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Chapter VI: Keeping Multilateralism and Development in Mind: Proposals for a New Model of North-South Agreements

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Chapter VI

KEEPING MULTILATERALISM AND DEVELOPMENT IN MIND: PROSOSALS FOR A NEW MODEL OF NORTH-SOUTH AGREEMENTS

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General objectives

In the past decade a trend has emerged to increasingly feature "beyond trade" regulatory disciplines in international trade agreements. "Beyond trade" refers to trade-related disciplines that apply to national internal regulation in all areas of economic activity. When dealing with trade in goods, the term "beyond trade" encompasses measures applicable to internal operations (standards mainly, but also government procurement); outside the area of goods, it covers all other measures relating to services, establishment and post-establishment treatment of foreign firms, movement of capitals and of workers.

It is known that, in recent years, the number of bilateral North-South trade agreements has increased. In recent months, maybe as a reaction to the WTO's failure in Cancun and the -unconfessed- failure of the Free Trade Area of the Americas (FTAA) Ministerial Conference in November 2003, negotiations between developed and developing countries have multiplied[69]. A consequence of this is that interest in the multilateral system is waning, and upsetting doubts about the "adequacy" of the system to confront this "new" reality are being cast.

Against this background, we have sought to find a new approach for the ongoing EU-Mercosur bi-regional negotiations. Most of this approach can be applied to other North-South bilateral negotiations and agreements; this is what we will attempt in this paper.

EU-Mercosur, or for that matter, any other bilateral trade agreements, should focus on two main policy objectives:

- the strengthening the multilateral system, through the signature of an agreement that guarantees the compatibility of bilateral relations with the broader ambit of the WTO;
- the introduction of a coherent and development-friendly regulatory framework, that might serve as a model for future developments in bilateral as well as multilateral level. These values should be reflected throughout the agreement, but most especially in sensitive areas such disciplines on foreign investment and services.

[68] This chapter draws upon the content of a study presented in the 2004 Second Cluster Workshop of the Chaire Mercosur de Sciences-Po (Paris) on the ongoing EU-Mercosur negotiations convened in Rio de Janeiro on 29-30 April 2004 under the auspices of the BNDES. The study entitled "Beyond Trade in EU-Mercosur: Towards a New Model of North-South Agreements", was published by the Chaire Mercosur and also appears as the first chapter of the book "Implementing an EU-Mercosur Agreement: Non-Trade Issues" edited by Alfredo Valladão.

[69] In the Americas, the failure of the FTAA has meant that there are now several ongoing parallel negotiations, which will convert the Northern countries (the USA, but also Canada) the major "hubs" of the continent.

At the same time, these agreements can evolve and be strengthened in order to ensure true economic integration between the parties and to broaden the economic gains accruing from the bilateral relation. To this effect, agreements may provide for a specific instrument, namely:

- the creation of a common institution (the Joint Council) with the ability to develop binding disciplines towards the parties. This institution may prove to be an adequate forum for the creation of common rules on those issues where consensus was unable to be reached during the negotiations, as well as deepening existent disciplines.

Strengthening the multilateral system

Cancun's failure[70] has, at the very least, had some analytical and political advantages, which are very relevant for our paper.

Firstly, it has buried, probably for the foreseeable future, the strategy of ever widening WTO's scope (the strategy of the "Singapore issues"). This strategy has often been attributed to developed countries as a whole, but has, in fact, only been strenuously and consistently defended by the European Commission, with, at most, a passive acquiescence by the EU Council. This burial can lead to a clarification of the relation between regionalism and multilateralism, in particular in the area of services and foreign direct investment. Until Cancun, the discussion on FDI in bilateral/regional agreements was overshadowed by the argument of the possible transfer into the WTO of their approach and specific provisions. This has also spilled over into the discussion on the treatment of services; however, this situation has now changed and we will be drawing the consequences of this in the section that will follow on services and investment.

Secondly, it has proved that the multilateral trading system is really in deep trouble and that there is a real risk for the multilateral approach being replaced by a bilateral one. In reality, this phenomenon may lead to the prolongation of the unilateral approach of the "big powers". The recent US policy in the Americas is the best indication of the risk. This being so, the issue of the compatibility between bilateral/regional agreements and WTO should be addressed squarely and in full transparency, without relying on wishful thinking appeals to the virtues of the "new" or "open" regionalisms or on completely unfruitful attempts to define the GATT's notion of "substantially all trade". In our opinion, the only clear and transparent way, both legally and politically, is that of introducing a "WTO conformity clause" in bilateral/regional agreements. We will discuss it below in Section 3.

A WTO "Conformity Clause"

We have already emphasized that one of the strategic objectives of the new agreement is to avoid further weakening the multilateral system. If this is the case, the issue of the relationship between the new agreement and existing WTO agreements must be raised.[71]

Analytically, there are only three possibilities to organize a system of overlapping international trade agreements, in particular Preferential Trade Agreements (PTAs) and WTO agreements.

[70] On Cancun's failure, see Sauvé (2004).
[71] The argument developed in this section is taken from Torrent (2004) where it is discussed in a broader context.

The first possibility consists of renouncing any organizing mechanism: ensuring that the agreements can co-exist alongside each other with no clause or provision establishing the relationship between them. This is the model chosen by bilateral or plurilateral agreements concluded by the European Community (alone or accompanied by its individual Member States). The well known "banana war" and its extremely damaging effects (on all sides) is maybe the best demonstration of the risks of this model.

The second possibility consists of inserting a provision in the PTA establishing its primacy over WTO agreements. The best example of this is NAFTA's Article 103,[72] which establishes that:

> 1. *The Parties affirm their existing rights and obligations under the GATT and other agreements to which such Parties are party.*
> 2. *In the event of any inconsistency between this Agreement and such other agreements, this agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement (emphasis added).*[73]

This approach has the advantage of clarity and transparency. However, it runs contrary to the spirit and the letter of WTO agreements, proving, incidentally, that the examination of the percentage of trade covered by the agreement (NAFTA in this case) is not a necessary condition for establishing the lack of conformity with WTO rules, or at least some of its provisions.

The legal and political logic of Article 103 of NAFTA is best understood when comparison with Art. 104 of the same agreement. It establishes that:

> *In the event of any inconsistency between this Agreement and the specific trade obligations set out in ...(*follows a list of environmental agreements*)... such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement (emphasis added).*

The situation, then, is clear: in environmental matters, NAFTA recognizes explicitly the primacy of sectoral international agreements to which its Members are also parties;[74] in trade matters, however, this primacy is reversed.

The third possibility is, of course, to insert a clause recognizing the primacy of the WTO agreements into the PTA. Such a clause would be the counterpart of Art. XVI.4 of the WTO Agreement, which establishes that;

> *Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.*[75]

[72] Such a provision is no longer included in recent US-led agreements.
[73] Art. 802 is a concrete application of this general rule to the case of safeguards.
[74] See also Arts. 712 and 713 (sanitary and phytosanitary measures) and Art. 905 (on standards in general).
[75] This provision was considered by the European Community and its Member States (and in particular by the European Commission) as one of the major victories obtained in the last stage of the Uruguay Round negotiations (mainly as a sort of 'anti-section 301 of the US Trade Act' provision). However, they were also the first to forget its significance, notably after the loss of the hormones case, in favour of the argument that compensations (or acceptance of retaliatory measures) are a valid way of 'conforming' with WTO rules (in spite of the fact that, as is well known, the Understanding on Dispute Settlement explicitly states the contrary).

Such a clause would establish that, in the case where (and/or to the extent that) the WTO competent organs would determine that a specific provision of the PTA was not in conformity with WTO rules, this provision would no longer apply between the parties to the PTA without any need to denounce the agreement or to renegotiate it. In order to facilitate the continuity of the bi/plurilateral relations regulated by the PTA, the conformity clause could be accompanied by a procedural clause establishing a simplified mechanism for the adoption of the adaptations needed to bring that specific provision in conformity with WTO rules.[76]

Finally, the insertion of such a clause would have a sort of "liberating effect" on the question of whether the outcome of the negotiations fits within the requirements of GATT article XXIV and GATS article V. The discussion, ultimately academic and never conclusive, on the meaning of GATT's "substantially all trade" (and corresponding wording of GATS' article V) would indeed be replaced by a legal/procedural mechanism able to react to any WTO finding of non-conformity to these provisions.

Regulatory issues

A comparison of current disciplines

When considering the regulatory framework enacted in investment agreements, a comparative examination of the regulatory content of a set of selected bilateral and regional agreements leads to three general conclusions.[77]

The first general conclusion stemming from the comparison is that, in spite of all the relevance accorded lately to the issue of "rules beyond trade liberalization", the regulatory content of bilateral/regional economic agreements remains relatively low. Key provisions limiting domestic regulatory capacities are either non existent or consist mainly of "treatment obligations" (either national or most favoured nation – NT or MFN- treatment). Although the burden of these obligations on national legislation is not to be underestimated (nor its political and economic significance), such obligations do not necessarily alter national policy preferences (in a traditional right-left perspective, for example) since they focus on the application of national policies on a non-discriminatory basis.

The only exception to this conclusion is the agreement establishing a European Economic Area (1992)[78], precisely because its main goal was not to create a free trade area,[79] but to extend the European single market to those countries.[80] To this effect, it creates a mechanism to replicate as EEA law the relevant past and future *Community acquis*. Therefore, this

[76] The introduction of a conformity clause along these lines was included by the Council of the European Union in the negotiating mandate given to the Commission for an agreement with South Africa in 1996. At the time, the initiative was fiercely contested by the Commission, which, in the end, was able to persuade the Council to approve an agreement, which did not contain it (see Chapter 9 in Torrent 1998 for further information).

[77] The agreements reviewed are Mercosur, EEA, Europe Agreement (EU-Poland), EuroMed (EU-Morocco), EU-Russia, EU-Chile, NAFTA, and CAFTA.

[78] The agreement was rejected by Switzerland by referendum. After the entry into the EU of Austria, Finland and Sweden, only Norway, Liechtenstein and Iceland are Parties to the agreement, together with the European Community and its Member States.

[79] (A free trade area existed already as a result of the agreements signed between the European Community and the members of the European Free Trade Area –EFTA.

[80] The expanded European single market to the EEA did not encompass matters of agriculture and rules on taxation, and it did not foresee the establishment of a Customs Union.

agreement is and will probably remain unique; however, it can always be used as a benchmark for the regulatory content of any other agreement.

The second general conclusion has a historical character. Contrary to what is generally thought, the "Europe agreements" concluded by the European Community and its Member States with countries in Central and Eastern Europe formerly under Soviet Union hegemony, and whose negotiation began at the end of the 1980s, do not constitute a turning point and are quite limited in scope.[81] Concerning the regulatory content of trade agreements, the turning point, if any, was constituted by NAFTA and the WTO agreements resulting from the Uruguay Round (1993-1995). Under the influence of NAFTA, US-led economic agreements show a trend to include within their scope more and deeper obligations on regulatory matters than EC-led agreements.[82] As a matter of fact, the only EC-led agreement comparable to NAFTA is the recently signed with Chile.

The third conclusion relates to the absence of a single pattern. This is important because it leaves room for imagination and political bargaining when applying the results of our study to new North-South agreements. In the absence of a single pattern, a "new model" can be found by combining, if necessary, features of all the agreements that have been analysed.

Current approaches on specific regulatory issues

On the question of the internal regulations applicable to trade in goods, FTAs show a trend to recall or reproduce the disciplines enshrined at the multilateral level (e.g. WTO's agreements on sanitary and phytosanitary measures [SPS] and on technical barriers to trade [TBT]), emphasizing maybe the aspect of transparency. In this respect, Mercosur follows a distinctive pattern: it does not have any "primary" obligation on the topic but has produced a lot of "secondary" legislation on it. However, much of this "Mercosur legislation" simply recognizes the regulatory *status quo* (consisting of divergent national rules); however, a lot of it has not entered yet into force because of lack of completion of the "internalization" process.

On services and investment, the architecture of the agreements varies widely according to two criteria: a) the period before or after the launch of WTO's Uruguay Round; b) the fact that was spearheaded by the US or the EC.

- Agreements conceived before the end of the Uruguay Round (even if, in many cases, they were signed and concluded later on, as those of the European Community and its Member States with other countries in Central and Eastern Europe, the former Soviet Union and the Mediterranean), always make a distinction between international exchanges of services, on one hand, and investment on all sectors, including the services sectors, on the other.
- For agreements conceived after the end of the Uruguay Round, there is a sharp distinction between US-led and EC-led agreements. The US continues to keep the NAFTA, pre-Uruguay Round's logic. The European Community and its Member States have shifted, on the contrary, to the GATS approach of segregating FDI

[81] This is why, in order to promote the adoption of the Community *acquis* in those countries, a new instrument had to be invented in 1998: the "partnerships for accession", which made financial assistance conditional on that adoption.

[82] An element of explanation for this can be the following: even if, in all the agreements examined, Member States accompany the EC as Contracting Parties, they remain very reluctant to include in them provisions remaining under national competence (on investment, for example, or on intellectual property).

investment in the services sectors from general FDI provisions and treating it as a "mode of supply" of services: the third one, "commercial presence".

In EC-led pre-Uruguay Round agreements, provisions on international exchanges of services are either non-existent or have a very limited scope. The agreement recently signed with Chile, the only one that includes a full-fledged chapter on "trade in services", simply reproduces GATS disciplines and adopts its positive list approach for liberalization of market access and the obligation of national treatment. By adopting the GATS approach, it covers not only cross-border exchanges of services but also FDI in the services sectors (as "commercial presence" of foreign providers of services), and includes, like GATS, disciplines not only on access but also on internal regulatory treatment. As a consequence, the investment chapters only address the question of FDI in the goods' manufacturing sectors.

On services, US-led agreements keep to the same structure and, to a large extent, the very same provisions of NAFTA. This approach focuses on cross-border exchanges of services, which, in a comparison with GATS, would include its modes 1 and 2 and, to a limited degree, mode 4. Liberalization is addressed through negative listing, and the disciplines concentrate mainly on market access obligations, although there is room to list applicable quantitative restrictions. Disciplines on GATS mode 4 should be understood to address the international supply of a service when it requires the physical movement of natural persons in order to duly provide the service, and applies mostly to highly skilled professionals. Access to the labour market as such and rules on permanent residence are explicitly excluded from the scope of the agreement.

On investment, US-led agreements closely follow the typical structure and content of Bilateral Investment Treaties (BITs), namely:

- broad asset-based definition of investment, covering both FDI and portfolio investment;
- liberalization of access and obligation of national treatment for post-establishment, subject to a list of exceptions ("negative list" approach);
- rules on expropriation and compensation;
- Investor – State dispute settlement.

A very interesting development is taking place in the United States-Central American Free Trade Area (CAFTA) concerning expropriation clauses. Indeed, it includes an annex on the definition of expropriation, which narrows the scope of the notion of "indirect expropriation", and recognizes that:

> *"except in rare circumstances, non-discriminatory regulatory actions ... that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations"*.

This broadens the ability of the Parties to regulate domestically without incurring in so-called "regulatory taking of property".

On the European side, the equivalent of the BIT/NAFTA approach lies in the bilateral agreements on investment that continue to be signed and concluded by individual Member

States (with no list of exceptions),[83] although European BITs concentrate on "treatment" (after access) and do not create obligations on access. As all BITs, they include far-reaching provisions on expropriation and compensation as well as Investor-State dispute settlement clauses. Instead, EC-led agreements focus mainly, particularly with respect to the Europe agreements, on market opening obligations and access rights for European investors, and disregard investment protection disciplines. In the pre-Uruguay Round agreements concluded by the European Community and all its Member States, there is a distinction between movement of capital on the one hand, and the establishment and treatment post-establishment (or "operation") on the other.

Current EC-led agreements, while keeping their market opening goal, have undergone a shift in approach. Firstly, as already noted, FDI in services has been segregated from the investment chapter and expatriated to the "trade in services" chapter, creating thus divergent disciplines for the same phenomenon depending on the sector to which FDI is addressed. Secondly, by doing so, they have unified access and post-establishment commitments into one single positive list, hence limiting the possibility of attaining more sectoral coverage in one phase or the other of the investment process. On the contrary, they continue to exclude provisions on expropriation or investment protection,[84] something which should come as no surprise as there are no rules in EC law on such areas and each Member State keeps its full competence on the issue.

Some agreements include no provisions on government procurement. Those that do (NAFTA, CAFTA and EU/Chile) share a common approach, very similar to that of the plurilateral WTO agreement on Government Procurement. They impose national treatment to foreign companies for procurement that exceeds a minimum amount to a pre-established list of Government entities and include a precise set of rules to which national tendering procedures must conform.

The agreements under consideration differ sharply on the question of competition policy (in its meaning of anti-trust). Some of them, both US- and EC-led, contain no provisions on the subject (NAFTA, CAFTA or EU-Chile). Others, in particular Europe and EuroMed Agreements, which otherwise fall short of many others in terms of content, include provisions on the topic and, more significantly, confer powers to a joint organ set up by the agreement to develop them. In the case of the Europe agreements, such powers have been widely used, enacting in the framework of the agreement a set of quite detailed rules that tend to replicate those enshrined in the EC Treaty.

Extensive disciplines on intellectual property rights are to be found exclusively in US-led agreements. EU-Chile and EuroMed agreements provide just for the obligation to grant protection to intellectual property in accordance with the highest international standards, but

[83] The lack of a list of exceptions, in particular to National Treatment, leads to a systematic violation of the agreements by European countries because there exist a significant number of pieces of legislation (both within European Community and national government legislation) that grant better treatment to firms controlled by nationals than to those controlled, directly or indirectly, by foreigners. Furthermore, the conclusion of these agreements by Member States alone violates the division of competences between the Community and Member States because it covers topics internally regulated by the Community and on which, as a result, they have lost the competence to undertake international obligations. Recent ECJ jurisprudence confirms this interpretation, particularly on the "open skies" agreements: 5 November 2002 judgments, cases 466, 467, 468, 469, 471, 472, 475, 476, 478/98. See Solé (2003) and Torrent (1998), Chapter 3, for more information.

[84] The EU-Chile agreement does not even include provisions on transfers of funds, but this was probably a Chilean request.

do not, in themselves, regulate it. NAFTA and CAFTA, instead, impose a national treatment obligation to foreigners concerning intellectual property rights and include a set of standards to be met by internal legislation. NAFTA's provisions, to a large extent match, later WTO TRIPS disciplines, while CAFTA adds protection on new technologies issues, such as Internet domain names and programme-carrying satellite signals.

On the environment and labour, US-led agreements are the only ones that tend to include some standards — even if they are quite vague and excluded from the regular dispute settlement mechanism — while at the same time recognizing the principle of national regulatory capacity on these areas.[85]

A "new model" of North-South PTAs

Law making institutions

A mere "rendez-vous clause" does not create a "two-steps agreement". More often that not, such clauses simply mask the inability to get to a substantial agreement (at least on the specific area subject to the clause). In any case, they are unnecessary because the possibility is always open for a new agreement to modify any existing agreement: this is a matter of political will and does not depend on the existence or not of any "rendez-vous clause".

A "two-steps agreement" requires: a) to include into the "first-step" enough provisions that act as a "hook" for later developments; and b) to set up the institutions able to guarantee that, in the framework of those "hooks", such developments will effectively take place through more detailed disciplines; in order to achieve these goals these institutions must be endowed with law-making powers.[86]

The debate on law-making institutions has been muddied by the misleading use of the terms "intergovernmental" and "supranational". In order to avoid misunderstandings, it is better to replace that terminology with the more neutral of the "two techniques" that can be used by an international economic treaty (as a matter of fact, by any treaty) in order to enact rules: a) to previously insert rules in the treaty that must be complied with by member states; or b) to institute a mechanism for creating laws within the framework of the agreement.[87]

The creation of the European Community — a legal entity with its own competencies — certainly provides the best example of the second technique. However, the European integration process still relies just as much on the first one. The treaty itself contains a set of rules imposing far-reaching and serious obligations on member states when they exercise their own competencies; these obligations are underscored by the general overarching obligation of non-discrimination as regards member state nationality in any area covered by the treaty. NAFTA, by contrast, relies exclusively on the first technique (and is, as a result, a completely static "one step" treaty).

[85] On environment and labour, the specific protocols simply envisage the possibility of examining the internal implementation of applicable domestic law, not its conformity to the agreement.
[86] Much of the remaining section is adapted from Torrent (2003).
[87] Of course, such a mechanism has a limited, predetermined scope; it can never have (as the European Community itself does not have) what in German is called the *Kompetenz-Kompetenz*; i.e. the capacity to decide to which areas it extends its law-making powers.

It is very important to emphasize that the WTO agreement also includes such a mechanism to create rules. For example, Article IX. 3 allows the Ministerial Conference to modify and adapt the set of rights and obligations accepted by Members by way of waivers; and Article XII sets up a mechanism for accepting new Members (China, for example) through an agreement *with the organization itself*[88] approved also by the Ministerial Conference[89]. Completely new international law is created in both cases without any need for ratification procedures by WTO Members.

A very interesting feature of recent bilateral agreements negotiated in the Americas by the United States is that, for the first time, law-creating joint institutions have been established. Their powers are quite limited,[90] but the "taboo" is broken: there is absolutely no "constitutional impediment" to the setting up of such institutions (as had already been proven, on the other hand, by WTO membership).[91]

When such institutions are created in bilateral agreements involving already existent regional integration processes, they might have an additional positive effect. Indeed, the establishment of a joint council in the framework of EU-Mercosur negotiations, for instance, would have an extremely important integrating and strengthening effect on Mercosur. Indeed, it would necessarily imply a revision of its institutional foundations and, more significantly, a clarification of all the confusion that has been generated by mixing the question of the production of new *international law (or law for the states)* with the completely different one of its *applicability to individuals*.[92]

Regulatory Disciplines

Trade in Goods

Given the broad scope of ***regulatory aspects of trade in goods***, and the traditional complexity of bilateral negotiations on these issues, the joint institutions set up by the agreements could prove to be the proper channel to address these matters in an incremental manner after the agreement has entered into force. In their regulatory activity, the joint councils should be

[88] Art. XII concerning Accession to the WTO Agreement states that: "1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms *to be agreed between it and the WTO*. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto. 2. Decisions on accession shall be taken by the Ministerial Conference. *The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO*" (emphasis added).

[89] It must be underlined that in both cases, and contrary to common belief, the Ministerial Conference may act by a three-quarter and a two-thirds majority, respectively, even if it strives to arrive to a consensus in conformity with Article IX. We do not insist on this because our point relates to the capacity to produce new international law in the absence of any national ratification procedure and not the voting requirements necessary for this.

[90] CAFTA Art. 19.1, para. 3, regarding the Free Trade Commission, reads: "3. The Commission may: (a) establish and delegate responsibilities to committees and working groups; (b) modify in fulfillment of the Agreement's objectives: i) the Schedules attached to Annex 3.3 (Tariff Elimination), by accelerating tariff elimination; ii) the rules of origin established in Annex 4.1 (Specific Rules of Origin); iii) the Common Guidelines referenced in Article 4.21 (Common Guidelines); and iv) Annex 9.1 (Government Procurement). On this, see Esteban Agüero's ongoing study for the Observatory of Globalization.

[91] The sophisticated institutional and procedural provisions included in the 1993 Agreement on the European Economic Area provide an excellent precedent to prove that solutions can always be found to any so-called "constitutional impediment" to the institution of a mechanism of law-production within the framework of an international agreement.

[92] This confusion is analysed in detail in Bouzas, Motta Veiga and Torrent (2002); see in particular section 2.4.

guided by the goal of increasing the "effective content" of the bilateral agreement, avoiding the temptation of simply copying or recalling existent multilateral rules in bilateral context. Indeed, these attempts may (temporarily) mislead public opinion, but add nothing to the content of the agreement, while increasing disorder and uncertainty, as they tend to produce a range of parallel provisions that are never alike, even when they are risk being interpreted differently in the various regimes (bilateral/regional or multilateral).

Services

In the **regulation of services** there is a trend, followed mainly by the European Community, but that is also followed elsewhere, e.g. within Mercosur with the Montevideo Protocol, to reproduce GATS structure and regulation. This approach attempts to focus on a more extended undertaking of liberalization commitments by the parties at the bilateral level. It has the advantages of making easier the comparison between commitments undertaken in the multilateral GATS level and in the bilateral level, and, perhaps, of facilitating the discussion of whether the bilateral agreement fulfils the requirements established by GATS Article V for regional integration agreements.

However, the approach does not seem very promising in terms of integration/effective liberalization and makes much more difficult an adequate treatment of investment and movement of workers.

On the effective liberalization/integration issue, the regulatory content of such an agreement risk not going much further than existing disciplines at the multilateral level. The "net effects" (or the "effective content") of the agreement would be limited to the regulatory adjustments necessary to guarantee some access and to ensure the application of national treatment obligations in the specific sectors added to the GATS schedules of commitments, but no obligations would be imposed on national policies beyond that. In some cases, one can even see some GATS-minus disciplines on services.[93] Remarkably, not even a transparency obligation concerning regulation of trade in services, as seen in GATS Article III, is imposed in an across the board manner in EU-Chile agreement.

On the effects on the treatment of investment and movement of workers, the disadvantages of the GATS approach in the context of bilateral agreement are also, in our opinion, clear.

The fact of segregating FDI in the services sectors from general provisions on investment in order to treat it as an aspect of trade in services (the third mode of supply: "commercial presence") may make some sense in an agreement, which unlike WTO agreements, does not directly address the question of investment. It completely loses this sense and becomes an unnecessary source of confusion and technical, legal and negotiating difficulties when this is not the case and the agreement (like the EU-Mercosur agreement) has a specific chapter on investment.

Much of the same argument applies to movement of workers. There is no need to deal with it as GATS mode four on supply of services, an approach that, furthermore, will lead nowhere. Indeed, GATS' general logic, the term "movement of physical persons" does not refer to

[93] The EU-Chile agreement, remarkably, does not even foresee an across-the-board transparency obligation concerning regulation of trade in services, in the same manner as can be found in GATS Article III.

independent workers entering a Member's labour market,[94] but to workers *already employed* by a foreign supplier of services and used by him to provide services in another country or to independent services suppliers who have to travel and stay a limited period of time abroad in order to duly provide their service.[95]

When transposed to the bilateral level, the disadvantages of the GATS approach indicate the need for an alternative approach. This has also become politically possible (even desirable) from a broader perspective.

Indeed, until Cancun, both defenders and critics of the Singapore issues coincided (certainly for opposite reasons) in considering investment as a "new issue" for WTO,[96] concealing the fact that the GATS is mainly an agreement on foreign direct investment (re-baptized as "commercial presence", GATS third mode of services supply). Once the idea of dealing with investment as a new issue is no longer a topic for discussion, rational thinking and analysis should emphasize the fact that, from an economic, legal and political perspective, GATS issues fall under two completely different, even if interrelated, headings:[97]

a) international exchanges of services, duly accounted for traditionally in the services balance of the balance of payments, and
b) foreign direct investment (mainly for internal provision of services in the host country), whose economic relevance is not measured by the "once-and-for-all" entry of foreign capital (not necessary, in fact), but by its continued contribution to GDP (or, from another perspective, employment). [98]

From this perspective, the GATS appears as an anomaly to be explained (and maybe justified for some) in the context of the Uruguay Round negotiations, but not to be exported outside the WTO.[99]

If we separate GATS' four "modes of supply" and treat each of them on its own merits, a new world of possibilities appears. The first two modes ("cross-border supply" and "consumption abroad") share an essential economic characteristic: demand comes from one country and supply from the other, and give rise to international current transactions. This is not the case for the third ("commercial presence", i.e. FDI), which refers to investment (more precisely, to establishment) and should be treated like that. And, finally, there is an obvious need to address movement of natural persons (or at least, movement of workers and their families), even if they are not employed by a foreign supplier of services and, as a consequence, do not fall

[94] This concern was reflected on GATS Annex on Movement of Natural Persons, where it is expressly recognized that services liberalization does not involve labour-market opening obligations, nor it affects national abilities to regulate the entry and stay of persons in their territories. Such a provision is also enshrined in EU-Chile agreement.
[95] Or to movement abroad of service buyers if we refer to the second mode of supply (consumption abroad).
[96] Some had to conceal that they had already "won" (maybe too much) and some that (maybe inadvertently) they had already "lost" in bringing this new issue under WTO's umbrella.
[97] For more on this topic, see Molinuevo (2004).
[98] An international movement of capital is not needed for a foreign company to become established in a different country. It can rely on financing directly obtained in the host country, or be the result of a merger operation through an exchange of shares, for example. This possibility proves that "establishment of foreign firms" is, legally, economically and politically, a completely different problem from that of capital movement.
[99] Europeans, in particular, should recall (and be reminded of) the fact that in the Treaty of Rome instituting the European Community, exchanges of services have always fallen under one chapter and investment (in its three related aspects of movements of capital, right of establishment and treatment post-establishment) in other different chapters.

under the scope of GATS. There are individual characteristics in each case that deserve a special normative treatment.

For cross-border supply of services and consumption abroad, general obligations of access liberalization and national treatment could be envisaged, subject to a "negative list" approach, which would mainly identify quantitative restrictions and, as a consequence, bring regulatory restrictions to a more transparent environment. There could also be specific provisions applicable when these exchanges of services require movement of persons across borders. Such an approach is followed in US-led agreements.

Additionally, since trade in services might constitute a sensitive area in North-South agreements, where full consensus may not be easily reached in the course of negotiations, joint councils could play a key role in the resolving the issue if they are given powers to address progressive liberalization. Such abilities would grant the common institutions the space it needs to improve the parties' integration in services, especially by: a) introducing or eliminating some exceptions; b) authorizing safeguard measures; c) delaying or accelerating the timetable for the application of the provisions according to the parties' needs and political will.

Foreign Investment

Disciplines on foreign investment, as the instable Mercosur-EU and the failed FTAA negotiations are proving, are becoming a key element of bilateral agreements. The first issue to be solved in such regulation is that of the definition of "investment" in terms of the agreement and the distinction between foreign direct investment (FDI) and portfolio investment. While the possible contribution to development of FDI is widely recognized, mainly by its capacity to increase productive capacity and to introduce technical progress, portfolio investment may have dangerous effects in medium-sized, developing economies. Bilateral North-South agreements should therefore focus exclusively on FDI, leaving to national governments the ability to regulate movements of capital related to portfolio investment according to their economic needs and preferences.[100]

The second issue touches on the sectoral coverage of FDI. As discussed in an earlier section, the apparent "ease" of applying the GATS approach to FDI in the services sectors (as a mode of "trade in services") may contribute to the "feasibility" of the agreement but at the risk of a complete loss of effective content.[101] Therefore, we consider that provisions of bilateral agreements on FDI/establishment of foreign firms should apply to all sectors.

The third issue is that of the approach to be followed in the two relevant "phases" of FDI: a) access (or "first establishment");[102] and b) treatment post-establishment. Both the GATS and the US-led model apply the same approach to both phases, a "bottom-up" or "positive list"

[100] A very pedagogical way of emphasizing this fact (and the differentiation with the US-led approach) would be that of calling the chapter "Establishment of foreign firms" rather than "Investment".

[101] Sauvé and Pena's (2004) paper, while recommending the GATS approach on grounds of feasibility for the EU-Mercosur bi-regional agreements, also recognizes the lack of legal and economic motivation for differentiating between investment in the services and the manufacturing sectors.

[102] We prefer these two expressions to "pre-establishment", also widely used. Strictly speaking, "pre-establishment" means either nothing (because "before establishment" there is no FDI), or everything (because everything can be considered to happen before establishment).

approach in the case of GATS[103] and a "top-down" or "negative list" approach in the case of NAFTA and other US-led agreements. In our opinion there is no clear underlying logic for this.[104]

Concerning access or first establishment, development, social, or security national policies may provide national governments with legitimate grounds to restrict foreign ownership or participation in enterprises in certain economic sectors. Such an approach would greatly benefit of the existence of the institutional arrangements that we propose, which allow for a very flexible mechanism of enlarging (and in some justified cases narrowing down) the list of sectors to which the liberalization provisions apply.

To the contrary, it is arguable that, for already-established firms[105], national firms under foreign membership should only very exceptionally be discriminated against. Therefore, for treatment post-establishment, a horizontal obligation of national treatment subject to a "negative list" of exceptions should be acceptable. If needed, the institutional arrangements we propose could also apply to the introduction of some justifiable transitory exceptions.

In our opinion, this diversified approach would provide an effective, transparent and "development-friendly" environment to foreign investment liberalization.

The fourth issue is that of disciplines on post-establishment regime that go further than the (comparative) standard of national treatment. Here, different aspects must be distinguished and discussed separately.

- The first is that of performance requirements and investment incentives. These two issues, because they are conceptually different and apply to different phases of the investment process, have up to now been regulated independently. In practice, however, these two issues come closely linked. Investment incentives seek to attract foreign investment into particular sectors of the national economy by lowering general obligations imposed to private firms enshrined in national and sub-national regulation. On the other hand, performance requirements impose additional obligations to foreign companies in order to foster national economic goals related, in particular, to balance of payments policy.[106] One could say that they are the two complementary "bargaining tools" of the two agents (foreign firm/national government) involved. Strict prohibitions of performance requirements, as adopted in a number of free trade agreements as well as in the WTO TRIMs agreement, with no mandatory disciplines on investment incentives, simply increase the latter's "race-to-the-bottom" effect, as they reduce governmental bargaining ability with foreign investors. On the other hand, a comprehensive approach embracing both questions would enhance the "development-friendly" aspect of the agreement.

[103] To be precise, it is important to remember that the GATS uses also the "negative list" approach once a sector has been introduced in the "positive list" of sectors for which liberalization commitments are undertaken. However, as the "negative list" only applies after the sector has been included in the positive list, and the positive list embraces at the same time commitments on market access and on national treatment post-establishment, we still can argue, for our needs, that the GATS approach is that of the "positive list".
[104] Sauvé and Pena (2004) also point this out.
[105] Either in the sectors "bound" in the positive lists of access liberalization or in any other sector in which the establishment of a foreign firm has taken place because of any "autonomous" measure or regulation ("autonomous" in the sense of "going further" than "bound commitments").
[106] This issue is most adequately discussed in Lavagna (1999).

Of course, any discussion on disciplines on these two interrelated aspects, given their political sensitivity and complexity, should be kept out of the major negotiation, and left to a more profound and detailed analysis by the joint councils. However, in this specific case, the mere introduction of a provision recalling the interdependence of the two aspects and assigning to the joint councils the task of dealing with them in the future would have an important signaling effect from the political point of view in spite of its initial legal emptiness.

- Some specific regulatory topics could be addressed in the body of the agreement, mainly those related to payments and transfer provisions. However, they could also be skipped because, very often, such provisions simply match obligations already assumed under the IMF agreement.
- Disciplines on expropriation have proven extremely dangerous in the context of bilateral/regional agreements. North-South agreements should therefore avoid introducing such disciplines or, learning from NAFTA's difficult experience with indirect expropriation provision, focus solely on direct expropriation.
- Finally, it would also help to define a "new model" the inclusion in the agreement of the topic of corporative conduct. It would be enough to leave it to further development by the joint council. This would create a "hook" able to link civil society to the operation of the agreement.

The fifth issue is that of dispute settlement: The general provisions of the agreement would apply and, of course, there would be no mention of a private investor/state mechanism.

In the overall context of global architecture, the new approach that we have outlined constitutes a true "*new model*" for all countries as it stands somewhat in the middle of the US-led agreements on one side and WTO and EC-led agreements on the other.

Other Regulatory Issues

Movement of workers cannot be excluded from bilateral agreements seeking to seriously enhance economic relations between North and South countries. Of course, the whole set of issues related to the international movements of persons cannot be tackled, but, at least, bilateral/regional should include obligations concerning the (national) treatment of legally employed foreign workers. Specific provision on residence permits for spouses and children could also be envisaged as well as on access for them to the local labour market. Provisions of this kind, already included in Europe Agreements have proved no risk to developed countries' employment market, at the time they have helped consolidating friendly economic relations with the Eastern partners.

In line with current trends in free trade agreements, rules on ***government procurement*** are to be included in the agreement; however, such disciplines should take into account the need of developing countries to encourage growing local industries in public tenders, by admitting a fixed rate of preference for local companies based on a negative list approach. The joint institution should have a regulatory role on this issue, and be able to modify thresholds of coverage of the standard national treatment obligation, and to reduce the preferential rate for local tenders when applicable. In all cases, however, general rules should apply to all levels of government, including sub-federal and local entities.

In the area of ***intellectual property*** regulation, the agreements are to confirm existent multilateral obligations undertaken by the parties with no major further developments. North-South agreements should, however, pay particular consideration to the needs of developing and least developed countries in their efforts to develop patent-free fundamental goods (mostly medicine) or to access key technology to support development policies.

The feature of provision on ***competition*** should focus on strengthening the developing countries' regulatory ability on the issue, leaving room for later common regulatory disciplines. At most, the agreements should feature some very basic common principles that could provide guidance to the joint councils when they develop further disciplines according to common needs.

Final remarks

This chapter has attempted to design a "new model" of North-South agreement, on the basis of the specific circumstances of the EU-Mercosur bi-regional relationship, but with a potential to present a general scheme able to apply in many scenarios of North-South agreements, and to come up with alternative solutions that might help to consolidate economic relationships between developed and developing countries, while fostering the strengthening of the multilateral system and the needed space for development policies.

Of course, it is always easier not to innovate and leave negotiations proceed in the usual "race to the bottom", leaving all leading role to defensive interests. The dangers of such an approach are soon understood: reaching an agreement with so little effective content would, leaving aside rhetorical speeches and collective pictures, do very little to deepen the North-South relationship while giving an additional blow to a multilateral system deserving more care than ever before.

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