but with exceptions, specifically for customs unions and FTAs	Third parties do not benefit from non-discrimination
Transparency	(a) Notification of legislation and possibly secondary provisions (b) Opportunity for parties to comment (c) Obligation on regulator to explain decisions	Promotes regulatory best practice Facilitates compliance and guards against capture	General transparency provisions in all areas Some agreements also require (c)	Third parties not provided with information Third parties have no access to consultations
Substantive measures	(a) Harmonization (b) Partial harmonization (c) Approximation as a general aim (d) Equivalence (e) Mutual recognition of regulations or test results	(a)–(c) Eliminates or reduces “frictional” costs (d)–(e) Reduces costs but retains regulatory autonomy	Selective harmonization Encourages but does not require mutual recognition or equivalence	Preference for regional norms or rules over international rules Preference for partners in mutual recognition

Cooperation	<ul style="list-style-type: none"> (a) Common decision-making institutions (b) Intergovernmental committee to oversee agreement (c) Specialist bodies for specific policy areas (d) Technical cooperation and capacity-building 	<p>Promotes convergence on rules and/or best practice</p> <p>Helps identify regulatory barriers</p> <p>Helps less developed economies develop best practice</p>	<p>Cooperation difficult with large membership</p> <p>Mostly general provisions and technical assistance thinly spread</p>	<p>Third parties not involved in more intensive cooperation within the RTA</p> <p>Third parties excluded from assistance</p>
Regulatory “safeguard”	<ul style="list-style-type: none"> (a) Exemptions from obligations (b) “Right to regulate” provisions (c) Proportionality in use of “safeguard” (d) Required use of least or less trade-distortive measure 	<p>Tight discipline promotes predictability</p> <p>Loose wording limits allow discretion</p>	<p>Generally broad exceptions that offer considerable scope for regulatory discretion but some tightening, e.g. SPS Agreement</p>	<p>Potential for greater discretion <i>vis-à-vis</i> third parties</p>
Implementation	<ul style="list-style-type: none"> (a) Legal persons have standing in regional/ bilateral dispute settlement (b) Independent reviews of secondary instruments (c) Remedies (e.g. financial penalties) 	<p>Effective implementation promotes confidence and thus trade and investment flows</p>	<p>State-to-state dispute settlement only, focuses on national legislation (rather than secondary legislation)</p>	<p>Third parties have no recourse to tougher and more immediate remedies and reviews</p>

Once negotiations are engaged, the interests of actors shape the scope and content of rules. There will be the offensive and defensive sector interests, the interests of various (often) competing central government departments, the interests of subcentral governments, independent regulatory bodies, consumers and various non-governmental organizations. The interests shaping rule-making will vary from case to case, but some general hypotheses about the respective roles of interests can help set the scene for the specific cases that follow.

Offensive interests seeking greater market access will favour greater coverage. In terms of sector coverage the balance between offensive and defensive sectors is likely to be central. Coverage of entities becomes more complex. Offensive sectors will favour greater coverage because they wish to have greater transparency or predictability in rule-making, but some domestic commercial interests may also stand to gain from the better regulatory practice. Likewise domestic consumers may stand to benefit from more transparent regulation and less discretionary powers in the hands of regulators or government. On the other side of the debate regulators are likely to oppose rules that constrain their regulatory autonomy and add to compliance costs. Extending coverage of rules to subcentral government includes similar issues, but with the added complication of political or constitutional questions about the allocation of powers between federal and state authorities. States may resist inclusion of rule-making at the multilateral level if this is linked to negotiations, such as trade in which federal government has competence. For example, chapter 8 shows how investment is excluded from EU-centred RTAs because this does not fall under European Community competence. Finally, on coverage, extension of rules to secondary instruments is likely to be favoured by those seeking greater openness and predictability, but opposed by regulators who must carry the often considerable cost of ensuring there is *de facto* and not just *de jure* compliance with rules.

National treatment and non-discrimination in general tends to be relatively straightforward and uncontroversial. Defending a “level playing field”, as it is often put, is relatively easy. The difficulty arises when there is *de facto* discrimination or perceived *de facto* discrimination when national laws are *de jure* non-discriminatory. In such instances offensive business interests will seek a deeper integration in the form of policy approximation, harmonization or mutual recognition in order to ensure *de facto* non-discrimination. National governments or regulators wishing to retain regulatory autonomy or control, liberal economists and defensive sector interests are then likely to oppose policy approximation or convergence.

Transparency is generally favoured by those interests seeking more open markets, and also those desiring more open and predictable regula-

tion. The latter need not necessarily lead to increased trade, as the case of public procurement in chapter 5 shows. It is therefore difficult for defensive interests that may benefit from opaque rules or regulation to argue against it. The governments, entities or regulatory bodies that have to implement transparency rules are, however, likely to argue that compliance costs, especially for secondary instruments, necessitate limited coverage. This is also illustrated in the case of transparency rules in public procurement. But in reality those who gain rents from opaque rules, such as established (uncompetitive) suppliers of public contracts, not to mention those who get kickbacks from such suppliers, will have a significant interest in blocking transparency rules.

Substantive rules tend to be favoured by those who see national treatment as inadequate. These will include sectors seeking access to specific markets. Harmonization or mutual recognition, at least outside the European Union, is something that only tends to occur in specific sectors or policy areas. Thus coalitions or sector interests may press for policy approximation, such as in telecommunications services or for that matter in intellectual property rights. As noted above, harmonization will be opposed by those who wish, for different reasons, to retain national regulatory autonomy. While there may be protectionist interests involved in opposing approximation or harmonization of rules, it is often a reluctance to accept the costs of domestic adjustment that is the more important factor.

When it comes to cooperation governments may see this as a means of both promoting their own approaches to regulation and assisting governments elsewhere that have less developed regulatory procedures or cultures. Independent regulators are likely to favour cooperation as a means of exchanging information and again promoting their own approaches. Developed country regulatory agencies will see promotion of better regulatory practices in developing economies as a means of promoting economic development. Developing country governments and regulatory agencies will also tend to see regulatory cooperation as a means of gaining useful expertise and as a form of technical assistance. But cooperative machinery will only be supported if there is a genuine dialogue. As cooperation provisions generally entail no binding commitments, the only opposition comes when it is seen as unproductive or costly.

All governments and regulators will tend to favour the introduction of regulatory safeguards because, from experience, they will have learned the value of being able to make exceptions to get around unforeseen problems. This is the case even when there is a general desire to promote liberalization. Defensive interests will also always want to see a safeguard because it holds out the possibility of protection if the industry or sector

concerned is threatened by intense competition. Civil society groups favour flexibility because they wish to ensure that public health, consumer safety, environmental protection or other legitimate objectives can be safeguarded. Opposition to safeguards is generally much less specific and probably weaker. It will come from those, including offensive interests, who are concerned that these will be used as a means of protection. These interests therefore press for balancing rules that seek to preclude the abuse of regulatory safeguards, including effective enforcement rules.

Finally, provisions on effective enforcement are supported by those who stand to gain from the agreement as a whole. Business and possibly civil society NGOs may favour enforcement mechanisms that allow rapid remedies and the ability to initiate procedures themselves. Governments are often viewed as holding back from rapid and effective enforcement for diplomatic reasons. More generally, enforcement provisions may be seen as a means of achieving through the interpretation of any agreement what was not or was only partially achieved in negotiation on the rules. Those with offensive interests will therefore tend to favour more effective enforcement, while defensive interests will oppose it. Regulators and their sponsoring departments will resist rigorous enforcement provisions if these open the way for judicial activism, while government departments with more general, liberal interests will favour effective enforcement as a means of promoting predictable and credible rules and thus trade and investment.

Comparison of the main approaches to deep integration

The European Union and the United States are the main actors promoting deeper integration and the inclusion of rule-making at all levels. It is therefore important to understand how the approaches used by these two “hubs” compare. A close similarity between the two approaches will mean that third countries will not have too much difficulty complying with both sets of rules. Divergence between the approaches will mean additional costs for third parties and could result in “regulatory regionalism” (van Scherpenberg, 1998).

The general motivations of the United States and the European Union in their RTA policy are not the subject of this volume. As discussed elsewhere, the initiation of RTAs is likely to have a number of motivations (Schott, 2004; Aggarwal and Fogarty, 2004). US policy on FTAs is shaped by a combination of commercial/market access issues, foreign policy objectives and a desire to “lock in” domestic reform in partner countries. EU policy is equally shaped by foreign policy and commercial interests. The European Union, like the United States, is also affected by

a range of domestic factors. EU policy towards RTAs is shaped by the European Union's own positive experience with regional integration. This underlies EU policy and leads it to view regional integration elsewhere in the world as a means of promoting economic development and peace, hence the EU policy of pursuing region-to-region agreements or agreements between the European Union and other regional groups.

The United States came relatively late to an active FTA policy, but since adopting a multilevel approach to trade in the 1980s it has been more aggressive than the European Union. This is reflected in the US approach to negotiations and in the use of clearly defined models for FTAs. After the conclusion of NAFTA, the NAFTA text was used as the starting point for US FTA negotiations. Subsequent improvements on the model in the form of, for example, the US-Singapore FTA then tend to be the starting point for any further FTA negotiations. In comparison the European Union does not appear to have a single model agreement in the drawer ready for any FTA or region-to-region negotiation. The agenda for agreements varies depending on the circumstances, the negotiating partner and domestic EU constraints.

At a more substantive level the US and EU approaches vary in terms of their general structure as well as on detailed provisions in the respective policy areas. In terms of general structure the US approach to FTAs can be characterized as "policed non-discrimination". In other words the United States tends to limit deeper integration to selected areas in which it will pursue policy harmonization and rely on national treatment provisions with extensive enforcement procedures. The preference for national treatment may reflect a desire on the part of the US Congress to avoid loss of policy autonomy. The enforcement provisions often involve a right to initiate actions by legal persons (i.e. companies or non-state actors), such as in the case of investor-state dispute settlement. An illustration of the importance placed on such enforcement provisions and procedures can be found in the investment rules in US-centred FTAs, in which the enforcement provisions account for more than half of the text of investment agreements.

The EU approach to rule-making is based on an expectation of policy approximation or harmonization. The scope for policy approximation varies between potential accession states that are expected to adopt the existing body of EU rules, the *acquis communautaire*, including the case law regarding its interpretation developed in the European Court of Justice (ECJ). Agreements with other countries will include some degree of policy harmonization, but not across the board. For example, the association agreements with the EU's Mediterranean partners include the aim of the EU's partners moving towards the adoption of European competition rules over an indefinite period.

Finally, with regard to the detailed rules in a range of policy areas US and EU approaches can differ. These differences are discussed in the case studies in this volume. Differences in detail can be of major importance. Transatlantic cooperation has been an important feature of trade and investment rule-making, especially since the European Union emerged as a major actor in its own right with a distinct approach to rule-making. During the 1980s and 1990s the transatlantic duopoly shaped the evolution of rules on agriculture, rules of origin, public procurement services, investment, intellectual property rights, technical barriers to trade etc. This close, but not always harmonious, cooperation was broadly successful in bridging differences between the US and EU approaches. In some cases differences were only papered over, such as in the case of how to regulate biotechnology, but transatlantic cooperation ensured that the rules on most policy areas embodied in the US- and EU-centred RTAs were compatible with each other and with the common multilateral rules that emerged from this cooperation.

The interaction between levels of rule-making

This volume is above all interested in the nature of the interaction between the different layers of rule-making in trade and investment policies. In this introduction it may therefore be helpful to set out possible types of interaction. The following are some types of interaction that might be found. No doubt there are more.

- *Synergistic interaction* could be said to occur when rule-making on different levels interacts in an iterative, two-way process, with techniques or approaches developed at one level applied on other levels and improved upon.
- *Liberal forum shopping* might be said to occur when parties switch between levels (forums for negotiation) in order to overcome insurmountable barriers to the progression of liberal policies. For example, if negotiations on rule-making at the multilateral level are blocked due to the willingness of some WTO members to use their veto powers, efforts might switch to the plurilateral, regional or bilateral levels. This kind of interaction is liberal if the aim is to establish rules that have widespread benefits.
- *Mercantilist forum shopping* would apply if countries or actors switch between levels of rule-making in order simply to further their own narrow national or sectoral interests. Clearly it may be difficult to tell when rule-making is pursuing mercantilist and when liberal ends. But again the analytical framework helps. If a country switches levels in order to push ahead with substantive rules that differ from agreed in-

ternational rules, this might be seen as the action of the selfish (regional) hegemon seeking to use the greater asymmetric power it has in bilateral or regional negotiations in order to further its own narrow self-interest and enhance its relative gains. If, on the other hand, a party uses an alternative level or route in order to push rules that enhance transparency and promote good regulatory practice, it could be said to be liberal forum shopping.

- *Exporting domestic rule-making* would apply when regional/bilateral layers are used to extend the prevailing domestic or regional approach. In this case the main driving force could well be precedent rather than sectoral interests. When globalization results in a tension between the domestic rules and those in other countries or regions, the least-cost route to resolving such tensions is to seek to export one's own domestic rules. Here the main power at work is that of precedent and the heavy hand of established practice. Whilst the established practice in one country is unlikely to be optimal for other countries, established domestic systems of rules are generally based on a balance of sector and other interests. So one must differentiate between the mercantilist forum shopping in which specific interests seek to frame rules in their narrow self-interest, and the effort to export a domestic model of rule-making that has achieved a balance between, for example, liberal aims and other legitimate policy objectives. In terms of North-South regional agreements, the problem is that few Northern countries have had to worry much about development objectives in recent decades.

Governance issues

The debate on levels of rule-making is of central concern for (global) governance, because it addresses the global subsidiarity issue. In other words, at which level should rule-making take place or at which level should policies be harmonized, if at all? The layer at which rules are decided may also have a bearing on who participates in decision-making.

In terms of the *global subsidiarity* debate there is much controversy surrounding the question of whether there should or should not be policy harmonization or approximation. On the one hand, liberal economists as well as those who question the feasibility of policy harmonization argue that policy competition should prevail. It is argued that policy competition (or competition among rules) facilitates experimentation that will ultimately result in better rule-making. In other words, competition among rules reduces or removes the risk of policy failure. "Non-trade" issues should therefore be left to competition between jurisdictions. There is also opposition to harmonization from those wishing to protect develop-

ing country interests against what they see as the effort of developed countries to impose inappropriate Northern norms or standards on the South.

Harmonization is also opposed by those sceptical of the feasibility of significant or meaningful cooperation. This is particularly relevant for any discussion of rule-making at the multilateral level in the WTO. With 150 members of the WTO, progress at this level is seen as posing major problems. This line of argument leaves open the path for cooperation or harmonization of policies to be pursued on other levels. This can mean the use of greater asymmetric power relationships to impose national rules on others at other levels, such as bilateral, regional or plurilateral levels. Blocking the Singapore issues in the WTO does not mean they are not being pursued through FTAs and RTAs.

The alternative view is that harmonization or at least approximation of rules is necessary because markets are global. Rule-making cannot therefore remain within the confines of national jurisdictions and still be effective in addressing failures or imperfections in global markets. This view is held by those who are more concerned about market failures than government (or governance) failures and who wish to see sustainable economic development, address global problems such as global environmental threats or establish certain common minimum standards or collective preferences.

The case for harmonization or approximation can also be made on the grounds that policy competition may result in regulatory regionalism and the emergence of divergent rules that will undermine multilateralism. On the pretty safe assumption that the United States, the European Union and other major trading entities will continue to include rule-making in the bilateral, regional or plurilateral agreements they conclude, a point illustrated in all the chapters in the volume, there also remains a danger that North American, EU and possibly other approaches to deep integration will diverge. When this occurs it threatens multilateral approaches and creates added costs for third parties, because the latter have to comply with, for example, both the US and European rules of origin or food safety measures if they wish to trade, rather than one agreed set of rules.

The case for policy approximation or harmonization is also made by those who believe that the only effective means of achieving and maintaining market access is through common approaches to regulatory policies. Where tariff barriers are insignificant, as is the case with much trade between developed economies, or of diminishing relative importance, as in the case of developing country exports to developed economies, non-tariff and especially regulatory barriers have become or are becoming a central issue in trade and investment relations.

In practice there are no clear dividing lines between those interests fa-

vouring harmonization and those favouring policy competition. In terms of overarching ideologies, liberalism would tend to favour policy competition over harmonization, but then so would realists or economic nationalists who do not believe national governments can be bound by international rules. At the same time those who support multilateralism could argue for stronger multilateral rules as a means of preventing the erosion of the existing multilateral element in trade and investment regimes by bilateral and regional agreements. And mercantilists could argue that policy harmonization is necessary to ensure effective market opening.

Unsurprisingly, the current picture in terms of rule-making is one that includes elements of both harmonization and competition among rules. More relevant to the issues discussed in this volume is not so much whether harmonization of rules occurs, but at which level? The analytical framework may help define *subsidiarity* or the division of labour in rule-making. For example, there could be agreed common principles at a multilateral level but more far-reaching harmonization of substantive provisions or procedures at the regional or bilateral level. The case of public procurement can be used to illustrate this point. Whilst multilateral agreement on all aspects of public procurement is probably not feasible because of the diversity of practice and the complexity of the issues, agreed multilateral rules may be possible on transparency and possibly on provisions that prohibit explicit *de jure* discrimination. More detailed policy harmonization on contract award procedures, effective enforcement measures and other rules could then be left to plurilateral or regional levels.

An analysis of the complex interactions between rule-making at different levels on the basis of the above framework might then provide more operational guidelines for policy prescription than has been offered to date in harmonization or policy competition debate.

Governance also concerns questions of who participates in rule-making and thus the *political legitimacy of decision-making*. The issue of interaction between levels of rule-making is relevant here because, as the case studies in this volume show, there may be forum shopping by governments and interest groups in order to find the path of least political resistance. As some of the case studies show, rule-making used to be a largely technocratic process conducted by a relatively small policy élite consisting of government officials and – mostly business – experts. This is perhaps most clearly shown in the case of investment, where bilateral and plurilateral rule-making proceeded throughout the period from 1950 to the mid-1990s without close scrutiny by public and NGO opinion. Investment was politicized towards the end of the 1990s in the debate on the Multilateral Agreement on Investment (MAI). This also led to the politicization of the debate on investment within the WTO, but only partially

to the discussion of investment in regional-level agreements. To date investment at bilateral or regional level has been less politicized than at the level of the WTO, but as the case study suggests this may be changing. In intellectual property, the politicization of the issue in the WTO has led to some increased activity at the regional or bilateral levels, possibly as a result of efforts to regain ground lost at the multilateral level.

Conclusions

This chapter has set out the assumptions on which the following chapters are based, provided an analytical framework for assessing the interaction between levels of rulemaking and set out some general hypotheses relating to the interaction between levels of rule-making. The following chapters provide case studies in rule-making that apply the broad framework set out here.

Notes

1. Some clarification of terminology is needed. This volume addresses rule-making at different levels. Multilateral rule-making is essentially rule-making that takes place within the World Trade Organization (WTO), although there may be cases of multilateral rule-making in other more or less global membership bodies such as UNCTAD or other UN bodies. Plurilateral rule-making occurs when groups of “like-minded” countries come together to adopt common rules regardless of their geographic locations. The Organization for Economic Cooperation and Development (OECD) is the main plurilateral rule-making body discussed in this volume. But there are forms of plurilateral rule-making within the WTO, both formal, in the shape of plurilateral agreements such as the 1994 WTO Government Purchasing Agreement, and less distinct forms of plurilateralism, such as in the sector agreements under the General Agreement on Trade in Services (GATS), which only a selected number of WTO member countries apply. Regional rule-making is that which occurs in regional agreements, i.e. agreements between contiguous countries. Free trade agreements may be regional in nature but are more often bilateral between countries that are not necessarily congruous. In the text the term regional trade agreements (RTAs) is used to describe both regional agreements and free trade agreements. In some cases, however, it is necessary to differentiate between regional, free trade and bilateral trade agreements.
2. See Bhagwati, Krishna and Paragariya (1999) for a valuable collection of the key contributions to this literature.
3. This is an area addressed by GATT article XXIV, which states that RTAs and FTAs must address “other restrictions or regulation of commerce” and that the general incidence of protection should not increase as a result of the creation of an RTA. There is, however, no agreed interpretation of these provisions, especially on how they may relate to deeper integration.
4. In fact the CRTA has three tasks: to provide legal analysis of the RTAs (and their compatibility with the rules); to make horizontal comparisons (inventories of RTA provisions

- covering non-tariff barriers and TBTs and SPS measures have been made); and to debate the context and economic aspects of RTAs.
5. See, for example, a discussion of whether TBT and SPS measures should be included in substantially all trade provisions in Trachtmann (2002).
 6. In the 2005 discussions of this topic in the CRTA some developing country WTO members maintained that the introduction of common regional rules or standards constitutes an increase in the incidence of protection, whilst the European Union and others that have introduced deeper integration see them as liberalizing.

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Regional trade agreements are playing a greater role in shaping trade and investment rules around the world. To date the study of preferential agreements has focused on their impact on tariff preferences, but as tariffs are reduced rule-making becomes more important in trade and investment.

This book addresses the role of regional and bilateral agreements in rule-making; provides an analytical framework for assessing the impact of regional and other preferential agreements on rule-making; and illustrates the role of regional agreements in a multi-level process of rule-making.

Seven detailed case studies show that regional agreements can make a positive contribution to the evolution of predictable trade and investment rules, but much depends on the kind of rules they promote.

To date regional rule-making has gone hand-in-hand with the evolution of multilateral rules, but recent developments give some pause for thought.

It is important to understand more fully the interaction between the regional and other levels of rule-making, if the positive aspects are to be furthered and negative aspects contained.

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