DEFENDING DEVELOPMENT SOVEREIGNTY: THE CASE FOR INDUSTRIAL POLICY AND FINANCIAL REGULATION IN THE TRADING REGIME

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Abstract

As nation States and development experts contemplate renewing commitments for global development goals, it is imperative that countries have the national-level flexibility to meet those goals. It is equally imperative that emerging market and developing economies pursuing sustainable and inclusive growth are able to meet their global economic governance commitments. This chapter focuses on the expanding trade regime. While the benefits and economic rationale for gradual liberalization of trade in goods is well-founded, global barriers to goods trade are at an all-time low. Therefore, a new "trade" policy has evolved, seeking to liberalize all perceived impediments to global commerce – reaching into the realms of financial regulation, innovation policy and a range of domestic regulations that promote public welfare. This chapter argues that there is a fine line between what may be perceived as "protectionism" by actors seeking further market access and the legitimate deployment of domestic regulation for sustainable and inclusive growth on the part of emerging market and developing economies. Global and regional trade rulemaking will need to preserve nation States' ability to deploy country-specific policy for development.

I. Crisis-era protectionism and the expanding trade regime

Following the Great Depression and World War II, the global economic consensus reflected the need for countries to direct and stimulate their economies, while also drastically lowering traditional barriers to trade in goods. The Bretton Woods regime, referring to the triad of the International Monetary Fund (IMF), the World Bank and the General Agreement on Tariffs and Trade (GATT), aimed at globalizing trade while leaving "plenty of space for governments to respond to social and economic needs at home" (Rodrik, 2011: 69). Where the two aims – globalization and domestic policy needs – clashed, national interests dominated.

Out of the success of the Bretton Woods regime came an even greater push for global trade liberalization. Tariffs had been brought low and global trade flows had exploded. As a result, the gains from liberalizing trade in goods slowed down. Indeed, full global trade liberalization in goods is now estimated to yield a one-time increase in GDP of less than one per cent (Ackerman and Gallagher, 2008). Thus, market actors now seek increased market access in other areas – including services, investment and intellectual property – in an effort expand exports and market share. Combined with the desire for greater market access, a philosophical shift toward suspicion of government intervention in the market led to a set of beliefs now called the Washington Consensus. The creation of the World Trade Organization (WTO), with its increased market access commitments and more enforceable dispute settlement procedures, reflected and reinforced the prevailing view that

broader and deeper liberalization beyond tariffs and quotas in goods was the best way to promote growth worldwide.

Circumstances changed again in the wake of the Global Financial Crisis and the resulting Great Recession. The Washington Consensus view of the 1990s is becoming a minority view in many capitals across the world, as well as the halls of academia. The growth success stories of China and other East Asian nations on the one hand, and the fact that the global financial crisis was due to problems in the West on the other, have generated a widespread questioning of the Washington Consensus (Moreno-Brid, 2013).

In terms of financial stability, many countries across the world – regardless of their income level – have been re-regulating the financial sector in an attempt to prevent and mitigate the next financial crisis. In emerging market and developing economies (EMDE), there has been a renewed effort to regulate foreign financial flows that can be de-stabilizing for long-run development prospects. Moreover, to the surprise of many, the IMF has endorsed the use of such cross-border financial regulations in some circumstances (IMF, 2013). This thinking has also permeated the World Bank (Ju et al., 2011; Lin and Treichel, 2012).

Perhaps more stark than the IMF and World Bank endorsement of regulating the capital account is the embracing of industrial policy in the advanced countries. David Cameron, Prime Minister of the United Kingdom, urged the staff of the Foreign Office to "develop [their] global comparative advantage" and create a "modern industrial strategy".[1] In response to what was perceived as the "increasingly aggressive industrial policies of America, Britain, China and France",[2] Japan has promised similar policies to support domestic manufacturing (Moreno-Brid, 2013). Indeed, the majority of all such measures introduced in the past five years have come from already-industrialized countries and emerging economies in the Group of Twenty (G20) (Evenett, 2013a). Of course, EMDE have been pioneers of industrial policy over the past decade and many – such as those discussed below – are at the forefront in current times.[3]

Dani Rodrik posits a "political trilemma" in which nations are divided between pursuits of democracy, national self-determination and economic globalization. He argues that a nation "cannot simultaneously pursue" all three at once (Rodrik, 2011). In practice, one of the three gives way to the others. Furthermore, choosing which interests should prevail is not always a straightforward decision. Thus, despite a growing consensus in favour of domestic policy interests, some market actors have pushed against this, electing to favour economic globalization instead.

There is a growing concern, for example, that policies introduced at the onset of the Financial Crisis may have "morphed into another, potentially longer-lasting, form of discrimination against foreign commercial interests" (Evenett, 2013b: 148). Simon Evenett argues that despite the importance of prioritizing economic growth, employment and financial sector management, "the harm done by beggar-thy-neighbor policies should not be overlooked" (Evenett, 2013a: 1). Evenett and others are rightly concerned that a rise in protectionist policies like those during the Great Depression could slow a global economic recovery and at considerable cost (Kindleberger, 1986). Globally, governments have pledged not to repeat such mistakes in their public commitments at global bodies such as the G20. Nevertheless, there remains a concern that market distortions could act to cover up domestic competitive deficiencies rather than forcing governments and the markets to fix them (Evenett, 2013a).

Evenett argues that WTO disciplines have not done much to keep countries from resorting to protectionism; rather, it has only "altered the composition" of that protectionism (Evenett, 2013a: 7). Since the crisis, global growth has continued at a slow and uneven pace. If these unregulated measures are used as substitutions for – or disguised versions of – older forms of protectionism, Evenett and others argue that the global trade regime should at least have a method for phasing these policies out over time. Otherwise, the policies initially introduced for legitimate reasons may be used in the long term to "discriminate against foreign goods, companies, workers and investors" (Baldwin and Evenett, 2009: 4).

"Murky" or "soft" protectionism are the most commonly used terms for these technically legal measures that are not yet directly governed by the WTO or other trade rules. Attempts to measure this type of "protectionism" suggest that 60 per cent of the trade-distorting measures put in place since 2012 are non-traditional, i.e. not tariffs or trade defence mechanisms (Evenett, 2013c). Such measures have included health and safety regulations, stimulus packages that direct spending domestically, government

subsidies limited to local manufacturers, bank bailouts, industrial and innovation policies, as well as many other ways to boost the domestic market while not running afoul of the international trade laws.

There is an additional concern about investment-related protectionism that specifically targets policy related to foreign direct investment as well as cross-border financial regulations. In an article published shortly after the crisis, Claude Barfield made a plea that measures blocking foreign investment are just as significant as trade measures and called on United States of America President Barack Obama to lead an effort to prevent such protectionism (Barfield, 2009). Between 2009 and 2012, the Organisation for Economic Co-operation and Development (OECD) – long a supporter of the deregulation of investment markets – and the United Nations Conference on Trade and Development (UNCTAD) issued nine reports to the G20, calling for a restraint on investment-related measures restricting the flow of capital and companies across borders, and continue to do so (OECD, 2013a).

Some proponents of this view uphold the WTO as the best option for creating and enforcing global economic commitments to keep this kind of protectionism at bay (OECD, 2013a). Others argue that the WTO is not structured to place these kinds of restraints on member nations, but rather that the initiative to continue global commercial liberalization should come from the individual nations (Evenett, 2013b). Reflecting the latter argument to some degree, governments worldwide are pushing for additional market access commitments outside of the purview of the WTO. The Transatlantic Trade and Investment Partnership (TTIP) on one side and the Trans-Pacific Partnership (TPP) on the other are each attempting to secure commitments in services, investment, intellectual property and financial services worldwide. Plurilateral negotiations for the Trade in Services Agreement (TISA) have begun between governments in favour of further liberalization in services sectors. Therefore, the global trend in trade and investment agreements seems to reflect the concern over crisis-era protectionism, pushing for ever-broader and deeper economic globalization.

II. The soft foundations of soft protectionism

The emerging narrative around “soft” and “murky” protectionism rests on relatively weak foundations and thus it should be examined with scrutiny. The economic case for expanding the trade and investment regime to include measures that regulate for financial stability and industrial diversification is fairly limited. Economic theory surrounding the liberalization of investment flows is quite weak, likewise the empirical evidence. Those nations that liberalize the free flow of capital (both foreign direct investment (FDI) and financial flows) have not been correlated with strong growth and have been more susceptible to financial crises. Moreover, those nations that regulate foreign capital flows have done so in an effective manner. In addition, economic theory has long shown that EMDE should deploy certain regulations on trade to correct for market failures and generate long-run dynamic comparative advantages. The empirical evidence shows that those nations that steer trade in this manner have developed more than those that have not. Furthermore, almost all conventional models of trade liberalization have shown that the benefits of further liberalization are relatively small.

Jeanne et al. (2012) conduct a sweeping “meta-regression” of the entire literature, including 2,340 regression results, finding little correlation between capital account liberalization and economic growth. They conclude: “the international community should not seek to promote totally free trade in assets – even over the long run – because (as we show in this book) ***free capital mobility seems to have little benefit in terms of long run growth*** and because there is a good case to be made for prudential and non-distortive capital controls” (Jeanne et al., 2012: 5). There is also considerable work demonstrating that capital account liberalization is associated with a higher probability of financial crises. Reinhart and Rogoff (2010) show that, since 1800, capital mobility has been associated with banking crises. Indeed, the most recent research has shown that capital market liberalization is only associated with growth in nations that have reached a certain institutional threshold: a threshold that

most developing nations are yet to achieve (Kose et al., 2009; Jeanne et al., 2012). This is partly due to the fact that the need for external investment is not the binding constraint for some developing country growth trajectories, but rather the lack of investment demand. This constraint can be accentuated through foreign capital flows because such flows appreciate the real exchange rate, thus reducing the competitiveness of goods and reducing private sector willingness to invest (Rodrik and Subramanian, 2009).

There is an even older and deeper tradition in economics that industrial policy can also be optimal (see Wade, 1990; Amsden, 2001; Chang, 2002; Rodrik, 2007). For EMDE, what matters most in the longer run is not static comparative advantage at any one moment in time, but rather the ongoing pattern of dynamic comparative advantage: the ability to follow one success with another, to repeatedly build on one industry by launching another. Since the process of technology development is characterized by increasing returns, many models will have multiple equilibria. It is easy to specify a model in which the choice between multiple equilibria is not uniquely determined by history; rather, it becomes possible for public policy to determine which equilibrium will occur (Krugman, 1991). If the multiple equilibria in such a model include high-tech, high-growth paths as well as traditional, low-growth futures, then public policy may make all the difference in development. Four key market failures plague nations seeking to catch up to the developed world: coordination externalities, information externalities, dynamism and technological change and human capital formation. By definition, diversification can mean the creation of whole new industries in an economy and sometimes may require linking new industry to necessary intermediate goods markets, labour markets, roads and ports and final product markets (Rodrik, 2007).

Of course, many policies to provide public goods for the welfare of the public stand on the strongest economic grounds. Pigou (1920) long established that in cases where private and social costs diverge, taxes or subsidies that internalize externalities can lead to significant welfare gains. Regulations on food safety and security, environmental policy, alternative energy and beyond all fall into this category. Most economists prefer price-based interventions to correct for market failures such as taxes or subsidies. However, under conditions of significant uncertainty and high damage costs (such as in climate change and chemical substances with lethal impacts) at the tails of a distribution there is a stronger justification for outright bans and quantitative restrictions (Weitzman, 1974).

With the right accountability policy in place, it has been shown that those nations that have deployed capital account regulations and industrial policies have been among the best growth performers of the past centuries: Europe, the United States, Japan, the Republic of Korea, Taiwan Province of China and, more recently, China. Moreover, it has been shown that trade liberalization is not correlated with economic growth in ex-post econometric analyses (Rodrik, 2007). Even in the theoretically-driven computable general equilibrium models, a high estimate for full global trade liberalization would give a one-time boost in global output of 0.27 per cent (Ackerman and Gallagher, 2008).

Juxtaposed with the relatively minor benefits of the further liberalization of trade and investment, the costs of further deregulating the global economy in the name of "murky protectionism" are significant. Moreover, while many countries pay lip service to the expanding and deepening trade regime, their domestic policy tells a different story. Opponents of "murky protectionism" are gathering extensive data on policies employed all over the world that place restraints on trade. While many of the measures that are seen as impediments to trade have some justification, a number of measures that are well justified and key to an effective development strategy have been targeted as soft or murky protectionism. As table 1 demonstrates, many of the measures targeted aim at financial stability, industrial development and public welfare. Some involve domestic regulations, like United States of America and European Union environmental regimes, some involve direct government subsidies to support certain industries, while others use government procurement policy for the same purpose.

Nations must have the policy space to put measures such as these in place under the right conditions. Table 1 lays out important policies for financial stability, industrial development and public welfare that have been singled out as protectionist. The justification for such policies is much stronger than the justification to de-regulate for private gain. However, new proposals at the WTO as well as under regional and bilateral arrangements from industrialized countries are increasingly critical of such measures in the name of soft protectionism. This is very concerning

Table 1

THE NEW PROTECTIONISM? COUNTRY EXAMPLES

Purpose of measure	*Country examples*
Financial stability	***India:*** Reserve Bank of India prohibits Indian banks from engaging in proprietary trading in currency futures
	Australia: 2013–2014 budget specifies new "thin-capitalization" ratios for non-resident multinational corporations
	Brazil: Extends programme for sustaining investment to capital goods in 2014, including local content requirements for subsidized credits from the Brazilian Development Bank (BNDES)
	Brazil: Tax on financial operations (IOF tax) – allowing the Government to raise and lower taxes on capital flows to stabilise the economy
	Republic of Korea: Lowered the ratio of banks foreign exchange derivatives to equity
Industrial development	***Canada:*** Government subsidies for R&D provided through a new technology demonstration programme
	Viet Nam: Restricted bidding by foreign firms on public procurement tenders except where domestic bidders cannot provide the necessary services
	Brazil: Preferential treatment of local construction products in public procurement process
	Viet Nam: Increased import duties for certain mineral resources (from 30 to 40 per cent)
	Russian Federation: State guarantees export sales for companies with 30 per cent local sourcing/content
	Indonesia: Franchise law requiring 80 per cent of inputs to be sourced locally
	India: Local content requirements extended to private telecommunications firms
	Ghana: Local content requirements in the petrol industry
Public health and welfare	***European Union:*** Fuel quality directive; maximum residue levels of pesticides
	United States: Denial of entry to goods not complying with energy conservation and labeling standards
	China and Japan: import restrictions on beef due to bovine spongiform encephalopathy (BSE)
	China: Financial aid provided for purchasing new energy vehicles (including electric and hybrid vehicles)

Source: Global Trade Alert (2014) and OECD (2013a).

for those EMDE working to "catch up" and stimulate sustainable and inclusive growth in their economies. In the following section, we compare bilateral and regional trade agreements with disciplines under the WTO to determine the extent to which the various regimes constrain policy space for member nations, as well as what this means for countries negotiating new agreements.

III. The threat to financial stability and industrial development policies

As we have discussed above, developing and developed countries alike have historically had a wide range of policy tools available to respond to market failures and direct their economies. Today, the variety and number of those tools are shrinking. This section focuses on specific policy tools that remain in use under the current global trade regime.

We find that while the WTO permits a fair amount of flexibility outside of traditional trade policy, other agreements making up the global trade regime are not so open to government "creativity" in guiding trade and investment for development. Bilateral and regional agreements widely vary in the policy space that they permit, depending on which countries are involved, their geographic proximity and whether there is a large development gap between them, among other factors. Bilateral agreements between developing nations (South-South agreements) tend to provide ample space to all parties to promote development and rarely delve deep enough to bind a country's "behind the border" activities (regulation, taxation, environmental measures).

By contrast, bilateral agreements between the European Union or the United States of America and a developing country tend to restrict policy space both more broadly and deeply. As we discuss in more detail below, trade and investment agreements in which the United States of America is a partner attempt to keep countries from imposing *any* new restriction that could interfere with trade or investment flows. United States of America agreements prohibit export incentives, forbid local labour, technology transfer and research and development requirements for foreign investors and have mechanisms in which foreign companies (private sector) can sue the host country if regulations interfere with their investment. The United States of America model reflects the current global trend to broaden and deepen global commerce commitments through bilateral and regional agreements.

Table 2 provides an illustrative list of policy tools that countries have employed (and still do!) in an effort to promote financial stability, industrial development and public welfare. The table indicates whether these measures are prohibited under the indicated trade regimes. In the next pages, we explore how differences in agreement breadth and depth affect the policy flexibility that countries enjoy within the global trading system.

There are a few things to note about the chart above. First, where provisions are prohibited under both the WTO and bilateral regimes, differences in enforcement and exceptions leave room under the former that is not there under the latter. Second, South-South agreements are far from uniform with respect to these measures. Furthermore, the arrangements may act as special protection from developed world competition by keeping tariffs among members low while keeping external tariffs high. Likewise, even North-South agreements are not all the same (despite being considerably more uniform). For example, European Union agreements tend to vary based upon the treaty partner, leaving more policy space available to lesser developed countries.

Table 2

ILLUSTRATIVE TOOL BOX: PROHIBITED MEASURES

Measure Types	*WTO*	*North-South trade agreements*	*South-South trade agreements*
Tariff rate flexibility		●	●
Import bans, licensing	●	●	
Tax-based export incentives		●	
Performance requirements	●	●	
Capital controls		●	
Domestic environmental/ health regulations			
Public procurement preferences		●	

Source: Thrasher and Gallagher (2010).

A. Tariffs

Tariffs have long been the preferred trade barriers under the global trade regime because they are easy to measure, transparent to apply and straightforward to liberalize progressively over time. Employed carefully, countries can raise and lower tariffs to protect nascent industries until they are ready to face global competition. Under the WTO, countries

Table 3

ILLUSTRATIVE TARIFF COMPARISON: IRON AND NON-ALLOY STEEL BARS AND RODS (2012 HS06 721310)

(Per cent))

Country/agreement	*WTO binding*	*Regional/bilateral applied tariff*	*MFN applied rate (avg) (2012)*
Brazil (MERCOSUR)	35.0	0.0	12.0
Chile (European Union-Chile)	25.0	0.0	6.0 (2011)
Mexico (NAFTA)	35.0	0.0	11.5
Guatemala (DR-CAFTA)	20.0	4.5[a]	15.0
Malaysia (ATIGA)	Unbound	0.0	5.0
South Africa (European Union-South Africa)	15.0	0.0	5.0 (2013)
Viet Nam (ATIGA)	21.7	5.0	15.0

Source: WTO Current Schedules.
a Guatemalan tariffs were scheduled to be eliminated as of 1 January 2014. Since the latest data available was from 2012, it is possible that the 4.5 per cent duty has now been eliminated.

often bind their tariff rates far above their applied rates, leaving room for such measures. By contrast, bilateral and regional agreements have tended to demand lower tariff bindings.

Many countries have taken advantage of the WTO flexibilities and with some success. In Viet Nam, this method has been used to great effect to stabilize energy prices and protect various key industries, even as a member of the ASEAN trade in goods agreement (ATIGA). The chart below indicates that Malaysia has reserved an entire classification of goods from WTO binding, presumably as a way of protecting the automotive industry. Likewise, Brazil has leaned on tariff rate flexibilities to protect industries facing impossible competition from Asia. Table 3 provides an example of one particular line of goods, comparing bound and applied rates for iron and non-alloy steel bars and rods (WTO Current Schedules).

This chart highlights some interesting trends. First, in every instance, whether North-South or South-South, the regional or bilateral tariffs are much lower than the bound tariff levels at the WTO. Also in every instance, the countries in question have average rates above their bilateral bindings, indicating that they take advantage of tariff rate flexibilities with respect to trade partners outside of their bilateral arrangements. Second, as mentioned above, low or non-existent tariffs in the South-South arrangements may actually protect industries from competition rather than exposing them. This is the case in both MERCOSUR[4] (with a common external tariff) and ATIGA (without one). They allow developing nations to work together to build up nascent industries within the region without competition from the developed world. Finally, it is important to note that the 0.0 per cent applied tariffs represent all kinds of different arrangements. Where the European Union and United States of America might provide 12–14 years for the elimination of some tariffs, other product duties were eliminated immediately (compare European Union-South Africa[5] and NAFTA[6] with European Union-Chile[7]).

B. Import licensing and bans

Despite being disfavoured except under dire circumstances, import licensing and bans have been historically used to protect domestic industry and stabilize economies. Actual quantitative restrictions (quotas) and import bans are generally prohibited under the WTO, except to address food shortages and balance of payments difficulties or enforce certain local standards and regulations (GATT Arts. XI, XII). Import licensing programmes are more widely used, although they are heavily regulated in the WTO Import Licensing Agreement to promote transparency.

Outside of the WTO, the availability of these measures widely varies. Treaties with the European Union generally mimic WTO exceptions but can vary

with the treaty partner; for instance, European Union-Chile prohibits both quotas and import licensing, while European Union-South Africa only mentions quotas (European Union-Chile Art. 76, European Union-South Africa Art. 19). Both agreements leave some space for exceptional circumstances (European Union-Chile Art. 93 (shortages), European Union-South Africa Art. 24 (safeguards)). Treaties where the United States of America is a partner increasingly shrink the same kind of room for exceptional circumstances. Only one of six treaty partners under the Dominican Republic-Central American Free Trade Agreement[8] (DR-CAFTA) retained a shortages exception, while most recent agreements have eliminated the exception for balance of payments (see United States of America agreements with Colombia,[9] Peru[10] and Singapore;[11] DR-CAFTA Annex 3.2(F)). If the United States of America model carries the day in the current TPP negotiations, it could have very real consequences for the developing countries involved. For example, both Viet Nam and Malaysia have ongoing programmes of import licensing to control imports in certain sectors. Viet Nam's automatic licensing programme is limited to steel products as of 2012 (WTO, 2013). Malaysia, on the other hand, maintains an extensive set of border measures including import permitting and quotas to protect its highly prized auto industry (United States Trade Representative, 2013).

C. *Tax-based export incentives*

Tax-based export incentives have also played a key role in making global trade work for development. In fact, this may be an area where there remains the most flexibility in promoting development locally. Taking the form of duty drawbacks, tax deferrals, exemptions and deductions, these measures can promote a healthy trade balance and enable local industry to compete globally (Mai, 2004). Under the WTO's Agreement on Trade-Related Investment Measures (TRIMs), tax-based advantages limiting import purchases to a value related to exports of local products would violate the general pillar of national treatment under the WTO. However, as exports have long been considered a key vehicle for economic growth, broad-based tax incentives that encourage exports are generally accepted. This sharply contrasts more direct subsidy programmes prohibited by the Subsidies and Countervailing Measures (SCM) Agreement.

While most bilateral regimes follow the example of the WTO in this respect, certain United States of America agreements almost universally prohibit such incentives. Under NAFTA and United States-Chile,[12] for example, member States may not provide drawbacks or tax deferrals on condition that goods are exported or used as material for another exported good (Art. 303; Art. 3.8). Once again, if the TPP reflects this approach, it could directly affect developing country members.

Viet Nam has moved away from explicit export performance-based tax incentives since entering the WTO. However, it continues to indirectly support domestic industry through tax incentives for corporate or land use taxes (WTO, 2013). Malaysia relies on a complex tariff, tax, quota and credit system to support its national car companies. The National Automotive Policy gives tax exemptions to exporters based upon a percentage of domestic value-added. Concurrently, taxes on primary goods export have increased linkages within the auto industry and the economy more generally (United States Trade Representative, 2013). Following a United States of America model, these countries will face far more restrictions on their domestic tax laws.

D. *Performance requirements*

Performance requirements are highly scrutinized under the global trade regime. The TRIMs of the WTO prohibits any measures that violate national treatment (Article III) or the general obligation to eliminate quantitative restrictions (Article XI). It subsequently lays out an illustrative list of prohibited measures in its annex. Under TRIMs, countries may not require that foreign investors achieve a certain level of domestic content in their goods or prefer domestic producers or products in their production process. They may not limit foreign investors' imports in relation to their local production or export levels. Moreover, they may not require investors to acquire foreign exchange only through export and they may not demand that investors sell a certain amount of their product within the domestic market. Furthermore, WTO members may not create incentives by requiring any of the above as a condition for receiving economic advantages.

Once again, United States of America agreements tack on several "plus" provisions that place

additional limits on government policymakers. In addition to WTO disciplines, United States of America agreements forbid technology and knowledge transfer requirements and management nationality pre-requisites (NAFTA Art. 1106, DR-CAFTA 10.9). Nonetheless, even members of United States of America agreements may continue to provide advantages to companies that "locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory" (NAFTA Art. 1106, DR-CAFTA 10.9). Certain other measures such as local infrastructure investment, directed credit and administrative guidance for multinational corporations lay beyond the scope of these investment provisions, making them available to all countries that have the capacity to impose and enforce them.

Despite their high level of scrutiny today, performance requirements have commonly been used with tax incentives to funnel FDI into favoured or essential industries for economic development. Both Malaysia and Viet Nam openly used local content, labour and capital, as well and domestic location and export performance requirements to promote industrial development (WTO, 2013, Fuangkajonsak, 2006). Malaysia has had to eliminate explicit performance requirements since joining the WTO, although it retains some more subtle measures connecting financial benefits to local value-added and local content (United States Trade Representative, 2013).

A key difference between the multilateral trade and investment regime and the United States of America model of investment provisions appears in the dispute resolution process. Unlike the WTO State-to-State dispute settlement (or other State-to-State arbitration processes in most trade agreements, both North and South), *investment* disputes under the United States of America model allow private investors to sue States in a private arbitration forum. Although the TPP has yet to agree on a full draft of the proposed agreement, leaked drafts of the investment chapter indicate that investor-State dispute resolution may be included (Citizens Trade Campaign, 2012). NAFTA is the only agreement in force long enough to have a history of investor-State disputes and since then a few agreements have attempted to clarify certain treaty standards (Van Harten, 2009). Nonetheless, countries like Malaysia and Viet Nam could likely experience regulatory chill due to NAFTA's arbitration history and the threat of expensive lawsuits.

E. Financial regulation

Financial regulation is another tool that countries have used to promote development and stabilize their financial environment. Brazil's Tax on Financial Operations (IOF tax) introduced at the outset of the 2008 financial crisis provides one example, as does tax of the Republic of Korea on foreign exchange derivatives. Indeed, similar regulations have been put in place by India, Indonesia, Taiwan Province of China, Uruguay and numerous other nations in the wake of the crisis (Global Trade Alert, 2014; OECD, 2013a).

However, restrictions on foreign capital flows are generally disfavoured within modern trade agreement models. The WTO as well as all North-South trade agreements prohibit international transfer and payment restrictions presumptively. Nonetheless, under the WTO, capital flows are treated under the General Agreement on Trade in Services, which employs a positive-list approach to binding measures, whereby countries select which sectors and industries they want to bind under the agreement. By contrast, United States of America trade agreements – as well as more recent European Union agreements (European Union-CARIFORUM)[13] – apply a negative list approach to investment protection, where liberalization is the rule rather than the exception.

The WTO rules provide an exception in the case of "serious balance of payments and external financial difficulties" (General Agreement on Trade in Services Art. XII). This exception is mirrored in most – if not all – bilateral and regional agreements. While this protects in emergency situations, it would be better if countries could employ capital controls preemptively to avoid financial instability and crisis.

F. Public welfare and "green" measures

Public welfare and "green" measures may be directed at the quality of certain products or the effects of their production. While these measures have been used less frequently in the developing world, with increasing awareness of the cross-border effects of health and environmental problems, they are becoming more prevalent. The European Union restricts the pesticide residue level on imported agriculture, based upon a concern that such pesticides will cause harmful health effects. Both China and Japan placed restrictions on imported beef due to fear of

the bovine spongiform encephalopathy, which can be fatal to humans. As carbon-based energy sources start to dwindle, many countries are realizing the importance of developing national green energy projects. Thus, environmental measures are used to protect the environment as well as domestic industry. Feed-in tariffs in Europe and targeted subsidies in China have helped countries like Germany, Spain and China itself to gain global comparative advantages in low carbon-renewable energy while increasing up the value chain.

The somewhat conflicting relationship between trade and the environment is far from new, whereby all modern global, regional and bilateral agreements make some mention of promoting sustainable resource development and environmental protection. NAFTA was the first trade agreement to include environmental provisions as a part of the agreement, and the trend continues to date (Gallagher, 2009). At the WTO, the Commission on Trade and the Environment has the ongoing concern of considering questions of environmental protection in global trade. Nonetheless, those concerned with "murky" protectionism identify environmental measures as suspect alongside policies protecting domestic industries and firms (Global Trade Alert, 2014). Under NAFTA investor-State disputes, all three countries' foreign firms have challenged environmental laws in their host States as measures "tantamount to expropriation" (Gallagher, 2009). Environmental protection is quickly becoming a widely accepted global norm that may eclipse the concern for fully free trade. However, it seems important to recognize the tension between trade and environmental interests, as the expanded trade regime blurs the lines between domestic and global regulation.

G. *Public procurement*

Public procurement remains an area in which most countries retain plenty of flexibility to promote their domestic policy goals. Procurement measures have been used historically – as well as recently – to protect vulnerable people groups, favour domestic industries and show support for environmental and social concerns. In much of Europe, public procurement is an accepted tool for reaching public welfare and environmental goals. Through procurement policies, Viet Nam actively prefers local suppliers and discourages imports where domestic inputs can be produced (WTO, 2013). Malaysia public procurement in favour of its indigenous people group continues to respond to the historical race tensions that exist in the country (United States Trade Representative, 2013). Brazil, alongside its MERCOSUR partners, stands out as having initiated a pilot programme of sustainable public procurement, promoting environmental sustainability through their tender policies (Instituto Argentino de Desarrollo Sostenible, 2008).

Such measures currently remain beyond the scope of the global trade rules, at least as they apply to all members. The Government Procurement Agreement (GPA) in the WTO only has 15 members, whereas most countries are reluctant to subject their government spending to global scrutiny. As with many types of measures, European Union treatment of public procurement depends on the treaty partner. European Union-South Africa simply mentions liberalization as a future goal and European Union-Chile contains a comprehensive chapter governing procurement within the parties. United States of America agreements are more uniform, as with many other areas, containing chapters that put in place rules for the valuation and awarding of government contracts (NAFTA Ch. 10, DR-CAFTA Ch. 9). Interestingly, even some South-South agreements have begun to incorporate public procurement provisions.

MERCOSUR countries signed the Protocol of Mercosur Public Bids for Tender in 2006, under which countries commit to non-discrimination on a sector-by-sector basis in goods, services and public works. As noted above, each of our case studies has extensively relied on public procurement for national development aims. Within the newest negotiations, it is unclear whether the United States of America and the European Union will push for greater market access in government procurement. Both are signatories to the GPA of the WTO, although its membership remains limited. However, it is clear that broader and deeper trade rules in this area could bind government hands more tightly than most of the world would like.

IV. Alternatives for emerging market and developing countries

The terms "soft", "murky" and "investment protectionism" emerge from the view that trade liberalization should extend beyond trade in goods into areas traditionally not seen as part of trade policy. The intellectual foundations of these concepts, as well as the empirical record of what happens when regulations in these areas are stripped, are weak. Targeted government regulation has been part and parcel of growth and inclusive development for over a century. Nevertheless, powerful interests in the West have been expanding the mandates of trade and investment treaties to include measures on financial stability and industrial policy in particular.

By examining some key policies employed by developing and developed countries alike, we show that the United States of America model of trade agreements (and to some degree also European Union agreements) more severely constrain nations from deploying adequate industrial strategies. Drawing on this analysis, it appears that North-South free trade agreements should be considered with great caution for nations looking to expand or devise industrial development strategies. EMDE are also urged to develop new model treaties (as Brazil and South Africa are) that steer closer to the South-South model prioritizing development-oriented trade and investment.

Many countries are already working to this end, albeit in different ways. At the WTO, a coalition of EMDE has been successful in resisting industrialized country proposals to expand the mandate of the WTO. During the early days of the Doha Round, there was a push by the advanced countries to include (further) investment measures, government procurement, competition policies and other measures now repackaged as "protectionist", although these coalitions were able to hold the debate to look at distortions in agricultural and manufacturing markets. On a more proactive level, EMDE have proposed a "product basket approach" to manufacturing tariff reductions, although movement on such proposals has stalled as the Doha Round is at a near standstill. Somewhat analogous to the "box" approach in the WTO Agreement on Agriculture, nations could put certain sectors in a "basket" that could have higher tariffs as long as they are balanced by further reductions in other baskets of countries.

Some countries have simply avoided new treaties that may further restrict their existing policies, with Brazil being one example here. The country underwent a major inter-governmental assessment and concluded that the most beneficial approach would be to focus on multilateral trade negotiations at the WTO. It has not ratified bilateral investment treaties or trade agreements beyond the MERCOSUR agreement. Other countries are working on South-South trade or investment agreements that have a starkly different model. For instance, the ASEAN +6 treaty only deals with goods trade and some services; itincludes FDI but not other financial flows, has special and differentiated treatment for poorer nations and does not feature investor-State dispute resolution. A group of countries is trying to come up with new language and rules for North-South treaties. Chile and other nations are proposing safeguards for financial stability in the TPP Agreement. Other countries, such as South Africa, are carefully withdrawing from their bilateral investment treaties and offering to re-negotiate them to balance them with national development priorities (Haftel and Thompson, 2014). Finally, other countries are simply walking away from their existing commitments, such as Argentina, the Bolivarian Republic of Venezuela and the Plurinational State of Bolivia (Gaillard, 2008; Lavopa et al., 2013).

The path taken will need to cater to each country's specific circumstances. Given that we live in one of the most open periods in global economic history, rather than searching for new barriers to deregulate, nations need to work to design the appropriate national policies to thrive in a globalizing world.

Notes

1 *The Telegraph,* Speech by David Cameron at Lord Mayor's Banquet. 12 November 2012.

2 *The Economist*, The global revival of industrial policy: picking winners, saving losers. 5 August 2010.

3 For more on the role of industrial policies for development, see the contribution of Robert Wade to this volume.

4 Available at: http://www.sice.oas.org/trade/mrcsr/mrcsrtoc.asp.

5 Available at: http://eur-lex.europa.eu/resource.html?uri=cellar:df28bbd2-29f1-4cea-86ab-81d81c47903b.0004.02/DOC_3&format=PDF.

6 Available at: https://www.nafta-sec-alena.org/Home/Legal-Texts/North-American-Free-Trade-Agreement.

7 Available at: http://trade.ec.europa.eu/doclib/docs/2004/november/tradoc_111620.pdf.

8 Available at: https://ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text.

9 Available at: https://ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text.

10 Available at: https://ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text.

11 Available at: https://ustr.gov/trade-agreements/free-trade-agreements/singapore-fta/final-text.

12 Available at: https://ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text.

13 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:289:0003:1955:EN:PDF.

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