Regional and bilateral trade agreements: why countries exceed WTO obligations

Selina Adam Khan *

The past half century has seen a sharp increase in economic interdependence. Shallow integration in the form of lowering trade and investment barriers and the granting of national treatment of foreign products and firms, has given way to deep integration, essentially between the North and the newly industrialized countries. Deep integration or 'behind the door policies – policies once deemed wholly domestic' – ranges from 'harmonization of standards to macroeconomic policy coordination'.

In this essay, it will be argued that deep integration in the context of regional and bilateral trade agreements (RBTAs) is the result of international political concerns compounded with resulting economic issues. Debt crises and the subsequent policy conditionality attached to debt relief programmes, enhanced conditionality attached to multilateral and bilateral assistance, the loss of international commercial lending coupled with balance of payments deficits and declining investments, international and domestic politics and the agendas of International Financial Institutions as determined by powerful economic players, such as the United States, have eroded national autonomy in policy making such that countries find themselves forced to commit to obligations that exceed what they sign on to under the World Trade Organization (WTO).

Such an extension of obligations as seen in RBTAs in areas of trade, investment and intellectual property rights would be discussed. However, the present analysis would be limited to RBTAs concluded by the U.S.

The institutionalist paradigm entails that countries join voluntary multilateral agreements because even when such regimes are biased in favour of more powerful members, they are ultimately conducive to the welfare of all its participants (relative to the status quo ante); even realists such as Grieco and Krasner concur with this view. The positive sum analysis orientation articulated most forcefully by Keohane suggests that international institutions facilitate multilateral cooperation and that such cooperation in turn allows for utility gains for member governments or States. Gruber argues that resultant debates focus only on the first step: in probing the truth behind the second leg, Gruber questions whether such international cooperation always allows for all participating members to be better off relative to the pre-cooperation status quo. “The fact that cooperation and institution building are matters of voluntary choice does not imply that the institutions in question raise (or even that their signatories expect them to raise) their baseline utilities.” Hence, Gruber argues that signatories to such agreements may very well prefer that the agreements did not exist in the first place and that they could return to there original non-cooperative status quo (for example, Mexico and Canada during NAFTA negotiations). The question that begs an answer, then, is why do developing countries sign on to such RBTAs?

Bilateralism

Haggard defines bilateralism as “the negotiation of agreements between two parties that are not subject to mutually agreed set of international principles and rules and in which States are not limited in their recourse to sanctions to realize their objectives.” Although RBTAs may not provide for completely free entry, they allow for efforts that make conditions for entry simpler and transparent, guarantee national and most favoured nation treatment, smooth the progress of financial flows, provide insurance against nationalization and establish dispute settlement mechanisms. However, in exchange for broad and stable market access, parties to the RBTAs agree to change policy regimes governing investment and intellectual property, such that preferential market access means to relinquish a broad range of policy instruments and requires them to exceed their WTO obligations.

Shadlen argues that “fundamental changes in global patterns of investment and trade, in combination with international and domestic power asymmetries, contribute to the spread and proliferation of regional and bilateral trade agreements (RBTAs) between the United States and its hemispheric neighbours.” He argues that the dynamics of integration must be contextualized in the American economic strategy, a key element of which is the offer of enhanced market access to ‘can do’ countries by the U.S., countries that are willing to undertake extensive economic reforms with regards to their national regulatory regime. In the context of Latin America and the Caribbean (LAC), the U.S. allow them preferential access with the removal of regulatory trade barriers as a quid pro quo for the access. Such agreements are modelled on the North American Free Trade Agreement (NAFTA) and continue to spread throughout the region.

RBTAs versus the WTO

Signing on to RBTAs and the WTO both entail shallow and deep integration: it is shallow in the sense that countries receive market access for traditional and non-traditional items and is deep in the sense that developing countries must accept new constraints to their investment and intellectual property regimes. However, under RBTAs, both sets are magnified and obligations surpass those imposed by the WTO in that in exchange for greater market access, developing countries must give up autonomy over even more development instruments: “to put it another way, RBTAs embody an intensification of the WTO bargain.” Whereas the WTO allows countries to retain their rights and make use of opportunities to implement industrial policies, regional and bilateral treaties take away these options altogether. Shadlen argues that the very tools used historically to capture the developmental benefits of integration are the price that countries must pay to increase their access to the American market.

Intellectual Property Rights

Strong rules for the protection of intellectual property rights are a common feature in the recent set of RBTAs: a key market access interest of the U.S., the rules reflect the interests of the American private corporate sector which derives significant revenues from export of intangible goods. The rules, which reflect protection standards similar to what one would find in the U.S., are a quid pro quo for concessions in areas such as preferential access to the agriculture and manufacturing market in the America. Whereas TRIPS mandates that a 20 year patent term be provided, RBTAs go beyond that in requiring that the term be extended in the event that there are delays caused by regulatory processes; some agreements ask for extensions for delays that are caused due to the granting of the patent itself.

All RBTAs extend TRIPS (trade-related aspects of intellectual property righsts) obligations by mandating that patent protection be provided to plants and animals as well: the strongest agreement in this context is the U.S.-Morocco treaty which explicitly orders protection for all life forms. TRIPS, on the other hand, allows for an exemption of patents on plants and animals. Three agreements (those of U.S. with Australia, Bahrain and Morocco, respectively) mandate that patents must be available for new uses of known products. RBTAs contain provisions that limit a government’s choice in introducing competition from generic producers (of medicines). Whereas TRIPS allows for compulsory licensing without specifying grounds for issue, four RBTAs (with Australia, Jordan, Singapore and Vietnam) limit the issue of compulsory licensing to emergency situations, anti-trust solutions and cases of public non-commercial use.

Furthermore, all RBTAs, with the exception of those with Vietnam and Jordan, prohibit parties from approving the marketing of generic drugs during patent term without the approval of the patent holder: TRIPS imposes no such obligations on its members. Whereas TRIPS only requires that test data be protected from unfair commercial use, most RBTAs mandate exclusivity of test data so that once a company has submitted such data, no competing firm can rely on the original data for five years in support of a request for approval of it own drug. Once a company submits test data to a regulator in one country, test data exclusivity applies automatically in all FTA jurisdictions as well as in countries outside the FTA (free trade agreement) area. Whereas TRIPS allows for flexibility in permitting parallel importation of patented drugs, U.S. agreements with Australia, Morocco and Singapore allow patent holders to prevent parallel importation through contractual means.

Under TRIPS, copyrights are protected for the duration of the author's life plus 50 years; except for agreements with Jordan and Vietnam, RBTAs with America extend this duration for another 20 years. Such FTAs also include obligations against evading technological protection measures, an issue that is not covered under TRIPS. Also, in copyright infringement cases, the burden of proof in RBTAs (except the one with Vietnam) is placed on the defending party to prove that the work is in the public domain: once again, TRIPS imposes no such obligations on its members. Parallel imports of copyright work are not placed under any rules of permissibility in TRIPS; in contrast, U.S. RBTAs with Jordan and Morocco give copyright holders the right to block such imports.

"TRIPS does not create any obligation with respect to the distribution of resources as between enforcement of intellectual property rights and the enforcement of law in general." That is so because the WTO recognizes the institutional and financial limitations of developing countries. RBTAs with most countries do not explicitly allow for such flexibilities, and in fact go further in treaties with some countries in stating that resource constraint cannot be invoked as an excuse for not complying with intellectual property regulations.

Finally, whereas TRIPS require fines that reflect monetary damages suffered, FTAs require fines suffered due to copyright piracy and trademark counterfeiting, irrespective of the injury suffered by intellectual property right holders. Under TRIPS, only wilful trademark counterfeiting or copyright piracy on a commercial scale warrants criminal procedures. Under RBTAs, however, the standard is broadened and more explicitly defined so that, for example, even when piracy is not necessarily for financial gains but results in substantial aggregate monetary value, criminal procedures may be initiated.

Bilateral Investment Treaties (BITs)

Academics point out increased investment opportunities as impetus for signing on to RBTAs, especially since commercial lending has gone down. Furthermore, when domestic investment is augmented by foreign investment, the size of the potential market increases, an aspect particularly important for industries that only generate economies of scale when they reach or pass a particular size threshold. To sign on to RBTAs, countries may want to undergo reforms to project themselves as credible; private investors find it easier to plan and invest given increased credibility on the part of the government and foreign investors are given incentives to invest in the host State. Birdsall and Lawrence argue that entering into treaties that allow for deeper integration may mean that countries are more easily able to implement certain types of reforms that are beneficial for their economies but are otherwise opposed by powerful interest groups.

Whereas the WTO allows for State vs State arbitration, BITs elevate the legal status of investors in international law by allowing them to claim damages against host States. Multinational enterprises then have significant advantages in capital exporting and importing countries at the expense of government flexibility. The power of contemporary investor-State arbitration is evident in the case of CME vs Czech Republic where an arbitration committee constituted under a BIT ordered the Czech Republic to pay U.S. $ 353 million in damages and interest to a private investor (the Dutch company was owned by an American investor) for violation of the Czech-Netherlands investment treaty. The amount paid was roughly equal to the Czech Republic's annual health care budget.

From a historical perspective, too, the system of private arbitration is more favourable to investors than to host States. Not only is the ability of foreign firms to make international claims against States a significant departure from international law, the system also "reflects the expansion of private authority as a method of regulation… (and the system) relies on the coercive authority of States within their territory to seize the assets of other States and make those assets available to investors." The WTO merely obliges the State to change its regulatory programme (and that also if the State in question is caught) such that there is no punishment for violations as such; the investor country retains the right to sanction the host State on its own. Whereas TRIMS provides for a very narrow definition of investment, successive international treaties have expanded the definition of investment and that of expropriation; “above all, the system of investor protection is highly enforceable because of the availability of compulsory arbitration leading to a damages award rather than more conventional public law remedies…private arbitrators are given the authority to decide upon the appropriate role of government in relation to the activities of multinational enterprises.”

Although general consent to private arbitration was common but not universal in the 1970s and 80s, by the 1990s, investor-State arbitration became compulsory. General consent to compulsory arbitration in present and future investment treaties allows a wide range of regulatory issues to be resolved through private arbitration. Such issues include giving the arbitrators the authority to decide upon the level of public power allowed to, for example, tax businesses, deliver public services, establish regulatory standards and control tax use: “In this way, the general consent to investor-State arbitration is the conception of the system of investor protection as an institution of transnational governance.”

Van Harten suggests that the system of such arbitration emerged in the 1990s due to factors driven by debt crisis, collapse of the Soviet Union and reductions in Western aid that put pressure on developing countries to attract foreign capital in order to stimulate domestic growth. Owing to increased international capital mobility, multinationals were in a stronger position to demand concessions from host States. Furthermore, the pro-liberalization ideology called for the privatization of State assets and liberalization of domestic controls on foreign investment. Significantly, the conclusion of particular BITs may be tied to larger takeovers of domestic assets or conditions attached to international loans. The WTO allows for measures such as a country’s right to screen foreign investment, limit ownership in particular sectors, encourage the employment of local managers and to oblige joint ventures and technology transfers. Under RBTAs, however, such investment measures are not acceptable and are greatly reduced if not eliminated altogether.

Mansfield and Reinhardt argue that countries are likely to seek preferential trade agreements (PTAs) when, for example, GATT/WTO membership rises, thus reducing the leverage that member States may enjoy or if they have recently participated in multilateral negotiations, especially when the outcome has been unfavourable to the country in question. Thus, the creation of such multilateral institutions leads to PTAs in the hope of maximum possible benefits.

Export competition and better than MFN treatment

Response to ‘the U.S. agenda’ has varied across countries and across time; some countries show little or inconsistent interest, while others that had no interest in the past are now keen to sign on to such agreements. Shadlen argues that competitive pressures resulting from globalization and power asymmetries manifested in international and domestic power play have powerful implications for a country’s orientation towards RBTAs. The surge of China and South-East Asia in general as powerful exporters has started a process whereby LAC countries that are dependent on the U.S. for light manufactures are keen to sign on to such RBTAs. Although RBTAs come with a significant cost in the form of compromised autonomy in policy making, the prospect of a stable and preferential market access to the U.S., especially in the face of competing export regions/countries such as South-East Asia, means that LAC countries are now keen to sign on to bilateral agreements with the U.S.

Furthermore, bilateral treaties allow for preferential and better than MFN access that is stable and secure; reductions in transport costs coupled with low labour costs in South-East Asia may threaten LAC countries, thus inspiring them in a quest for better than MFN treatment that RBTAs afford. Shadlen suggests that countries that have relatively non-diversified export structures are most likely to feel competitive threats most strongly and would want enhanced market access in the face of increasingly fierce competition for export market shares. He finds strikingly low degrees of diversification in the export structures of the LAC countries; although the principle export to the U.S. is primary products, countries that rely on light manufacturing are most sensitive to changing production and trade patterns. Of the seven countries for whom apparel is the most important export, five have negotiated RBTAs with the U.S., whereas a sixth, Jamaica, has expressed interest in doing so as well.

At the same time, for LAC countries that do enjoy better than MFN treatment through the General System of Preferences (GSP) and other GSP-like programmes, it is worth pointing out that such access/treatments are not stable or secure because they can be unilaterally evoked by the U.S. without any compensation since they are not governed by the WTO. Thus, the GSP becomes a “political football” open to the whims and abuse of actors within importing countries. “Political trade dependence” or trade dependence on better than MFN treatment is locked in when countries sign on to RBTAs, which unlike the GSP or other such measures are not subject to renewal. Shadlen concludes that countries with high political trade dependence are most eager to establish RBTAs with the U.S.

International and domestic power asymmetries

Policymakers in the LAC countries and in developing countries in general vehemently oppose reforms or policy constraints in areas of investment and intellectual property rights in WTO negotiations; yet, it is these very policy tools that they more or less give up when they sign on to RBTAs with America. Countries that have opposed efforts to replace or exceed TRIMS and/or actively resisted TRIPS accept intellectual property and investment reforms when embracing the RBTA agenda. To explain the paradox, Shadlen makes a distinction between international power asymmetries and domestic power asymmetries; together these two structures make entering into RBTAs with the U.S. extremely appealing.

He argues that a country's decision to enter or not enter into an RBTA with the U.S. is not made in isolation; instead, "one country's decision is made in the context of other countries' decisions." Thus, the decision of one country, for example taking Shadlen's case of Peru, is not merely a reflection of the country's choice between agreeing or not agreeing to sign on to an RBTA with the U.S., but rather it is contextualized in the knowledge that her neighbours – and competitors for market share and foreign investment – may enter into such agreements. The payoffs and incentives are now different, given that the cost of not entering into such agreements increases when neighbouring countries sign on to agreements that grant them preferential market access. Shadlen builds up on Gruber's argument that indicates that "weaker countries may participate in plurilateral institutions that are not in their interest simply because other countries may, and the costs of participating, though greater than the previous status quo, are less than the costs of not participating."

Countries understand that although signing on to RBTAs may not be beneficial to them, not negotiating will mean that "go it alone countries" will realize welfare gains even as they shied away from RBTAs. Thus, "by instilling a fear of marginalization in non-participating countries" the U.S. "generates a dynamic in which countries compete to become fuller members of the trading system and better partners of the United States." That is also true of large countries such as Canada (as well as Mexico during the NAFTA negotiations) and Brazil. Decisions regarding participation in RBTAs are then made in power-constrained choice sets where there exist international power asymmetries. Power is here is not coercive or bargaining power but rather power that yields absolute losses on losers without requiring winners to force opponents into submission.

International power asymmetries are underscored by domestic power asymmetries: whereas, traditionally, beneficiaries in a standard model of trade politics were unaware of potential gains, in such a structure, beneficiaries are well organized and form powerful concentrations such that they are conscious of such gains. On the contrary, potential losers threatened by export orientation are geographically diffuse and unorganized and do not have a powerful voice in government lobbying. Shadlen argues that not only do firms with an eye on access to the American market have powerful interests in such agreements, they also have more influence and weight in policy making than those who stand to lose from regulatory harmonization. Furthermore, Shadlen argues that "prior liberalization and the creation of export processing zones – events that precede the contemplation of integration – both create the political conditions for RBTAs by eviscerating potential sources of opposition while solidifying and strengthening eventual advocates."

Thus, domestic asymmetries between winners and losers are most likely to exist in countries that have already undergone liberalization since actors/firms threatened by openness and the eventual loss of policy tools it entails will be reduced if not eliminated. Domestically, advocates of export promotion will be made more powerful by the threat of marginalization that exists internationally as well as the disproportionate weightage given to exporters' interests, such that international power asymmetries will reinforce domestic ones. The erosion of 'rejectionists' as Haggard refers to them, that is, people or groups that oppose integration or more integration, is not confined to the domestic economy only; the rejectionist stance championed by India and Brazil during the pre-negotiations of the Uruguay Round saw an eroding support base for several reasons, including changing interests within the coalition. Important liberalizing reforms that needed to be supplemented with revaluation in foreign policy and the appeal of developing comparative advantages in certain services were some of the reasons that led to the divergence in interests between different developing countries.

Super 301

The initial 1974 301 legislation allowed the U.S. to enforce trade rights under GATT or bilateral treaties by giving the executive the right to initiate retaliatory action. The U.S. could thus use the GATT's dispute mechanism for disputes covered by the GATT, while allowing for a second list of punishable offences for violations not covered by GATT. Under the 1988 Super 301, the U.S. trade representative was required to list down all foreign trade barriers, put together a priority list for countries singled out for action, set compliance deadlines and retaliate in the event of non-compliance. The act went further than promoting deep integration on a bilateral basis: it referred explicitly to workers' rights, export targeting (defined as government actions that seek to increase the international competitiveness of an enterprise or industry – a virtual definition of industrial policy) and systematic toleration of anticompetitive practises.

Developing countries' fears that they would be the target of such legislations were confirmed when out of six Super 301 cases, three were aimed at India and Brazil. "Virtually every 301 case resulted in policy changes in the direction that the United States sought." Developing countries are forced to comply with 301 obligations for fear of U.S. sanctions, sending a negative signal to foreign investors or the risk of not being able to negotiate with the U.S. in future and to remove themselves from the Super 301 list. The Super 301 thus allows the U.S. to take unilateral action against other countries and allowed America to secure concessions from developing countries in the Uruguay Round through bilateral consultations and negotiations.

Conclusion

Bilateralism includes (but is not limited to) an 'activist' or 'strategic' trade policy whereby developing countries are restrained from employing 'unfair trading practices' such as dumping or subsidies. By giving up policy tools for preferential market access, developing countries not only compromise potential growth strategies, they cater to American sensitivities that are threatened by rising export sources in the developing world. RBTAs thus 'lock' such countries in to stable market access to the American market – yes – but they also lock (read: shackle) them out as potential competition to America in the world market. The aim of bilateralism is to secure the position of the already dominant U.S. and lock away developing countries from their potential as future competitors to America through reduced autonomous policy space and the appeal of preferential access to the American market. Developing countries in there quest for preferential access to the American market and haunted by fears of trade isolation are forced to sign on to treaties that compromise indigenous growth strategies.

Notes & References

* The writer is former Research Fellow at the Institute of Strategic Studies, Islamabad.

[1] Haggard, p. 2.

[2] Ibid.

[3] Ibid.

[4] Ibid., p. 708.

[5] Ibid., p. 27.

[6] Ibid

[7] Shadlen 2006, p. 1.

[8] Ibid.

[9] The U.S. signed NAFTA with Mexico and Canada.

[10] Ibid., p. 10.

[11] Fink and Reichenmiller.

[12] Ibid., p. 290.

[13] Ibid., p. 293.

[14] Ibid., p. 296.

[15] Van Harten.

[16] Ibid.

[17] Ibid., p. 610.

[18] Ibid., p. 606.

[19] Ibid.

[20] Ibid., p. 607.

[21] Shadlen 2006.

[22] Ibid., p. 8.

[23] Shadlen, 2006, p.14.

[24] Ibid., p.15.

[25] Gruber: ‘go it alone’ countries are ones that sign on to RBTAs in the event that other(s) don’t.

[26] Ibid.

[27] Ibid.

[28] Gruber, p. 7.

[29] Ibid., p. 18.

[30] Haggard.

[31] Ibid., p. 36.

[32] Haggard.

Bibliography

Andrew Guzman, “Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties”, Virginia Journal of International Law, 38 (1997-1998).

Carsten Fink and Patrick Reichenmiller, “Tightening TRIPS: Intellectual Property Provisions of U.S. Free Trade Agreements”, World Bank Trade Note, February 2005.

Edward Mansfield and Eric Reinhardt, “Multilateral Determinants of Regionalism: The Effects of GATT/WTO on the Formation of Preferential Trading Arrangements”, International Organization, Vol. 57, No. 4 (2003).

Gus Van Harten, “Private Authority and Transnational Governance: The Contours of the International System of Investor Protection”, Review of International Political Economy, Vol. 12, No. 4 (2005).

“Investment, Doha and the WTO,” Background Paper to the Chatham House Meeting on Trade and Sustainable Development Priorities Post-Doha, April 2003.

Kenneth Shadlen, “Exchanging Development for Market Access? Deep Integration and Industrial Policy under Multilateral and Regional-Bilateral Trade Agreements”, Review of International Political Economy, Vol. 12, No. 5 (December 2005).

Ken Shadlen, “Globalization, Power, and Integration: The Political Economy of Regional and Bilateral Trade Agreements in the Americas”, Journal of Development Studies, Vol. 44, No. 1, January 2008.

Lloyd Gruber, “Power Politics and the Free Trade Bandwagon”, Comparative Political Studies, Vol. 34, No. 7 (September 2001).

Nancy Birdsall and Robert Z. Lawrence, “Deep Integration and Trade Agreements: Good for Developing Countries?” in Inge Kaul, Isabelle Grunberg, and Marc A. Stern, ed., Global Public Goods: International Cooperation in the 21st Century (Oxford University Press, 1999).

Peter Hakin, “President Bush’s Southern Strategy: The Enterprise for the Americas Initiative”, The Washington Quarterly, Vol. 15, No. 2 (Spring 1992).

Peter Drahos, “Thinking Strategically About Intellectual Property Rights”, Telecommunications Policy, Vol. 21, Issue 3 (April 1997).

Robert Wade “What Strategies are Viable for Developing Countries Today? The World Trade Organization and the Shrinking of ‘Development Space’”, Review of International Political Economy, Vol. 10, No. 4 (November 2003).

Raquel Fernandez and Jonathan Portes, “Returns to Regionalism: An Analysis of Nontraditional Gains from Regional Trade Agreements”, World Bank Economic Review, Vol. 12, No. 2 (1998).
http://wber.oxfordjournals.org/cgi/content/abstract/12/2/197

Stephan Haggard, “Developing Nations and the Politics of Global Integration”, Brookings Institute, 1995.