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INVESTMENT PROVISIONS IN ECONOMIC INTEGRATION AGREEMENTS

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I. INTRODUCTION

A. Background and Scope of the Study

International investment rules are increasingly being adopted as part of agreements that address inter alia trade and investment. The large majority of these agreements belong to a category of agreements that, under different names, seek to facilitate international trade and cross-border movements of the factors of production, generally referred to in this study as "economic integration agreements" (EIAs).[1] The recent expansion of EIAs covering a variable range of economic transactions has been identified in the literature as a major new phenomenon with potentially profound implications for international economic relations.[2] An important characteristic of recent EIAs is that, while trade remains their principal component, they increasingly address an expansive set of investment issues. By June 2005, the number of EIAs dealing with investment (referred to as "economic integration investment agreements" (EIIAs) in this study) had reached 218. Most countries, both developed and developing, are signatories to one or more EIIAs, and new negotiating initiatives are under way, thus promising further expansion. Indeed, no country can escape today from the systemic effects of EIIAs, either as an active participant or as an outsider. From the perspective of international investment law, the proliferation of EIIAs is changing the configuration of the investment relations landscape worldwide and creating important new challenges for investment rule-making and implementation.

In spite of the growing importance of EIIAs, however, there is no comprehensive study that focuses specifically on the investment component of these agreements. This study seeks to fill the research and policy analysis gap in the specialized literature. Its purpose is to contribute to a better understanding of the changes that are taking place in the international normative framework on investment through EIIAs, surveying the latter's growth and geographical expansion, analysing their approaches to investment issues, and examining the interactions between their provisions and those of other agreements. In this manner, it is hoped that the study will assist policymakers in making informed decisions regarding the negotiation and application of all types of international investment agreements (IIAs).

The scope of the study is confined to EIAs dealing with investment (EIIAs) concluded after 1945. Thus, for the purposes of the study, an EIIA means an EIA that deals with inter alia trade, and contains at least one provision directly setting out a specific commitment on investment.[3] The investment commitment or commitments in an EIIA may be narrow or extensive, and may address issues related to the promotion, protection, liberalization and/or

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[1] The term "economic integration agreement" has been used in, among other instruments, the WTO Agreement on Trade in Services (GATS) (Article V) in relation to agreements that cover trade in services, and also in the Energy Charter Treaty in relation to agreements that cover *inter alia* trade and investment. The definition of "economic integration agreement" in this study is broader than that used in the GATS, as it encompasses all sectors. It therefore includes also "preferential trade agreements" dealing with trade in goods, referred to in article XXIV of GATT. For seminal studies on the phenomenon of economic integration and related definitions, see, among others, Viner (1950), Balasa (1961) and Bhagwati and Panagariya (1996). For a comprehensive bibliography on issues related to economic integration see OECD (2001, pp. 133-144).

[2] See OECD (2001and 2003) and World Bank (2005), among the recent studies that were prompted by the increasing importance of various types of EIAs in international economic relations.

[3] Some agreements that seek to facilitate trade and investment flows but do not aim specifically at economic integration have also been considered in this study, as have stand-alone investment agreements that are part of a broader economic integration scheme.

regulation of investment. [4] Moreover, the substantive analysis of these agreements is limited to their investment provisions. Provisions related to the movement of goods, services, people or information are not examined, except to the extent that they affect investment provisions directly. Two other categories of agreements are also excluded. The first is the category of multilateral EIIAs, notably WTO agreements. These have been widely discussed in the literature and, in fact, some familiarity on the part of the reader with the GATS, the TRIPS and the TRIMS agreements is assumed in this study. Another category which is excluded from this study — and indeed falls outside the definition of an EIIA — is that of the more than 2,400 bilateral investment treaties (BITs) that have been concluded since 1959. Although BITs have influenced the investment provisions of many EIIAs, they have been analysed extensively elsewhere, notably in UNCTAD's study entitled Bilateral Investment Treaties in the Mid-1990s (UNCTAD, 1998a). Finally, the study examines the texts of the relevant treaties, but does not address the interpretation or application of the treaties through State practice or the decisions of arbitral tribunals.

The study is divided into six chapters. By way of introduction to the topic, the present chapter discusses briefly the nature of EIAs and the theoretical economic and policy rationales behind their adoption, distinguishing EIIAs from other types of EIAs. Chapter II reviews the historical evolution of EIIAs, describing briefly the main features of each agreement. In this overview the agreements are grouped by geographical regions and presented in chronological order, so as to highlight key developments from their origins to their present status. The purpose of this overview is to give the reader a comprehensive picture of the agreements included in the study, before proceeding to a more detailed comparative analysis of their features. Chapter III examines in detail the universe of EIIAs, namely their numbers and geographical distribution, and identifies several patterns in EIIAs in relation to the investment issues they address. Chapter IV discusses first broad differences and similarities between EIIAs and with other investment agreements, and then looks in further detail at the main provisions on investment found in EIIAs, explaining their meaning and policy implications. Chapter V examines the question of EIIA interactions, both among investment-related provisions within individual agreements and between agreements. The role of these interactions in shaping the present framework of investment rules has become a particularly important issue in recent international discussions, especially in the light of the increasingly complex network of agreements that is emerging across countries and regions. Finally, the concluding chapter provides some insights regarding the challenges facing policymakers in relation to the adoption and implementation of EIIAs.

B. EIAs: Nature, Types and Rationale

As noted, economic integration agreements (EIAs) may be defined as agreements that facilitate international trade and cross-border movement of the factors of production. EIAs may address one, some or all these types of economic transactions in various combinations, with trade being the central component, and foreign investment activity one possible ingredient (in the latter case EIIAs). They may cover transactions that take place between countries and they may also address activities that occur inside the borders of a country that may affect such international flows. EIAs may be established at the multilateral, regional, interregional, plurilateral or bilateral levels. The fundamental difference between multilateral EIAs and those at other levels is that the latter offer reciprocal (and sometimes non-reciprocal) treatment on a preferential basis to their

[4] Agreements falling under the broad denomination of EIIAs are given different names, including, for example, free trade agreements, free trade and investment agreements, preferential trade agreements, regional integration agreements, partnership and cooperation agreements, association agreements, economic partnership agreements, and framework agreements on trade and investment relations. For the sake of convenience, in this study all of these agreements are referred to as economic integration investment agreements (or EIIAs).

member countries. Thus, the adoption of a non-multilateral EIA creates two levels of rules: one level of rules that apply to the countries that are members of the group, and another level of rules, typically less favourable than the first, applying to non-members. Such preferential EIAs are concluded by two or more countries in an effort to expand and deepen their economic relations in a limited and flexible setting. This allows them to move beyond the minimum common denominator established by the existing multilateral system and undertake new and complex policy initiatives that are difficult to broach at the multilateral level. (Given that multilateral EIAs are not addressed in this study, unless otherwise stated, throughout the study the term "EIA" or "EIIA" means non-multilateral EIA or EIIA.). The depth of market and economic integration sought by an EIA, in terms of the types of the restrictions or obstacles it tries to remove and the range of activities it covers, can vary considerably among agreements. Several different types of EIA models have been identified, although there may be numerous variations of each. An example of a typology of agreements in relation to the depth of market integration they seek is described in box I.1.

Box I.1. Types of agreements in relation to the depth of market integration they seek

- ***Sectoral trade agreements***. They provide for lower tariffs or duty free treatment among their members on a limited number of sectors.
- ***Non-reciprocal preferential trade agreements***. They grant access to a larger market without a demand for reciprocity.
- ***Free trade agreements***. Member countries eliminate substantially all tariff and non-tariff barriers between themselves.
- ***Customs unions***. Member countries eliminate substantially all tariff and non-tariff barriers among themselves and establish a common external tariff for goods from third countries.
- ***Common markets***. A custom union is supplemented by the removal of barriers to factor movement.
- ***Economic unions***. The members integrate all or most of their economic policies.

Source: Amponsah (2001).

As this typology suggests, in theory the evolution from shallow to deep integration may be described as proceeding through various stages (UNCTAD, 1993, ch. VII, pp.160-164). The reduction or elimination of tariffs and other border barriers to trade in goods among EIA country members remains the central component of any process of economic integration and, hence, of many EIAs. This approach alone, however, represents a limited and "shallow" type of integration. The simple removal of border barriers to trade in goods, while other internal barriers remain in place, might not be sufficient to provide greater access to the markets of one country even for some goods of another country. To take account of this, an EIA may incorporate more complex measures aimed at reducing internal barriers to imports, measures such as harmonization of product standards among its members. However, if an EIA leaves external trade policy to the discretion of individual member countries, third country imports into the area are likely to be redirected to exploit the tariff differences among EIA members. To avoid this problem, countries may decide to integrate further by creating a common external trade policy or customs union. The transition from a free trade area to a customs union involves a deeper level of policy commitment and institution building. Even then, the integration of goods markets, while other aspects of cross-border economic integration are left outside the scope of an EIA, may frustrate the objectives of such integration. One major aspect is that of international transactions in services, which are an important part of most economies today. Another is that of investment by which firms extend their production activities beyond national borders, seeking markets or access to resources and created assets. The inclusion of these (and other) aspects in EIAs may help to better achieve the objectives of integrating markets and economies.

In practice, however, the passage from a limited and shallow model to broader and deeper levels of integration as described above is not necessarily reflected in the design of existing EIAs. Rather, the picture that emerges from EIAs, old and new, in terms of the extent and depth of their coverage of specific types of transactions, is rather mixed. Thus, for example, some EIAs that seek to eliminate internal tariffs and non-tariff barriers, but do not contemplate reaching the stage of a customs union, nevertheless contain comprehensive rules on investment (table I.1).

Table I.1. EIAs do not follow a clear integration pattern

Agreement	Trade in goods	C.E.T*	Standards**	Trade in services	Investment	Labour
United States - Central American Free Trade Agreement (CAFTA) (2004)	Yes	No	Yes	Yes	Yes	Yes
Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) (2004)	Yes	No	Yes	Yes	Yes	No
South Asian Free Trade Area (SAARC) (2004)	Yes	No	No [a/]	No	No [a]	No
European Community (EC) - Mediteranean partners (1995-2004)	Yes	No	No	Yes	Yes	No
United States-Singapore (2003)	Yes	No	Yes	Yes	Yes	Yes
Chile-Republic of Korea (2003)	Yes	No	Yes	Yes	Yes	Yes
Economic Cooperation Organization Trade Agreement (ECO)[1] (2003)	Yes	No	No	No	No [b]	No
European Community (EC) - Mexico (2001)	Yes	No	Yes	Yes	Yes	No
United States-Jordan (2000)	Yes	No	No	Yes	Yes	Yes
European Community (EC) - South Africa (1999)	Yes	No	No	No	Yes	No
Chile-Canada (1996)	Yes	No	No	Yes	Yes	Yes
North American Free Trade Agreement (NAFTA) (1994)	Yes	No	Yes	Yes	Yes	Yes
European Community (EC) - Russian Federation (1994)	Yes	No	Yes	Yes	Yes	Yes
The Southern Common Market (MERCOSUR) (1994)	Yes	Yes	Yes	Yes	Yes	Yes
Commonwealth of Independent States Free Trade Agreement (CIS)[2] (1994)	Yes	Yes [c]	Yes	Yes	No	No
Common Market for Eastern and Southern Africa (COMESA) (1993)	Yes	Yes	Yes	Yes	Yes	Yes
European Free Trade Association (EFTA) -Turkey (1991)	Yes	No	Yes	No	No	No
South Pacific Forum Cooperation Agreement (1980)	Yes	No	No	No	No	No
Southern African Customs Union (SACU) (1969)	Yes	Yes	Yes	No	No	No
Andean Community (1969)	Yes	Yes	Yes	Yes	Yes	Yes
Treaty Establishing the European Community (1957)	Yes	Yes	Yes	Yes	Yes	Yes

Source: UNCTAD.

* CET: Common external tariff.

** Product standard regulation.

[a] The parties agree to consider the adoption of additional measures aimed at, inter alia, the harmonization of standards and the removal of barriers to intra-SAARC investment.

[b] The agreement deals with the protection of intellectual property rights.

[c] The free trade area is considered a transitional stage in the formation of a customs union.

[1] Members of ECO are: Afghanistan, Azerbaijan, the Islamic Republic of Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkey, Turkmenistan and Uzbekistan.

[2] Members of the CIS Trade Agreement are: Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, the Republic of Moldova, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and Kyrgyzstan.

Each increasingly deeper integration stage entails potential economic and policy gains as well as costs for the countries involved. A comprehensive assessment of the economic and policy implications of the integration stages reflected in different types of EIAs, and in particular in EIIAs, would require a through empirical analysis of all the elements at work, which is beyond the scope and purpose of this study. A number of recent studies have looked in detail at these issues [5] and, while there is no consensus in the literature as to the economic and policy benefits and costs of these agreements, there is wide recognition of the theoretical rationales behind the adoption of EIAs, including EIIAs. In terms of the economic rationale, the formation of economically-integrated areas is a natural step in the process of geographical expansion of markets from local to national to international, which is driven by efficiency considerations, as larger markets "allow gains from specialization (division of labour), differences in resource endowments, and from economies of scale in manufacturing and technology" (Kobrin, 1995, p. 21). The removal of barriers to international trade in goods is a major step towards obtaining the economic gains mentioned above. But the removal of barriers to other types of international transactions, including services transactions and investment, expands the extent and range of such benefits.

In the case of trade in services, the economic rationale for their inclusion under an EIA's coherent liberalization and regulatory processes is explained, to a significant extent, by the complex nature of services and their strategic importance for national economies. Many services are inputs to other economic activities and, consequently, their orderly functioning can have a significant effect on the entire economy. Moreover, undertaking cross-border trade in services often requires the establishment of a facility in the country whose market is being supplied. This adds a foreign-direct-investment dimension to many international services transactions that further increases their complexity. These characteristics of services have traditionally justified the existence of more formal and informal barriers to market access by service enterprises — and the establishment locally of production facilities by foreign firms in particular — than probably in any other economic sector. The efficient reduction and monitoring of such barriers may be seen as a necessary step when moving to a "deep" level of economic integration. However, this is also a difficult and sensitive policy task that can be facilitated if it is carried out through the concerted intergovernmental efforts of an EIA.

The economic rationale for dealing with investment in EIAs, and hence for EIIAs, is also compelling. Foreign direct investment has become an important mode of delivering goods and services to foreign markets,[6] and integrated international production systems through foreign investment have become an increasingly important means for firms to improve their efficiency.[7] Indeed, one of the economic effects expected — and to some extent realized (UNCTAD, 1998b, ch. IV) — from EIAs dealing with trade is an increase in investment flows into and within the EIA area. This increase is driven by two main types of economic effects of EIAs on foreign direct investment.[8] The first effect is linked to the removal of trade barriers, which enlarges the

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[5] For recent discussions of the economic and policy implications of various types of EIAs, see for example World Bank (2005), Abugattas (2004), Sampson and Woolcock (2003), Okamoto (2003), Inter-American Development Bank (2002), OECD (2001) Gilbert, Scollay and Bora (2001), Laird (1999) and UNCTAD (1998).

[6] For example, in 2003, world sales of foreign affiliates were estimated to be nearly twice the value of world exports of goods and services (UNCTAD, 2004a, p.9).

[7] This discussion assumes a basic understanding of the potential benefits and costs of foreign direct investment in general, and integrated international production in particular, for host and home countries. Detailed analyses of the various effects of FDI and their implications for host and home countries can be found in the 14 volumes already published of the World Investment Report Series (1991-2005).

[8] For a more detailed discussion of the effects of EIAs on investment, see, for example, OECD (2001), Brewer and Young (2000, pp.167-170) and UNCTAD (1998a).

market and allows firms to benefit from greater scale. This effect helps attract market-seeking production activities, from within and outside the EIA area, for which scale is an important consideration (OECD, 2001, p. 7; UNCTAD, 1998, ch. IV). The second effect of EIAs is linked to the facilitation of changes in the location of production within EIA member countries. Relocation is driven by comparative advantage and helps increase intra-EIA efficiency-seeking investment. Relocation is related to the adoption of investment rules that relax market entry restrictions and provide for legal protection. Thus, to ensure the combined efficiency effects of scale and comparative advantage, lowering tariffs alone is not sufficient, although it is a necessary precondition. Little can be gained, in fact, if the countries within an EIA area maintain substantial investment barriers between themselves. There is, therefore, an incentive for addressing investment facilitation issues in EIAs — resulting in EIIAs — if countries seek a "deeper" level of economic integration (box.I.2).

On the other hand, EIIAs can generate potential economic costs for individual member countries. In the case of EIIAs between developed and developing countries, for example, the burden of services and investment liberalization is likely to fall asymmetrically on the less developed countries members of the EIIA (Abugattas, 2004). In addition, different parties may stand to benefit asymmetrically from the efficiency-motivated relocation effects of an EIIA. For example, while relocation effects can be an instrument of convergence of income levels among the countries members of an EIIA, in certain circumstances, relocation of production can also be a cause of severe job losses for the countries with less competitive labour markets (OECD, 2001, p. 8). Job losses in a member country due to relocation can impose heavy economic and social costs on some sectors within the economy, while other sectors may expand, resulting in an unequal distribution of any gains from the EIIA to the economy as a whole. The process of adjustment may be quite prolonged and there is no guarantee that those displaced in contracting sectors will easily be absorbed back into expanding activities, especially when there is large-scale unemployment, as in many developing countries. This suggests that, in order to fully capture the gains from EIIAs, liberalization and integration efforts may need to be accompanied by policy measures — such as social safety nets and retraining programmes — that facilitate the adjustment process.

Certain well-recognized broader policy effects of EIIAs may also act as important motivations or rationales for the conclusion of these agreements. Although these policy effects apply in principle to all types of EIAs, they would tend to be stronger as the level of integration deepens, for example when investment and services are made an integral part of an EIA, resulting in an EIIA. One of the first important potential policy effects of EIIAs relates to the locking-in effect in relation to national policy (World Bank, 2004; OECD, 2001). Thus, while countries can undertake unilateral liberalization of investment and trade in services, the lock-in effect of making investment and services liberalization commitments a part of an EIIA adds credibility to these commitments. This in turn contributes to providing policy stability, transparency and reliability, which are the hallmarks of a favourable foreign investment climate. The investment-related provisions in EIIAs signed by Central, Eastern and South-Eastern European countries during their transition towards market economies were mainly intended to achieve this effect. It may be argued in this respect that investment and services liberalization, protection or promotion can also be pursued in stand-alone investment agreements, independently from an EIA. However, the counter-argument in favour of the inclusion of investment provisions in an EIA addressing trade (or trade and other components) — or as part of separate agreements which are linked to the main EIA — is that this model contributes to policy coordination, coherence and an orderly process in the design and implementation of trade and investment policy, thus minimizing the cost of conflicting approaches.

Box I.2. Effects of EIIAs on international production

By addressing investment issues, an EIIA facilitates FDI flows between member countries with potential benefits for the countries involved.

It improves access to markets within the EIIA area for firms established in countries within the area that produce goods and services for which proximity between producers and customers — and hence local establishment of production facilities — is an advantage. In competitive markets, this can lead to increased competition, lower prices and/or improved quality of products for consumers in the host countries, as well as improved competitiveness of the firms involved.

Furthermore, an EIIA creates increased opportunities for firms operating in EIIA countries to establish or participate in the establishment of facilities for the exploitation of natural resources, and thereby obtain better access to such resources. This can lead to increased export-oriented extraction of natural-resource products (and related employment and income) in countries within the EIA area endowed with such resources, improved conditions of supply of products, wherever they may be sold, and improved competitiveness of the firms involved.

An EIIA also increases opportunities for firms established in EIIA countries to engage in efficiency-oriented international production, dispersing their production activities within their integrated international production systems and fragmenting their activities more closely in accordance with the comparative advantages of different locations in the EIIA area (UNCTAD, 1996 p. 112). This can contribute to increased export-oriented production (and related employment and income) in the host countries in segments of goods and services production for which they have comparative advantage, improved conditions of supply of the final products based on them, wherever they may be sold, and improved competitiveness of the firms involved.

In a world with significant economic integration through trade, many of the potential benefits from EIIAs arise from the strong interrelationship between FDI and trade as firms increasingly seek to locate their activities and functions wherever the latter contribute most to their efficiency. They also arise from the fact that in the services sector, where many products still have limited tradability and where proximity of customers is still an advantage, foreign direct investment remains the dominant mode of delivery of products to international markets. Thus, investment has increasingly followed trade as a component of EIAs.

Of course, the degree to which FDI increases between participant countries as a result of the conclusion of an EIIA depends on a number of factors. Notable among these factors is the pre-existing level of investment barriers between the countries involved before joining an EIIA and, consequently, the changes that actually take place in national investment regimes as a result of membership. In some cases, the policy climate created in anticipation of the conclusion of an EIIA may be sufficient to bring about some of the expected benefits.

Source: UNCTAD.

The locking-in quality of EIIAs would be beneficial to individual member countries when the EIIA is an instrument that supports their national policy objectives. However, as EIIAs embody an increasingly wider range of policies and activities, they may also preclude policy options otherwise available to national Governments. This is particularly challenging for developing countries that embrace EIIAs as a development option. Hence, while EIIAs are in principle aimed at promoting competitiveness and the effective integration of national economies into the international economy, they can reduce significantly the policy space available for individual policy initiatives and options.

A second policy effect of, and motivation for, EIIAs is the strengthening of the bargaining power of the group vis-à-vis third countries. For example, it has been observed that the launching of negotiations on NAFTA was aimed at spurring European countries into acting on the Uruguay Round of multilateral trade negotiations (World Bank, 2005, p. 32). EIIA members can also use their bargaining strength to prevent the adoption of certain decisions at the multilateral level, as exemplified by the reluctance of the Economic Community to make certain concessions to advance on the liberalization of agricultural trade in WTO negotiations. In principle, this bargaining effect would be particularly beneficial for countries that lack the political critical mass of their own necessary for imposing or substantially influencing positions in international policy discussions and negotiations. South-South EIIAs can also enhance the collective bargaining power of developing countries in multilateral forums, especially when their membership confers significant numerical superiority.

On the other hand, EIIAs, especially North-South EIIAs, can also be used by the stronger parties to exercise their bargaining strength vis-à-vis weaker members, and put pressure on them regarding internal group policies as well as external agendas and negotiations. This potential effect is of particular concern to less developed country members of EIIAs, as they may see their ability to promote their own national developmental strategies, and to play a developmental role in multilateral forums, reduced.

A third policy effect of, and motivation for, EIIAs (and all EIAs) noted by authors (World Bank, 2005; OECD, 2001, pp. 6-7), is the improvement of political relations between the members. This effect emphasizes the EIIAs' dimension as providers of public goods. Thus, in many cases, the creation of an EIIA is a part of larger efforts to strengthen political relations among the parties, as economic integration increases regular political interaction and helps build trust in other areas. This was a motivation behind the creation of the European Community shortly after the Second World War, and is also behind the European Community's bilateral agreements with countries in Central, Eastern and South-Eastern Europe (World Bank, 2005, pp. 34-35). A related motivation is to limit migration from poorer countries by raising the living standards in those countries. This motivation was behind NAFTA and is behind the Euro-Mediterranean agreements. Here again, the bargaining power of the strong parties vis-à-vis the weaker ones may be used to impose policy options that are not always favourable to the national policy interests of the latter.

In short, there are significant potential economic and policy gains as well as costs for the countries participating in EIAs, which may increase as integration deepens (as in the case of EIIAs). One overarching potential policy cost of deeper integration for the countries involved is a greater loss of policy autonomy. This is a particularly important concern for developing countries parties to EIIAs, which may see their policy space for individual development strategy design and implementation reduced as a result of their EIIA membership. For example, this may cause national Governments to forgo the use of policy instruments for development purposes where externalities are involved (e.g. in basic services). Another overarching policy cost of EIIAs is more complex policymaking for national Governments. For example, the relatively recent inclusion of trade in services as part of EIAs (since the Uruguay Round negotiations) has added a new dimension to the rules, the implementation of which is not yet fully gauged through experience and practice.[9] The intrinsic additional complexity of managing deeper integration rules is further aggravated in the present context by the proliferation of EIIAs with overlapping membership of countries and regions. The web of overlapping EIIAs (and corresponding rules) that are in existence today resembles an "spaghetti bowl" (figure I.1) (World Bank, 2004, p. 38-

[9] See Abugattas (2004) for a discussion of the issues raised by the new wave of EIAs dealing with services.

39 and figure 2.2; OECD, 2001) and is in constant change. The simultaneous implementation of multiple EIIA processes at different stages of evolution in which many countries are currently involved, and the administration of the procedures that it entails, can be a daunting task even for the most sophisticated institution, let alone for many developing countries that lack the necessary institutional backing. However, the administration of EIIAs at both national and group levels is an important matter since the test of success of an EIIA is ultimately determined by its effective and timely implementation.

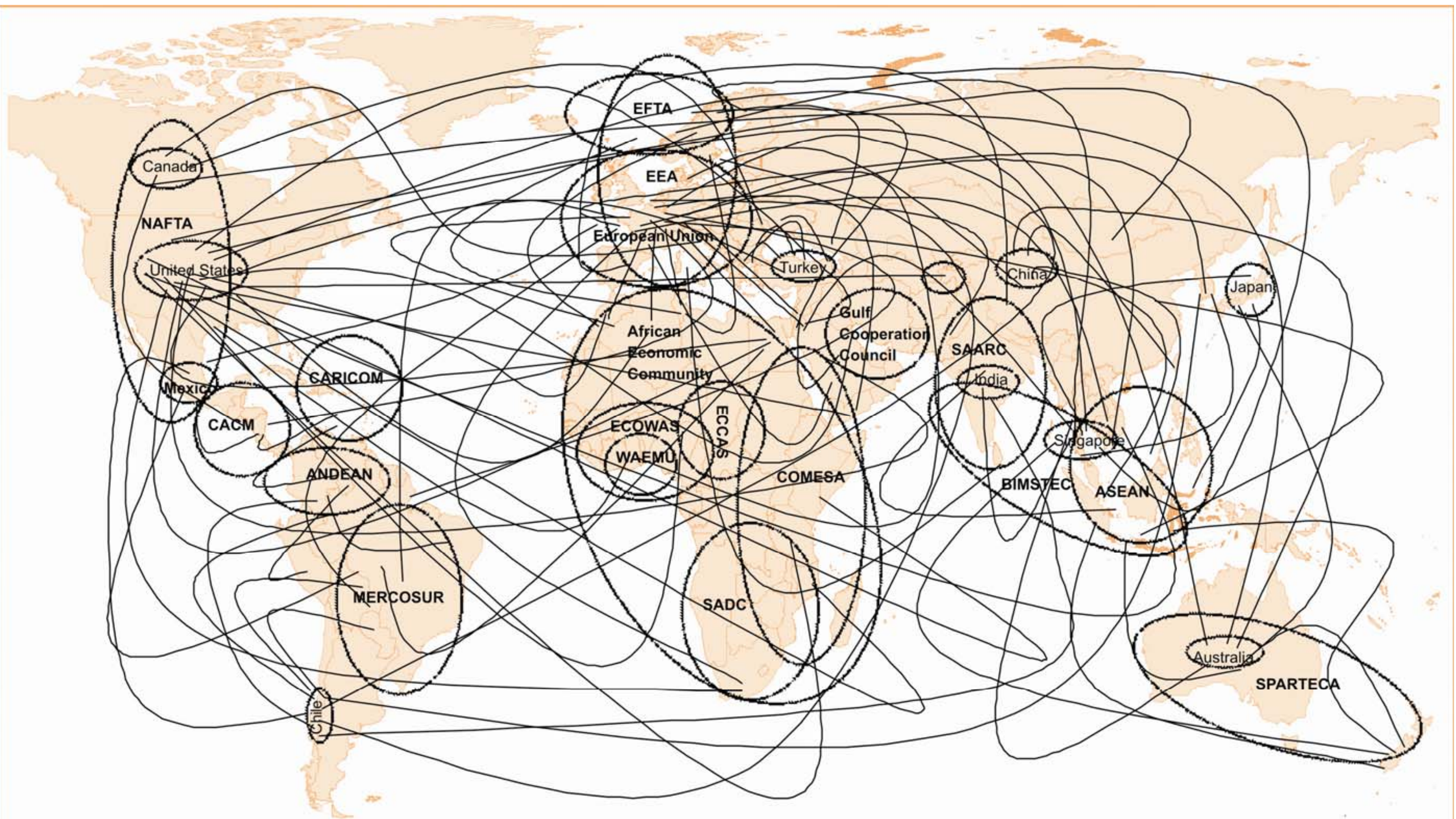
The creation of economically integrated areas through EIIAs (and EIAs) can also entail potential economic gains as well as costs for countries outside the integrated area. With respect to gains, an EIIA (or EIA) that improves efficiency and increases real income within the area can expand the size of its market for goods and services (whether served through trade or foreign direct investment), including products imported from, or provided through, FDI by firms from non-member countries, thereby benefiting the latter. As for costs, EIIAs, like all EIAs, normally introduce a degree of "discriminatory" (i.e. less favourable) treatment between their member countries and non-members. Even when such "discrimination" is not significant (i.e. when national non-discriminatory investment regimes have already established a "level playing field"), in a world of fierce competition for resources and markets, every inch of preferential treatment matters. In fact, a strong motivation for countries to participate in EIIAs (and EIAs) is to counteract the potential negative effects of discrimination and marginalization as other countries conclude them. This raises the question of whether EIIAs are complementary to broader national or multilateral efforts that seek to facilitate trade and investment flows across a broader spectrum of countries, or whether they create additional external artificial barriers to trade and investment, thus exacerbating economic exclusion and marginalization. While the countries that tend to benefit most from preferential trade and investment provided by an EIIA are usually the least developed of the EIIA group, poorer countries also stand to be the main losers when they are excluded from such preferences. This study looks briefly at various patterns found in EIIAs with respect to the treatment they provide to non-parties in the area of investment (chapter III.B.3). However, the overall impact of the differential treatment resulting from an EIIA is a larger empirical question that impinges on many variables and its consideration exceeds the scope of this study.[10]

More broadly, the beneficial or prejudicial effects of EIIAs depend to a certain extent on their relationship with the existing multilateral framework on trade and investment.[11] In the area of trade, the parameters are clearly established by the WTO multilateral trading system. In fact, one of the preconditions for allowing economic integration schemes under GATT is that they do not raise barriers to trade with third parties, or that any such effect is offset by at least a proportionate degree of trade liberalization (GATT, article XXIV). In the area of investment, however, there is no comparable road-map, as no comprehensive multilateral system exists, except for certain specific trade-related areas such as services, TRIMS and TRIPS. The question

[10] The economic effects of EIAs on third countries have been examined predominantly with regard to trade. The debate has focused on the issue of whether EIAs result in trade creation or trade diversion with respect of non-EIA member countries (Viner, 1950). For a recent empirical study of the welfare impact of EIAs (including EIIAs), see, for example, OECD (2003). The study reviews 40 empirical studies and finds *inter alia* that the welfare impact of EIAs is positive, but small; that trade diversion "can be an issue"; and that deep integration generates larger welfare gains than does integration through trade in goods only. The study concludes that economic theory cannot provide clear-cut conclusions, and therefore the determination of the net impact of a given EIA (or EIIA) is ultimately an empirical issue.

[11] The relationship between multilateralism and regionalism in relation to trade has been widely discussed in the literature; see, for example, Laird (1999) for a review, Bhagwatti (1993), Kobrin (1995) and Lawrence (1995).

Figure I.1. The "spaghetti bowl": Multiple overlapping EIIAs, June 2005



Source: UNCTAD, based on World Bank, 2005, figure 2.2.

thus is whether the explosion of EIIAs contributes to the creation of a clear, transparent, stable and fair framework of international rules in the area of investment, or whether these agreements result in an increasingly complex and intractable web of opaque, unclear, unpredictable and (sometimes) conflicting investment rules, the full implications of which are difficult to ascertain. Some efforts are already under way in the direction of clarity and order, including through provisions dealing with the interrelations between provisions and agreements. These are discussed in chapter V of this study, not to mention the contribution that the study as a whole may make in that direction.

In spite of the potential economic and policy costs of deeper integration, the number of EIAs that have moved beyond the shallow phase to increasingly deeper phases of integration is expanding rapidly: they address activities that occur inside the borders of a country and they address transactions other than trade in goods, notably, trade in services and investment. But while the inclusion of investment rules in EIAs, resulting in EIIAs, is a logical step in a gradual process of deeper integration of markets, there are great variations among EIIAs in terms of their coverage of investment issues. Thus, some EIIAs provide for liberalization and non-discrimination, while other EIIAs include also protection standards, often following closely BIT provisions in this area. Some include separate provisions on services, while others introduce provisions regulating investment activity (e.g. prohibition of anti-competitive practices and corporate governance). Yet other agreements do not go that far and limit themselves to a fairly light set of commitments to promote investment between the countries. The different approaches to investment in EIIAs are discussed in detail in chapters III and IV below.