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# Reassessing North-South Relations: An Examination of North-South Preferential Trade Agreements for Developing and Emerging Economies

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## **Abstract**

The rapid proliferation of North-South preferential trade agreements (PTAs) during the last quarter century has had broad implications for developing and emerging economies. As a result of North-South power asymmetries and the aggressive trade policy that has been characterized as ‘competitive liberalization,’ it has been argued that these agreements have produced asymmetric results in favor of Northern countries.

This thesis advances a novel approach in the assessment of North-South preferential trade relations that goes beyond the simplistic interpretation of North-South trade politics as a phenomenon largely dominated by North-South power asymmetries. By acknowledging that not all North-South PTAs have the same characteristics, this thesis divides North-South PTAs into two sequential categories: first-order, *i.e.*, Southern countries’ first North-South PTAs and second-order, *i.e.*, Southern countries’ subsequent North-South PTAs.

The thesis argues that, while first-order North-South PTA negotiations can produce asymmetric outcomes in favor of Northern countries because they have the ability to exert discriminative pressure on Southern countries, second-order North-South PTA negotiations follow a different logic. Having secured preferential access to Northern markets through first-order PTAs, Southern countries become immune to competitive pressures and can themselves exert discriminative pressure on Northern countries during second-order negotiations.

The thesis examines the North-South PTA negotiations of Mexico, Chile, Korea, Colombia, and Peru, five countries of the Global South that have been especially active in North-South preferential trade. Based on the author’s personal interviews with EU and US trade officials and primary and secondary sources, this thesis conducts process tracing to account for the process of the five Southern countries’ first-order and second-order North-South PTA negotiations and reveal the impact of first-order North-South PTAs on the bargaining powers of Southern countries in second-order negotiations and hence the outcomes of second-order agreements. The thesis concludes that, albeit to varying extents, first-order agreements improve the bargaining powers of Southern countries in second-order North-South trade negotiations.

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## List of Abbreviations

AIDS	Acquired Immunodeficiency Syndrome
ARV	Antiretroviral Drug
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
CAFTA	Central America Free Trade Agreement
CAFTA-DR	Dominican Republic-Central America Free Trade Agreement
CFE	Comisión Federal de Electricidad
CIPR	Commission on Intellectual Property Rights
CODELCO	Corporación Nacional del Cobre de Chile
CRS	Congressional Research Service
DSU	Dispute Settlement Understanding
EC	European Community
ECLAC	Economic Commission for Latin America and the Caribbean
EU	European Union
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GI	Geographical Indicator
GNP	Gross National Product
GPA	Agreement on Government Procurement
GSP	Generalized System of Preferences
HIV	Human Immunodeficiency Virus
ICSID	International Centre for Settlement of Investment Disputes
IMF	International Monetary Fund
IP	Intellectual Property
IPRs	Intellectual Property Rights
JETRO	Japanese External Trade Organization
MAFF	Japanese Ministry of Agriculture, Forestry and Fishery
METI	Japanese Ministry of Economy, Trade and Industry
MFN	Most-Favored Nation
MITI	Ministry of International Trade and Industry
MOFA	Ministry of Foreign Affairs of Japan
MSF	Médecins Sans Frontières
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
PEMEX	Petróleos Mexicanos
PhRMA	Pharmaceutical Research and Manufacturers Association
PTA	Preferential Trade Agreement

RIETI	Research Institute of Economy, Trade and Industry
RQ	Research Question
SDR	Special Drawing Rights
TPA	Trade Promotion Authority
TPP	Trans-Pacific Partnership
TRIMS	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UK	United Kingdom
UNCITRAL	United Nations Commission on International Trade Law
US	United States
USA	United States of America
USD	United States Dollar
USDA	United States Department of Agriculture
USITC	United States International Trade Commission
USTR	United States Trade Representative
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

## 1. Introduction

This thesis will contribute to the debate of what are the policy preferences of Northern and Southern countries in North-South trade relations and how these preferences are advanced or constrained during North-South preferential trade negotiations. The thesis draws on the argument that, given North-South power asymmetries, North-South trade relations have increasingly been influenced by a North-South power play that has brought about global, regional, and bilateral trade rules that favor the preferences of Northern countries. This thesis contributed to the debate of who gets what share of the increased pie as a result of North-South preferential trade liberalization by advancing a novel framework, whereby it is acknowledged that Southern countries' first and subsequent North-South preferential trade negotiations share different characteristics that can have serious implications for the outcomes of these negotiations. The sequencing of North-South PTAs will provide additional insights on the bargaining power of the parties and provide a more accurate interpretation of North-South trade relations.

The liberalization and institutionalization of international trade in the post-World War II era, which started with the creation of the General Agreement on Tariffs and Trade (GATT) in 1947, have rendered significant results in terms of the reduction of tariffs and non-tariff barriers to trade, as well as the establishment of a credible dispute settlement body. After the creation of the World Trade Organization (WTO) in 1995, however, progress in multilateral trade negotiations has been limited. The Doha Development Round, which started in 2001, has brought multilateral trade negotiations to a standstill.<sup>1</sup> The North-South divide in the Doha Round over issues related

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<sup>1</sup> To be sure, at the Ninth Ministerial Conference, held in Bali, Indonesia, in December 2013, ministers adopted the 'Bali Package' on trade facilitation, which, although an important step in the otherwise stagnant multilateral negotiations, is a rather small achievement (Koopmann and Witting, 2014; Petersmann, 2014). Meanwhile, the

to agricultural and non-agricultural market access, investment measures, trade in services, and intellectual property rights (IPRs) still persists, which makes a possible final deal under the Doha Round less likely in the near future (Wade, 2004; Rodrik, 2008b; Hufbauer *et al*, 2010; Bagwell and Staiger, 2011; IMF, 2011; Schwab, 2011; Hufbauer and Schott, 2012; Koopmann and Witting, 2014; Petersmann, 2014; Decreux and Fontagné, 2015).

With the WTO in its current form still ‘ill-suited’ to address recent developments in international trade, these developments have been increasingly covered by a variety of preferential trade agreements (PTAs) between different WTO member-countries (Koopmann and Witting, 2014; Petersmann, 2014). It is not only the quantity of such agreements that has soared during the last quarter century that matters, however, but also the terms and scope of PTAs that have changed to encompass the constantly evolving trends in the world economy (Chauffour and Maur, 2011; Hoekman, 2011; WTO, 2011). Given the sharp decline of the average most-favored nation (MFN) tariff<sup>2</sup>—the non-discriminative rate of tariffs, which, if offered to one member, should be made available to the other members of the WTO—eschewing high MFN tariffs has become a less important objective for the signatories to PTAs.

As distinct from the ‘old regionalism’ of the 1960s, which was characterized by South-South linkages aimed at providing higher scales for industries in developing countries’ quest for industrialization (Bhagwati, 1968; 1993; Balassa, 2012), the ‘new regionalism’ of the 1990s includes new features, such as North-South linkages, deeper pre-agreement reforms, and deeper and beyond-the-border integration (Ethier, 1998; 2001; Estevadeordal *et al*, 2000). The nature of regionalism has evolved even further from that of the 1990s. In the words of one prominent

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prospects of its ratification have become gloomy after India withdrew its support, worried that the deal might impede with its food security programs (Economist, 2014b).

<sup>2</sup> The average applied tariff was as low as 4 per cent in 2009, down from the recent peak of over 9 per cent in 1994 and close to 40 per cent when GATT was established in 1947 (Heydon and Woolcock, 2009; WTO, 2011).

voice in the debate, today's regionalism is different from its predecessors, for the current bargain is 'foreign factories for domestic reforms' rather than one over preferential tariffs (Baldwin, 2011:28).

As a result of the recent proliferation, the number of PTAs increased four-fold during the 1990s and 2000s, reaching around 300 in 2010 (WTO, 2011). As of December 2015, the count of PTAs in force was put by the WTO at more than 400,<sup>3</sup> which constitutes more than a five-fold increase during the last quarter century. Volume-wise, intra-PTA trade comprised over 50 per cent of world merchandise exports in 2008 (including trade in the EU), up from 28 per cent in 1990 (WTO, 2011). Although the number of PTAs between developing countries has risen sharply, North-South PTAs—*i.e.*, between developing and developed countries<sup>4</sup>—have attracted extensive political and academic scrutiny due to the power asymmetry between the parties and developmental implications they entail.

There has been a mixture of factors behind the rapid proliferation of PTAs during the last quarter century. The economic rationale behind PTAs largely rests upon trade creation<sup>5</sup> and welfare maximization. Trade theory has identified the optimal levels of external tariffs and other factors, such as the distance between, as well as the size and relative factor endowments of PTA partners, which affect welfare gains and make preferential trade economically viable. The ideal type of PTAs, which is seen to increase the members' welfare and not erode the welfare of non-participants, is both desirable and potentially possible. The ideal outcome does, however, depend

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<sup>3</sup> WTO: [https://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](https://www.wto.org/english/tratop_e/region_e/region_e.htm) (accessed 3 December 2015).

<sup>4</sup> For the purposes of this thesis, the US, EU, and Japan are defined as developed economies.

<sup>5</sup> Trade creation implies the exploitation of economic efficiencies within a free-trade area and creation of more trade via tariff elimination between the members. Trade diversion, on the other hand, implies a shift from a more efficient producer outside of the free-trade area towards less efficient producers in the free-trade area, which is made possible by high external tariffs and tariff-free trade within the free-trade area.

upon governments' optimal policies, which are often hard to achieve politically (Kemp and Wan, 1976; Krugman, 1991a; Baier and Bergstrand, 2004).

Despite falling short of (consistently) providing trade creating and welfare maximizing outcomes, PTAs have proliferated during the last quarter century. In fact, it has been argued that the political viability of PTAs can be strengthened if the agreements are trade diverting, *i.e.*, contrary to the economic rationale, for the narrow interests of the industries gaining from a PTA will prevail over those who become worse off (Grossman and Helpman, 1995; Krishna, 1998; Manger, 2009). This happens because industries gaining from trade liberalization are politically more organized and can lobby for agreements, while the costs of the agreements are dispersed among taxpayers that have little incentive to mobilize for negligible gains. 'To the extent that industry interests are better represented in the political process than are taxpayer's interests, trade diversion will enhance political viability while contributing to an inefficient allocation of resources in the two partner countries' (Grossman and Helpman, 1995:680). Likewise, 'preferential arrangements that divert trade away from the rest of the world are more likely to be supported politically' (Krishna, 1998:244). In relation to North-South PTAs, in order to ensure the political feasibility of the agreements within developed countries, North-South PTAs *should* discriminate against third—usually developed—countries (Manger, 2009). 'Trade blocs have economic effects,' argues a World Bank (2000:123) report, 'but that is not why they are established.'

Thus, the inherent discriminative nature of PTAs appears to be the most plausible explanation for the proliferation of PTAs during the last quarter century. Because PTAs are inherently discriminative, they put pressure on countries that see their welfare diminished as a result of the trade-diverting effects of PTAs. As a result, countries are compelled to sign counter-agreements

to level the playing field with their competitors and counter the trade-diverting effects of PTAs. For obvious reasons, Baldwin (1993; 1995) termed this phenomenon a ‘domino effect.’ Moreover, with the recent wave of regionalism, PTAs have brought about an increase in trade and investment flows between members (Berger *et al*, 2013; Dür *et al*, 2014; Bütte and Milner, 2014; Egger and Nigai, 2015). This has invigorated the discrimination towards non-participants even further that have sought counter-agreements to redress the negative consequences of third-party PTAs (Baccini and Dür, 2012; Baldwin and Jaimovich, 2012).

Against the backdrop of the discrimination-induced proliferation of PTAs, North-South relations have been presented as a phenomenon largely explained by North-South power asymmetries. Southern countries’ increasing interest in reciprocal trade relations with the North, beginning from the 1990s, emerged partially because of changes in multilateral trade rules. Unlike in the pre-1994 GATT system, where Southern countries were not required to reciprocate by opening up their own economies while enjoying access—albeit only limited—to industrial countries’ markets, the WTO required policy change within Southern countries in return for foreign direct investment (FDI) and preferential access to rich markets (Schott, 2004). The *quid pro quo* of policy change in return for better market access and more FDI was taken to a new level in preferential trade negotiations. In fact, through the trade policy termed ‘competitive liberalization’ by Robert Zoellick (2002), the then US Trade Representative (USTR),<sup>6</sup> Northern countries have pushed for policy change and trade liberalization in Southern countries. ‘Competitive liberalization’ has been characterized by pressure on developing and emerging economies to sign deals with industrialized countries under the threat of losing vital access to the markets of rich economies while their competitors enjoy preferential treatment. As a result,

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<sup>6</sup> The term was introduced by Bergsten (1996), but was popularized as a result of Zoellick’s trade policy during the 2000s.

North-South PTAs have restricted the policy space in Southern countries, which is generally referred to as ‘the flexibility under trade rules that provides nation states with adequate room to maneuver to deploy effective policies to spur economic development’ (Gallagher, 2008:63; Shadlen, 2008). This view presents the North-South preferential trade relationship as essentially a zero-sum game of who gets what share of the increased pie as a result of freer and more efficient trade within a PTA.<sup>7</sup>

Given the North-South power asymmetry and the unique settings provided by the discriminative nature of PTAs, Northern countries have managed to reap bigger benefits from North-South PTAs. Based on the capacity of generating discriminative pressure on non-participants, the domino effect ‘can trigger membership requests from countries that were previously happy to be non-members’ (Baldwin, 1995:45). The US, for example, was successful in altering the status quo by negotiating an agreement with Canada, which put pressure on Mexico, forcing it to choose between joining the bandwagon on terms largely dictated by the US and being marginalized while Canadian exports (which were increasingly converging in structure with those of Mexico) enjoyed preferential access to the US market. As a result, Mexico chose the North American Free Trade Agreement (NAFTA), which may have not necessarily been in its best interests at the time (Gruber, 2000). In fact, similar rhetoric can be observed in the comments of James Baker, Ronald Reagan’s Treasury Secretary, regarding the US-Canada PTA in 1988. Baker (1988:39) argued that the US-Canada PTA would serve as ‘a lever to achieve more open trade’ as other countries should understand that the US will push for and support free trade with or without them, thus ‘[i]f they don’t open markets, they will not reap the benefits.’ The asymmetric power relations between the US and Mexico enabled the US to basically dictate

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<sup>7</sup> The idea that ‘power can be used to extract greater gains from trade from the other party,’ notwithstanding the non-zero-sum nature of freer trade for the trading parties, has been initially advanced by Bhagwati (1991:52).

the terms of the agreement in almost all important areas, including agriculture, investment measures, and IPRs (Maxfield and Shapiro, 1998; Cameron and Tomlin, 2000; Dumberry, 2001; Interview 10).

Likewise, in the wake of the collapse of the US-Andean talks over a regional agreement between the US, Colombia, Peru, and Ecuador, the US went bilateral with Colombia and Peru, in order to achieve the negotiating outcomes it failed to push for during the Andean talks. Neither Colombia nor Peru could afford to be left out of deeper integration while the other signed a PTA with the US. Hence, both countries had to agree on restrictive and hitherto unacceptable terms, including in sensitive areas like IPRs and agriculture, which were predicted to have negative consequences on the two Andean countries. Colombian negotiators felt that ‘in order to sign a FTA with the USA it is necessary to pass the “lineas rojas,”’ including in measures related to IPRs and agricultural liberalization (von Braun, 2012:136), but they had to agree on terms proposed by the US as the alternative was deemed as less desirable. As a result, both Colombia and Peru signed separate agreements with the US on terms largely dictated by American negotiators (von Braun, 2012; Interview 11). A similar mechanism was in place in the EU’s negotiations with the Association of Southeast Asian Nations (ASEAN). Following a stalemate in the negotiations with the bloc due to irreconcilable differences between the parties, the EU started separate negotiations with individual ASEAN countries. As a result, the negotiations with Singapore triggered response from Malaysia and Vietnam, while Thailand was predicted to be next in line. Although the negotiations are still under way,<sup>8</sup> the EU is hopeful to push for the type of liberalization in individual PTAs that was proved impossible during the negotiations with ASEAN as a bloc (Interview 4; Interview 5; Interview 8).

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<sup>8</sup> Except for the negotiations with Singapore that concluded in December 2012.

Thus, the conventional interpretation of North-South preferential trade relations as an affair largely dominated by power asymmetries implies heavy concessions for Southern countries, *i.e.*, ‘to sacrifice many important and traditional tools of development policy’ (Shadlen, 2008:10), including in IPRs, investment measures, trade in services, and government procurement, in return for preferential access to Northern markets. These are the areas where developed countries have their vested interests. At the same time, restricted policy space in these areas impedes development and even circumscribes governments’ ability to cope with a national emergency (Wade, 2003; 2006; Rodrik, 2008b; Gallagher, 2008; Shadlen, 2008; 2009).

However, the conventional view fails to distinguish between the individual features of North-South PTAs that can play an importance role in mitigating the effects of the power asymmetry in North-South preferential trade relations. Instead, it takes a largely ‘universal’ approach to these relations strictly from the lens of North-South power asymmetries. In fact, not all North-South PTAs have the same characteristics. This thesis takes a novel approach towards (re)assessing North-South preferential trade relations by distinguishing sequentially between first-order, *i.e.*, Southern countries’ first, North-South PTAs and second-order, *i.e.*, Southern countries’ subsequent, North-South PTAs. This thesis argues that the ‘order’ of an agreement can have serious implications for the outcome of North-South trade negotiations. While Southern countries are vulnerable to marginalization during the negotiations of first-order North-South agreements, second-order North-South trade negotiations follow a different logic. Having secured preferential access to Northern markets through first-order agreements, Southern countries become immune to discriminative pressures during second-order North-South PTA negotiations. Moreover, first-order North-South PTAs can subsequently induce pressure on Northern countries that feel the urge to sign counter-agreements to level the playing field for

their multinationals vis-à-vis their competitors from other developed economies. Hence, while power asymmetries may have heavily influenced the outcomes of first-order North-South PTAs, this study hypothesizes that first-order agreements increase the bargaining powers of Southern countries in subsequent—*i.e.*, second-order—North-South PTA negotiations by alleviating the fear of exclusion among Southern countries and discriminating against other Northern countries. The novel approach introduced in this thesis goes beyond the simplistic interpretation of North-South trade politics as an affair largely dominated by power asymmetries between the parties and takes a longer-term view on North-South trade relations that seeks to provide a more accurate interpretation of these relations, with serious implications for both developed and developing countries.

It appears that first-order North-South PTAs raise the bargaining powers of Southern countries during second-order North-South PTA negotiations by making them immune to discriminative pressures and by exerting pressure on other Northern countries. Indeed, North-South PTAs can discriminate against exporting industries in developed countries, which influence trade policies in their home countries via well-organized lobbying activities and push for counter-agreements to redress the negative consequences of discriminatory PTAs (Manger, 2005; 2009). In fact, as recounted by Dür (2007; 2010) and Baccini and Dür (2012), a number of EU, US, and Japanese (North-South) PTAs concluded during the 1990s and 2000s were signed as a result of lobbying by European, American, and Japanese industries that were discriminated in terms of access to emerging and developing economies. This thesis finds there is sufficient evidence to suggest that Southern countries, albeit to varying extents, did take advantage of the pressure on Northern governments from domestic industries and stable and preferential access to Northern markets as a result of first-order agreements, to secure more favorable deals in second-order North-South

PTAs. Southern countries may accept restrictive first-order North-South PTAs because the alternative is even less favorable. They, however, can use these agreements as a bargaining tool in subsequent negotiations and as ‘a solid cornerstone upon which to build other critical ties in the global economy’ (Preece and Milman, 1994:56).

As per the hypothesis of this thesis, second-order North-South PTAs are more likely to be in line with developing and emerging countries’ interests and preferences than first-order North-South agreements, because Southern countries experience enhanced bargaining powers during second-order agreements because of first-order PTAs. In order to account for the impact of first-order North-South PTAs on the bargaining powers of Southern countries and hence the outcomes of second-order agreements, the thesis employs a process tracing methodology to examine the negotiations of the agreements. Based on the author’s personal interviews with EU trade officials and policy-makers at the Directorate-General for Trade in Brussels (conducted in December 2012) and US trade officials and policy-makers at the Office of the USTR in Washington, DC (conducted in April 2012), as well as primary and secondary data, the thesis studies the negotiations of the first-order and second-order North-South PTAs of the US, EU, and Japan with Mexico, Chile, Korea, Colombia, and Peru, five countries of the Global South that have been active in North-South trade negotiations and have PTAs with at least two developed economies.<sup>9</sup> By doing so, the thesis seeks to establish links between first-order and second-order agreements that transform the utility of a first-order agreement into enhanced bargaining powers of Southern countries during second-order negotiations. Furthermore, to illustrate the results of the enhanced bargaining powers in second-order agreements, the paper conducts a comparative analysis of the first-order and second-order North-South PTAs of Mexico, Chile, Korea,

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<sup>9</sup> For practical purposes, the assessment of the negotiations and outcomes of the North-South PTAs is carried out in Chapters that are organized around the Northern countries, while final conclusions are drawn from the Southern countries’ perspectives.

Colombia, and Peru. The analysis is carried out as per the actual texts of the agreements, as well as other primary and secondary sources, and is based on provisions related to policy areas that have been argued to diminish the policy space in developing and emerging economies, as discussed in Chapter 3.

A few caveats before proceeding. Firstly, this thesis does not attempt to measure the impact of North-South PTAs on their members and non-members. This, in fact, would have been next to impossible, given that most PTAs were concluded relatively recently, and the actual effects can possibly be known in a longer time span. Instead, the aim of this thesis is to explore the power dynamics in North-South relations, which among other things, are reflected in the outcomes of North-South PTA negotiations. Hence, to evaluate these outcomes, the thesis assesses the provisions of each agreement on a range of key aspects of North-South trade, including tariffs and related measures, agricultural liberalization, government procurement, trade in services, investment measures, and IPRs, as discussed and justified in Chapter 3.

Secondly, by no means does the thesis intend to make strong causal claims on the sequential order of PTAs and negotiation outcomes. Other factors may account for different outcomes in second-order PTAs. However, based on the assessment of the negotiations and outcomes of the first-order and second-order North-South PTAs of Mexico, Chile, Korea, Colombia, and Peru, the thesis seeks to test the proposition that the sequence of PTAs does affect bargaining positions and power dynamics, which could shape negotiation outcomes. Moreover, it is hereby acknowledged that, due to the time span between the negotiations (that may have changed the priorities of the countries), difference between Northern countries (some project power more efficiently than others), and other factors this thesis does not account for due to objective reasons, such as the scope of the project and scarcity of time, there may be variables other than

the order of an agreement that may have accounted for the difference in the outcomes of North-South negotiations.

The rest of the thesis is organized the following way. Chapter 2 discusses the economics and politics of North-South preferential trade relations and the factors behind the proliferation of (North-South) PTAs during the last quarter century. It then reviews the power dynamics in North-South trade relations and argues why the approach introduced in this thesis is better suited to explain these relations against the backdrop of the proliferating PTAs. This is followed by the formulation of the thesis research questions and hypothesis and the introduction of the research design, methodology, and data sources. Chapter 3 discusses and emphasizes the importance of policy autonomy (policy space) for developing and emerging economies, as well as points out the restriction of the policy space in key policy areas in developing and emerging economies as a result of North-South PTAs. The outline of the key policy areas is later used for the analysis and comparison of first-order and second-order North-South PTAs in subsequent chapters. Each of Chapters 4, 5, and 6 respectively assesses the negotiations and outcomes of the US, EU, and Japanese North-South PTAs with Mexico, Chile, Korea, Colombia and Peru, whereby comparative overviews of first-order and second-order North-South PTAs, based on the policy areas outlined in Chapter 3, are carried out. And, finally, Chapter 7 provides concluding remarks and discusses the findings of the thesis and their implications for Northern and Southern countries.

## **2. The Economics and Politics of PTAs and North-South Preferential Trade Relations**

Before delving into the debate of what are the drivers behind the recent proliferation of North-South PTAs and how it has shaped the North-South preferential trade relations, this thesis introduces the concept of the ‘order’ of a PTA. The thesis distinguishes between first-order, *i.e.*, Southern countries’ first, and second-order, *i.e.*, Southern countries’ subsequent, North-South PTAs. It is hereby hypothesized that the order of a PTA can affect its negotiation outcome, as illustrated further in this chapter. Hence, the novel approach introduced in this thesis that takes a differentiated view towards North-South PTAs, the thesis argues, will provide a better explanation of North-South trade relations.

PTAs have had two main rationales behind them: economic and political. The literature review in this chapter is carried out as follows. Chapter 2.1 examines the economic rationale behind PTAs. It acknowledges the conditions of economic viability of PTAs and points out the political obstacles for consistently achieving welfare-improving PTAs. Chapter 2.2 reviews the political drivers of the proliferation of North-South PTAs, with a particular emphasis on their inherent discriminative nature that has strong effects on third countries. Chapter 2.3 discusses North-South relations against the backdrop of the proliferating PTAs that rest largely upon North-South power asymmetries. Chapter 2.4 introduces a novel approach to reassess North-South preferential trade relations that adopts a differentiated view towards North-South PTAs based on the sequential order of the agreements. Chapter 2.5 elaborates the research questions and hypothesis of the thesis, and finally, Chapter 2.6 lays out the research design, methodology, and data sources.

## 2.1. The Economic Rationale behind PTAs

The institutionalization of international trade, which started with the creation of GATT in 1947, has been based on the principles of reciprocity and nondiscrimination. Reciprocity exists when ‘policy adjustments bring about changes in the volume of each country’s imports that are of equal value to changes in the volume of its exports’ (Bagwell and Staiger, 2002:6). Nondiscrimination implies that import tariffs on a specific good cannot be more restrictive for the exports of one GATT member than for the exports of another (the MFN principle). Although these ‘complementary principles’ are there to help governments strike more efficient bilateral agreements and make sure these agreements do not alter the welfare of non-participants (Bagwell and Staiger, 2002:8), GATT Article XXIV does allow governments to create free trade areas and customs unions<sup>10</sup> on a discriminatory basis that may have negative welfare implications for non-participants.

The exception to the MFN principle is stipulated by Paragraph 8 of GATT Article XXIV, which states that ‘duties and other restrictive regulations of commerce ... are eliminated with respect to substantially all the trade between the constituent territories of the union.’<sup>11</sup> Thus, the exception to the MFN principle is justified on the grounds that full integration with the abolition of all (or ‘substantially all’) trade barriers between the members of customs unions will create unions with ‘quasi-national’ status and single-nation characteristics that would presumably preclude trade diversion and its negative impact on welfare maximization (Bhagwati, 1991;

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<sup>10</sup> As distinct from a free trade area, where each member-country has its own policy towards non-members, a customs union is a type of a preferential trade arrangement that abolishes tariffs among its members and sets common external tariffs for non-members (Frankel *et al*, 1997).

<sup>11</sup> GATT text, available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gatt1994\\_09\\_e.htm](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm) (accessed 3 December 2015).

1993). The practice shows, however, that the ‘unfortunate’ Article XXIV has actually fallen short of serving that purpose, producing preferential liberalization with trade-diverting characteristics (Bhagwati, 2008:9).

GATT Article XXIV (Paragraph 4) explicitly states that ‘the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.’<sup>12</sup> Thus, the economic rationale behind PTAs rests upon the idea, initially promoted by Jacob Viner (1950), that preferential tariff elimination is welfare improving if it is ‘trade creating,’ and not ‘trade diverting.’ Trade creation implies the exploitation of economic efficiencies within the customs union and creation of more trade via tariff elimination between the members. Trade diversion, on the other hand, implies a shift from a more efficient producer outside of the customs union towards less efficient producers in the union. Trade diversion is, therefore, made possible by the sufficiently high external tariffs of the customs union, while its members trade duty-free among themselves.

Even if a PTA is trade diverting, it may be welfare increasing for its members, as the members’ terms of trade vis-à-vis the rest of the world improve. However, the pursuit of such agreements may backfire if other such agreements emerge and trigger ‘a beggar-all trade war that leaves everyone worse off’ (Krugman, 1991b:16). It is worth noting that ‘while a customs union with a *given* external tariff may be harmful to the members, a customs union that adjusts its tariff optimally is always beneficial’ (Krugman, 1991a:11, italics in the original). The idea that it is always possible for countries to form customs unions with common external tariffs, whereby members improve their own welfare while outsiders do not incur welfare deterioration, was

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<sup>12</sup> GATT text, available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gatt1994\\_09\\_e.htm](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm) (accessed 3 December 2015).

originally advanced by Kemp and Wan (1976). They argue that, through the adjustment of the external tariff, the members of a customs union can ensure that there is no trade diversion and that countries always gain from forming a customs union. The utility of customs unions, hence, becomes conditional upon governments' decisions to pursue optimal policies.

While a customs union can always be potentially beneficial to the members and harmless to outsiders if external tariffs are right, specific factors can increase the welfare gains as a result of forming a customs union. More specifically, (1) the higher the initial rate of tariffs on imports into the partner countries, (2) the greater the share of world production, consumption, and trade covered by the union, (3) the higher the trade volume between partner countries, (4) the more competitive and complementary in structure the economies of partner countries, and (5) the lower the rate of tariffs for the outsiders, the greater the likelihood of welfare gains from the formation of a customs union (Meade, 1980). Other factors, such as the distance between and the size of PTA partners and their relative factor endowments, also affect welfare gains and make preferential trade economically viable (Baier and Bergstrand, 2004; Baier *et al*, 2015). In addition, a recent study by Kim (2015) suggests that the formation (as well as the depth) of PTAs may also be determined by the existence of production networks between potential PTA members.

In theory, PTAs can always be beneficial, if external tariffs are adjusted accordingly. This adjustment is, however, often politically difficult, because very often inefficient local industries, such as agriculture in developed countries, are politically too strong and organized and will not tolerate welfare improving tariff adjustments that are harmful for their specific industries. Moreover, it will be in the interests of the members of customs unions to raise the external tariffs

in order to improve their terms of trade. Thus, ‘a customs union ordinarily will choose policies that *do* lead to trade diversion’ (Krugman, 1991a:12, italics in the original).

Krugman further argues that the optimal number of trading blocs is one (*i.e.*, free trade). However, complete free trade is politically difficult, if not impossible, to achieve, and ‘when the number of blocs is reduced from a very large number to a still fairly large number, it would not be surprising to find that world welfare falls’ (Krugman. 1991a:13), as it is in the interests of the member of customs unions to erect higher external tariffs in order to improve their terms of trade. Thus, PTAs are often concluded contrary to the economic rationale, whereby the welfare of non-participants diminishes as a result of trade-diverting effects of these agreements (Krugman, 1991a; Bhagwati, 2008). The economic rationale is based on an ideal model of the state of the world that does not fully explain the soaring number of regional and cross-regional PTAs the world has witnessed during the last quarter century. In order to get a more complete account of the recent proliferation of PTAs, the political rationale behind PTAs needs to be taken into consideration.

## **2.2. The Power and Politics behind Contagious PTAs**

*‘Trade blocs have economic effects, but that is not why they are established.’*  
-- World Bank (2000:123)

While the economic rationale behind PTAs rests largely upon welfare maximization among both the PTA participants and third countries, the political approach has attempted to determine whether and how international politics explain patterns of global trade. The distribution of power (hegemony), for example, has been argued to affect the level of global trade (Mansfield, 1992). Although in later studies too hegemony was found to be positively associated with PTA

formation, its impact was estimated to be relatively modest (Mansfield and Milner, 2015). Meanwhile, with the decline of hegemony and signs of possible distress of the international trading system, countries have increasingly opted for PTAs to secure undisrupted trade with other nations and guarantee their competitiveness abroad (Mansfield, 1998). By signing PTAs, the argument goes, countries insure themselves against adverse developments in the multilateral trading regime. For example, as argued by USTR Mickey Kantor in 1993, the proposed Free Trade Agreement of the Americas was seen by the US as an alternative to the Uruguay Round, if the latter faltered. Another reason why countries have embraced PTAs has been to obtain leverage in multilateral negotiations via accumulated market power (Mansfield and Reinhardt, 2003).

It has also been argued that the emergence of regional institutions would reduce the number of actors in multilateral negotiations and hence play down the bargaining and collective action problems. In addition, PTAs can become an important tool to undertake and consolidate important (and sometime painful) economic reforms that would eventually promote multilateral liberalization serving as building blocks to multilateral liberalization (Mansfield and Milner, 1999). Moreover, it has been argued that preferential trade arrangements are more likely to emerge among political and military allies, as in such cases, security externalities that arise from international trade are better contained (Gowa and Mansfield, 1993; Gowa, 1994). This provides a link between economic and security regionalism, whereby countries join regional blocs both for economic and security considerations, as they also form collective security mechanisms (Mansfield and Solingen, 2010). Other factors of domestic politics, such as the regime type and number of veto players, may influence the formation of PTAs. The more democratic the

countries and the fewer veto players they have, the higher the probability of PTA formation (Mansfield and Milner, 2015).

The above explanations, notwithstanding their merits, do not fully explain the recent proliferation of PTAs. As seen above, trade was argued to be positively associated with hegemony, but the decline in hegemony has produced new incentives for countries to pursue PTAs to insure against possible malfunction of the international trading system (Mansfield, 1998). Moreover, ‘whether variations in hegemony contributed to earlier episodes of regionalism are issues that remain unresolved’ (Mansfield and Milner, 1999:608), while in any case, the link between hegemony and PTA formation was found to be modest, as was the relationship between alliances and preferential trade arrangements (Mansfield and Milner, 2015). Meanwhile, whether PTAs are building blocks or stumbling blocks to multilateral liberalization remains an open question, as the effects of regionalism on multilateral liberalization remain ambiguous (Mansfield and Milner, 1999). In the words of Frankel and Wei (1998:216), ‘regionalism can, depending on the circumstances, be associated with either more or less general liberalization.’

So, why have PTAs proliferated during the last quarter century, despite falling short of (consistently) providing trade creating and welfare maximizing outcomes? It has been argued that the political viability of PTAs can be strengthened if the agreements are trade diverting, *i.e.*, contrary to the economic rationale (Grossman and Helpman, 1995; Krishna, 1998; Manger, 2009; Mansfield and Milner, 2015). In order to make PTAs politically viable, policy-makers often need to win the support of politically powerful inefficient import-competing industries, while they can ignore the interests of taxpayers (the perceived losers from economically inefficient PTAs) because the potential costs of inefficient trade are dispersed among numerous taxpayers that lack the incentive to mobilize and lobby against trade-diverting PTAs. As a result,

‘trade diversion will enhance political viability [of a PTA] while contributing to an inefficient allocation of resources in the two partner countries’ (Grossman and Helpman, 1995:680). Import-competing industries are not politically powerful enough to prevent the proliferation of PTAs, but they are powerful and organized enough to push for greater flexibility in PTAs as a form of protection, which may compromise the economic efficiency of these agreements (Baccini *et al*, 2015).

As discussed in Chapter 2.1, PTAs are often concluded contrary to the economic rationale, whereby the members improve their terms of trade, while non-participants see their welfare diminished as a result of trade-diversion (Krugman 1991a; Bhagwati 2008), for ‘preferential arrangements that divert trade away from the rest of the world are more likely to be supported politically’ (Krishna, 1998:244). In relation to North-South PTAs, in order to ensure the political feasibility of the agreements within developed countries, North-South PTAs *should* discriminate against third—usually developed—countries. As a result, ‘to make North-South liberalization politically feasible, governments therefore erect new barriers as they tear down others’ (Manger, 2009:3).<sup>13</sup>

An alternative explanation of the recent proliferation of PTAs is the contagious nature of such agreements. Because PTAs are inherently discriminative, they put pressure on third countries that experience diminished welfare as a result of trade-diverting PTAs. Thus, countries, lobbied by discriminated domestic industries, are tempted to sign counter-agreements to offset their losses (Baccini and Dür, 2012). For obvious reasons, Baldwin (1993; 1995) termed this phenomenon a ‘domino effect.’ The spark of the domino effect is an idiosyncratic shock that ‘can trigger membership requests from countries that were previously happy to be non-members’

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<sup>13</sup> Tovar (2012), for example, shows that products with bigger reductions in preferential tariffs in CAFTA-DR experienced greater increases (or smaller decreases) in MFN tariffs.

(Baldwin, 1995:45). It is assumed that such shocks in the form of a trading bloc formation, such as the European Community or NAFTA, can and will emerge because countries seek to increase their welfare by signing PTAs. Thus, when countries seek welfare maximizing PTAs, they engage in a self-fulfilling cycle of PTA proliferation (Baldwin, 1995).

An account of the discriminative nature of PTAs, which was responsible for the recent proliferation of these agreements, was provided by a number of studies (Baccini and Dür, 2012; Baldwin and Jaimovich, 2012). Based on an analysis of PTAs signed between 1990 and 2007 that involved 167 countries, Baccini and Dür (2012) explain the recent proliferation of PTAs as a result of competition for market access. Discriminated by PTAs concluded by foreign countries, exporters push their governments to sign counter-agreements to level the playing field in markets where their exports are threatened. In addition, Manger (2009) argues that investment discrimination of outsiders as a result of PTAs is another major force behind pushing discriminated countries to seek redressing agreements. In line with this reasoning, based on data for 145 countries, Egger and Larch (2008) show that during 1955-2005, pre-existing PTAs increased the probability that a pair of countries would join an existing PTA or sign a new agreement, while Mansfield and Pevehouse (2013:602) argue that ‘PTAs that add a new member tend to do so again in the near future.’

For example, the 2011 ratification by the US Congress of the PTA that was signed with South Korea in 2007 looked especially timely for putting additional pressure on Japan amid the ever-increasing discussions about the Trans-Pacific Partnership (TPP), an ambitious free trade agreement recently signed by 12 Pacific Rim countries, the US and Japan included. The ratification of the US-Korea PTA put pressure on large Japanese exporters, which would struggle to compete against South Korean rivals without preferential access to the US market. In this

context, the pressure on the Japanese government from *Kiedanren*, a large Japanese business lobby, to pursue countervailing agreements does not seem surprising (Economist, 2011). This argument seems complementary to the assertion that the US-Korea PTA was going to produce only modest gains for the US, and its main objective was to unleash a catalytic effect on trade liberalization in the region (Choi and Schott, 2004; Financial Times, 2007a). As a result, in November 2011, Prime Minister Yoshihiko Noda announced ‘Japan’s intention to begin consultations with Trans-Pacific Partnership countries toward joining the TPP negotiations’ (USTR, 2011). Japan’s intentions to participate in the TPP negotiations were later confirmed by Prime Minister Shinzo Abe, and Japan participated for the first time in the 18<sup>th</sup> round of negotiations in July 2013 (CRS, 2015). The agreement was signed on October 5, 2015, awaiting ratification in the member-states’ parliaments. In fact, the catalytic effect of the US-Korea PTA went beyond the region and, in the words of Peter Mandelson, then EU Trade Commissioner, ‘strengthen[ed] the prospects for the planned EU-Korea free trade agreement’ (Financial Times, 2007b).

The TPP is, in fact, one initiative that was largely determined by the politics of discrimination. The TPP’s predecessor, the Trans-Pacific Strategic Economic Partnership, initially comprised of Brunei, Chile, New Zealand, and Singapore. After the US joined the negotiations in 2008, the initiative gathered momentum as other countries felt they would lose out if they stayed out of the agreement. As a result, within only a few years, Australia, Peru, Vietnam, Malaysia, Japan, Mexico, and Canada joined the negotiations. ‘Ironically, because of the fear of being left out, the interest for the TPP has been rising despite its alleged lack of transparency, restrictive clauses on investment protection and intellectual property rights’ (Sahakyan, 2015).

Hence, notwithstanding the merits of alternative explanations, the intrinsic discriminative nature of PTAs that triggers a domino effect appears to be the most plausible factor behind the recent proliferation of PTAs. The discrimination-induced proliferation of PTAs has had serious implications for North-South preferential trade relations that have been largely explained by North-South power asymmetries. The next section looks at how power politics have defined these relations.

### **2.3. North-South Trade Relations against the Backdrop of the Proliferating PTAs**

North-South trade relations, it has been argued, have been shaped by power politics determined by North-South asymmetries. The inclusion of a number of contentious measures in the WTO, such as those related to IPRs, has largely been attributed to the Northern countries' ability to exercise power politics and force Southern countries to agree on terms that favor developed economies. The US, for example, in addition to multilateral pressures backed by other developed economies such as the European Community (EC) and Switzerland, put additional pressure on Southern countries through unilateral actions via its Section 301 of Trade Act of 1974 and the Special 301, to make them agree on the IPRs provisions envisioned by the North. As a result of such pressures, negotiators from Southern countries admitted that the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) that mostly reflected the priorities of Northern countries appeared a better option than resisting it under American unilateral sanctions (Shadlen, 2004; Pugatch, 2004).

The power dimension of North-South trade relations has become more acute during North-South preferential trade relations, as the discrimination-induced proliferation of PTAs has

provided ample opportunities for Northern countries to take advantage of North-South power asymmetries and further their interests in North-South PTAs through a policy known as ‘competitive liberalization.’ Given the North-South power asymmetry, Northern countries have managed to exercise game-changing tactics and force Southern countries to sign North-South PTAs on terms largely dictated by the North, because being left out has been perceived by Southern countries as the least desirable option. Since Southern countries are in competition amongst each other for mobile international investment and access to industrial markets, they have been forced to liberalize regardless of their ‘prior policies or philosophies’ (Bergsten, 1996:2). Putting competitive pressure on Southern countries has largely been a deliberate action as part of a broader trade policy of Northern countries, particularly the US (Zoellick, 2002). The PTAs with Singapore and Chile, two pro-free trade and relatively open countries, for example, were signed by the US to, *inter alia*, exert pressure on other emerging and developing economies in Asia and Latin America and force them to seek similar agreements (BusinessWeek, 2003; DeRosa, 2004; Weintraub, 2004).<sup>14</sup>

Enabled by North-South power asymmetries, Northern countries have exploited the inherent discriminative nature of PTAs to marginalize Southern countries and force them to join the bandwagon on terms largely dictated by the North. Gruber (2000), for example, illustrates the exploitation of North-South power asymmetries by the ability of the more powerful actor to alter the status quo and make the weaker party choose between an asymmetric outcome and a new status quo, which is even less desirable. If a Southern country does not wish to sign a North-South PTA because it sees the terms of the perspective agreement as unfavorable, a Northern

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<sup>14</sup> The notion that power can be used to extract greater gains from international trade, when there is ‘power disequilibrium’ between countries, was earlier advanced by Hirschman (1969:12). Hirschman argued that such power disequilibrium served as a means of coercion and shaped the direction and composition of trade between an imperial power and its colonies that largely favored the former.

country can ‘go it alone’ and sign an agreement with countries that are relatively open and willing to engage in bilateral trade. By doing so, it exerts pressure on non-participating countries (while their competitors enjoy preferential access to a Northern market), making the cost of non-participation even greater than joining the bandwagon on less favorable terms. This mechanism, as hypothesized in this thesis, is better utilized by Northern countries during first-order North-South PTA negotiations. The mechanism of the ‘go-it-alone’ power is illustrated in Figure 2.3.1 below.

**Figure 2.3.1. Illustration of the ‘go-it-alone’ power**

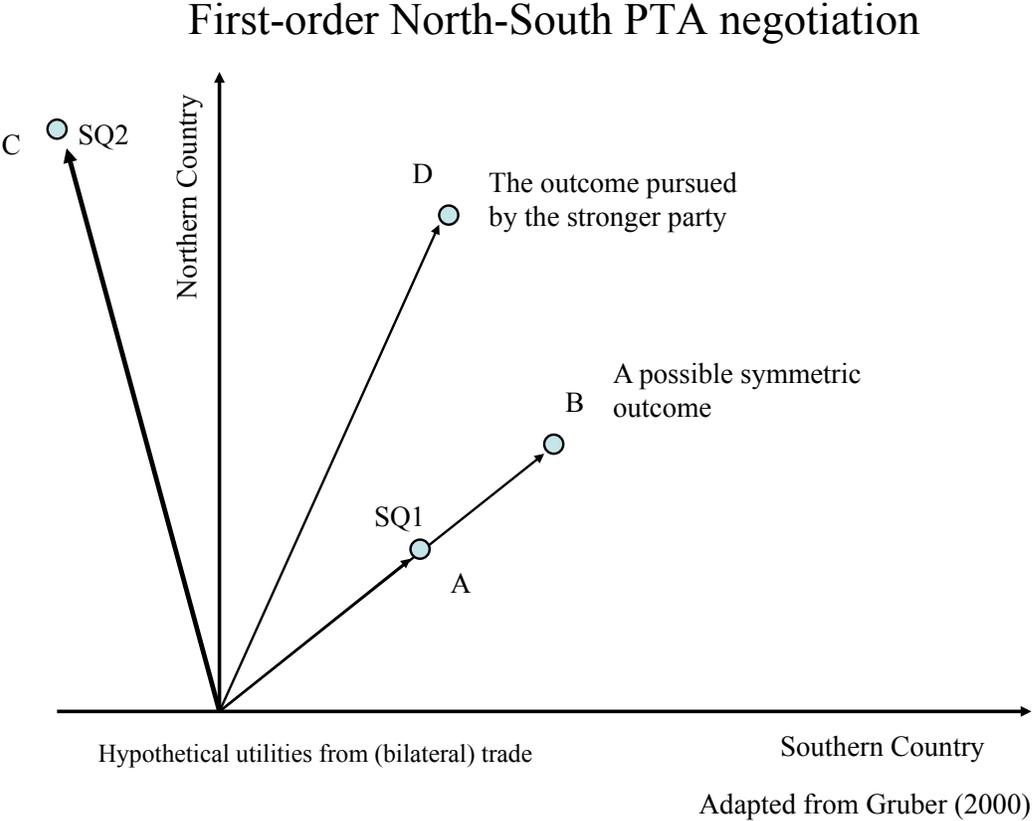


Figure 2.3.1 illustrates the ‘go-it-alone’ power of a hypothetical Northern country (portrayed on the y-axis) vis-à-vis a hypothetical Southern country (portrayed on the x-axis). To make the

Southern country agree on the outcome D, which reflects the power asymmetry between the negotiators, the Northern country alters the status quo (point A) and shifts it to the point C. By doing so, it leaves the Southern country with two undesirable options: the new status quo (point C) and the outcome D, which is asymmetric but less undesirable.

Gruber (2000) argues that the power play illustrated in Figure 2.3.1 is exactly what happened during the NAFTA negotiations between the US and Mexico. According to Gruber, sticking to the status quo (point A), *i.e.*, no agreement at all, may have been Mexico's preferred choice. But when the US 'went alone' and signed a PTA with Canada, it altered the status quo (point A) and shifted it to the point C. As reflected in the figure, the new status quo (point C) was an even less desirable option for Mexico, for it could not afford to be left out while Canadian exports were enjoying preferential success to the US market. As a result, Mexico was forced into a situation whereby joining NAFTA, albeit on undesirable terms largely dictated by the US, was a better option than the alternatives. Thus, Mexico's decision to join NAFTA was to a considerable extent influenced by the ability of the US to exercise its 'go-it-alone power' and alter the status quo, rather than by possible costs and benefits of the agreement. As argued by Moe (2005:227), institutions, usually defined as structures of cooperation, are also structures of power, which are often not mutually beneficial for the parties involved. In line with Gruber's argument, when power is exercised, (weaker) parties' 'voluntary' choice has to be made from a 'power-constrained choice set,' which implies choosing options they otherwise would have not.

At first, as quoted by the New York Times (1988), President-elect Carlos Salinas ruled out the possibility of even a modest agreement with the US. However, Mexico was soon forced to change its attitude towards NAFTA and start the negotiations. This was made possible by unilateral trade retaliations and coercive actions from the US (Cameron and Tomlin, 2000), as

well as the power play depicted in Figure 2.3.1. The asymmetry between the parties enabled the US to easily achieve its negotiating objectives during the negotiations in a number of areas, including sensitive sectors such as agriculture, investment measures, and IPRs, where the text of the agreement was basically dictated by the US (Maxfield and Shapiro, 1998; Cameron and Tomlin, 2000; Dumbery, 2001; Interview 10).

Other US North-South PTAs, such as the US-Colombia and US-Peru agreements that emerged as a result of the stalemate in the US-Andean<sup>15</sup> negotiations, followed the mechanism illustrated in Figure 2.3.1. After the collapse of the US-Andean talks in the wake of serious disagreements, including over IPRs and the liberalization of agriculture, the US was quick to go bilateral with Peru and Colombia. Being left out for either Colombia or Peru, given the other's conclusion of talks with the US, was the least acceptable outcome, which neither of the Andean countries could afford. This brought about pressures on both Andean countries. Although both Colombia and Peru successfully resisted pressures from the US during the US-Andean talks, including in relation to unacceptable clauses on IPRs, they could not afford to do it after the US went bilateral with them. As a result, the fear of being left out made both Colombia and Peru ready for painful compromises, as the US was swift to extract the concessions from Colombia and Peru it failed to achieve during the US-Andean talks (von Braun, 2012; Interview 11).

Other developed economies, such as the EU, also used their economic weight to trigger actions from Southern countries. Following a stalemate in the negotiations with ASEAN, which as a bloc was not ready to accept the terms demanded by the EU, the EU started separate negotiations with individual ASEAN countries. As a result, the negotiations with Singapore triggered responses from Malaysia and Vietnam, while Thailand was next in line. Apart from the

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<sup>15</sup> The US-Andean agreement was being negotiated between the US, Colombia, Peru, and Ecuador.

talks with Singapore that were concluded in December 2012, the EU negotiations with individual ASEAN countries are still under way. Nevertheless, the EU hoped to achieve with individual countries what had failed to accomplish during the negotiations with ASEAN as a bloc (Interview 4; Interview 5; Interview 8).

The positions of Southern countries in North-South power relations are exacerbated even further when they have strong trade dependence on Northern countries, calculated as the share of their exports that goes to a single Northern market. Higher trade dependence reduces the negotiating power of Southern countries in North-South PTAs even further, as being left out of vital markets becomes especially costly.<sup>16</sup> In the case of political trade dependence, calculated based on the share of a Southern country's exports to a Northern market through the GSP and other unilaterally granted preferential schemes, Southern countries look even more vulnerable, as they are constantly exposed to the threat of the removal of such preferences at the discretion of their trading partner. As a result, in order to transform unilaterally granted preferences into stable and predictable provisions under North-South PTAs, Southern countries agree to asymmetric concessions in North-South PTA negotiations (Shadlen, 2008; Manger and Shadlen, 2014). The argument for trade dependence influencing trade relations between countries was also advanced by Hirschman (1969). This 'influence effect of foreign trade' raises the bargaining power of economically stronger countries because weaker countries cannot dispense without trade with it, nor can they replace it with other countries (Hirschman, 1969:17).

Power asymmetries are best utilized when there is competition among Southern countries, which augments the discriminative pressure on non-participants. As argued by Guzman

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<sup>16</sup> For example, although it was initially reluctant to sign an agreement with the US, the Dominican Republic suddenly became enthusiastic about one when the US started negotiating the Central American Free Trade Agreement (CAFTA) with Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua (Shadlen, 2008). This does not seem surprising as, in 2002, two years before the completion of the CAFTA-DR, 85 per cent of the Dominican Republic's merchandise exports were absorbed by the US (Hornbeck, 2004:15).

(1997:666) in the example of bilateral investment treaties (BITs), Southern countries as a group are interested in utilizing their collective bargaining power and securing favorable provisions under BITs, ‘that leaves significant power in the hands of the sovereign state in its relations with investors.’ Individually, however, Southern countries seek BITs with Northern nations that will give them advantage over other Southern countries in the competition to attract FDI. As a result, Southern countries not only sign BITs that leaves them worse off in the long run, but also trigger actions from other Southern countries to sign similar agreements in order not to fall behind in the fierce competition for FDI.

The proposition that Southern countries are ‘compelled’ to join PTAs that are not necessarily in their best interests is confirmed by, for example, a World Bank study of 91 trade agreements negotiated since 1980, which reconfirms lack of evidence of reciprocity in North-South agreements, which mostly favor developed nations, while it reports strong evidence of reciprocity in North-North and South-South agreements (Freund, 2003).

Market regulated trade is ‘a non-zero-sum game: It will benefit each party to the transaction. But while each gains from trade, we also teach that power can be used to extract greater gains from trade from the other party’ (Bhagwati, 1991:52). Thus, a North-South PTA may be a non-zero-sum arrangement that increases the overall welfare pie, but within that non-zero-sum arrangement there is a zero-sum game of who gets what piece of the increased pie. In line with the illustration in Figure 2.3.1, the zero-sum game of who gets what piece of the increased pie is dominated by power asymmetries between the parties. Developed countries change the game into one where developing and emerging economies are forced to choose between being marginalized (while competitors enjoy preferential treatment) and joining the bandwagon on terms largely dictated by developed countries instead of claiming their ‘symmetric’ share of the

increased pie. Hence, Southern countries agree on restrictive WTO-plus provisions under North-South PTAs that circumscribe their policy space and limit their policy choices to cope with different developmental challenges and national emergencies.<sup>17</sup>

It is worth noting, however, that the argument that Southern countries seek to preserve the policy space available under the WTO when entering into North-South PTAs does not go unchallenged. A competing view on North-South PTAs argues that leaders in Southern countries may want their countries to enter into such agreements in order to tie their hands and implement painful and unpopular domestic economic reform that would, in fact, limit the policy space in these countries. For instance, Baccini and Urpelainen (2015) argue that Southern countries may enhance the credibility of commitment to reform if they are bound to implement such reform as part of the deal under a PTA. Moreover, the authors argue, PTAs can create domestic political support for economic reform, because the expected benefits from PTAs may not materialize without economic reform committed to as part of the deal with a Northern country. While the argument advanced by Baccini and Urpelainen (2015) is convincing for certain countries, particularly for new democracies with unstable new leaders, there have been instances when resistance to economic reform that would limit the policy space in Southern countries has been a key reason behind inconclusive North-South PTA negotiations. For example, the EU negotiations with Mercosur and ASEAN did not produce conclusive results, among other things, because of these regions' resistance to the type of beyond-the-border liberalization, including in IPRs, investment measures, and trade in services, demanded by the EU (Interview 4; Interview 7).

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<sup>17</sup> The shrinking policy space in Southern countries as a result of North-South PTAs is discussed in detail in Chapter 3.

Because intentions behind the governments of Southern countries to pursue North-South PTAs are key to the analysis carried out on this thesis, this study has sought to unveil whether economic reform that, in fact, limits the policy space in Southern countries was a predetermined goal of the governments of the Southern countries discussed in this study or whether reforms were agreed to as part of the North-South bargain. In fact, as the analyses carried out in Chapters 4, 5, and 6 show, resisting to restrictive terms under PTAs and preserving the policy space available under the WTO seem largely to be part of the negotiating agenda of the five Southern countries in question.

The chapter next advances a new framework, whereby the effects of power asymmetries are mitigated, and North-South PTA negotiations produce a more symmetric outcome for Southern countries.

#### **2.4. A Novel Approach to North-South Power Relations: The ‘Order’ of a North-South PTA**

When the non-zero-sum game of increasing the welfare pie by signing a PTA transforms into a zero-sum game of who gets what share of the increased pie, power politics dominate the game. As shown in Figure 2.3.1, other things being equal, power asymmetries imply that weaker countries lose in the zero-sum game of dividing the increased welfare gains. Other things, however, are not always equal, as not all North-South PTAs share the same characteristics. As introduced above, this thesis distinguishes between first-order, *i.e.*, Southern countries’ first, and second-order, *i.e.*, Southern countries subsequent, agreements. The novelty of the approach introduced by this thesis suggests the acknowledgement of different characteristics of North-

South PTAs that can affect the outcomes of the negotiations and hence the nature of North-South power relations. In second-order North-South negotiations, the factors that enable Northern countries to exploit North-South power asymmetries, namely the fear of exclusion and competition between Southern countries, are eliminated, mitigated, or reversed. First, having secured preferential access to Northern markets as a result of first-order agreements, Southern countries become immune to marginalization. Second, the discriminative pressure, as a result of the proliferation of North-South PTAs, creates a complex structure where the direction of discriminative pressures can go either way. North-South PTAs exerts discriminative pressure on Northern countries too.

The proliferation of North-South PTAs has created competition between the US and EU in third markets. The expansion of US PTAs starting from the 2000s has triggered a reaction from the EU, which, in order to protect the interests of its firms in third markets, began to negotiate counter-PTAs (Sbragia, 2010). For example, the US engagement in preferential trade with countries, such as Colombia, Peru, and the members of ASEAN, triggered actions from the EU, as European businesses felt discriminated in these markets vis-à-vis their American counterparts. The EU was lobbied by export-oriented European firms that pressured the EU to redress the situation by establishing its own terms for preferential access to these markets and make sure EU companies are provided the same terms as other multinationals. As a result, the EU was quick to initiate its own preferential trade negotiations with Colombia, Peru, and ASEAN countries, including Singapore, Malaysia, Vietnam, and Thailand (Interview 1; Interview 3; Interview 4; Interview 5; Interview 8). Moreover, the competition between developed economies in third—usually developing and emerging—markets has not been limited to the US and EU. The signing of NAFTA, for instance, exerted pressure on both the EU and Japan and forced them to seek

redressing agreements with Mexico to level the playing field for their multinationals competing with US firms. After the EU signed a PTA with Mexico, it augmented the discriminative pressure on Japan and made it seek a counter-agreement with Mexico in the shortest possible period of time (Keidanren, 1999; Reiter, 2003; Yoshimatsu, 2005; Manger, 2009; Interview 1; Interview 2).

Japan's other second-order North-South PTAs, more specifically with Chile and Peru, were also largely motivated by the diminishing share of Japanese businesses in Southern countries. The Japan-Chile PTA was largely motivated by the discrimination of Japanese export-oriented companies, especially in the auto industry, vis-à-vis American and European multinationals in Chile. It was largely due to the lobby by domestic pro-liberalization forces led by the auto industry that pushed the Japanese government to sign an agreement with Chile in the shortest possible time (Wehner, 2007). Meanwhile, Japan's diminishing market share in Peru and Latin America in general made the Japanese government to pursue a PTA with Peru and make all the efforts to conclude the talk as soon as possible. A Japan-Peru PTA was to, among other things, level the playing field for Japanese multinationals with their American and European rivals in the Peruvian market (Gonzalez-Vigil and Shimuzu, 2012).

Hence, against the backdrop of the discrimination-fuelled proliferation of North-South PTAs, Southern countries may become immune to marginalization once they secure stable preferential access to Northern markets via first-order North-South PTAs. Moreover, first-order North-South PTAs can reverse the arrow of discriminative pressure towards Northern countries and make them seek redressing agreements with Southern countries. This can potentially strengthen the positions of Southern countries and leverage their bargaining powers in subsequent—*i.e.*,

second-order—PTA negotiations. Figure 2.4.1 below illustrates the logic of second-order North-South PTA negotiations.

**Figure 2.4.1. Illustration of the logic of second-order North-South PTA negotiations**

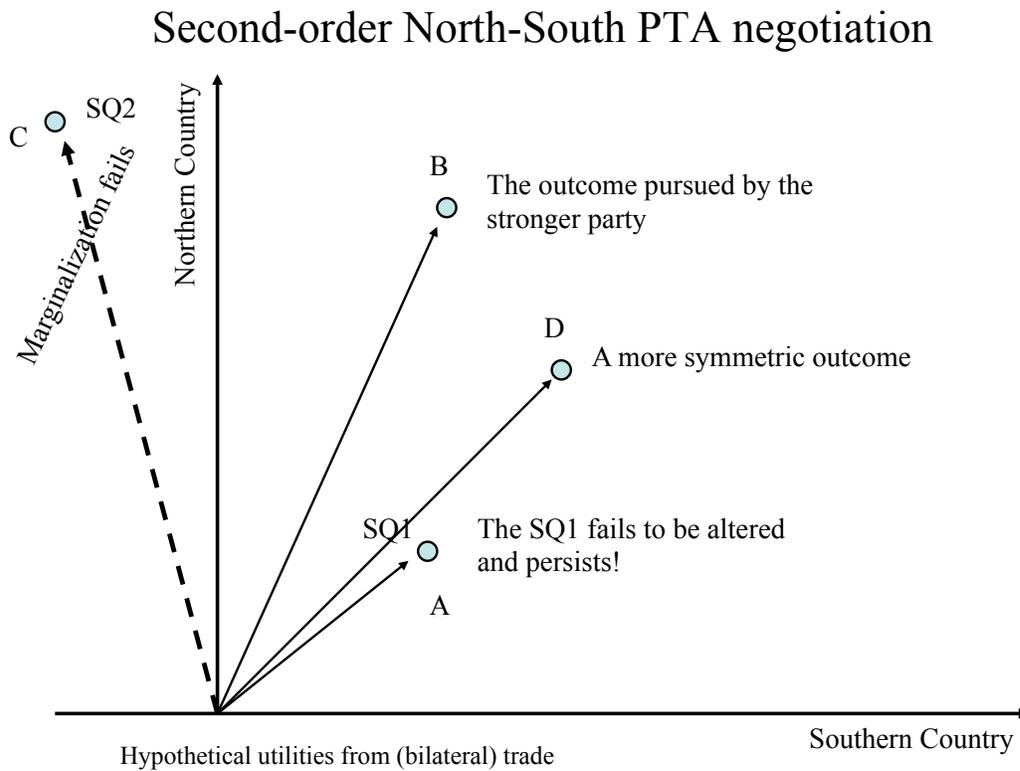


Figure 2.4.1 illustrates a hypothetical model of second-order North-South PTA negotiations. Here, in contrast to the scenario depicted in Figure 2.3.1, the status quo (point A) is not easily altered. Having secured preferential access to a Northern market, the Southern country (portrayed on the *x*-axis) is not easily marginalized when the stronger party (portrayed on the *y*-axis) signs a PTA with its competitors. Hence, the attempt to shift the status quo to the point C fails, and the status quo (point A) persists. In this case, the choice for the Southern country is between the status quo (point A) and a more symmetric outcome (point D), and not between a

new (and extremely unfavorable) status quo (point C) and an asymmetric outcome pursued by the Northern country (point B), like it was in first-order PTA negotiations. Thus, the outcome is either no agreement at all (point A) or one with a more symmetric result (point D).

As seen from Figures 2.3.1 and 2.4.1, the settings in which power asymmetries are utilized matter. Power asymmetries are efficiently utilized when the powerful country is successful in altering the status quo. In first-order PTA negotiations (Figure 2.3.1), the status quo is easily altered. As a result, Southern countries face a choice between being marginalized and joining the bandwagon on terms largely dictated by Northern countries. Meanwhile, in second-order PTA negotiations (Figure 2.4.1), the status quo persists and the choice for Southern countries is one between a more symmetric outcome and no outcome at all.

In first-order North-South PTA negotiations, the ‘no agreement’ outcome is costlier for the Southern country, because a ‘no agreement’ comes with an additional cost in the form of diverted trade as a result of North-South agreements elsewhere. In second-order North-South PTA negotiations, on the other hand—because Southern countries proceed to them with stable preferential access to a Northern market and can themselves exert pressure on Northern countries—the ‘no agreement’ outcome becomes costlier for the Northern country, for its multinationals lose out in the competition with their peers from other developed economies. Thus, in second-order North-South PTA negotiations, Southern countries can afford to procrastinate and stick to the status quo until the alternative becomes attractive enough.

In line with this logic, one of the explanations as to why the Uruguay Round of negotiations was successful and the Doha Round was not is that in the first case, Northern countries, namely the US and EC, managed to alter the status quo by withdrawing from the GATT 1947. That left Southern countries with the option to either ratify the WTO with its different agreements as a

‘single undertaking’ or be left with the old GATT 1947 that had no meaningful economic significance as major countries had withdrawn from it. While in both rounds of negotiations deals could have been better for developing and emerging economies, the Doha Round did not materialize due to, among other reasons, the inability of developed countries to exercise a ‘power play’ and alter the status quo. Southern countries could afford to say no to the Doha Round and stick to the status quo, *i.e.*, the Uruguay Round provisions, because these provisions were there to remain. Of course, Northern countries could hypothetically leave the WTO too, but this would entail lots of technical problems with binding consequences (Steinberg, 2002:360; Shadlen, 2010).

The second type of utility that first-order North-South PTAs provide to Southern countries, *i.e.*, the ability to reverse the arrow of discriminative pressure towards Northern countries, derives from the competition among developed economies for accessing important production destinations and levelling the playing field for their multinationals vis-à-vis their competitors from other developed economies. Because multinationals in developed countries influence trade policies via well-organized lobbying activities, they push for counter-agreements to redress the negative consequences of discriminatory PTAs (Manger, 2005; 2009). In fact, as highlighted by Dür (2007; 2010) and Baccini and Dür (2012), a number of US, EU, and Japanese (North-South) PTAs concluded during the 1990s and 2000s were signed as a result of lobbying by American, European, and Japanese industries that were discriminated in terms of access to emerging and developing economies. Thus, enabled by first-order agreements, Southern countries can potentially use domestic lobbying by multinationals in Northern countries in their favor during second-order North-South PTA negotiations and extract more concessions and/or resist unfavorable provisions from Northern countries.

For example, having signed NAFTA, albeit with terms and provisions mostly dictated by the US, Mexico managed to exert pressure on the EU and Japan. The EU's share of Mexico's total trade slipped from around 11 per cent in the beginning of the 1990s to about 6.5 per cent in 2001 (Reiter, 2003; Espach, 2006). The EU was losing out in Mexico because of NAFTA provisions, and it was one of the main reasons why it started negotiating a PTA with Mexico and put every effort to conclude the talks as soon as possible. NAFTA gave an idea of the type of liberalization the EU could demand from Mexico, but at the same time, the 'NAFTA factor' enhanced Mexico's negotiating position, which it exploited very well and resisted a number of key EU proposals it deemed unfavorable. In addition to NAFTA, the proliferation of North-South PTAs elsewhere in Latin America and East and Southeast Asia during the 1990s and 2000s made the EU react to American and Japanese preferential trading initiatives in these regions by pursuing its own PTAs with countries and regions, such as Colombia, Peru, Central America, and ASEAN (Interview 1; Interview 2; Interview 3; Interview 4).

By the same logic, NAFTA and the EU-Mexico PTA exerted pressure on Japan. According to Yoshimatsu (2005), the share of Japanese products in Mexican imports shrank from 6.1 per cent in 1994 to 3.7 per cent in 2000, equivalent to an estimated loss of USD 3.54 billion for Japanese exporters. Meanwhile, tariff elimination on EU steel products, which resulted from the EU-Mexico PTA, would have caused an anticipated USD 300 million annual loss for Japanese steel exporters. Such threats eventually pushed Japan to initiate bilateral trade talks with Mexico and put every effort to complete them in the shortest possible time (Yoshimatsu, 2005; Solís and Katada, 2007a; 2007b). In fact, the pressure on Japan to conclude a deal with Mexico as soon as possible may have increased Mexico's bargaining power during the negotiations with Japan, whereby Mexico managed to reject a number of key proposals from Japan. Among other things,

Mexico was able to achieve ‘a policy change [in Japan] away from the absolute exclusion of agricultural products to their inclusion in the FTA.’ This seems to be a significant achievement, given Japan’s historically high tariffs on agricultural products and the fact that more than 20 per cent of Mexico’s exports to Japan consisted of agriculture-related products in 2001 (Yoshimatsu, 2005:271; Pempel and Urata, 2006:89-90).

Other North-South PTA negotiations by Japan, such as those with Chile and Peru, were motivated, among other things, by discriminative pressures from other North-South PTAs. Levelling the playing field for Japanese firms operating in Chile and Peru vis-à-vis their competitors from the US and EU was among the main reasons why Japan started PTA negotiations with Chile and Peru (JETRO, 2001; Gonzalez-Vigil and Shimuzu, 2012). Meanwhile, Japan’s desire to sign an agreement with Korea was invigorated by the signing of the US-Korea PTA (and its belated ratification in 2011), which was going to produce only modest gains for the US but had the potential of producing catalytic effects on trade liberalization in the region (Choi and Schott, 2004; Financial Times, 2007a).

In sum, by distinguishing between the ‘orders’ of PTAs, this thesis suggests a novel approach towards reassessing North-South preferential trade relations, which takes a differentiated and longer-term view on North-South trade relations that have conventionally been presented as a phenomenon largely dominated by power asymmetries.

## **2.5. The Research Questions and Hypothesis**

North-South trade relations have been conventionally presented as an interaction largely based upon power asymmetries between the parties. The North-South cleavage over who gets what

share of the increased welfare pie as a result of preferential trade liberalization raises some important questions that have strong developmental implications. It has been argued that, due to North-South asymmetries, preferential trade liberalization through North-South PTAs has mostly favored developed countries and have circumscribed policy autonomy in developing and emerging economies, thus impeding with development in Southern countries (Gallagher, 2005; 2008; 2011; Shadlen, 2005c; 2008; 2009; Kumar and Gallagher, 2007). Moreover, despite the adverse developmental implications of North-South PTAs, these agreements have proliferated during the last quarter century because of the agreements' discriminative and contagious nature. Utilizing North-South power asymmetries, Northern countries have succeeded in marginalizing Southern countries and changing the game of North-South PTA negotiations into one where joining the bandwagon on terms dictated by developed countries has been the least bad outcome for developing and emerging economies (see Figure 2.3.1) (Gruber, 2000; Shadlen, 2008).

As illustrated in Figures 2.3.1 and 2.4.1, the successful utilization of power asymmetries by developed countries depends on the latter's ability to alter the status quo. In first-order PTAs, altering the status quo is relatively easy, for Southern countries are in stiff competition for access to Northern markets. Hence, being left out while competitors enjoy preferential treatment can be unbearably costly. Here the status quo does not depend only on the two countries that intend to negotiate an agreement. It also depends on whether third country competitors remain in their initial positions. Once competitors gain preferential access to a Northern market, the status quo is effectively altered, and the choice for Southern countries becomes one between a new status quo—staying out while competitors' exports enjoy preferential treatment—and joining the bandwagon on terms dictated by the North. However, once the problem of market access is resolved—albeit at the expense of restrictive first-order North-South PTAs—the positions of

Southern countries become less shaky, and altering the status quo by Northern countries more difficult. In fact, the very existence of a first-order PTA can exert pressure on other developed countries and potentially redress North-South power asymmetries during the negotiations of second-order PTAs.

This thesis argues that North-South preferential trade relations can be better explained through a novel approach that takes a differentiated view towards North-South PTAs, based on the sequential order of these agreements. First-order agreements—however restrictive or unfavorable for Southern countries—can make these countries less vulnerable to the game-changing aggressive policies of Northern countries and strengthen their positions in subsequent—*i.e.*, second-order—North-South trade negotiations by providing secure access to Northern markets and by enabling them to exert pressure on other Northern economies.

**RQ1.** Do first-order North-South PTAs increase the bargaining powers of Southern countries in subsequent North-South negotiations?

**RQ2.** Are Southern countries' second-order North-South PTAs substantively different from first-order North-South PTAs, as a result of improved bargaining powers in second-order negotiations?

**Hypothesis:** Second-order North-South PTAs are more favorable to Southern countries than first-order agreements because of the following two factors made possible by first-order PTAs:

1. Southern countries are immune to marginalization when negotiating second-order PTAs because they already have stable preferential access to Northern markets via first-order agreements.

2. Southern countries can exert discriminative pressure on Northern countries that are in competition amongst each other for accessing important production destinations in Southern countries and leveling the playing field for their multinationals vis-à-vis their competitors from other Northern countries.

## **2.6. The Research Design, Methodology, and Data Sources**

As per the hypothesis of this thesis, second-order North-South PTAs are more favorable to Southern countries than first-order agreements, and this difference comes from the proposition that first-order agreements raise the bargaining powers of Southern countries in subsequent agreements by providing them with stable access to Northern markets and enabling them to exert pressure on Northern countries. To reveal Southern countries' improved bargaining positions in second-order PTA negotiations (RQ1), this study carries out process tracing (based on the author's personal interviews with EU and US trade officials and other primary and secondary data) with the view to account for the negotiations of the first-order and second-order North-South PTAs of Mexico, Chile, Korea, Colombia, and Peru, five countries of the Global South that have North-South PTAs with at least two developed countries.

In addition, to account for the actual effects of Southern countries' increased bargaining powers in second-order negotiations (RQ2), the study carries out an analysis of the first-order and second-order North-South PTAs, based on their actual texts, focusing on policy areas that have shaped the North-South divide in international trade, as discussed and justified in Chapter 3. These policy areas of North-South trade relations that include tariffs and related measures, agricultural liberalization, government procurement, trade in services, investment provisions, and

IPRs, have, according to a widely held view (Wade, 2003; 2006; Rodrik, 2008b; Gallagher, 2008; Shadlen, 2008), circumscribed the policy autonomy in developing and emerging economies with adverse effects on economic development in the Global South.

The thesis has adopted the methodology of process tracing because it is suitable for conducting an empirical analysis of both agent- and structure-related issues aimed at establishing a relationship between variables: in my case, between the dummy variable of a first-order North-South PTA and the outcomes of second-order agreements (George and Bennett, 2005; Odell, 2006; Checkel, 2008). Tracing ‘*recurrent processes* linking specified initial conditions and a specific outcome’ (Mayntz, 2004:241, italics in the original) has been hereby regarded as suitable to trace the events that unfolded during the period between signing a first-order North-South agreement and the conclusion of second-order PTA negotiations for each of the five Southern countries. The unfolding events this thesis has particularly looked at include the developments that have emerged because of first-order agreements and have affected the negotiations and outcomes of second-order agreements. Because ‘[p]rocess tracing is strong on questions of interactions’ (Checkel, 2008:116), the choice of this method has hereby been deemed efficient in explaining the highly interactive process of North-South preferential trade negotiations.

The examination of North-South PTAs has been conducted based on the actual texts of the agreements and secondary sources related to the negotiations and outcomes of these PTAs. In addition, interviews have been conducted with the officials of the Directorate-General for Trade of the European Commission in Brussels in December 2012, as well as with USTR officials in Washington, DC in April 2012. The author of the thesis has personally interviewed EU and US trade officials involved in trade policy coordination with countries and regions discussed in this

study. The interviewees are referenced in the text on a non-personified basis, which was a precondition for the interviews.

### **3. From Developmental State to PTAs and the Shrinking Policy Space**

The ultimate aim of this chapter is to discuss the policy areas that have been most affected by North-South PTAs and where Southern countries have seen their policy space circumscribed the most. The outline of these policy areas will serve as a set of criteria based on which the assessment and comparative overview of the first-order and second-order North-South PTAs in question are carried out in Chapters 4-6. For this reason, this chapter reveals the most contentious policy areas that have shaped the North-South divide in multilateral and preferential trade liberalization. More specifically, Chapter 3.1 sketches a brief overview of the debate over which policies are better suited for industrialization and economic development with a particular focus on developing and emerging economies. It outlines specific policy areas that have been especially crucial in boosting developmental policies in Southern countries. Furthermore, Chapter 3.2 discusses how the policy autonomy of Southern countries has been circumscribed as a result of North-South PTAs, which has led not only to the limited flexibility of the governments in Southern countries to deploy effective policies to spur economic development, but has also circumscribed their options in dealing with national emergencies. Finally, the key policy areas of North-South PTAs are outlined as the criteria based on which the comparative assessments of the first-order and second-order North-South PTAs are carried out in Chapters 4-6.

### **3.1. Industrial Development Policies and Economic Growth: The Role of the Developmental State and the Policy Space**

There is a raging debate about economic liberalization as the strategy for Southern countries. Many of the proponents of liberalization are in the developed world. Many of the critics, on the other hand, have argued differently, pointing to the experience of East Asian economies and today's developed economies in their early stages of industrialization, which have combined export-led growth policies with unorthodox measures to protect and nurture infant industries until they are ready to compete on the global scale. Liberal economic policies promoted by developed countries and international trade and financial institutions, such as the WTO, International Monetary Fund (IMF), and World Bank, have been countered by the critics of orthodox policies (Amsden, 1989; Wade, 1990; 2006; Rodrik, 2001; 2004; 2008b; Chang, 2002b; 2003; 2007; Chang and Green, 2003; Gallagher, 2005; Studwell, 2013), who argue that liberalization in the form promoted by today's orthodox policies is not a panacea for development and growth. According to these scholars, although it is hard to envisage rapid and high economic growth without outward orientation and specialization, economic liberalization is better carried out gradually and timely, by giving domestic perspective industries time to become competitive internationally. This chapter seeks to highlight how this debate has emphasized the shrinking policy space and specific policy areas that have been especially crucial in boosting developmental policies in developing and emerging economies.

One of the key aspects of the debate is whether there is a positive correlation between openness and growth. A number of studies (Dollar, 1992; Sachs and Warner, 1995) have shown that there is, indeed, a positive link between openness and growth. These claims do not go

unchallenged, however. An important question remains the definition of openness. Both studies by Dollar (1992) and Sachs and Warner (1995) include countries in their samples (*e.g.*, Korea), which, in fact, have had a heavy involvement of the state in the process of industrialization and economic policies in general (Rodriguez and Rodrik, 1999). Moreover, openness that is often measured by average tariffs may not reflect the true nature of managed industrialization, as the newly industrialized countries adopted a selective approach, keeping tariffs high in strategic industries and low for other product lines, thus ensuring that the average tariff is not significantly high (Wade, 1990; Chang, 2007).

Rodriguez and Rodrik (1999) show that the relationship between a country's average tariff level and non-tariff trade barriers and its economic growth is, at best, ambiguous. A more recent study by Ortega and Peri (2014), too, fails to establish an effect of trade openness on income, while Abbas (2014) finds that trade liberalization deteriorates economic growth in developing countries. Meanwhile, Kim and Kose (2014) find that trade liberalization can result in welfare gains if the lost tariff revenues are financed by consumption and labor income taxes, while in the attempt to finance them with capital income taxes may result in welfare losses. In sum, although a number of studies find a positive correlation between openness and growth, the relationship, in the words of Singh (2010:1554), is 'not ubiquitously unambiguous.'

According to Chang (2003), the correlation between liberal policies and growth has not just been ambiguous but negative for developing countries. During 1960-1980—a period of strong involvement of the state in economic development activities—developing countries grew at an annual per capita rate of 3 per cent, whereas during 1980-2000—a period characterized by more integration and liberalization—the growth rate was only 1.5 per cent. Moreover, if China and India (two interventionist states) are taken out of the sample, the growth rate falls below 1 per

cent. Similarly, Stiglitz (2005) and Chang (2007) showed that growth rates in Latin America in the 1960s and 1970s, when the economies of the region were relatively less open, were around 3.1 per cent compared to 1.7 per cent in the 1980s and 1990s, when neo-liberal policies were embraced more vigorously in the region. In the first half of the 2000s, growth rates in Latin America dropped even further to as low as 0.6 per cent.

Nor has FDI alone been correlated with growth in developing countries (Gallagher and Zarsky, 2005). Moreover, capital market liberalization not only did not lead to faster growth, but also led many developing and emerging countries to be exposed to the risk of capital outflow, which, in the words of Stiglitz (2005:17), represents ‘risk without reward.’ The effects of sudden capital outflows are well known to East Asia as a result of the 1997 financial crisis and to Latin America as a result of the 1980s debt crisis. As argued by Wade (1998:1535), capital account liberalization, which left ‘hot’ capital to flow unrestrictedly in and out of East Asian countries, was ‘the single most irresponsible act of public authorities in the whole crisis.’ Under-regulation of capital accounts (financial liberalization), coupled with careless investment practices as a result of the abundance of ‘hot’ foreign capital, has been, in fact, widely cited as one of the major causes of the 1997 Asian financial crisis (Chang, 1998; Chang *et al*, 1998; Jomo, 1998; Lauridsen, 1998; Amess and Demetriades, 2010).

Ironically, the East Asian crisis of 1997 came after the East Asian ‘miracle’ and revealed the weaknesses of liberalization. The run on the Thai, Indonesian, Philippine, Malaysian and other East Asian currencies resulted in the breach of the peg of these currencies to the US dollar and caused their sharp depreciation. The short-term ‘hot’ capital that had entered the region in the boom years ‘rapidly fled through the liberalized market channels,’ triggering debt and financial crises (Yamazawa, 2003:277). A similar scenario was observed during the Latin American debt

crisis of the 1980s that left the continent in its ‘lost decade.’ The abundance of hot and cheap money, among other things a result of the oil shock of the 1970s, fuelled Latin American economies with easy credit, adding onto their debt pile. When the right-wing governments of Thatcher and Reagan in the UK and US raised interest rates to combat high inflation, the non-regulated ‘hot’ money left Latin America for more attractive destinations, leaving Latin America with piles of debt and no means to repay it (Shadlen, 2005a). High external debt in developing countries, as argued by Haggard (1995:7), ‘produced strong incentives for policy change, especially so that developing countries could regain access to foreign investment and borrowing.’ Such policies led to liberalized investment measures, stricter investment protection, and the alignment of domestic policies with international neoliberal norms, which constrains policy autonomy in developing countries and hinders development in the long run.

Policy autonomy (or policy space)—generally referred to ‘the flexibility under trade rules that provides nation states with adequate room to maneuver to deploy effective policies to spur economic development’ (Gallagher, 2008:63)—has been a crucial aspect of industrial development across time and across countries. The lack of policy space has been argued to have impeded with long-term growth, while its availability, if utilized correctly, can bring about industrialization and rapid economic growth (Amsden, 1989; Wade, 1990; Chang, 1993; 2002a; 2007; Gallagher, 2005; 2008). Rodrik (1996), for example, argues that the role of the state is essential in moving a developing country into a higher-value added specialization track and upgrading into a high-income equilibrium. Without such a boost from the state, poorer countries may get stuck in a low-income equilibrium, specializing in traditional low-tech and low-skill-intensive productions. Thus, as also argued by Akyuz (2005), lowering industrial tariffs should not be viewed as simply achieving short-term efficiency-related gains. Longer-term

consequences should also be taken into consideration, for opening up may lock developing countries in labor-intensive industries and hinder capital accumulation, technological progress, and productivity growth.

State-directed industrialization with unorthodox economic policies played a crucial role in the late industrialization of East Asian countries. In the words of Alice Amsden (1989:8, italics in the original), '[i]n late-industrializing countries, *the state intervenes with subsidies deliberately to distort relative prices in order to stimulate economic activity.*' Wade (1990) provides evidence of state-led industrialization coupled with free-market policies in Japan, Taiwan, Korea, Hong-Kong, and Singapore that produced continuous growth rates of about 7 per cent per annum for two and a half decades starting from 1960. Meanwhile, Amsden (1989; 2001) and Chang (1993; 2002a; 2007) demonstrate state-managed rapid economic growth in Korea during the same period. A mix of orthodox and unorthodox policies was employed in East Asian countries to achieve significant growth rates since the early 1960s. East Asian countries implemented selective unilateral reduction of tariffs and non-tariff barriers to attract investment. They, however, also 'tended to retain governmental guidance and interventions in sectors of high growth potential' (Yamazawa, 2003:273). During the 1970s industrialization process in Korea, '[s]pending foreign exchange on anything not essential for industrial development was prohibited or strongly discouraged through import bans, high tariffs and excise taxes.' Euphemistically labeled as 'luxury consumption tax,' a levy was introduced in Korea that covered even items like foreign produced small cars, whiskey, and cookies (Chang, 2007:8).

The Korean government not only exercised 'absolute control over scarce foreign exchange,' but also managed the inflow of FDI based on its priorities, selectively welcoming them in certain sectors and banning them in others (Chang, 2007:14). The ultimate destinations of FDI inflows

mattered, and East Asian countries, including Korea, were successful in directing FDI inflows via unorthodox policies into high-tech and export-oriented sectors. Selectively picking industries with high growth potential and providing government support for them was part of Korea's economic development policies from the 1960s to the 1980s. Tariff protection and government subsidies were commonplace for these industries until they could stand on their own feet and compete internationally. All the banks were government owned, thus credit was channeled based on the priorities of overall economic and industrial development and not solely for the sake of maximizing bank profits. State-owned enterprises (in steel and chemical production, for example) played a crucial role in leading the country's industrialization process (Chang, 2007).

The proponents of neo-liberal policies have mostly viewed Korea as a free-trade economy following neo-liberal policies during its miracle years until the 1990s. Export-led growth, however, which was a significant factor in Korea's overall economic achievements, did not always include free-market policies. In fact, in some cases Korea employed targeted government intervention to promote specific promising industries (World Bank, 1993; Akyuz *et al*, 1998; Chang, 2007; Rodrik, 2001; 2008a). As noted by one scholar (Yamazawa, 2003:273), the 'interventions conflicted with the free trade principles of GATT and the World Bank' but were nevertheless accepted by the World Bank (1993) as 'market-friendly' for the high rates of growth they ensured. In fact, '[t]he Korean economic miracle was the result of a clever and pragmatic mixture of market incentives and state direction' (Chang, 2007:15). Korea was successful in applying selective high tariffs in industries that were vital for its economic development, and keeping the tariffs lower for other sectors, thus keeping the average tariff levels not very high (Chang, 2007). Moreover, despite its current status as an 'innovative' nation, Korea was a major infringer of intellectual property (IP) rights during the course of its industrialization and was

using ‘reverse engineering’<sup>18</sup> to copy leading technologies for local production. The IP regimes of other late industrializers and now-developed countries during the periods of their rapid industrialization would have been deemed as insufficient in today’s standards that are being imposed onto developing countries (Chang, 2001; 2007; Kumar, 2003).

Korea’s economic growth rates slowed down after the 1997 financial crisis, which was partly because the country made a significant shift towards open-market neoliberal policies. This policy shift in Korea and other crisis-hit East Asian countries was partially IMF-imposed, as part of the bailout conditions. Another reason was that once Korea became economically bigger, it became harder for it to hide behind high tariffs with the sole justification of nurturing infant industries and implementing development policies (including import bans and restrictions) that hurt its trading partners (Chang, 2007).

Another success story in export-led growth and industrialization was Chile during the period of its impressive growth of 7 per cent in the 1970s and 1980s. Chile has often been praised by neo-liberals for maintaining high rates of growth during this period, but was not in fact fully liberalized. Most importantly, capital accounts in the country were not fully liberalized and Chile was selective in attracting FDI. The tax on short-term capital prevented a surge of hot and footloose capital into the economy. Privatization, despite pressures from the IMF, was not to its fullest scale either, and government enterprises continued to play an important role in the economy. Even as of the mid-2000s, some 20 per cent of Chile’s exports came from one government owned enterprise, CODELCO (Stiglitz, 2005).

The policies used by the newly industrialized countries of East Asia have not been unique to East Asia alone. Many of today’s developed countries used similar policies during their own

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<sup>18</sup> ‘Reverse engineering’ refers to infringing with IPRs by copying technology through dismantling a product and reproducing its part to get the replica.

periods of rapid industrialization. It has been argued that, having achieved rapid industrialization and impressive economic growth by means of non-orthodox economic policies, such as high tariffs and subsidies, today's developed countries are preaching different policies for developing countries, which are yet to go through their own industrialization processes. The metaphor used here is 'kicking away the ladder,' used in 1841 by the German economist Friedrich List, who accused Britain of advocating against policies for other countries that helped its own economy to gain global economic supremacy in the nineteenth century (Wade, 1990; Chang, 2001; 2002b; 2003; 2007; Chang and Green, 2003; Akyuz, 2005; Kumar and Gallagher, 2007).

The automobile industry in Japan, which has become an iconic symbol of Japan's economy, was struggling to compete against American manufacturers for many years in the mid-20<sup>th</sup> century. Toyota's unsuccessful attempt to compete in the American market in 1958 would have prompted many that 25 years after its establishment as a car manufacturer in 1933 it was time to explore other competitive advantages. The Japanese government, however, did not give up and provided the industry the needed support through high protective tariffs and management of investment. As a result of such protective measures, the Japanese car industry became what it currently is—both a symbol of Japanese economic success and the locomotive of its economy (Chang, 2007). The industrial development policies that were at the core of Japan's economic success in the second half of the 20<sup>th</sup> century were carried out by the Ministry of International Trade and Industry (MITI) and the Japan External Trade Organization (JETRO), which were also promoting the outward orientation of Japanese firms by providing information and marketing support. Although the tariff levels were not particularly high in Japan after World War II, imports and foreign exchange were under the tight control of the Japanese government, which

also provided subsidized credit to the promising strategic industries and strictly regulated inward FDI (Johnson, 1982; Chang, 2007).

The role of MITI in the Japanese ‘miracle’ cannot be underestimated. In the post-World War II period, the Japanese state was extremely successful in implementing its priorities in economic development and industrialization policies. Through MITI, with its unique design of vertical bureaus for each strategic industry, the Japanese state oversaw the economic rise of the country after World War II through subsidizing strategic sectors with high growth potential, channeling investment, providing subsidized credit and selective tax breaks to export-oriented industries (Johnson, 1982).

To conclude, the relationship between openness and growth is, at most, ambiguous. Moreover, as seen from the experience of the newly industrialized countries of East Asia and today’s developed countries, state involvement in industrial development policies, in a manner highly contradictory to today’s orthodox policies preached by high-income countries, can be vital in promoting development and growth in the early stages of industrialization. If utilized correctly, development policy space is an important lever that allows the implementation of developmental policies to raise the competitiveness of developing countries internationally and close the income gap between the world’s rich and poor countries. As will be seen next in Chapter 3.2, this policy space has been restricted as a result of multilateral and, especially, preferential trade liberalization through North-South PTAs.

### **3.2. North-South PTAs and the (Severely Constrained) Policy Space**

Following the emphasis on the importance of developmental industrial policy made in Chapter 3.1, this chapter discusses how the policy autonomy of developing and emerging economies has been circumscribed as a result of multilateral and, especially, preferential trade liberalization, which has led not only to the limited ability of Southern country governments to boost economic growth, but has also circumscribed their options of dealing with national emergencies. Most importantly, this chapter outlines the policy areas, where the diminished or forgone sovereign control as a *quid pro quo* deal for secure and better-than-MFN access to Northern markets has had significant developmental implications. These policy areas are subsequently used in Chapters 4-6 as criteria for the comparative analysis of the first-order and second-order North-South PTAs.

It has been widely argued that, as a result of orthodox policies promoted by developed countries, policy autonomy of developing and emerging countries has been circumscribed, while with the proliferation of North-South PTAs, the options for national governments have become narrower not only for promoting economic growth but also for coping with national emergencies (Rodrik, 2001; Wade, 2003; Gallagher, 2005; 2008; 2011; Shadlen, 2005c; 2009; Kumar and Gallagher, 2007). As shown in Chapter 2.3, Southern countries have been forced to sign North-South PTAs, because power asymmetries enabled Northern economies to change the North-South PTA negotiation game into one whereby being left out (while competitors enjoy preferential access to Northern markets) has been less desirable than signing North-South PTAs on terms largely dictated by Northern countries (Gruber, 2000; Shadlen, 2008).

Thus, preferential access to the US and other developed countries' markets comes with a high price for Southern countries, *i.e.*, 'to sacrifice many important and traditional tools of development policy' (Shadlen, 2008:10). The key policy areas, where Southern countries see their policy autonomy diminished, include tariffs and related measures (including in agriculture), government procurement, trade in services, investment measures, and IPRs. These are the sectors where Northern countries have vested interests. At the same time, these are the areas where Southern countries still have certain leeway for autonomous industrial policies under multilateral agreements, particularly the WTO. These loopholes are, however, effectively eliminated in North-South PTAs (Shadlen, 2008). This chapter next looks at how policy autonomy is circumscribed in each area as a result of North-South PTAs.

### **Tariffs and Related Measures**

Tariff reduction starting from the second half the 20<sup>th</sup> century both as a result of multilateral WTO negotiations and regional and bilateral preferential trade arrangements has been quite impressive. According to the WTO (2011), the average applied tariff was as low as 4 per cent in 2009, down from the recent peak of over 9 per cent in 1994, and close to 40 per cent when GATT was established in 1947. However, the estimates of the distribution of welfare gains brought about as a result of tariff cuts vary among developing and developed countries.

By one account (Brown *et al*, 2001, Table 1, p. 32), the estimated increase in global welfare of USD 75 billion, as a result of the Uruguay Round tariff cuts, went predominantly to developed countries (about USD 70 billion), while the remaining went to the newly industrialized countries, with only small benefits for developing countries. Bouët (2006) provides an overview of studies that put the welfare increase as a result of possible full trade liberalization at 0.3-3.1 per cent.

The effects on poorer countries, however, were estimated to be much lower because of soaring food prices and eroded preferential access to richer markets. Meanwhile, Yanikkaya (2003:84) found that the relationship between trade barriers and growth, contrary to all orthodox theories, is positive, which provides ‘considerable evidence for the hypothesis that restrictions on trade can promote growth, especially of developing countries under certain conditions.’

Anderson (2004) puts the amount of estimated annual welfare gains as a result of the full trade liberalization and abolition of agriculture subsidies in the range of USD 254 billion (of which USD 108 billion accruing to developing countries) to USD 2080 billion (of which USD 431 billion accruing to developing countries). The share accrued to developing countries, according to this estimate, is around 20-40 per cent, which is not just low but also highly dependent on the abolition of agricultural subsidies (agriculture is 60-70 per cent contributor to the gains accruing to developing countries). Given that main beneficiaries of agricultural liberalization are food producing bigger emerging economies and the consumers in developed countries, the overall impact of trade liberalization on least developed countries was estimated to be very small. Some food-importing least developed countries may even be left worse-off (Francois *et al*, 2003).<sup>19</sup> Other studies (Harrison, 1996; Cernat *et al*, 2002; IMF and World Bank, 2002; Baldwin, 2003) produced more optimistic estimates of welfare gains for developing countries as a result of trade liberalization. Nevertheless, there does not seem to be much reciprocity between the North and the South in relation to welfare gains as a result of trade liberalization; there rather is an asymmetry with unequal exchange (Akyuz, 2005).

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<sup>19</sup> There is a negative estimated welfare change of around 1 per cent of GDP for most of the food-importing least developed countries as a result of Uruguay Round agricultural tariff liberalization (Ingeco, 1997).

Unlike the WTO, where member-countries are required to bind their tariffs for different categories of goods at certain levels,<sup>20</sup> most PTAs require parties to lower and eventually eliminate all import tariffs, exposing their industries to an uneven competition from giant multinationals. The WTO allows generous safeguard clauses to protect infant industries from competition and promote industrial policy measures. More specifically, GATT Article XVIII allows countries to use safeguard measures for balance of payment purposes. Article XIX allows temporary safeguarding measures in case of import surge, whereas Article VI sanctions anti-dumping and countervailing duties as a response to unfair trade practices. The pre-1994 GATT did not formally limit the duration of safeguards, while the WTO restricts them to a maximum of eight-year period. In addition to the formal safeguard tools allowed by the WTO, developing countries can unilaterally raise their tariffs up to their bound levels (which for most developing countries are significantly higher than the applied tariff levels) with no whatsoever violation of WTO rules and, in effect, enjoy additional safeguard measures (Amsden and Hikino, 2000; Amsden, 2003).

Although the WTO has limited the choices for Southern countries, there still remain policy options that developing and emerging countries utilize. Although historically dominated by developed countries, antidumping cases have recently widely involved Southern countries too. India, for example, has been especially active in taking advantage of antidumping measures, maintaining ‘almost permanent import surcharges to protect its balance of payments’ (Amsden, 2003:86). Turkey is another country that successfully took advantage of trade policy flexibilities allowed under the WTO and navigated its economy through the post-2008 recession relatively

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<sup>20</sup> Unlike in most developed countries, the bound tariff levels for many developing countries are higher than the applied tariff levels. This fact gives developing countries an opportunity to raise tariffs to the bound levels without whatsoever violation of WTO rules (Amsden, 2003; Shadlen, 2005b; Gallagher, 2008).

smoothly. Its policy-makers introduced changes to its relatively liberal import regime by applying new WTO-consistent import restrictions exercised through changes to its applied tariffs and the use of anti-dumping and safeguards measures and ‘managed a remarkable recovery’ from the 2007 financial crisis (Bown, 2014:215).

Provisions of the WTO agreement on subsidies and countervailing measures do provide WTO members with policy space to address problems ranging from poverty reduction to environmental sustainability. Article 8 of the agreement defines three broad categories of non-actionable (*i.e.*, permitted) subsidies: for research and development, for regional development, and for environmental protection (Aguayo and Gallagher, 2005). Meanwhile, GATT Article XIX sanctions the use of safeguards when an import surge ‘threaten[s] serious injury to domestic producers’ (Bown and Wu, 2014:181). In practice, however, safeguards and other temporary trade barriers may also be utilized by countries, in line with WTO provisions, to cope with recession and other unfavorable economic situations (Bown, 2014). The use of safeguards and options for other temporary trade barriers, however, have been severely circumscribed under PTAs, as ‘PTAs may impose additional constraints on a country’s ability to exercise policy options to respond to increased foreign competition through escape clause mechanisms’ (Bown and Wu, 2014:183).

Most PTAs do have safeguard clauses, but these clauses are much restricted compared to those under the WTO. Most notably, the conditions under which safeguard clauses can be applied in most PTAs require compensation in the form of concessions. Such compensations are not required under the WTO, and the maximum possible period for safeguards is substantially longer than that under most PTAs (Shadlen, 2005b). In addition, WTO rules allow countries to provide subsidy-like support to local companies. Called duty drawbacks, these subsidy-like

provisions provide import tax rebates on goods used as inputs for exports. Consistent with WTO provisions, duty drawbacks have been efficiently utilized by governments, such as that of Brazil, to compensate for the higher cost of capital for local producers (Abbott, 1995; Shadlen, 2005b). Similarly, duty drawbacks significantly contributed to export promotion in South Korea (Mah, 2007). Duty drawbacks have gained higher importance due to the increasing number of global value chains and the change in the nature of international trade, whereby the imported content of the average export accounts about 40 per cent. Drawbacks are, however, restricted in most PTAs. The abolition of duty drawbacks was especially significant in NAFTA, which were widely used in the *Maquiladora* system, whereby Mexican assemblers (usually located along the US border) were using imported inputs from third countries to assemble final products and re-export them to the US. The ban of duty drawbacks in NAFTA was meant to raise the cost of non-NAFTA inputs in Mexican products designed for the US market, which restricted the ability of outsiders to use Mexico as an export platform for accessing the US market (Shadikhodjaev, 2013).

## **Agriculture**

The protection of agriculture in Northern countries remains an important obstacle for agriculture producing Southern countries to expand exports to the rich world. Although agriculture and textile are the main sectors where developing countries have comparative advantage, these are also sectors that are highly protected in developed countries (Khor and Ocampo, 2010). Agricultural subsidies are huge in the EU, for example, which spends about 40 per cent of its budget on agriculture, despite the fact that the industry generates less than 2 per cent of its GDP and employs less than 5 per cent of its workforce (Economist, 2012).

According to Anderson *et al* (2000), developing countries incur an annual loss of around USD 11.6 billion as a result of the agricultural policies of OECD countries. Ironically, developed high-income countries themselves would have benefited hugely (USD 110.5 billion) as a result of the abolition of agricultural trade barriers. Hence, because the overall gain from agricultural liberalization would be more than what producers would lose, in theory, OECD countries could produce mechanisms to compensate agriculture producers who oppose liberalization. However, despite the urge to lower or abolish industrial tariffs in Southern countries during PTA negotiations, the protection of agriculture remains relatively untouched (OECD, 2010).

GATT Article XXIV requires that PTAs cover ‘substantially all’ trade, which in theory makes the exclusion of whole sectors, such as agriculture, from PTAs not an easy task for Northern countries. The interpretation of ‘substantially all’ trade, however, has been quite vague, and Northern countries have managed to exclude sensitive commodity lines from liberalization, while PTAs have mostly covered agricultural product lines that had already had low or zero tariffs as a result of WTO or unilateral liberalization. This, in particular, was the case with Japan’s PTAs with countries, such as Singapore, Malaysia, Thailand, and the Philippines, where tariffs on major agricultural commodities comprising around half of Japan’s agricultural imports from the above-mentioned countries were barely affected by the PTAs (Ando and Kimura, 2008). As reckoned by Shearer *et al* (2009), by year 10 of the implementation of 33 PTAs signed during the 1990s and 2000s, on average only 81 per cent of agricultural tariff lines were to go down to zero, which is below the stringent 90 per cent mark that justifies the inclusion of ‘substantially all’ trade in a PTA as per GATT Article XXIV.

Agricultural liberalization was estimated to benefit Southern countries to different extents. It would be more favorable to bigger agricultural producers than to smaller least developed

countries that have been net importers of agricultural products. For most of the food importing less developed countries the negative welfare change would amount around 1 per cent of GDP, which was believed to be offset by positive changes elsewhere (Ingco, 1997).

GATT Article XVI allows export subsidies for agricultural products ‘as long as the country using them did not gain more than an equitable share of the world market.’ According to Binswanger and Lutz (2003), however, the equitable share condition has been neglected, and most OECD countries have been using subsidies, which have lowered the world price and have harmed efficient producers elsewhere, including in Southern countries, which have not enjoyed the privilege of government subsidies.

### **Government Procurement**

Government procurement has been an important area in PTA negotiations for Southern countries because it has largely been omitted from the WTO agreement. Hence, the PTAs have been imposing new obligations on most developing and emerging economies regarding government procurement. WTO members are currently allowed to keep government procurement out of the WTO market access provisions. In the multilateral settings, government procurement is regulated by the WTO plurilateral Agreement on Government Procurement (GPA), which is optional for WTO members to join. As of December 2015, the GPA had 17 signatories (the 28 EU countries counted as one party),<sup>21</sup> most of which are high-income countries, including the US, Japan, and the EU. Given that most Southern countries have not signed to the optional provisions of the agreement, Northern countries have been trying to introduce binding market access and national treatment rules in government procurement ever since the conclusion of the Uruguay Round,

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<sup>21</sup> The list of GPA signatories can be found at [http://www.wto.org/english/tratop\\_e/gproc\\_e/memobs\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm) (accessed 3 December 2015).

including during the 1996 Singapore and 1999 Seattle Ministerial Conferences. So far unsuccessful in multilateral setting, developed countries have been promoting strong government procurement clauses in North-South PTAs (Khor, 2001).

In a number of countries, government procurement represents a bigger industry than their total imports, thus it is not surprising that this sector has attracted a lot of attention, especially by multinationals from Northern countries. By keeping out of the GPA, many Southern countries shield local firms from outside competition for government contracts. Thus, liberalizing government procurement in both the federal and sub-federal levels has been a means to access government contracts in developing and emerging countries by firms from developed countries, such as the US and EU (Khor, 2001).

Clauses regulating government procurement have been an integral part of PTAs. Two-thirds of PTAs signed in the 2000s and notified to the WTO include government procurement clauses and close to one-third of them include comprehensive regulation of government procurement (Dawar and Evenett, 2011). Public procurement clauses can have developmental consequences, ranging from increased cost efficiency to the promotion of small- and medium-sizes companies in Southern countries. For this reason, the nature of government procurement clauses under PTAs, such as the levels of government (federal vs. sub-federal) affected and procurement thresholds applied, matter. An important factor is whether government procurement regimes in PTAs follow a positive list approach, like in the GPA, or a negative-list approach. The positive-list approach, with pre-defined coverage of commitments that applies to specifically listed procurements, provides for 'greater national flexibility and a more incremental approach to procurement reform' in Southern countries. The negative list approach, on the other hand, implies that all procurements are subject to the clauses of the agreements, except those explicitly

listed as exempt (Dawar and Evenett, 2011:374). The negative-list approach in government procurement implies that the provisions on liberalization will also apply to future activities, because such activities are not subject to limitations at the time of the signing of the PTA. Thus, the negative list approach provides ‘an automatic commitment to free trade’ regarding future activities (Fink and Molinuevo, 2008:275).

### **Trade in Services**

Although the liberalization of trade in services can bring about efficiency and reform in Southern countries, it is better implemented with caution. If the liberalization is ‘inadequate,’ it ‘may affect the strength of the domestic regulatory function, especially if the right to regulate—following best international practice—is not adequately preserved.’ Moreover, ‘developing countries may assume significant regulatory obligations that may not be appropriate for the reality and level of development of their markets.’ Thus, governments need to retain control of the regulation of trade in services, in order to make sure the benefits of liberalization are shared among all stakeholders (Sáez, 2010:11).

The WTO General Agreement on Trade in Services (GATS) has limited the ability of the governments of Southern countries to regulate services industries, ranging from financial services to education, and protect their industries from unfair competition from well-established foreign firms (Wade, 2003). Thus, rapid liberalization in cross-border provision of services that may affect the control over regulation may not be in the best interest of developing and emerging economies. In Latin America, for example, early reformers, such as Chile and Mexico, were less successful in exporting services than Brazil, which is relatively less open. India is another

example of a Southern country, which has been one of the leaders in providing cross border services, while having a high service restrictiveness index (Sáez, 2010).

Many PTAs take the liberalization of trade in services much further than what has been agreed on in the WTO GATS agreement. As was the case with government procurement, PTAs often require a negative-list approach in services, which means that governments can exclude certain services from liberalization, while the rest of the services, including the ones that can emerge in the future, are subject to liberalization. This, in effect, circumscribes a governments' ability to effectively regulate industries in services (Fink and Molinuevo, 2008).

### **Investment Measures**

FDI and other types of investment have historically been an important source for the development of national economies in Southern countries. With the increased mobility of investment across national boundaries, however, host countries, mostly in the Global South, have been facing the dilemma of retaining full control over investment regulation versus attracting FDI that increasingly requires lighter regulation. Because capital has become highly mobile, while unskilled labor in Southern countries remains highly immobile, FDI recipient countries, in effect, compete for investment from developed countries, which, enabled by the high relative mobility of FDI over unskilled labor, enjoyed enhanced bargaining power and the privilege to choose the most attractive investment destinations. As a result, developing and emerging economies have felt the need to become more attractive to FDI, among other things, by giving up lots of policy measures related to investment regulation (Frieden, 1991; Rodrik, 1997).

Global investment rules have become more stringent with the establishment of the WTO Agreement on Trade-Related Investment Measures (TRIMS). For example, a number of

measures, such as local content requirements, which oblige foreign investors to use certain amount of local input in their productions, and trade balancing requirements, which obliges the use of a sufficient amount of local inputs in exports to maintain the import-export balance, are outlawed under TRIMS (Shadlen, 2005b). The TRIMS agreement, however, does not prevent countries from imposing certain performance requirements, such as export requirements in relation to investments in free-trade zones, local participation in equity, technology transfer, and local employment. These measures are, however, almost entirely restricted under most PTAs (Correa and Kumar, 2003).

PTAs have provisions, such as establishment, non-discrimination, national treatment, investment regulation and protection, which define the scope and depth of these agreements. Establishment is a critical market access component for foreign investors referring to either the creation of a new firm in the host country or the acquisition of an existing firm. It defines the terms under which foreign investors can invest and manage their investment, and hence the scope and depth of these rules define the scope of a PTA. Non-discrimination limits the ability of the host country to distinguish between different categories of investment when applying regulatory measures, while national treatment implies that domestic and foreign-owned companies must be treated equally. Investment regulation and protection provide for terms that limit a governments' ability to restrict the activities of foreign investors and expropriate their investment (Miroudot, 2011).

Investment-related dispute settlement is one area where Southern countries have experienced limited policy autonomy. The Dispute Settlement Understanding (DSU) of the WTO TRIMS agreement provides a new platform for binding international rules, which is different from the consensus-based dispute settlement mechanism under the pre-1994 GATT, whereby a single

country could block decisions. Notwithstanding its novel approach, however, the DSU appears ‘as inadequate in the eyes of investors’ that seek further-reaching investment protection rules under preferential accords (Horlick and Marti, 1997:43-44). Moreover, the TRIMS agreement, as the term suggests, focuses merely on ‘trade-related’ investment, whereas capital-rich developed countries seek to negotiate further-reaching investment-related clauses in PTAs that would regulate all types of investment, including in services and financial institutions (Shadlen, 2008; van Harten, 2005; Capling and Nossal, 2006; Miroudot, 2011).

A major provision that exists in many PTAs (and in virtually all the US agreements<sup>22</sup>) is investor-state arbitration, which allows private firms to file lawsuits for damages against nation-states at the International Centre for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL) arbitration tribunals. These tribunals can award monetary compensations and restitution of property, which can be enforced in US courts through the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Dumberry, 2001; Hufbauer and Schott, 2005). In contrast, under the WTO, where dispute settlement is strictly a government-to-government affair, the dispute settlement body does not provide relief in the form of compensation to the winning party. It rather obliges the party that has violated the rules to ‘bring its measure into compliance with the obligation’ (Price, 2000:108). Intended to protect foreign investors from unfair treatment by host countries, investor-state arbitration clauses require countries to give up some of their sovereignty, including over matters such as environment and public health. Many investor-state arbitration cases under NAFTA, for example, had little to do with the seizure of property, which is what such clauses are intended to prevent. Instead, the cases have challenged national environmental and public health

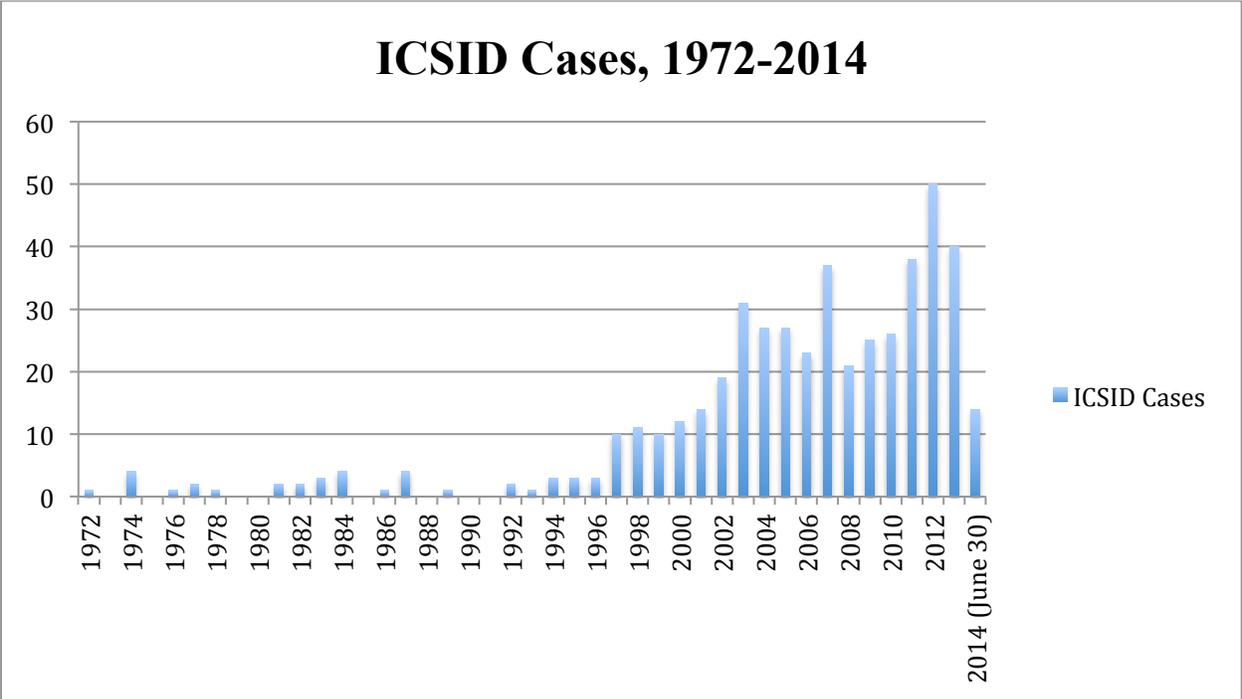
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<sup>22</sup> With probably the only exception being the US-Australia PTA (Capling and Nossal, 2006).

laws and regulations, obliging governments to pay significant sums to private firms as compensation for forgone profits (Public Citizen, 2001; 2005; Economist, 2014c).

In fact, with the proliferation of PTAs during the last quarter century, the number of cases filed at ICSID rose rapidly (see Figure 3.2.1). As of 30 June 2014, ICSID had registered a total of 473 cases. 421 of these cases were registered between 1997 and 2013. Only 38 cases were registered before 1997, and 14 cases during the first half of 2014. South America and East Europe & Central Asia were the two biggest regions involved in ICSID arbitration. States from these regions were involved in 27 per cent and 24 per cent of ICSID cases, respectively, as of June 2014. On the other hand, states from developed regions, such as North America and Western Europe, were involved in only 5 per cent and 3 per cent of all cases, respectively. 63 per cent of all ICSID cases were filed under BITs, and the remaining cases under other arrangements, including PTAs (ICSID, 2014).

**Figure 3.2.1. The number of ICSID cases, 1972-2014**



Source: ICSID (2014:7)

One aspect of investor-state arbitration that has been widely criticized by development NGOs is that many developing and emerging economies, recipients of investment, lack an appropriate legal system or judicial traditions so that investor-state arbitration is conducted based on their jurisdictions. As a result, investor-state arbitration has been carried out in jurisdictions other than that of the host state, which has circumscribed the abilities of host governments (mostly in Southern countries) to control the process of litigation (Kurtz, 2002). Such provisions of North-South PTAs have made the protection of public welfare increasingly difficult for Southern countries. NAFTA and CAFTA-DR, for example, prohibit direct or indirect expropriation of foreign investment unless it is for public purpose and with full compensation. Moreover, the definition of expropriation is quite broad, covering also direct and indirect measures ‘tantamount to nationalization or expropriation’—a wording that gives ICSID arbitrators broad room for interpretation (Hufbauer and Schott, 2005:206-207; Robert, 2011). The very idea of public purpose seems to be a matter of challenge at ICSID hearings. Even measures like a government’s anti-smoking policies have been viewed by tobacco producers as violating investment protection provisions, as Philip Morris International, a US firm, filed a lawsuit at ICSID against Uruguay for alleged violation of their BIT as a result of smoking restriction policies by the Latin American country (Economist, 2013b).

Moreover, clauses prohibiting indirect expropriation under PTAs might extend to areas such as tax legislation, which has historically been a strictly domestic matter. As noted by Rodriguez (2006:3), ‘protection to USA investors under an FTA could reach unsuspected dimensions via indirect expropriation arbitration claims where domestic tax matters could rise to the level of investment disputes.’ This will inevitably lead to restrictions in Southern countries’ ability to implement fully autonomous domestic tax policies. The example cited by Rodriguez (2006) was

a VAT dispute between Occidental Exploration and Production Company and Ecuador (1 July 2004), over which the London Court of International Arbitration ruled that the claimant, a private company, had the right to a VAT refund from Ecuador. Notwithstanding Ecuador's intentions to challenge the decision before a local court, the very possibility of such a ruling circumscribes Southern countries' sovereignty over domestic tax policy. In another dispute between Occidental and Ecuador, 'over its (apparently lawful) termination of an oil-concession contract,' ICSID tribunal awarded in 2012 damages of USD 2.3 billion, the largest award as of 2012 to be issued by an ICSID tribunal, to be paid to Occidental by the state of Ecuador (Economist, 2014d; Cheng and Bento, 2012).

Although the supporters of strong investment protection rules, including direct investor-state arbitration, argue that such clauses are necessary for protecting investors from state seizure of private property, 'investor-state cases filed to date have had little to do with government seizure of property. Instead, the cases challenge laws, regulations, court decisions and other government actions at the national, state and local level' (Public Citizen, 2005:xix). Investor-state arbitration clauses considerably constrain the sovereignty of nation-states in the management of foreign investments. By giving private arbitrators power to judge on claims by private investors against nation-states, this 'hybrid' legal system 'provides significant advantages to multinational enterprises at the expense of governmental flexibility' (van Harten, 2005:600).

Investment-related clauses of most PTAs are, therefore, highly restrictive for autonomous industrial policies of nation-states. These restrictive provisions have been more of a concern for Southern countries, as although the trend may have started to reverse itself since recently, developing and emerging economies have traditionally been net recipients of FDI (Kurtz, 2002). In order to maintain 'investor confidence' and secure more investment amid stiff competition for

FDI, investment regulation in developing and emerging countries has often been relaxed, which has harmed the working class in many Southern countries (Arnold, 2006:196).

### **IPRs**

The overarching debate in IPRs rests within the dichotomy of granting innovators temporary exclusive private rights over the invention (thus, giving them incentives to keep on inventing and furthering the boundaries of science) and giving the users of inventions, who, by definition, are the beneficiaries of technological progress, better access to these inventions. In the current setting, the global policy of IPRs is dominated by the ‘producers’ of IP, meanwhile ‘consumers,’ predominantly consisting of Southern countries, lack the voice and political clout to push for their own agenda (CIPR, 2002). It is worthwhile to mention that, despite some evidence that weak IPRs protection in host countries deter investment in high-tech industries (Smarzynska Javorcik, 2005), in general, strong IPRs protection alone in Southern countries does not necessarily ensure technology transfer and FDI. If this were the case, most FDI flows would have gone to Sub-Saharan Africa and Eastern Europe and not to Brazil, China, and other high-growth countries with weak protection of IPRs. Thus, FDI flows are more correlated with factors like market size, growth rates and prospects, factor prices, and trade costs rather than with the level of IPRs protection (Maskus, 2005).

IPRs have probably been the most sensitive area of North-South cooperation. This is not surprising, given that developing countries’ share in patents held globally has historically been at very low levels, comprising less than 2 per cent during 1977-1996 (Correa, 2000b:5). The picture has not changed much recently, for the share of developing countries in the filings for IPRs in 2012 was around 3 per cent (WIPO, 2013). Moreover, as of 2000, developed countries received

97 per cent of all patent royalties, while the World Bank estimated figure of annual South-to-North profit transfer under the TRIPS agreement was about USD 41 billion (Gallagher, 2008:69). As a result, the profit of the ten largest pharmaceutical companies in the US, for example, amounted to some USD 36 billion in 2002, who also made generous contributions to political campaigns, which amounted to almost USD 30 million in 2003 (Oxfam, 2003). In fact, the negotiations for the establishment of the TRIPS agreement were one of the most controversial in the Uruguay Round. The inclusion of IP rights into the negotiation agenda was initiated by the US, which was backed by other developed economies, such as the EC, Japan, and Switzerland. The US and EC even exerted pressure in the form of trade retaliations on major economies in the Southern country camp, such as Brazil, Korea, and India, who resisted the inclusion of IPRs in the Uruguay Round of negotiations. Through its Section 301 of Trade Act of 1974 and its amendments, namely the 1984 amendment and the Special 301 of 1988, the US made the violation of IPRs 'actionable' and provided the USTR the authority to act against countries that provided insufficient protection of IPRs. In the words of one participant of the negotiations (cited in Shadlen (2004:83)), 'given a choice between American sanctions or a negotiated multilateral agreement, the TRIPS agreement began to look better.' The strong North-South divide over the terms of the inclusion of IP rights into the new agreement was finally reconciled as a result of strong pressure from Northern countries, and the TRIPS agreement was signed, representing mostly the preferences of developed countries (Pugatch, 2004; Shadlen, 2004).

Contrary to the promise that Northern and Southern countries alike would enjoy the benefits of TRIPS, the supposed inflow of capital and innovation into developing and emerging economies remained unproven (Correa, 2000a). In fact, it has been argued that the IPRs

measures incorporated into trade-related agreements have been specifically tailored to the needs of technology-intensive industries in Northern countries, while Southern countries could, at best, marginally benefit from international IPRs rules (Dutfield, 2008; von Braun, 2012).

IP regimes influence national public health policies by affecting access to pharmaceutical products in developing and emerging economies. The proposed TRIPS-plus provisions of the Doha Round and most North-South PTAs would restrict the public health safeguards available for Southern countries under the WTO. As a result, millions in Southern countries have not been able to afford vital new medicines for diseases, such as HIV/AIDS (Oxfam, 2003; 2004; 2006; MSF, 2003; 2004; Fink, 2011; Scott and Harman, 2013). Because pharmaceutical products were not patentable in many Southern countries until the TRIPS agreement came into force in 1995, developing countries were able to enjoy cheaper access to vital drugs. Many PTAs, however, through what is known as ‘pipeline’ protection, require Southern countries to automatically grant patents to non-novel<sup>23</sup> drugs that were invented before they became patentable in their countries. A drug that was developed, say, in 1990 and was not patentable in a developing country, but was in a phase of clinical trials by 1995 and, thus, in the ‘pipeline,’ could be required by a PTA (NAFTA, in particular) to be granted a patent in a Southern country for the same period as in the original patent granted in another, usually Northern, country (Maskus, 1997; 2000; Shadlen, 2005c; 2009). Subramanian (1994) reckons that welfare losses to smaller developing countries as a result of high levels of pharmaceutical patent protection outweigh the gains to pharmaceutical companies, hence hinting that stringent IPRs protection may result in net welfare loss. Moreover, retroactive ‘pipeline’ protection of IPRs would increase the welfare losses to individual developing countries by more than 2.5 times.

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<sup>23</sup> Novelty has traditionally been a key requirement for filing for a patent. Patentable drugs have to be novel, non-obvious (include an inventive step), and have an industrial application (Correa, 2000a; Shadlen, 2009).

North-South PTAs restrict third party use of patented products. Most importantly, they limit governments' ability to issue compulsory licenses on patented products. Defined as the host country's ability to grant a local manufacturer rights to produce and distribute patented products without having to obtain consent from the patent holder, compulsory licenses have historically been in the arsenal of countries as a mechanism to interfere in the local IP regime (Maskus, 1997; Correa, 1999; 2000a; Shadlen, 2005c; Fink and Reichenmiller, 2005; Timmermans, 2006; Fink, 2011). Under TRIPS, as reaffirmed under the Doha Declaration on the TRIPS Agreement and Public Health of 2001, countries are free to issue compulsory licenses on whatever ground they choose. There are, of course, certain conditions to be met, but the grounds on which compulsory licenses are issued are left to the discretion of the issuing country. These conditions can be avoided in cases of national emergency, and each country is free to define what constitutes a national emergency. This, however, is not the case under most PTAs. Compulsory licenses on the grounds of local working requirement—implemented by Brazil and India as an important part of their industrial policy under TRIPS—are prohibited under most PTAs (Abbott, 2002; 2004; Fink and Reichenmiller, 2005; Odell and Sell, 2006; Shadlen, 2008).

The Doha Declaration of 2001 was a major achievement for Southern countries, as before 2001, many of them had difficulty using TRIPS-compliant measures for development- and emergency-related purposes. In 1997 and 1998, Thailand, for example, intended to produce a generic version of an AIDS drug to contain the AIDS epidemic in the country. Thailand, however, had to abandon this initiative when faced with sanctions threats by the US, lobbied by the Pharmaceutical Research and Manufacturers Association (PhRMA), a group that represents the pharmaceutical industry in the US. A similar situation was around South Africa's willingness to issue compulsory licensing for HIV/AIDS drugs to contain its own epidemic in December

1997. With a push from PhRMA, the US suspended South Africa's duty-free access to the US market through the GSP, while local subsidiaries of PhRMA companies in South Africa challenged the Mandela government's decision to issue compulsory licenses for HIV/AIDS drugs on the grounds that it violated the provisions of the TRIPS agreement. The whole issue attracted lots of attention from NGOs and mass media in the North, which eventually led to the Doha Declaration of 2001 (Odell and Sell, 2006). The 2001 Doha Declaration reaffirmed the right of developing countries to utilize TRIPS-compliant tools for development- and emergency-related policies. Under PTAs, however, IP-related measures have been getting more restrictive. Notwithstanding the Doha Declaration, most North-South PTAs—especially those of the US—prohibit Southern countries' rights to utilize the development-friendly clauses of the TRIPS agreement (Oxfam, 2003; Abbott, 2004).

Compared to TRIPS, most North-South PTAs are more restrictive on parallel importation, too. When a patented product is available in another market, it can be imported to the local market to create competition with the local producer, and thus push down the price. The exhaustion of IP rights can occur internationally, nationally, and regionally. Under international exhaustion, parallel importation is allowed because the right to control distribution is exhausted upon first sale. Whereas, under national exhaustion, IPRs holders can restrict parallel importation because sales within a specific nation exhausts only national rights to control distribution. A hybrid system of regional exhaustion allows parallel importation within a certain region but prohibits parallel importation from outside the region. TRIPS Article 6, as a result of strong pressure from Southern countries, maintains countries' rights for parallel importation. Once the patented product is available in markets elsewhere, the patent holder exhausts its exclusivity and parallel importation becomes possible (Maskus and Chen, 2005). According to Chang

(2007:123), African countries with high rates of HIV/AIDS prevalence managed to import antiretroviral drugs (ARVs) from generic producers, such as India and Thailand, at around 2-5 per cent of the cost of the patented drugs. Parallel importation has been especially important for countries that lack capacities for domestic production in order to take advantage of compulsory licensing provisions of the TRIPS agreements. Parallel importation is, however, prohibited under NAFTA and other North-South PTAs on the grounds of national doctrines of patent exhaustion (Correa, 2000a; Levis, 2006; Shadlen, 2009).

Most North-South PTAs call for the protection of test data on drugs' safety and efficacy submitted to national regulatory authorities for the approval of new pharmaceutical products. During the period of protection, generic producers cannot use or rely upon these data to apply for marketing approval of generic drugs based on their bioequivalence to the already approved products (Shadlen, 2005c; Fink and Reichenmiller, 2005; Correa, 2006; Fink, 2011). Test data exclusivity is also provided by the TRIPS agreement. More specifically, TRIPS Article 39.3 states:<sup>24</sup>

Members, when requiring, as a condition of approving the marketing of pharmaceutical or of agricultural chemical products which utilize new chemical entities, the submission of undisclosed test or other data, the origination of which involves a considerable effort, shall protect such data against unfair commercial use. In addition, Members shall protect such data against disclosure, except where necessary to protect the public, or unless steps are taken to ensure that the data are protected against unfair commercial use.

Data protection against 'unfair commercial use' gives the first applicant a temporary exclusive right over the use of test data obtained via lengthy and costly procedures. Data exclusivity under TRIPS does not, however, prevent generic producers in Southern countries from developing and marketing generic versions of off-patent drugs. In a number of countries,

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<sup>24</sup> The text of the WTO TRIPS agreement, available at [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips\\_04d\\_e.htm](http://www.wto.org/english/docs_e/legal_e/27-trips_04d_e.htm) (accessed 3 December 2015).

such as Argentina, Brazil, and Israel, authorities have approved third party applications for similar products based on their bioequivalence to the already approved products (Correa, 2002; 2006; Reichman, 2004). TRIPS Article 39.3 does not explicitly provide for a period of data exclusivity, but merely states that ‘undisclosed test or other data’ must be protected from ‘unfair commercial use’ and ‘disclosure,’ and leaves it up to the individual country to determine what constitutes as ‘unfair commercial use’ (Mercurio, 2007:226). Some additional loopholes in TRIPS Article 39 include the following. Firstly, TRIPS allows countries to rely upon data approved in foreign countries. Secondly, TRIPS refers to ‘undisclosed data’ and does not cover data that are publicly available. Thirdly, data protection encompasses only new chemical entities, which at the discretion of national governments can exclude second indications, new formulations, and other types of new use of old drugs. Finally, the data should be a result of ‘significant investment’ to qualify for protection under TRIPS Article 39. In other words, the formulation under TRIPS is quite vague that leaves Southern countries with leeway in their interpretation and treatment of test data (Correa, 2006:84).

Because, data exclusivity under TRIPS was not what developed countries were seeking in the TRIPS negotiations, Northern countries managed to incorporate further-reaching test data exclusivity clauses in North-South PTAs that go much beyond the TRIPS provisions. Most US PTAs require the introduction of test data exclusivity for at least five years, which constitutes a far stronger wording compared to the TRIPS requirement of the protection of undisclosed test data against ‘unfair commercial use.’ The exclusive protection of test data was intended to cause an additional barrier for generic firms. Generic producers would have to undergo costly clinical trials to be able to market generic versions of products after patent periods are over and would not be able to free ride by merely demonstrating the bioequivalence of generic drugs to the

patented medicines. This raises ethical questions, as regulation under PTAs bring about repeated expensive clinical trials solely for commercial purposes (Shadlen, 2005c; Fink and Reichenmiller, 2005; Abbott, 2006a; 2006b; Correa, 2006; Fink, 2011).

Although a test data exclusivity period of five years is less than the patent period of twenty years, it becomes an additional obstacle for Southern countries to make effective use of compulsory licenses. That is, even if a compulsory license has been granted, generic producers cannot produce drugs without undergoing costly and lengthy procedures of submitting trial data to prove the safety and efficacy of drugs (Fink and Reichenmiller, 2005). Moreover, when a drug is registered for a 'second indication,' before the expiry of the patent, a new period of test data exclusivity can be granted, which may be extended beyond the patent term, thus creating obstacles for generic production of off-patent drugs. Furthermore, a number of North-South PTAs refer to 'information' instead of 'undisclosed data.' The former is a broader term that may prevent generic producers from relying on data that are in the public domain (WHO, 2006).

Some North-South PTAs allow early working provisions. When the patent period expires, the drug goes into the public domain, and companies can produce generic versions of the drug based on the patented information. If the generic product development was allowed only after the expiry of the patent, the term of the patent would be effectively extended by the time it takes generic producers to produce the drug based on the patented information and get approval from healthcare authorities. For this reason, generic producers usually start the production of generic drugs before the patent expires, even though they need to wait until the end of the patent period to start marketing their products (Shadlen, 2009). Test data exclusivity periods, however, restrict the options of generic producers to take advantage of early working requirements by providing

additional restrictions to get marketing approval of generic drugs based on their bioequivalence to the patented medicines (Correa, 2006; Fink, 2011).

The potential negative effects of TRIPS-plus provisions of North-South PTAs on public health in Southern countries has raised concerns in a number of international organizations, which called for the relaxation or outright elimination of restrictive IPRs clauses in North-South PTAs (MSF, 2003; 2004; WHO, 2006). In fact, policies in Southern countries in response to the restrictive effects of the post-Uruguay Round IP regime were different. Brazil, for example, tried to push itself away from restrictive IP regimes, whereas Mexico's IP regime went in the other direction. Brazil tightened the requirements of obtaining pharmaceutical patents and amended its IP regulations to push down drug prices by allowing for more compulsory licenses and competition from generic producers. The patent laws of Mexico, on the other hand, made obtaining compulsory licenses more difficult, while the production of off-patent generic drugs became more complicated. Although there is no single factor that explains such a diversion of IP policies between Mexico and Brazil, 'the transformation of Mexico's pharmaceutical sector is not unrelated to NAFTA' (Shadlen, 2009:42). From the legal prospective, Brazil-style IP reforms were possible in Mexico, too, but political obstacles created by NAFTA prevented such reforms from occurring in Mexico, and the country went in the opposite direction (Shadlen, 2009).

IP regimes matter a lot for public policies. The diverging IP regimes of Brazil and Mexico in the late 1990s and early 2000s considerably affected the domestic public health policies of these countries. Brazil, which succeeded in distancing itself from restrictive IP regimes, managed its public health challenges more successfully. Brazil's response to an HIV/AIDS epidemic is a case to the point. Brazil passed a law in 1996 that entitled Brazilian citizens to free ARV drugs. Because of the epidemic by the late 1990s, the spending on ARVs was consuming a third of the

Health Ministry's budget for drugs. To prevent the HIV/AIDS treatment program from becoming unsustainable, the Brazilian government took measures to lower its costs by moving to the generic versions of new drugs. In doing so, Brazil modified its IP regimes by granting more powers to its healthcare authorities in reviewing patent applications, making compulsory licenses more accessible and using them as a tool for lowering the prices of patented drugs, and facilitating the entry of post-patent generic drugs into the market (Cohen and Lybecker, 2005; Shadlen, 2009).

In contrast, Mexico's IP regime was becoming TRIPS-plus, *inter alia*, because of its accession to NAFTA. As a result, Mexico responded to its public health challenges in a fundamentally different manner. The response to its HIV/AIDS epidemic was less comprehensive. Mexico could neither afford a Brazilian style obligation of providing free ARVs to its citizens, nor was it able to prevent the price increase of medications at a rate well above the inflation rate in the wake of the 1994 peso devaluation. Drugs were provided through the private sector, and most of those without medical insurance lacked access to treatment (Shadlen, 2009).

The subsequent three chapters discuss US, EU, and Japanese North-South PTAs with selective emerging and developing countries in the Global South that are especially active in North-South preferential trade relations, namely Mexico, Chile, Korea, Colombia, and Peru. Chapters 4, 5, and 6 provide comparative overviews of the North-South PTAs as per policy areas outlined in this chapter. Although the North-South PTAs are assessed from the Southern countries' perspectives, for the sake of convenience, the subsequent three chapters are organized around Northern countries.

#### 4. An Assessment of US North-South PTAs: A Comparative Overview

The US became particularly interested in regional and bilateral trade agreements in the early 1990s, when NAFTA was negotiated and signed. The second wave of US active pursuit of PTAs emerged during the 2000s, when a big number of US PTAs (mostly North-South) were negotiated. The signing of the TPP on October 5, 2015 and intensive negotiations with the EU in the framework of the Transatlantic Trade and Investment Partnership (TTIP) open up a new chapter of US preferential trade negotiations. All these periods coincided with Trade Promotion Authority (TPA) legislation (also known as ‘fast track’ authority), which, passed by Congress, gives the US executive branch a mandate and power to negotiate free trade agreements, which Congress can either approve or reject but cannot propose amendments or changes.<sup>25</sup> The TPA legislation of 1988 and its extension during the early 1990s helped the US sign and implement NAFTA, whereas the TPA legislation of 2002 was successfully exploited by USTR Robert Zoellick to strike a number of PTAs in the 2000s, including with Chile, Singapore, Australia, Central America,<sup>26</sup> Peru, Colombia, Panama, and Korea. No new US PTAs were signed between 2007, when the TPA Act of 2002 expired, and June 2015, when TPA legislation was renewed with the aim of completing the TPP and TTIP. In fact, the US was quick to take advantage of that fact and swiftly concluded the TPP talks with 11 other Pacific Rim countries in October 2015. The agreement awaits ratification in the member-states’ parliaments (Sahakyan, 2015).

Although NAFTA, one of the most prominent US PTAs, was signed in the early 1990s, the US embrace of preferential liberalization via PTAs started from the early 2000s, which was

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<sup>25</sup> TPA is believed to enhance the capability of the executive branch to strike free trade agreements. Moreover, there seems to be a positive relationship between the availability of TPA legislation and successful negotiations of free trade deals by the US (Destler, 2005; Sahakyan, 2015).

<sup>26</sup> Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

partly a result of the stalemate in multilateral negotiations. Because WTO deals require unanimous approval of all its members, progress in the WTO has been slow and mostly based on the lowest common denominator of its members' aspirations, which could not satisfy the US with its ambitious trade liberalization agenda. As a result, with the passage of the TPA Act of 2002, the US decided to pursue a rigorous regional trade agenda and promote trade liberalization in other parts of the world via PTAs (Zoellick, 2003; Cooper, 2014).

US national interests have been reflected in four main PTA strategies: firstly, create 'asymmetric reciprocity' to open up markets favoring US exporters and investors; secondly, create catalysts for competitive liberalization; thirdly, support domestic pro-liberalization and reformist actors in potential partner countries; finally, strengthen strategic partnership (Feinberg, 2006:95). With some overlap with the criteria outlined above, Schott (2004) lays out US PTA partner selection criteria that include the following: (1) domestic politics, *i.e.*, gaining favorable attitude and support from domestic political forces and business lobby groups; (2) economic policy considerations, *i.e.*, promoting the interests of US exporters and investors in the foreign country and leveling the playing field vis-à-vis their competitors from other countries; and (3) the commitment of the partner country to undergo comprehensive liberalization that goes beyond the WTO commitments.

Opening up new markets through 'competitive liberalization,' *i.e.*, forcing other countries to liberalize if they do not want to lose out while their competitors enjoyed preferential access to the US market, has been an important trade policy tool in the arsenal of US trade negotiators throughout the 1990s and 2000s (Zoellick, 2002, Weintraub, 2004; DeRosa, 2004). Although the US has been a path-breaker in promoting trade liberalization in other parts of the world, there were countries and regions where PTAs emerged without US participation. The proliferation of

such North-South PTAs would disadvantage US exporters and investors in these markets, and would trigger action to neutralize any possible adverse effects. Thus, in order to free itself from the need to mitigate the adverse effects of other North-South PTAs on its multinationals, proactive participation in North-South PTA negotiations, *i.e.*, getting ahead of other developed economies to sign North-South PTAs, became a priority for the US (Schott, 2001). This is, in fact, what happened during the 2000s, when, having secured TPA legislation in 2002, the US government signed a number of important North-South PTAs with countries, such as Colombia, Peru, and Korea.

The remaining part of this chapter seeks to account for ‘competitive liberalization’ in US preferential trade relations with developing and emerging economies, particularly Mexico, Chile, Korea, Colombia, and Peru. The following sections attempt to assess the US North-South agreements from the viewpoint of its trading partners and establish whether and to what extent the outcomes in first-order and second-order agreements are brought about by factors related to the sequential order of the agreements. The assessment of the US first-order and second-order North-South PTAs is carried out based on the criteria outlined in Chapter 3 and is summarized in Chapter 4.6.

#### **4.1. NAFTA<sup>27</sup>**

The initiative to create the North American agreement was announced in 1990 by Mexico’s president Carlos Salinas and US President George W. H. Bush. Canada also joined, motivated by the fear that its privileges from the 1989 US-Canada PTA would have diminished if it had stayed

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<sup>27</sup> For the purposes of this thesis, the examination of NAFTA has been carried out mostly from the lenses of the relationship between Mexico and the US. Canadian perspectives have been added occasionally as deemed necessary.

out. Formal negotiations started in 1991 and were completed with the signing of the North American Free Trade Agreement on 17 December 1992, which entered into force on 1 January 1994 (Dumberry, 2001; Hufbauer and Schott, 2005).

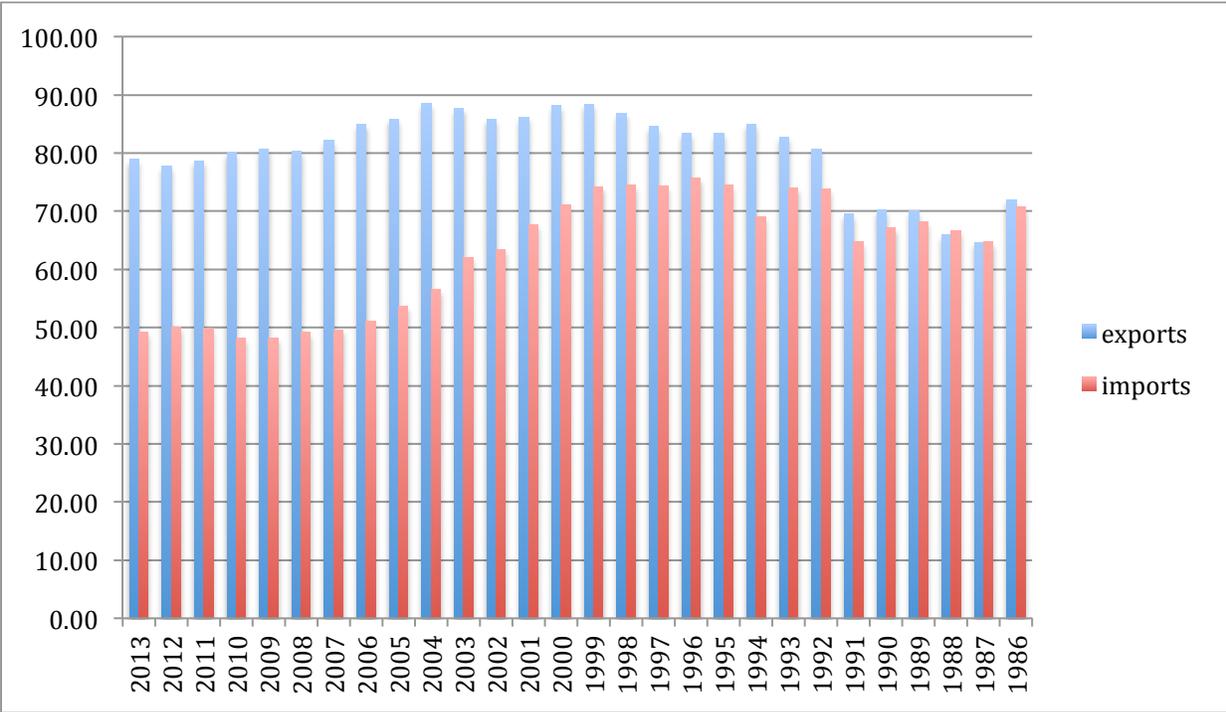
The asymmetric relationship between the countries, given the sheer size of the economies and Mexico's high degree of trade and investment dependence on the US, was a distinctive feature of the NAFTA negotiations, which kept the Mexican government wary of possible negative consequences of the agreement. Thus, it was not surprising that until 1988 the Salinas government was considering multilateral liberalization in the framework of GATT and not a preferential deal with the US. President-elect Carlos Salinas opposed a preferential deal with the US and was quoted by *The New York Times* (1988), saying, 'I believe that through the GATT we have a multilateral way to deal with our neighbors. There is such a different economic level between the United States and Mexico that I don't believe such a common market would provide an advantage to either country.' Moreover, he ruled out the possibility of even a modest agreement with the US 'in the foreseeable future.'

Notwithstanding some modest steps of liberalization in the 1980s, such as the reduction of import license coverage and average tariff rates, Mexican authorities perceived NAFTA-style liberalization as unfeasible only a few years before the signing of the agreement. The economic impact of the neoliberal reforms of the 1980s was not substantial enough to produce 'a significant improvement in employment and social welfare,' a fact that may have been responsible for Mexico's skeptical attitude towards NAFTA during the late 1980s (Pastor and Wise, 1994; 1998:42). Moreover, in addition to multilateral liberalization in the 1980s, Mexico sought to reduce its dependence on the US economy, which had historically been at high levels even before NAFTA (see Figure 4.1.1). Assuming office in 1988, President Salinas made an

attempt to diversify Mexico’s trade away from the US and towards Western Europe and East Asia, but he failed to establish formal trade deals with these regions and had to embrace the US and reinforce Mexico’s economic ties with it by signing the NAFTA agreement in 1992 (Feinberg, 2003).

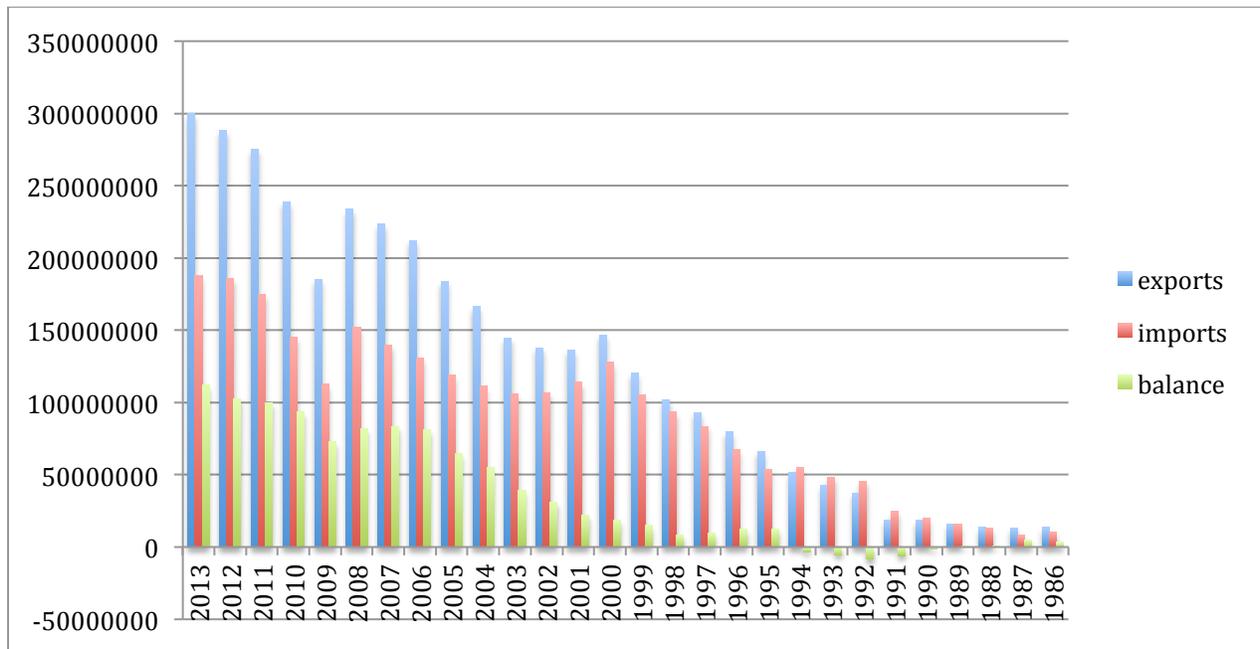
The reasons behind the shift in Mexico’s attitude towards NAFTA were numerous, ranging from unilateral trade retaliations and coercive actions from the US to changes in the geopolitical situation. ‘The US was brutal. Their positions were based on force more than on reasoning,’ said a Mexican negotiator, who could not explain such behavior on anything but the asymmetry between the countries (quoted by Cameron and Tomlin, 2000:225).

**Figure 4.1.1. Mexico’s trade with the US, as per cent of its total trade, 1986-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 25 September 2014)

**Figure 4.1.2. Mexico's trade with the US, in thousand USD, 1986-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 25 September 2014)

The asymmetry between the countries played in a geopolitical context, too. As discussed in Chapter 2.3 of this thesis, an important factor that shifted Mexico's attitude in relation to NAFTA was the US-Canada PTA that put pressure on Mexico and threatened marginalization if Mexico did not join the bandwagon. Given the US-Canada PTA, Mexico could not afford to be left out, while Canadian exports (which were converging in structure over time with that of Mexico) enjoyed preferential access to the US market. A senior Mexican diplomat was quoted by *The New York Times* (1988), saying that the US-Canada PTA augmented Mexicans' fears that, 'they will be left behind and frozen out of the economic integration of North America.' Hence, joining NAFTA was perceived by Mexico as a lesser evil than being left out of the US market while Canadian firms enjoyed preferential access (Gruber, 2000).

Canada in its turn would have faced adverse economic effects if it did not join the agreement, while Mexico was granted more privileged access to the US market. In fact, at first Canada was

reluctant to renegotiate the terms of its bilateral agreement with the US. In the words of Michael Wilson, Canadian Trade Minister, at a conference in 1991, ‘Canada is not going to let the United States get through the back door [NAFTA] what it failed to get through the front [FTA] door’ (quoted by Cameron and Tomlin, 2000:77). Reassessing its priorities, however, the Canadian government decided to join NAFTA, since being left out would have been a costlier option.

The NAFTA negotiations did not proceed without opposition in Mexico. The Foreign Ministry, for example, was against an agreement with the US, but all the negotiating authority was placed with the Trade Ministry, which was following the president’s instructions. The shift in trade policy and President Salinas’s views towards NAFTA made the agreement possible, which was approved by the Mexican Senate without much trouble (Ortiz Mena, 2004). In the fifth year of the agreement, a 1998 Newsweek article called President Salinas ‘Mexico’s all-time favorite villain,’ as after five years of implementation Mexicans would call the agreement ‘for the rich and people in power’ (quoted by Cameron and Tomlin, 2000:5).

Accounting for the actual effects of the NAFTA agreement, which are at most quite ambiguous and difficult to measure,<sup>28</sup> is not in the scope of this thesis. Instead, in light of the asymmetric relationship between the US and Mexico and the coercive power that forced Mexico to change its attitude towards NAFTA, this chapter attempts to assess NAFTA based on its provisions in tariff reduction, agricultural liberalization, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

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<sup>28</sup> While some scholars (Krueger, 1999; Kehoe, 2003; Caliendo and Parro, 2012; Shikher, 2012) point to the trade creating effect of the agreements, others (Heath, 1998; Audley *et al*, 2004; Romalis, 2007) claim that trade creation and welfare effects did not go hand in hand and, despite increasing trade volumes, the NAFTA welfare effects remained modest.

## Tariffs and Related Measures

The NAFTA agreement (Annex 302.2) provides for the elimination of tariffs on most goods effective immediately. Other goods placed under categories ‘B’, ‘C’, and ‘C+’ had a phase out period of 5 to 15 years.<sup>29</sup> As a result, the average Mexican tariff fell from 12 per cent in 1993 to 1.3 per cent in 2001. For the same period, the US tariffs for Mexican exports fell from 2 per cent to 0.2 per cent (Lederman *et al*, 2005). The US tried to shield sensitive sectors, such as glassware, rubber and plastic footwear, ceramic tiles, leather goods, and a list of agricultural products, from liberalization by putting them under the ‘C+’ (longest phase out category). Although the US had to agree to shorten the period of longest phase out from 25 to only 15 years, it still managed to place more item categories under the C+ list than Mexico: with three manufactured and eleven agricultural items in the C+ list, while Mexico did not place any manufactured good and only three agricultural items in the C+ category (Maxfield and Shapiro, 1998).

In addition to trade liberalization, NAFTA also phased out trade-balancing and national value added requirements, which were important industrial policy tools used by Mexico. In the auto industry, for example, trade-balancing and national value added requirements gradually fell from USD 1.75 exports for every dollar of imports and 36 per cent, respectively, in the pre-NAFTA period to full abolition by 2004 (Hufbauer and Schott, 2005).

Duty drawbacks, a measure under which tariffs on imported inputs are refunded if used as part of exported products, also were abolished as a result of NAFTA. The drawbacks were widely used in the *Maquiladora* system, whereby Mexican assemblers (usually located along the US border) were using imported inputs to assemble final products and re-export them to the US.

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<sup>29</sup> The text of the NAFTA agreement, available at <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> (accessed 3 December 2015).

Although duty drawbacks would have helped increase Mexico's attractiveness to non-US foreign investors, Americans feared that the scheme, combined with free trade, would transform Mexico into a countrywide *maquiladora* with inputs from around the world entering the US market duty-free as part of final Mexican products. Thus, the abolition of the drawback scheme was to raise the cost of non-NAFTA inputs into the Mexican products designed for the US market and to restrict the ability of outsiders to use Mexico as an export platform for accessing the US market (Abbott, 1995; Maxfield and Shapiro, 1998; Shadlen, 2005b; Shadikhodjaev, 2013; Villarreal and Fergusson, 2015).

Autos and auto parts comprised about 20 per cent of intra-NAFTA trade, the largest single sector (Hufbauer and Schott, 2005). Mexican and US priorities varied widely, as the auto sector in Mexico was still highly protected, whereas in the US it was basically open. The so-called five Mexican 'Auto Decrees' enacted during 1962-1989 allowed the importation of autos into Mexico only by auto companies that also manufactured there. There was also an export-to-import ratio requirement, according to which, for each exporter the monetary value of auto exports should have been at least 2.5 times the monetary value of imports. As a result of these restrictive policies, the imports of finished automobiles into Mexico were kept at insignificant levels just before the NAFTA negotiations. The negotiations reduced the 2.5:1 export-to-import ratio requirement to 0.8:1, which was to be eliminated in ten years, allowing anyone, and not just auto manufacturers established in Mexico, to import cars into Mexico. The US auto industry called the compromise 'the single most significant accomplishment of the NAFTA automotive negotiations,' which was largely a result of asymmetric bargaining positions between the parties (Maxfield and Shapiro, 1998:90).

The second major obstacle created by the 'Auto Decrees' for US automotive firms in the Mexican market was the strict local-content requirements, which was at 36 per cent of the value of the domestically sold automobiles. This caused a number of problems for American manufacturers in Mexico, such as a dependence on unreliable Mexican suppliers. The Mexican side opposed the outright elimination of local content requirements and agreed to only a slight immediate drop of the local-content requirement to 34 per cent, which was to phase out gradually during the first 10 years of the implementation of NAFTA. The US, however, managed to secure preferential options for American producers already established in Mexico. The exploitation of such options would lower the local-content requirement level for the already established manufacturers to as low as 20 per cent (Hufbauer and Schott, 1993; Maxfield and Shapiro, 1998). As a result of the negotiations, Mexican tariffs on finished cars were reduced from 20 per cent to 10 per cent immediately, while the remainder would phase out in ten years. The US reduced its tariffs on light trucks from 20 per cent to 10 per cent, while it would phase out altogether in five years. The remaining tariffs on cars and car parts on both sides were to be eliminated immediately or during a phase out period of 5-10 years (Maxfield and Shapiro, 1998).

### **Agriculture**

NAFTA does not have a single common text on agriculture. Instead, it is covered in three separate agreements between the US and Mexico, between Canada and Mexico, and between Canada and the US. Compared to the other two agreements, the US-Mexico agreement is far more liberalizing but it has longer phase out periods (Cameron and Tomlin, 2000; Hufbauer and Schott, 2005). At the time of the NAFTA negotiations, Mexico's average trade weighted tariff on US agricultural exports was about 11 per cent, while about 60 per cent of US agricultural exports

to Mexico were subject to restrictive import licensing requirements, as well as ‘numerous other nontariff barriers’ (Villarreal and Fergusson, 2015:4). In contrast to the agreement between Canada and the US, the US-Mexico agreement provides steps for the complete liberalization of agricultural trade. With phase-out periods of up to 15 years for sensitive products, such as corn, dry beans, winter vegetables, orange juice, peanuts, and sugar, the US-Mexico agreement provided steps for the complete liberalization of agricultural trade, with an ultimate goal of eliminating all import quotas and tariffs with no exception (USDA, 2002; Hufbauer and Schott, 2005; Cheong and Cho, 2007). The US was to eliminate 97 per cent of agricultural tariff lines on imports from Mexico within ten years, while the remaining 3 per cent would take a longer phase-out period of 15 years. Mexico instead was to liberalize over 90 per cent of its agricultural tariff lines within ten years, and another 2 per cent during a longer phase-out period. Mexico kept 70 tariff lines (7.6 per cent) out of the agreement (Cheong and Cho, 2007).

During the negotiations, the Mexican government was concerned about the domestic political consequences of liberalizing maize (and grains in general), beans, dairy (milk powder), sugar, and pork markets. Nevertheless, Mexico had to open up agriculture, including the sensitive areas, in order to get access to the US market for its winter vegetable and fruits sector, which was an important and powerful export industry in Mexico. Putting maize on the negotiation table and liberalizing agriculture across the board ‘was probably the single most important concession made by Mexico,’ as it was going to affect the lives of millions in the country (Cameron and Tomlin, 2000:110).

Agricultural interests in the US, on the other hand, were fragmented. Growers of certain crops lobbied for free trade, while a smaller number of producers were opposed to it. Fruit and vegetable procurers in the US, especially those growing oranges and tomatoes, were opposed to

free trade, arguing that even the longer phase out periods of tariff elimination will only ‘delay the pain’ caused by free trade (Maxfield and Shapiro, 1998:102). The US was the largest producer of corn in the world, thus eliminating or substantially reducing tariffs on corn was a priority for the US. In fact, NAFTA did reduce the tariff rates on corn, which cost the Mexican government at least USD 2 billion in tariff revenues (Hufbauer and Schott, 2005). As a result of domestic lobbying, the US was inclined to concede in orange juice for better access to the Mexican market for corn and other products. This is what Mexico agreed to, ‘based on the fact that Mexico’s inefficient corn producers have little chance of ever becoming internationally competitive’ (Maxfield and Shapiro, 1998:102). As a result, Mexico received an immediate 50 per cent tariff cut for Mexican exports of 40 million gallons of orange juice per year to the US market, which would lead to tariff-free access within 15 years (Maxfield and Shapiro, 1998).

The negotiations over agricultural subsidies, a sensitive issue in the US, produced mixed outcomes with an ambiguous wording. A number of agricultural producers were subsidized in the US. For example, in 2002, US corn exporters to Mexico received export credits of about USD 680 million, about 20 per cent of the US total (Hufbauer and Schott, 2005). Although the American Farm Bureau supported the elimination of agricultural subsidies, the wording on the issue was ‘imprecise,’ leaving the efficiency of the measures dependent on bilateral cooperation between Mexico and the US and the actions of dispute settlement committees (Maxfield and Shapiro, 1998:105).

In sum, agricultural liberalization, albeit with longer phase out periods, went in line with the priorities of the parties. It should, however, be noted that priorities, especially in the US, were fragmented, with different groups lobbying for different outcomes. Mexico managed to secure preferential access to the US market for its key agricultural exports, such as orange juice and

fruits, while the US pushed for its priorities and opened up the Mexican market for corn (and grains in general), despite the worries south of the border that it may negatively affect the livelihood of poor Mexicans.

### **Government Procurement**

The US wanted better access to government procurement in Mexico, from which US firms were largely excluded at the time of the negotiations. More specifically, the US wanted to limit the number of contracts available for internal bidders only, and increase the number available for open bidding on a non-discriminatory basis by both US and Mexican firms (Maxfield and Shapiro, 1998). Unlike the US, Mexico was not a member of the WTO GPA,<sup>30</sup> a plurilateral agreement on government procurement that is optional for WTO members to join, at the time of the negotiations. Hence the new government procurement-related provisions of NAFTA were going to have a greater effect on Mexico and its flexibility in regulating bidding for government purchases.

The negotiations were mostly around the thresholds, above which government procurements were to be open for non-discriminatory bidding by firms from both countries. The initial US position for the thresholds was USD 25,000 for goods and services contracts procured by federal government entities, USD 175,000 for goods and services contracts procured by federal government enterprises, and USD 6 million for construction constructs procured by federal government entities. Meanwhile, the Mexican position was USD 200,000 and USD 400,000 for goods and services contracts procured by federal government entities and enterprises respectively, and total exclusion of US firms from construction contracts of Mexican federal

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<sup>30</sup> The list of GPA signatories can be found on the WTO website, available at [http://www.wto.org/english/tratop\\_e/gproc\\_e/memobs\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm) (accessed 3 December 2015).

entities. The actual figures (see Table 4.1.1) represent the bargained outcome, which favors the US position (Maxfield and Shapiro, 1998).

The government procurement provisions of NAFTA go beyond those in the US-Canada PTA covering new entities and sectors, including services. The procurement thresholds outlined above are especially significant for Mexico because NAFTA allows competitive access to procurements of PEMEX, the Mexican government-owned oil giant, and CFE, the government-owned major electricity producer. In return, the US waived its Buy America requirements but retained small-business set-asides, which represent federal government purchases of up to a certain level that are set aside for small businesses in the US (Cameron and Tomlin, 2000).

**Table 4.1.1. Government procurement thresholds of NAFTA**

	Procurement by federal government entities, in USD	Procurement by federal government enterprises, in USD	Construction contracts by federal entities, in USD	Construction contracts by federal government enterprises, in USD
Proposed by the US	25,000	175,000	6,000,000	
Proposed by Mexico	200,000	400,000	Exclude from US bidding altogether	
NAFTA final text	50,000	250,000	6,500,000	8,000,000

Source: Maxfield and Shapiro (1998) and the NAFTA text<sup>31</sup>

The inclusion of procurements by sub-federal entities could have been regarded as more favorable for the Mexican side, for the amounts of procurement by Mexican states were small and not attractive for the US. However, the wording of the clause covering the procurement of sub-federal entities turned out to be quite vague, whereby ‘the Parties shall endeavor to consult

<sup>31</sup> The NAFTA agreement, available at <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> (accessed 3 December 2015).

with their state and provincial governments with a view to obtaining commitments, on a voluntary and reciprocal basis, to include within this Chapter procurement by state and provincial government entities and enterprises.’ This allowed leeway for different interpretation and loopholes to shield procurement by US states from outside participation. As a result, the negotiations on government procurement can be regarded as ‘a victory for the United States,’ for the NAFTA text goes mostly in line with US preferences (Maxfield and Shapiro, 1998:108).

### **Trade in Services**

Services, especially financial services, were a contentious issue during the NAFTA negotiations. The initial positions of Mexico and the US on the liberalization financial services were diametrically opposed, with Mexico wanting to keep financial services off the table, while the US called for deep liberalization, favoring them so much that it did not envision NAFTA without financial services liberalization. Under US pressure, however, Mexico later modified its position calling for permanent caps on foreign ownership and insisting on subsidiaries over branches as a means of the establishment of foreign firms (Cameron and Tomlin, 2000).

NAFTA liberalization of trade in services turned out to be deep and ‘far more extensive’ than WTO GATS measures. Firstly, the NAFTA services chapter provides a ‘negative list’ of the sectors that are not covered by the measures; that is, liberalization measures are extended to all services, except for those on the list. In contrast, GATS provides a ‘positive list’ of sectors that are covered by the liberalization measures, whereas all other services are excluded (Abbott, 1995; Cameron and Tomlin, 2000; Hufbauer and Schott, 2005:80). NAFTA Chapter 14 went on to provide for the establishment of financial institutions in a judicial form chosen by an investor from a NAFTA country, as well as ensure National Treatment (Article 1405.1) and Most-

Favored-Nation Treatment (1406.1) in the financial services sector.<sup>32</sup> NAFTA, according to Robert (2011), prohibits a member-country to require a services provider from another member to establish a representation or any form of enterprise for the cross-border provision of services.

### **Investment Measures**

The NAFTA chapter on investment contains three pillars: market access, protection, and dispute settlement. The market access component consists of four provisions: national treatment (Article 1102), MFN treatment (Article 1103), performance requirements (Article 1106), and senior management and boards of directors. NAFTA prohibits the imposition of any form of performance requirements (including local content requirements, foreign exchange-balancing requirements, and transfer of technology) in all phases of an investment. Certain limited exceptions are allowed for domestic content requirements, if these are not arbitrary or unjustifiable and are put in place in order to secure compliance with laws and regulations. No restrictions on the nationality of the members of the board of directors related to the investment may apply (Robert, 2011).

The protection component requires that investments from other NAFTA countries be treated in accordance with international law and be provided ‘fair and equitable treatment’ and full protection and security (Robert, 2011:4). NAFTA has strong provisions against any possible direct or indirect nationalization or expropriation of investment or measures ‘tantamount to nationalization or expropriation,’ except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and on payment of compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay (Robert,

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<sup>32</sup> The NAFTA agreement, available at <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> (accessed 3 December 2015).

2011). This broad definition of expropriation, which covers also direct and indirect measures ‘tantamount to nationalization or expropriation,’ gives ICSID arbitrators broad room for interpretation during investor-state arbitration (Hufbauer and Schott, 2005:206-207), hence are restrictive for the governments of developing and emerging countries who often lack the resources to fight litigation with multinationals in private arbitration courts (van Harten, 2005).

In contrast to NAFTA, second-order agreements, such as the US-Chile and the US-Singapore PTAs, have a relatively modest scope of investor protection, which limits the ability of firms to claim that environmental and health measures are ‘tantamount to expropriation’ (Hufbauer and Schott, 2005:207). In fact, many investor-state arbitration cases under NAFTA challenged national environmental and public health laws and regulations, obliging governments to pay significant sums to private firms as compensation for forgone profits (Public Citizen, 2001; 2005). In the *Metalclad vs. Mexico* case, for example, related to the refusal of a Mexican municipality to grant a permit for a toxic waste dump, a ‘NAFTA tribunal ruled that the denial of the contraction permit and the creation of an ecological reserve are tantamount to an “indirect” expropriation’ (Public Citizen, 2005:iii). As a result, the Mexican government was ordered to pay Metalclad, a California-based company, compensation worth USD 15.6 million, ‘a large amount relative to Mexico’s environmental protection budget’ (Public Citizen, 2005:ix).

NAFTA investment liberalization adopts a ‘negative list’ approach (Hufbauer and Schott, 2005). Moreover, the definition of Investment under NAFTA is ‘enormously broad’ (Price, 2000:109). Article 1139 defines investment as equity and debt security of an enterprise and loans to an enterprise, as well as real estate and other tangible and intangible property ‘owned or controlled directly or indirectly by an investor’ for receiving a profit or other business purposes. Moreover, as accounted by Maxfield and Shapiro (1998), the US even pushed for a definition of

a ‘NAFTA investor,’ which includes any enterprise doing business in a NAFTA country, regardless of the nationality of its owners.

NAFTA Article 1102 (National Treatment) states that ‘[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors,’ while Article 1105 (Minimum Standard of Treatment) calls for ‘fair and equitable treatment and full protection and security’ of the investments of investors from another Party. The wording of Article 1105, according to Meltz (2003:9), although ambiguous, has the purpose ‘to guarantee the foreign investor a minimum standard of treatment not contingent on domestic law in the event that national treatment and most-favored-nation treatment by the host country are not adequate.’ Article 1105 provides that foreign investment must be treated ‘in accordance with international law.’ This is a clause that, in the words of a former ICSID arbitrator and NAFTA negotiator, ‘should not be underestimated,’ because ‘[i]t incorporates into NAFTA the evolving standard of customary international law,’ which diminishes the influence of national laws over investment-related matters (Price, 2000:111). In addition, Article 1106 (Performance Requirements) prohibits the imposition of performance requirements, including balance of trade, domestic content, earnings of minimum level of foreign exchange, and technology and know-how transfer requirements.<sup>33</sup>

These restrictive investment clauses of NAFTA have been especially significant for Mexico, for it had been a proponent and champion of strict regulation of foreign investment under the so-called ‘Calvo Doctrine.’ For example, a 1973 law on foreign investment that limited foreign equity to a maximum stake of 49 per cent, screened investments through the National Foreign Investment Commission, as well as required foreign investors to balance their import and export

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<sup>33</sup> The NAFTA agreement, available at <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> (accessed 3 December 2015).

activities and locate their production sites away from Mexico City and in rural and less developed areas. This and other regulations of the 'Calvo Doctrine' were going to be scrapped under NAFTA (Hufbauer and Schott, 2005:201; Robert, 2011).

In contrast to the WTO TRIMS agreement, where investment-related dispute settlement is a government-to-government affair, NAFTA Chapter 11 provides an investor-state direct arbitration clause. In fact, the investor-state arbitration clause has proven to be quite popular among businesses and 'fostered litigation by business firms against a broader range of government activity than originally envisaged' (Hufbauer and Schott, 2005:54). NAFTA Chapter 11 allows firms to bring lawsuits directly against governments before arbitration tribunals operating under the arbitration rules of either ICSID or UNCITRAL that have the authority to award monetary relief to the winning party. In addition, under NAFTA articles 1116 and 1117, private firms can enforce government obligations in US courts through the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Hufbauer and Schott, 2005; Dumberry, 2001; Public Citizen, 2005).

NAFTA Chapter 11 allows not only lawsuits from member-country firms, but also from any firm that is incorporated in a NAFTA country, albeit with some limitations, such as the absence of diplomatic relations with the non-NAFTA country where the investment comes from. The NAFTA chapter on investment dispute settlement has a broad definition of investment that also includes minority interests, portfolio investment, and real property. Article 1139 defines an investor as a party that 'seeks to make, is making or has made an investment.' The controversial wording of 'seeks to make' entails privileges not only for the parties that have already invested but also for those that are yet to become an investor. This broad definition thus expands the scope

of private firms that could bring lawsuits against sovereign countries before ICSID tribunals (Horlick and Marti, 1997; Dumberry, 2001).

The innovative feature of NAFTA Chapter 11 is its internationalization of investment dispute settlement. The Calvo doctrine and the 1973 law, which implied stricter regulation of foreign investment in the pre-NAFTA period, postulated that investment disputes were to be resolved strictly in local courts. The very purpose of the Calvo doctrine was to emphasize national sovereignty over foreign investment, depriving foreign investors of diplomatic protection. The shift of investment regulation and dispute settlement away from national jurisdictions and towards interdependent arbitration, as a result of NAFTA, prioritizes investor rights over national sovereignty. Hence, the ‘protection of investor rights has since become the most contentious feature of the NAFTA dispute settlement system’ (Hufbauer and Schott, 2005:204).

NAFTA allows for dispute settlements in a number of areas. Chapter 11 covers investor-state disputes over property rights; Chapter 14 is designed to handle disputes in financial services; Chapter 20 provides for government-to-government consultation to resolve disputes at higher levels. Article 1110 has been especially controversial for it favors investor rights over governments’ measures to protect public welfare. It prohibits direct or indirect expropriation of foreign investments unless it is done explicitly for a public purpose, on a non-discriminatory basis, and with fair compensation. The controversial wording of the article extends the restriction to direct and indirect measures ‘tantamount to nationalization or expropriation,’ which could potentially be interpreted by arbitration panels broadly enough to also cover ‘regulatory takings.’ In such cases, host governments will be obliged to compensate investors for the investment and future profits lost (Hufbauer and Schott, 2005:206). In fact, an ICSID tribunal provided a very broad interpretation of expropriation in its decision in August 2000. In the *Metalclad* case,

expropriation was defined not just as ‘outright seizure,’ but was extended to cover ‘covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State’ (Dumbery, 2001:171; Hufbauer and Schott, 2005:207).

## **IPRs**

IPRs were another sphere where the positions of Mexico and the US differed diametrically. The initial position of Mexico was to have a deal similar to TRIPS and consolidate the changes already undertaken. The US, on the other hand, insisted on TRIPS-plus measures (Cameron and Tomlin, 2000). The actual text of NAFTA turned out to be TRIPS-plus, with the IPRs chapter of NAFTA ‘basically dictated by a determined U.S. negotiating team’ (Maxfield and Shapiro, 1998:115). More specifically, NAFTA Article 17.11.6 provides for the protection of test data submitted for the approval of pharmaceutical or agricultural chemical products for ‘not less than five years.’<sup>34</sup> In addition, NAFTA restricts the options for compulsory licenses and prohibits parallel importation of patented medicines on the grounds of national doctrines of patent exhaustion (Cameron and Tomlin, 2000; Shadlen, 2009).

NAFTA turned out to be TRIPS-plus in a number of aspects, thus making the IPRs regime in Mexico less development-friendly. For example, as a result of the adverse changes in its IPRs regime, Mexico failed to adequately respond to its public health challenges, more specifically, to the HIV/AIDS epidemic during the late 1990s. Mexico could neither afford to provide ARVs free of charge to its citizens (like it was done in similar circumstances in Brazil, which had less

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<sup>34</sup> The NAFTA agreement, available at <https://www.nafta-sec-alena.org/Default.aspx?tabid=97&language=en-US> (accessed 3 December 2015).

restrictive IP regime) nor was it able to prevent the price increase of medications at a rate well above the inflation rate in the wake of the 1994 peso devaluation. Drugs were provided through the private sector and most of those without medical insurance lacked access to treatment. Mexico's difficulties in efficiently coping with public health challenges were 'not unrelated to NAFTA,' which circumscribed its autonomy over public health policies (Shadlen, 2009:42).

#### **4.2. The US-Chile PTA**

The second-order US-Chile negotiations started in 2000 and an agreement was signed in 2003. Although both countries took NAFTA as a guide throughout the negotiations, each party had its priorities and interests in the negotiations. The agreement was especially important for the US, for, among other things, the agreement was to set precedent for other PTAs with the region, as well as for a possible ambitious hemispheric agreement, the Free Trade Agreement of the Americas (Kuwayama, 2003).

According to a statement released by the US House of Representatives,<sup>35</sup> leveling the playing field for US exporters and investors in Chile was a priority for American negotiators. The US sought to ensure its businesses' and investors' enjoyed a treatment no worse than what Chile accorded to its preferential trade partners, particularly the EU (but also Mexico and Canada). According to the statement, trade advantages accorded to other countries as a result of Chile's PTAs, coupled with other factors, eroded the volume of US exports to Chile. More specifically, the US share of Chile's total imports fell from 24 per cent in 1997 to under 17 per cent in 2002.

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<sup>35</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October 2014).

Likewise, the US share of services imported by Chile fell from 35 per cent in 1997 to 27 per cent in 2001.<sup>36</sup> The US was particularly worried about the EU-Chile PTA, ‘Chile’s most significant FTA, prior to the U.S.-Chile FTA,’ which was signed in 2002 and was going to enter into force in 2003. Countering the EU in Chile had become an urgent task for the US, for according to the National Association of Manufacturers, ‘6,000 U.S. jobs will be lost if the EU’s advantage is not quickly eliminated.’<sup>37</sup>

According to US congressional records, the US lost nearly a third of its share in Chile’s import market during 1997-2003, which was largely a result of Chile’s PTAs with other countries, chief among them the EU. The EU-Chile PTA resulted in the surge of EU exports to Chile that were in direct competition with goods and services exported by the US. Thus the US-Chile PTA was perceived as a necessity to level the playing field for American firms and raise their competitiveness in the Chilean market. The lack of an agreement with Chile was estimated to cost the US USD 800 million in sales and 10,000 in employment per annum (US Congress, 2007:18958, 20450).

The PTA with Chile was the first for the US in South America, and besides providing trade benefits to the US, it was also to set a precedent for future PTAs in the region. In line with Robert Zoellick’s doctrine of ‘competitive liberalization,’ the agreement with Chile, a relatively open and economically successful country in Latin America, was going to, among other things, discriminate against other developing and emerging countries in the region and make them seek

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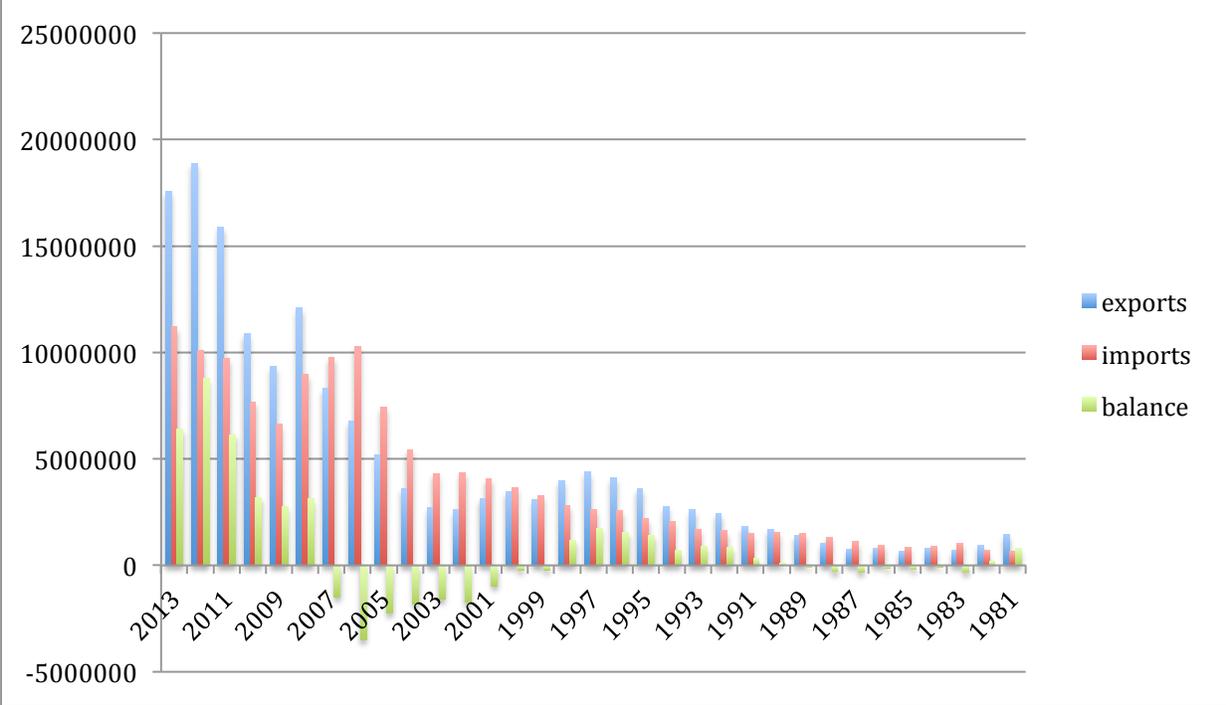
<sup>36</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October 2014).

<sup>37</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October 2014).

similar agreements, in order not to fall behind in competition with Chile for FDI and access to the lucrative US market (Weintraub, 2004).

Chile, on the other hand, with its relatively open economy with a 6 per cent applied MFN tariff rate and zero-tariff trade in certain capital goods (WTO, 2009), had set a target of covering 90 per cent of its trade by PTAs by 2010. Hence, an agreement with one of the major economic powers was considered to be a solid move towards this direction (Kuwayama, 2003). The US had been a major trade and investment partner for Chile, consuming 20 per cent of Chilean exports and providing 30 per cent of Chile’s inbound FDI during the six years preceding the completion of the PTA (Roffe, 2004). The dynamics of the US-Chile trade is presented in Figure 4.2.1 below.

**Figure 4.2.1. US trade with Chile, in thousand USD, 1981-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 7 October 2014)

Because both the US and Chile were already quite liberalized before starting the PTA negotiations, the welfare impact of tariff elimination on both countries was going to be ‘from negligible to very small’ (USITC, 2003:xiii). The bulk of the welfare gains were thus to come from the removal of non-tariff barriers, including in services, investment, and IPRs. Using the Michigan Computable General Equilibrium (CGE) Model of World Production and Trade, Brown *et al* (2010) estimated the welfare effect of the agreement on the US to be USD 6.9 billion (0.1 per cent of GNP), while on Chile the estimated impact was USD 1.2 billion (1.3 per cent of GNP).

The rest of the section looks at the negotiations and outcome of US-Chile PTA with a particular focus on a number of the key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment provisions, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

Chile’s exports to the US during the 1990s, as percentage of total exports, were in the range of 17-19 per cent, while its imports from the US amounted to about the same percentage of its total imports over the same period. Some 64 per cent of Chilean exports entered the US duty free before the agreement, while another 16 per cent enjoyed GSP treatment. Chile’s position was to further increase the share of products that enter the US tariff-free and make the concessions under GSP permanent (Kuwayama, 2003).

As a result of the US-Chile PTA signed in 2003, 85 per cent of industrial and consumer trade between the two countries became tariff-free immediately. By 2008 almost of all the remaining industrial tariffs between Chile and the US were going to be eliminated. By that time, two-thirds

of farm products were scheduled to become tariff-free, with subsequent elimination of all tariffs in 12 years. Especially crucial for Chile was the achievement of tariff-free trade for important export sectors, including textiles, clothes, and shoes. Moreover, Chile managed to convert the unilateral concessions provided by the US through the GSP into a permanent deal. All product lines included in the GSP became tariff-free as a result of the PTA (Roffe, 2004).

Article 3.8 of the US-Chile PTA prohibits the use of duty drawbacks, the subsidy-like provisions that provide import tax rebates on goods used as inputs for exports. The agreement, however, provides for an eight-year phase-out period before taking into effect. After the eight-year period, duty drawbacks would be eliminated only gradually with a period of 4 years by equal 25-per cent reductions, implying a complete elimination of duty drawbacks in 12 years after the implementation of the agreement.<sup>38</sup> In addition, Article 8.1 of the US-Chile PTA allows the imposition of safeguard measures, if, as a result of tariff elimination, ‘a good originating in the territory of the other Party is being imported into the Party’s territory in such increased quantities... as to constitute a substantial cause of serious injury, or threat thereof, to a domestic industry producing a like or directly competitive good.’<sup>39</sup>

## **Agriculture**

Although more than 60 per cent (by value) of Chile’s merchandise exports came from mining, agriculture has been an important sector contributing to the diversification of Chile’s export profile and comprising up to 19 per cent of all exports in 2009 (WTO, 2009). Chile did get agricultural concessions from the US, albeit phased out over a period of 10-12 years for the most

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<sup>38</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>39</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

sensitive products. For Chile, too, tariff elimination on sensitive products, again mostly in agriculture, were to be implemented over twelve years. The US would eventually completely liberalize its agricultural sector, with 85 per cent of tariff lines reduced to zero within ten years and the remaining 15 per cent in twelve years. 81 per cent of Chile's tariff lines in agriculture would go down to zero within ten years, with the remaining 19 per cent to be liberalized in two more years (Weintraub, 2004; Cheong and Cho, 2007).

Article 3.16 of the US-Chile PTA calls for the abolition of export subsidies in agriculture, while Article 3.18 allows agricultural safeguard measures in the form of additional import duties, 'if the unit import price of the good enters the Party's customs territory at a level below a trigger price for that good as set out in that Party's section of Annex 3.18.' Tariff-rate quotas have been provided for a number of agricultural products. These quotas were to be phased out during a 4-12-year period, after which an unlimited number of products could be exported duty-free.<sup>40</sup> The abolition of agricultural subsidies seems to be especially significant for Chile, for, as accounted by a WTO Trade Policy Report (WTO, 2009), unlike in the US, agriculture in Chile, although a major contributor to the country's economic development, had fairly low protection and subsidization. To the disappointment of certain industry representatives in the US, sensitive products, such as sugar, were not kept out of the agreement,<sup>41</sup> which was the case with the US agreements with Colombia and Peru, for example, which protect the sugar industry in the US even after the full implementation of the US-Colombia and US-Peru PTAs.<sup>42</sup> Thus, the US-Chile

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<sup>40</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>41</sup> USTR Trade Advisory Committee Reports, Feb 2003, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Chile\\_FTA/Reports/asset\\_upload\\_file362\\_4932.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Chile_FTA/Reports/asset_upload_file362_4932.pdf) (accessed on 3 December 2015).

<sup>42</sup> See Chapter 4.4 and Chapter 4.5 of this thesis.

negotiations over agriculture represented a case where the US could not pick and choose the areas it wanted to open up or keep off the agreement.

Moreover, in relation to certain product lines, such as farmed salmon and other types of fish, US congressmen expressed concerns over Chile's competitive advantages that were going to have adverse effects on the fish industry and employment in the US. According to congressional statements, the US-Chile PTA would only exacerbate the situation for the US farmed salmon industry, as Chile's exports doubled during 1998-2002 (US Congress, 2007:20440-1).

### **Government Procurement**

Unlike the US, Chile was not a member of the WTO Agreement on Government Procurement (GPA)<sup>43</sup> at the time of the negotiations of the US-Chile PTA. Thus, it can be presumed that government procurement clauses of the PTA were going to have a higher significance for Chile. Chapter 9 of the US-Chile PTA covers government procurement-related measures between the countries. It provides for 'national treatment and non-discrimination' that obliges the Parties to provide treatment to the goods, services, as well as the suppliers of the other Party 'no less favorable than the most favorable treatment the Party accords to its own goods, services, and suppliers.'<sup>44</sup> Annex 9.1 lists the thresholds of procurement contracts as follows:

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<sup>43</sup> The list of GPA signatories can be found on the WTO website, available at [http://www.wto.org/english/tratop\\_e/gproc\\_e/memobs\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm) (accessed 3 December 2015).

<sup>44</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

**Table 4.2.1. Government procurement thresholds of the US-Chile PTA**

Procurement by Central government entities, in USD	Procurement by sub-central government entities, in USD	Construction contracts by Central government entities, in USD	Construction contracts by sub-central government entities, in USD
56,190	460,000	6,481,000	6,481,000

Source: Annex 9.1 of the US-Chile PTA<sup>45</sup>

In addition, Section H (General Notes) of Annex 9.1 provides set-asides for US small businesses, a scheme that is designed to promote small businesses in the US.

### Trade in Services

The US-Chile PTA adopts a ‘negative list’ approach, which specifies the sectors that are not covered by the agreement, while everything else is up for liberalization. This, according to a statement by the US House of Representatives,<sup>46</sup> has been especially important for the US cross-border services providers that were particularly well-positioned to build on existing market access opportunities in Chile and expand their presence in the country. According to US congressional records (US Congress, 2007:20446), the negative list approach was significant for the US, as services were an important sector for the US, accounting for 65 per cent of the economy and 28 per cent of export value in 2003.

Chapter 11 of the US-Chile agreement calls for ‘National Treatment’ and ‘Most-Favored Nation Treatment’ that obliges each Party to treat services suppliers of the other Party no less favorably than how it treats, in like circumstances, its own services suppliers, as well as services suppliers of a non-Party. In addition, Article 11.5 bans the conditioning of the provision of cross-

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<sup>45</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>46</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October 2014).

border services on establishing a representative office or any form of enterprise.<sup>47</sup> In addition, Article 11.12 of the US-Chile agreement has a NAFTA-like definition of a service supplier as ‘a person of a Party that seeks to supply or supplies a service.’<sup>48</sup> As it was the case with the EU-Chile PTA, the wording ‘seeks to supply’ broadens the scope of the agreement providing for a greater coverage of the services provisions. Hence, according to a USTR official (Interview 10), the services section of the US-Chile turned out to be broadly in line with US preferences, as it was a sensitive area where US negotiators had to push for deep liberalization.

### **Investment Measures**

Chapter 10 of the US-Chile PTA establishes provisions regulating investment-related measures. More specifically, it calls for ‘National Treatment’ and ‘Most-Favored Nation Treatment’ that establish the treatment of investors of a Party no less favorably than their own investors, as well as investors from a non-Party.<sup>49</sup> Article 10.5 prohibits performance requirements, including export requirements, local content requirements, export-to-import ratio requirements, and technology transfer requirements.<sup>50</sup>

In addition, Article 10.9 prevents any direct nationalization or expropriation of investment or indirect measures ‘equivalent to expropriation or nationalization,’ except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on the payment of

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<sup>47</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>48</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>49</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>50</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay and be fully realizable and freely transferable. The wording sounds similar to NAFTA, but the US-Chile agreement, like most post-NAFTA US PTAs, contains an important exception formulated under Annex 10-D, whereby a government's nondiscriminatory regulatory actions directed towards the protection of public welfare, including public health, safety, and the environment, do not constitute indirect expropriation.<sup>51</sup> This is important, because environmental measures have been regarded as 'tantamount to expropriation' by private arbitration rulings in relation to PTAs, such as NAFTA, that have significant policy and monetary implications for governments (Public Citizen, 2005). Most importantly, Chapter 10 provides for investor-state dispute settlement clauses. Under Chapter 10, investors can submit direct claims for damages against nation-states at ICSID or UNCITRAL arbitration tribunals.

According to a USTR official, investment provisions of the US-Chile PTA turned out to be quite strong, as investment was a crucial aspect for the US. However, the agreement does not seem to match the highly restrictive clauses of NAFTA and, on the insistence of the Chilean side, includes provisions that mitigate some of the strong wording seen in other US PTAs and provides the parties a narrower scope of investor-state arbitration under ICSID (Interview 10).

## **IPRs**

In negotiating the IPRs clauses of PTAs, the US has been keener to establish stricter rules with relatively high-income countries, such as Singapore and Chile, than with lower income countries, such as the five Central American countries, because higher-income countries are assumed to

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<sup>51</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

have higher capabilities for taking advantage of the loopholes in the agreements, such as producing generic drugs under compulsory licensing provisions (Abbott, 2006a).

As a result, the final text of the US-Chile PTA incorporates a number of TRIPS-plus measures. The IPRs clauses of the agreement with the US are much more restrictive than in other PTAs signed by Chile, and in many aspects are WTO-plus. The Chilean pharmaceutical industry, meeting about 90 per cent of the public health sector needs, was concerned by the restrictive clauses of the agreement, such as the increase in patent terms, pipeline protection of pharmaceutical products, restricted parallel importation, introduction of exclusivity of undisclosed information, and restricted grounds for compulsory licensing. It was not a secret that IPRs, especially pharmaceutical patents, were a priority in the US agenda, thus the US was going to push for them during the negotiations (Roffe, 2004).

As a consequence, provisions for pipeline protection of patents (including pharmaceutical) were incorporated in the agreement. Some argue that this was not going to have a considerable impact on Chile, because the country had already made changes to its industrial property law in 1991 extending the scope of patentability to all kinds of products and processes (Roffe, 2004). However, the pharmaceutical and agricultural chemical test data exclusivity clauses were a novelty for Chile. According to Article 17.10.1 of the US-Chile PTA,<sup>52</sup> undisclosed test data are granted exclusivity ‘for a period of at least five years from the date of approval for a pharmaceutical product and ten years from the date of approval for an agricultural chemical product.’

The TRIPS-plus clauses of the US-Chile PTA notwithstanding, Chile was successful in mitigating the pressure from the US. As a result, Chile managed to strike clauses that are not as

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<sup>52</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

restrictive as they could have been, as well as compared to other US North-South PTAs negotiated almost simultaneously. As mentioned by Roffe (2004), the initial proposal by the US was more restrictive and contained broader scope of protection of pharmaceutical products. Chile, however, was successful in opposing more restrictive provisions and getting a relatively more favorable IPRs section in the agreement with the US.

On the one hand, the US attached a high priority to IPRs and was going to push its line all the way through to establish IPRs clauses in the agreement with Chile that reflect the interests of the US pharmaceutical industry. On the other hand, however, Chile apposed some of the highly restrictive wordings in IPRs, arguing it needs larger leeway in its policy autonomy in this field. As a result of the negotiations, the US managed to incorporate most but clearly not all its proposals and had to compromise in a number of issues. The compromise is largely due to Chile's strong bargaining power that was enabled by its wide network of PTAs, including North-South, and the determination of US negotiators to seal a deal with Chile as soon as possible, to redress the US declining positions in Chile (Interview 10).

The 'shortcomings' of the US-Chile PTA in IPRs were also acknowledged by a USTR Trade Advisory Committee Report, compiled by the Committee on Intellectual Property Rights for Trade Policy Matters. The report called it 'unfortunate' that the agreement with Chile falls short of providing the same level of IPRs protection as other US agreements negotiated simultaneously, such as with Singapore. The report also expressed concerns that 'the most serious deficiencies in the Chile intellectual property chapter' may set precedent in future US PTAs.<sup>53</sup>

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<sup>53</sup> USTR Trade Advisory Committee Report (The US-Chile Free Trade Agreement (FTA): The Intellectual Property Provisions), p.2-3, Feb 2003, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Chile\\_FTA/Reports/asset\\_upload\\_file799\\_4936.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Chile_FTA/Reports/asset_upload_file799_4936.pdf) (accessed on 3 December 2015).

In particular, Article 17.10.1 of the US-Chile PTA has an important nuance that is different from other US PTAs concluded after NAFTA. Article 17.10.1 states:

If a Party requires the submission of *undisclosed information* concerning the safety and efficacy of a pharmaceutical or agricultural chemical product which utilizes a *new chemical entity*, which product has not been previously approved, to grant a marketing approval or sanitary permit for such product, the Party shall not permit third parties not having the consent of the person providing the information to market a product based on this *new chemical entity*, on the basis of the approval granted to the party submitting such information. A Party shall maintain this prohibition for a period of at least five years from the date of approval for a pharmaceutical product and ten years from the date of approval for an agricultural chemical product. (Italics added)<sup>54</sup>

The relevant article (Article 16.8.1) of the US-Singapore agreement, for example, states:

If a Party requires the submission of *information* concerning the safety and efficacy of a pharmaceutical or agricultural chemical product prior to permitting the marketing of such product, the Party shall not permit third parties not having the consent of the party providing the information to market the same or a similar product on the basis of the approval granted to the party submitting such information for a period of at least five years from the date of approval for a pharmaceutical product and ten years from the date of approval for an agricultural chemical product. (Italics added)<sup>55</sup>

As illustrated above, Article 16.8.1 of the US-Singapore agreement does not specify *new chemical entities*, thus making the scope of the article much broader. Another ‘important accomplishment’ in the US-Chile PTA is the reference to *undisclosed information*<sup>56</sup> in Article 17.10.1. The initial US proposal referred to ‘information’ (as in Article 16.8.1 of the US-Singapore agreement above), whether undisclosed or not, and was changed as a result of the negotiations. The US-Chile agreement obliges the parties to protect undisclosed information ‘except where necessary to protect the public’, while definitions of such situations are left to domestic legislations (Roffe, 2004:25).

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<sup>54</sup> The text of the US-Chile PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (accessed 3 December 2015).

<sup>55</sup> The text of the US-Singapore PTA, available at [https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset\\_upload\\_file708\\_4036.pdf](https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf) (accessed 3 December 2015).

<sup>56</sup> The US-Chile PTA does not define ‘undisclosed information,’ and hence, argues Roffe (2004:25), the less stringent TRIPS definition (Article 39.2) applies to the agreement.

While the US-Singapore agreement allows no generic producer to rely on test data submitted to a *foreign* regulator, even if it seeks marketing approval *domestically*, the US-Chile agreement is friendly enough to omit such restrictive provisions. As distinct from the US-Chile agreement, the US-Morocco, US-Australia and US-Bahrain agreements include obligations to provide patents for the ‘new’ use of the known products (Fink and Reichenmiller, 2005). Moreover, ‘Chile resisted the US demand for commitments that would have gone beyond the WTO rules by reducing the Chilean Government’s ability to override drug patents through compulsory licenses’ (Kuwayama, 2003:207).

Provisions for compulsory licenses in the US-Chile agreement are not much innovative and are according to TRIPS standards (Fink and Reichenmiller, 2005; Roffe, 2004), leaving Chile with a full set of tools to make full use of compulsory licenses as reaffirmed in the Doha Declaration on TRIPS and Public Health of 14 November 2001. In contrast, PTAs, such as CAFTA-DR and the US-Morocco PTA, ‘are intended to restrict the flexibilities inherent in the TRIPS Agreement, Doha Declaration and Decision on Implementation of Paragraph 6.... They appear designed to negate the effective use of compulsory licensing by blocking the marketing of third party medicines during the term of patents’ (Abbott, 2004:12).

Based on a comprehensive review of the IPRs-related provisions of the US-Chile PTA, Roffe (2004:49) concludes that ‘the levels of its IPRs protection and enforcement provisions are less stringent than those negotiated by the USA—simultaneously with Singapore and subsequently with CAFTA, Australia, Bahrain and Morocco’. The reason why Chile managed to resist more restrictive terms in IPRs can be explained, among other things, by the fact that the Chilean agreement was second-order and its formal trade ties with the EU and other parts of the world enabled it to approach the negotiations with the US from a better position than did other

countries of the Global South. It can be argued that more restrictive IPRs-related provisions in the US-Singapore and US-Australia PTAs are due to the fact that Singapore and Australia are high-income countries, thus they would not lack the industrial capacity to take advantage of the leeway and loopholes in their PTAs (Abbott, 2006a). However, this argument will not prove to be robust for Central America and Morocco, whose first-order agreements with the US had a far more restrictive IPRs section than that of the second-order US-Chile agreement.

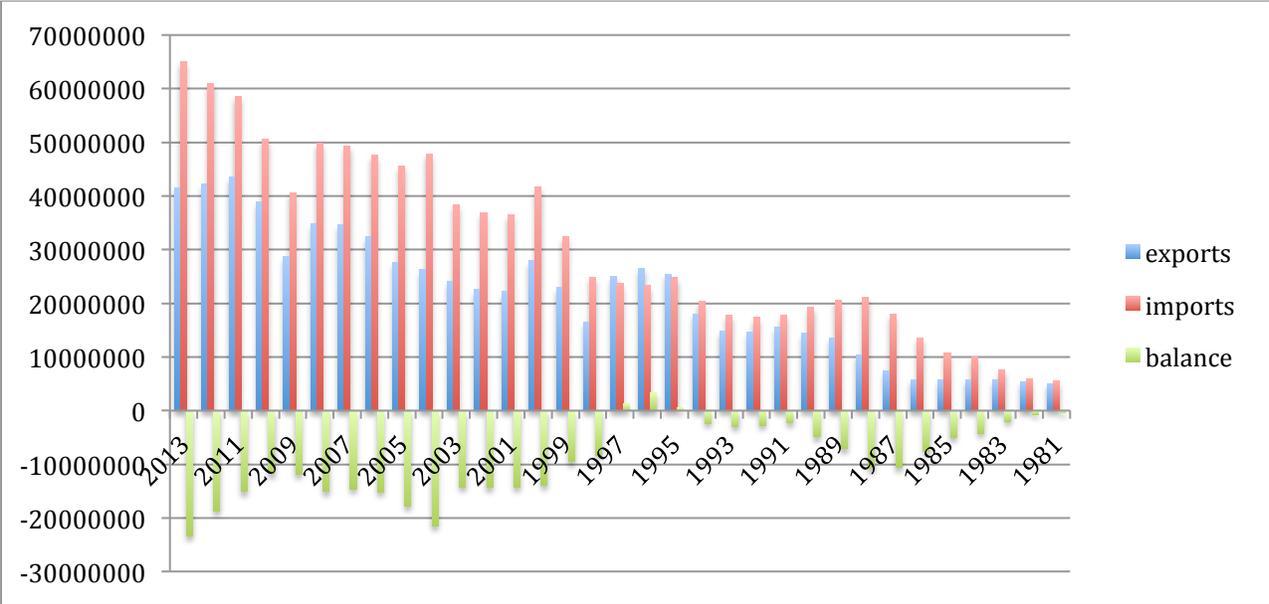
#### **4.3. The US-Korea PTA**

Trade relations with the US, albeit with serious trade disputes, have been an important contributor to Korea's spectacular economic rise since the 1960s. Given the growing economic interdependence between the two countries, talks on a US-Korea PTA began in the late 1980s when, faced with trade sanctions by the US, Korea wanted to secure steady access to the US market to level the playing field and get ahead of its competitors in East Asia, while the US wanted enhanced access to the booming Korean market (Choi and Schott, 2001; Schott *et al*, 2006; Koo, 2006; Cooper and Manyin, 2007). Although the US was not among the first countries to complete a PTA with Korea, it was the first big industrialized country to do so, thus getting in ahead of Japan and the EU in establishing preferential bilateral trade ties with Korea (Cheong, 2007).

Following its solid economic growth of about 7 per cent per annum for more than two decades starting from the 1960s, Korea could no longer afford the 'passive trade opening policy' of the 1980s while it was challenged by developed and emerging economies in its big export destinations, including the US. To maintain its export-oriented trade policy and compete with

developed and emerging economies in big export markets, as well as cope with the consequences of the 1997 Asian financial crisis, Korea had to embrace the globalization era of the 1990s. Thus, starting from the 1990s, Korea began to consider regionalism as a complementary option to multilateral liberalization (Sohn, 2001; Sohn and Yoon, 2001).

**Figure 4.3.1. US trade with Korea, in thousand USD, 1981-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 15 October 2014)

There have been close economic and political ties between Korea and the US. As of 2005, two years before the US-Korea negotiations completed, external trade between the countries (imports plus exports) exceeded USD 70 billion (the 2013 figure was above USD 100 billion (see Figure 4.3.1). Korea was absorbing more than 3 per cent of US exports, making it the seventh largest consumer of American goods and services, while the US was Korea’s second

largest export market (RIETI, 2006; Cheong, 2007).<sup>57</sup> Political cooperation between the parties was significant, too. The US was crucial in helping South Korea resist the invasion of the North in 1950, and has helped the South to defend its territorial integrity ever since (Choi and Schott, 2001). The dynamics of US-Korea trade is presented in Figure 4.3.1 above.

Given the close economic and political ties between the two countries, a US-Korea PTA was long overdue. The talks between the countries, however, were prone to producing stalemates, primarily due to pressures from uncompetitive industries in Korea, such as agriculture and financial services, which lobbied against the agreement with the US (Koo, 2006). When asked why the US had not considered a deal with Korea before, USTR Robert Zoellick answered in May 2004, ‘They’re not ready to talk about agriculture’ (cited by Schott *et al*, 2006:1). These impediments were, however, eventually resolved when preferential access to the US market acquired a greater priority for Korea, in order to get ahead of its competitors in the region and reignite its export-led growth (Schott *et al*, 2006). Thus, fuelled by competitive pressures, the negotiations resumed with greater vigour and an agreement was signed in June 2007, which USTR Rob Portman called ‘the most commercially significant free trade negotiation’ since NAFTA.<sup>58</sup>

The ratification of the PTA, however, was delayed for another four years, coming eventually in both countries only at the end of 2011. The reason for a delayed ratification was the different viewpoints, primarily over treatment of auto and beef, held by the executive under George W. Bush and the Democratic leadership of Congress. As a result, President Bush withheld the

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<sup>57</sup> In 2013, the two-way trade in goods exceeded USD 100 billion, making Korea the sixth largest trading partner of the US, while the US became Korea’s second largest trading partner. Services accounted for another USD 30 billion in two-way trade (CRS, 2014:8).

<sup>58</sup> USTR Press Release, Feb 2, 2006, available at [https://ustr.gov/archive/Document\\_Library/Press\\_Releases/2006/February/United\\_States\\_South\\_Korea\\_Announce\\_Intention\\_to\\_Negotiate\\_Free\\_Trade\\_Agreement.html](https://ustr.gov/archive/Document_Library/Press_Releases/2006/February/United_States_South_Korea_Announce_Intention_to_Negotiate_Free_Trade_Agreement.html) (accessed 3 December 2015).

submission of the agreement to Congress and it was ratified during President Obama's term when modifications in the agreement, including over autos and beef, were agreed upon by Korea and the US in February 2011. The agreement entered into force on 15 March 2012 (CRS, 2014).

Although the actual effects of the US-Korea PTA are yet to be seen, studies (Cheong and Wang, 1999; Choi and Schott, 2001; USITC, 2001; Cheong, 2007) estimate the long run welfare gains from the agreement to be in the range of USD 4 billion to 20 billion for Korea and USD 9 billion to 20 billion for the US, or around 2.41 per cent of GDP for Korea and 0.13 per cent of GDP for the US. Similarly, a study by the US International Trade Commission (USITC, 2007) put the estimated US GDP growth at USD 10-12 billion or approximately 0.1 per cent.

A distinctive feature of the US-Korea PTA has been its discriminative effect on non-participants. The agreement was estimated to have negative welfare implication for a number of countries and regions, such as Australia, New Zealand, ASEAN, Japan, China, Canada, and Mexico, in the range of 0.07 to 0.14 per cent of GDP (Choi and Schott, 2001). Considering the anticipated increase in FDI in Korea, other developed economies, namely the EU and Japan, were predicted to incur negative welfare effects as a result of the US-Korea PTA (Kiyota and Stern, 2007). The US-Korea agreement was argued to have big discriminative effects, especially on Japan, for among the countries negatively affected by the US-Korea PTA, Japan had the highest export similarity index, defined as having an export structure similar to Korean exports to the US market, as well as an import structure similar to Korean imports from the US (Choi and Schott, 2001).<sup>59</sup>

Thus, the 2011 ratification of the US-Korea PTA looked especially timely for putting additional pressure on Japan amid discussions on the TPP, an ambitious free trade agreement that was signed on October 5, 2015 by the US and 11 other Pacific Rim countries, including Japan.

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<sup>59</sup> The closer the similarity in export structure, the greater the possibility of trade diversion (Choi and Schott, 2001).

As argued by the Economist (2011), the ratification of the US-Korea PTA put pressure on large Japanese exporters, which would struggle to compete against Korean rivals without preferential access to the US market. In this context, the pressure on the Japanese government from *Kiedanren*, a large Japanese business lobby, to pursue countervailing agreements does not seem surprising. This argument looks complementary with the assertion that the US-Korea PTA was going to produce only modest gains for the US, and its main objective was the catalytic effect on trade liberalization in the region. Like it was the case with the US agreements with Chile and Singapore, the US-Korea agreement was part of the broader US strategy aimed at creating competitive pressures and inducing competitive liberalization in a specific region (Choi and Schott, 2004; Financial Times, 2007a). As a result, in November 2011, Prime Minister Yoshihiko Noda announced ‘Japan’s intention to begin consultations with Trans-Pacific Partnership countries toward joining the TPP negotiations’ (USTR, 2011), while Japan participated for the first time in the 18<sup>th</sup> round of negotiations in July 2013 (CRS, 2015). In fact, the catalytic effect of the US-Korea PTA went beyond the region and, in the words of EU Trade Commissioner Peter Mandelson, ‘strengthen[ed] the prospects for the planed EU-Korea free trade agreement’ (Financial Times, 2007b).

The rest of the section looks at the negotiations and outcome of the US-Korea PTA, with a particular focus on tariffs and related measures, agriculture, government procurement, trade in services, investment protection, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

As a result of the US-Korea agreement, within three years of the PTA’s entry into force, about 95 per cent of trade in consumer and industrial products between the parties would become duty-

free, of which about 80 per cent immediately. Virtually all of the remaining tariffs would be eliminated within 10 years (USITC, 2007; USTR, 2009; CRS, 2014). This was not going to change US tariff levels much, as by the beginning of the 2000s, the US trade-weighted average import duty was as low as 1.6 per cent, with most US tariffs already low or eliminated altogether (with the exception of limited high-tariff product lines, such as textile and apparel and leather goods). Korea, too, had a relatively low average tariff level at 9 per cent. The relatively low figure in Korea, however, was deceptive, for important sectors, such as agriculture and fisheries, were protected behind high tariffs, some of them with no bound level, while tariff levels in competitive industries were lower than the average (USITC, 2001).

After signing the agreement in June 2007, the two sides agreed to incremental changes to the agreement in December 2010, mostly related to trade in autos and light trucks and US pork exports. More specifically, the new agreement established a new auto-specific safeguard procedure and slowed down the pace of the elimination of tariffs on cars in both countries. In addition, the US maintained its 25 per cent tariff on light trucks until 2019, to be later gradually eliminated in the next three years, instead of the original agreement of eliminating tariffs on light trucks in 10 equal annual increments. Korea, however, did not slow down its reform of tariffs on light trucks and had to eliminate them upon entry into force of the PTA. As per the agreement, Korea cut its 8 per cent tariff on US-built passenger cars to 4 per cent and removed its 10 per cent tariff on trucks. The remaining tariffs were to be eliminated entirely in 2016. The US maintained its 2.5 per cent duty on passenger vehicles until 2016 (Schott, 2010; CRS, 2014). As a result of the changes, as a *quid pro quo* to the US maintenance of full tariffs on light trucks, Korea retained the right to maintain its 25 per cent tariff on US frozen pork until January 2016, two years longer than originally agreed (Schott, 2010).

In addition to tariff elimination, the agreement provides for ‘special motor vehicle safeguard’ clauses that allow the US to raise its tariffs to the pre-PTA levels in the case of ‘any harmful surges in South Korean auto imports due to the agreement.’ Moreover, a safeguard action ‘can be initiated by the United Auto Workers union, the domestic auto industry, or the U.S. government’ (CRS, 2014:3). The agreement includes a ‘special textile safeguard,’ allowing the parties to impose duties on certain textile goods, in case they cause injury to the domestic industry (USTR, 2009). Textiles, in fact, together with other manufacturing goods, such as chemicals and electronics, was the area where Korean exporters to the US were expected to have the largest gains, for Korea had been a net exporter of textile products. Thus, the incorporation of the ‘special textile safeguards’ in the agreement can be regarded as an achievement for the US (USITC, 2001; Lee *et al*, 2011).

## **Agriculture**

Agriculture was an important component of the US-Korea PTA negotiations, especially for the US. According to the US International Trade Commission (USITC, 2001:ix), ‘[t]he largest gains from an FTA for U.S. exports to Korea are expected in agriculture.’ Moreover, in 2013, Korea was the fifth largest destination for US agricultural exports (at over USD 5 billion), notwithstanding Korea’s historical record of protecting agriculture due to farmers’ political influence in the country. Korean agricultural exports to the US have been relatively small and, thus, did not cause controversy during the negotiation of the agreement. However, Korea wanted to exclude certain agricultural products from the agreement, fearing that its agriculture would not survive the competition with the US<sup>60</sup> (Cooper and Manyin, 2007; Lee *et al*, 2011; CRS, 2014).

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<sup>60</sup> In 2007, the year the PTA was signed, Korea’s average applied tariff on agricultural goods was 52 per cent, while in the US it was only 12 per cent (Cooper and Manyin, 2007).

The agreement turned out to be very much in line with US expectations and negotiating priorities. As accounted in a 2007 report by the US Agricultural Policy Advisory Committee for Trade,<sup>61</sup> the US-Korea PTA was going to benefit US farmers and ranchers in providing additional export opportunities for a number of agricultural products. The only disappointment was rice, which as a sensitive product in Korea, was kept out of the agreement. Due to the differences in the competitiveness of agriculture in the two countries, Korea was estimated to incur a production decrease worth USD 20-23 billion and a loss of more than 130,000 jobs in agriculture as a result of the PTA. Hence, the opening up of the agricultural sector could threaten ‘the very survival of Korean agriculture’ (Lee *et al*, 2011:135).

Despite the expected negative consequences, Korea agreed to provide preferential market access to all agricultural products, except rice (Lee *et al*, 2011). Almost two-thirds of US agricultural exports to Korea would become duty-free immediately after the agreement entered into force. These products included wheat, feed corn, soybeans, and cotton, as well as a range of high-value agricultural products such as almonds, pistachios, bourbon whiskey, wine, raisins, grape juice, orange juice, fresh cherries, frozen french fries, frozen orange juice concentrate, and pet food. Other products, such as avocados, lemons, and sunflower seeds, had a two-year phase out period. Certain sensitive agricultural products had longer phase-out periods of up to 10 years under Korean import quotas (USTR, 2009; CRS, 2014).

The key agricultural products in the negotiations were beef, rice, and oranges—all of great export interest to the US. As a result of the agreement, Korea agreed to eliminate its 40 per cent tariff rate on US beef muscle meats, albeit over a 15-year period. Oranges, too, were accorded

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<sup>61</sup> Report of the US Agricultural Policy Advisory Committee for Trade on the US-Korea PTA as part of the USTR Trade Advisory Committee Report, April 2007, available at <https://ustr.gov/sites/default/files/uploads/Countries%20Regions/africa/agreements/korus/Agricultural%20Policy%20Advisory%20Committee.pdf> (accessed 3 December 2015).

special treatment in the agreement through a special tariff rate quota. Oranges were subject to a 50 per cent MFN duty in Korea. A small duty-free quota was allocated for US ‘in-season’ oranges, while the 50 per cent duty was to be reduced to 30 per cent in the first year of implementation of the agreement, and gradually eliminated in seven years. The US, however, did not manage to secure additional access for its rice and rice products to the Korean market. Rice was a make-or-break issue for Korea, and US negotiators had to either agree on a good agreement without liberalization in rice or no agreement at all. They eventually decided not to lose the entire agreement because of one product line. The US, on the other hand, agreed to eliminate all its tariffs and quotas on agricultural products imported from Korea during a phase-out period lasting up to 15 years (CRS, 2014).

The importance of agricultural liberalization during the US-Korea PTA negotiations was significant, as it was a sensitive and well-protected sector in Korea and provided huge export opportunities for the US. Thus, the question during the negotiations was how many concessions could the US get from Korea, given the estimated negative consequences of agricultural liberalization in Korea. As it turned out, the US managed to achieve almost all its negotiating targets. The only exception was the liberalization of rice, which was too sensitive and too important for Korea to concede in. One of the main reasons for such an ‘asymmetric’ outcome in agricultural liberalization was that Korea felt the need to establish preferential trade ties with the US as soon as possible. In fact, the US-Korea negotiations had been previously interrupted due to Korea’s unwillingness to concede in agriculture. However, once pressure on Korea began to increase, as it was feeling left behind by its competitors, mostly in East and South East Asia, due to the absence of preferential trade relations with the US, it had to give in in a lot of areas, including agriculture. The considerable and painful concessions in agriculture were brought

about by pressure from Korean competitive industries on the Korean government to do whatever it takes and sign a PTA with the US, in order to bolster the competitiveness of Korean businesses vis-à-vis their competitors from East and Southeast Asia (Interview 12).

### Government Procurement

Both Korea and the US were signatories of the WTO GPA agreement at the time of the PTA negotiations. The US-Korea agreement reaffirms the parties' obligations under the GPA as a baseline to further mutual obligations in government procurement under the PTA. The GPA applies to contracts valued at USD 203,000, while the PTA lowered this threshold to USD 100,000. Moreover, as a result of the PTA, Korea added 9 more agencies to the list of 42 central and sub-central agencies covered under the GPA (CRS, 2014). This seems to be in line with US preferences that, as accounted by Cooper and Manyin (2007:17), 'press[ed] South Korea to expand its commitments under the WTO Agreement on Government Procurement to cover more government agencies and at lower contract-value thresholds.' The government procurement thresholds of the US-Korea PTA are presented in Table 4.3.1 below.

**Table 4.3.1. Government procurement thresholds of the US-Korea PTA**

	Procurement by Central government entities	Procurement by sub-central government entities	Construction contracts by Central government entities	Construction contracts by sub-central government entities
For the US	100,000 USD	Non-applicable	7,407,000 USD	Non-applicable
For Korea	100 million Won	Non-applicable	7.4 billion Won	Non-applicable

Source: Annex 17-A of the US-Korea PTA<sup>62</sup>

<sup>62</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

Although sub-central entities in both parties are not covered in government procurement clauses of the agreement, they are covered under the GPA. The threshold for the procurement of goods and services by Korean sub-central entities is 200,000 SDRs, while the threshold for the procurement of construction services is 15 million SDRs. The thresholds for US sub-central entities are 355,000 SDRs and 5 million SDRs, respectively.<sup>63</sup>

### **Trade in Services**

The services sector is another area where the US had had competitive advantage over Korea, thus the liberalization of the services sector was going to benefit especially the US. Not surprisingly, the US made all the efforts to remove all regulatory barriers to cross-border trade in services (Lee *et al*, 2011). The services chapter of the US-Korea PTA turned out to be WTO-plus. The commitments under the PTA were novel especially for Korea that extended WTO-plus commitments ‘across virtually all major service sectors’ (USTR, 2009). The services chapter adopted a ‘negative list’ approach to the liberalization of trade in services. For the first time, Korea agreed to open up its legal consulting and accounting services to foreign investors. Broad concessions were also made in the field of healthcare and education. Moreover, under ‘Improved Financial Services,’ US financial institutions obtained the right ‘to establish or acquire financial institutions in Korea to supply a complete range of financial services’ (USTR, 2009), including portfolio management services for Korean investment funds. In addition, within two years after the agreement entered into force, US companies were going to be allowed 100 per cent ownership of telecommunications operators in Korea (Cooper and Manyin, 2007; USTR, 2009).

Despite broad concessions in the liberalization of services acquired from Korea, the US refused a number of requests that were initially included in the negotiating positions of Korea.

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<sup>63</sup> The WTO GPA: [http://www.wto.org/english/tratop\\_e/gproc\\_e/thresh\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/thresh_e.htm) (accessed 3 December 2015).

More specifically, the US did not concede on issues related to the provision of temporary visas to Korean executives and professionals and denied opening up the US coastal shipment market for Korean shippers (Lee *et al*, 2011). Furthermore, Chapter 12 of the US-Korea PTA calls for ‘National Treatment’ and ‘Most-Favored Nation Treatment,’ while Article 12.5 bans conditioning the provision of cross-border services on establishing a representative office or any form of enterprise.<sup>64</sup>

In trade in services, too, the US managed to get what it intended during the negotiations. It was able to push for concessions from Korea, which was, among other things, made possible by the settings of the agreement, whereby Korea was feeling the pressure to conclude the talks as soon as possible (Interview 12).

### **Investment Measures**

The US-Korea PTA provides ‘New Protections’ for US investors operating in Korea. These include protection of all forms of investment, including enterprises, debt, concessions and similar contracts, and IP. Moreover, the agreement draws from US legal principles and practices ‘to provide substantive and procedural protection’ for US investors in Korea (USTR, 2009). Chapter 11 of the US-Korea PTA establishes provisions regulating investment-related measures. More specifically, it calls for ‘national treatment’ and ‘MFN treatment’ that establish the treatment of investors of a Party no less favorably than their own investors, as well as investors from a non-Party. Article 11.6 prevents any direct nationalization or expropriation of investment or indirect measures ‘equivalent to expropriation or nationalization,’ except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on the payment of

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<sup>64</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay and be fully realizable and freely transferable. Unlike NAFTA and like many post-NAFTA US PTAs, Annex 11-B of the US-Korea agreement asserts that a government's non-discriminatory regulatory actions directed towards the protection of public welfare, including public health, safety, and the environment, do not constitute indirect expropriation.<sup>65</sup> This is important, because environmental measures have been regarded as 'tantamount to expropriation' by private arbitration rulings in relation to PTAs, such as NAFTA, with significant policy and monetary implications for governments (Public Citizen, 2005). Article 11.8 of the US-Korea PTA prohibits performance requirements, including export requirements, domestic content requirements, export-to-import ratio requirements, and technology transfer requirements.<sup>66</sup> Moreover, Section B of Chapter 11 provides for investor-state dispute settlement clauses, whereby investors can submit direct claims for damages against nation-states at ICSID or UNCITRAL arbitration tribunals.<sup>67</sup>

## **IPRs**

As the leading producer of intellectual property in the world, the US demanded strong IPRs protection from Korea that would go beyond the country's commitments under the WTO TRIPS agreement. In fact, the IPRs chapter of the US-Korea agreement establishes TRIPS-plus commitments for the parties by exceeding 'TRIPS Agreement provisions in terms of the duration, extent, and enforcement of IPRs' (Lee *et al*, 2011:140). The PTA requires parties to

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<sup>65</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

<sup>66</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

<sup>67</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

extend national treatment to IPRs holders from the other country and provides an extension of patent terms to compensate for delays in the process of granting patents, as well as provides test data exclusivity for a period of five years for pharmaceutical products and ten years for agricultural chemicals (USTR, 2009).

More specifically, Article 18.9.4 prevents the marketing of generic drugs while the patent on the drug is still in effect (a so called ‘patent linkage’ system) (USITC, 2007), while Article 18.9.1 prevents the granting of marketing approval for ‘a new pharmaceutical or new agricultural chemical product’ based on the safety and efficacy information submitted for approval by the patent holder for at least 5 years for pharmaceutical products and 10 years for agricultural chemical products. Moreover, the agreement provides for a 3-year data exclusivity period for pharmaceutical products that include previously approved chemical entities. In addition, the article also prohibits the approval of new pharmaceutical or agricultural chemical products based on data submitted in another country without the consent of the patent holder.<sup>68</sup>

It should be noted that Article 18.9.1 of the US-Korea PTA,<sup>69</sup> which calls for the protection of submitted ‘information concerning safety or efficacy of the product,’ has a wording (‘information’) that makes the scope of the agreement very broad. Such a restrictive wording is also included in the US PTA with Singapore, for example. In contrast, a similar provision in the US-Chile agreement refers to ‘undisclosed information,’ which limits the scope of the article and is perceived to be more development-friendly (Roffe, 2004).

Hence, also taking into consideration the fact that Korea is a relatively high-income country, which makes it more capable of taking advantage of loopholes in IPRs legislation, the US pushed

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<sup>68</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

<sup>69</sup> The text of the US-Korea PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (accessed 3 December 2015).

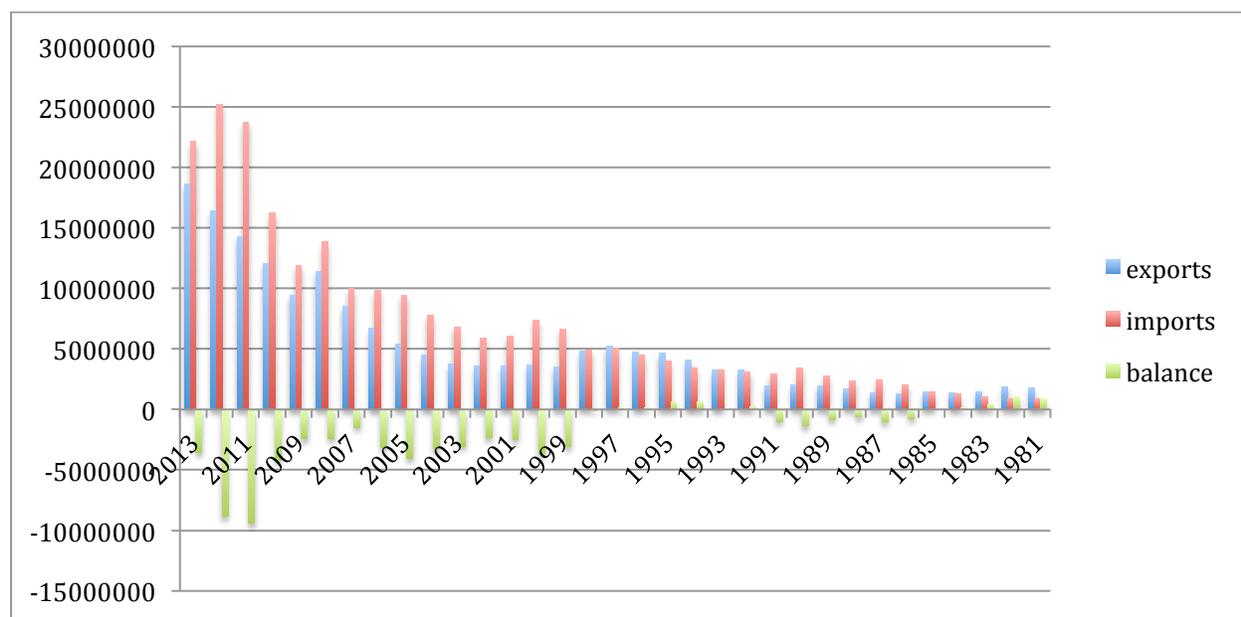
for and achieved desired concession from Korea in IPRs. It proved relatively easy, for Korean negotiators were largely concerned about levelling the playing field for their multinational vis-à-vis competitors in the region and were willing to make concessions for the quick conclusion of the talks (Interview 12).

#### **4.4. The US-Colombia PTA**

After rounds of negotiations during a two-year period, the first-order US-Colombia PTA was signed in November 2006. Upon ratification by the Colombian Congress in 2007 and US Congress in 2011, the agreement entered into force in May 2012 (Villarreal, 2014). At the time of the negotiations, more than 50 per cent of Colombia's exports were consumed by the US, while it also accounted for a quarter of Colombia's inbound FDI (von Braun, 2012). As of 2013, the US was still Colombia's leading trading partner, while Colombia ranked 31<sup>st</sup> among US export markets, accounting for only 1 per cent of US trade. The dynamics of US-Colombia trade is presented in Figure 4.4.1 below.

Due to the small amount of trade between the countries and the small size of the Colombian economy relative to that of the US, the effects of the US-Colombia PTA, albeit positive, were estimated to be very small (Villarreal, 2014). According to the US International Trade Commission (USITC, 2006a), for example, the US GDP was estimated to increase only 0.05 per cent as a result of the agreement, which is broadly in line with estimates by other studies, such as one by DeRosa and Gilbert (2006).

**Figure 4.4.1. US trade with Colombia, in thousand USD, 1981-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 13 November 2014)

The negotiations of the US-Colombia agreement took place in a regional competitive context. Firstly, the talks between the US and Colombia triggered action from Peru and Ecuador, who could not afford to be left out while Colombian exports enjoyed preferential access to the US market. As a result, the US and the three Andean countries started to negotiate a US-Andean agreement (Shadlen, 2008). Until the very end of the US-Andean negotiations, disagreements between the US and the three Andean countries over key issues, such as agriculture and IPRs, persisted.<sup>70</sup> While the US appointed special agricultural negotiators to Columbia and Peru to push for a final deal with the two countries, the negotiations with the Andean group collapsed as all three Andean countries withdrew from the negotiations due to irreconcilable differences with US negotiators, especially over IPRs and agriculture (von Braun, 2012).

<sup>70</sup> The summaries of the rounds of US-Colombia (US-Andean) PTA negotiations provided by the Organization of American States. Available at [http://www.sice.oas.org/TPD/AND\\_USA/col\\_usa\\_e.asp](http://www.sice.oas.org/TPD/AND_USA/col_usa_e.asp) (accessed 3 December 2015).

Secondly, after the US went bilateral with the Andean countries, the conclusion of the US-Peru talks triggered response from Colombia. Although Peru realized that resuming bilateral negotiations after the collapse of the Andean talks was going to diminish its negotiating power vis-à-vis the US, it decided to negotiate further, as stable preferential access to the US market was becoming a higher priority for Peru. As a result, Peru concluded its bilateral negotiations with the US in less than a month after the collapse of the US-Andean talks, albeit at the expense of considerable concessions to the US in a number of important areas. The reasons for such concessions was the fact that Peru could not have afforded to be left out of the US market, especially if its peers in the region had gotten ahead of it and had signed a deal with the US (von Braun, 2012). Furthermore, the US-Peru agreement triggered reaction from other countries in the region to follow suit and sign agreements with the US, notwithstanding the US stance in the negotiations that called for the incorporation of WTO-plus clauses into the agreements that were perceived by Southern countries as restrictive and non-development-friendly (Interview 11).

More specifically, despite the fact that after the conclusion of the US-Peru talks ‘the negotiating flexibility of the Colombian team was even further reduced,’ Colombia could not afford to delay the conclusion of its bilateral negotiations with the US and, realizing that the US would hardly agree on anything less than the terms finalized with Peru, had to join the bandwagon on terms largely dictated by the US (von Braun, 2012:137). In fact, several staff members of the Colombian negotiating team had to withdraw and even resign as public servants as they felt that ‘in order to sign a FTA with the USA it is necessary to pass the “lineas rojas”’ (von Braun, 2012:136). Thus, the start of the talks with Colombia first triggered action from Peru and Ecuador, then in the wake of the stalemate of the US-Andean talks, the conclusion of the

negotiations with Peru prompted action from Colombia. As a result, both Colombia and Peru signed separate North-South PTAs with the US on terms largely dictated by the US.

While Colombia needed stable and permanent preferential access to the US market to, among other things, not to fall behind its competitors in the region, one of the main motivations behind the US pursuit of a PTA with Colombia was to get ahead of rivals, particularly the EU, but also Canada and Mercosur, in the Colombian market.<sup>71</sup> The agreement, in fact, turned out to be strongly in the interests of the US, which, as discussed above, was partly enabled by the competitive pressure the US managed to trigger among the Andean countries that could not afford to be left out while others enjoyed preferential trade relations with the US. According to a report of the Advisory Committee for Trade Policy and Negotiations,<sup>72</sup> the US-Colombia agreement exceeds the negotiating objectives of the US in a number of areas, including investment protection, services, and IPRs.

The rest of the section looks at the negotiations and outcome of the US-Colombia PTA with a particular focus on a number of the key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

Before the agreement went into force, the average tariff in the US was considerably lower compared to that in Colombia, while certain products lines in Colombia had exceptionally high

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<sup>71</sup> USTR account of the US-Colombia PTA, available at <http://www.ustr.gov/uscolombiatpa/facts> (accessed 3 December 2015).

<sup>72</sup> The Advisory Committee for Trade Policy and Negotiations report to the President, the Congress, and the USTR, of 20 September 2006, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Colombia\\_FTA/Reports/asset\\_upload\\_file920\\_9821.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Colombia_FTA/Reports/asset_upload_file920_9821.pdf) (accessed 3 December 2015).

tariff rates, including automobiles (35%), beef and rice (80%), and milk and cream (98%) (USITC, 2006a; Villarreal, 2014). Moreover, Colombia enjoyed considerable preferential unilateral tariff concessions from the US under the Andean Trade Preference Act and GSP. The percentage of Colombian exports entering the US market duty-free through normal trade relations or preference programs was around 90 per cent for each year since 2004 with the exception of 2011. Thus, tariff liberalization as a result of the PTA was going to benefit US exporters more than their Colombian counterparts, although the overall effect was estimated not be very high due to the small amount of trade between the countries relative to the size of the US economy (Villarreal, 2014:13).

As a result of the agreement, over 80 per cent of US exports of consumer and industrial products, including most key US exports in sectors, such as agriculture and construction equipment, aircraft and parts, auto parts, fertilizers and agro-chemicals, information technology equipment, medical and scientific equipment, and wood, were going to become duty-free immediately, with the remaining tariffs to phase out in a 10-19-year period.<sup>73</sup> In addition, 99 per cent of industrial and textile tariff lines were to become duty-free upon the implementation of the PTA (USITC, 2006a). Subject to the agreement's rules of origin, all textile and apparel products became duty free immediately. The agreement also provided for a 'special textile safeguard' provision for the parties in case textile and apparel import surges threaten to damage domestic producers (Villarreal, 2014).

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<sup>73</sup> USTR account of the US-Colombia PTA, available at <http://www.ustr.gov/uscolombiatpa/facts> (accessed 3 December 2015).

## **Agriculture**

Businesses in the US were largely in support of a PTA with Colombia, among other things, because of America's declining market share in Colombia, especially in agriculture, which, they argued, was because of Colombia's participation in PTAs, particularly with Canada. For Colombia, on the other hand, agriculture was a sensitive industry, with tariff lines on certain agricultural products as high as 80-100 per cent and other types of protectionist measures, such as quotas and direct support for production (Salamanca *et al*, 2009; Villarreal, 2014). Moreover, Colombia was seeking moderate liberalization of agriculture, arguing that agricultural liberalization would have adverse effects on rural regions in the country and drive farmers into coca production. As a result, the US did agree on longer phase-out periods for sensitive products, such as rice and poultry, but managed to secure immediate full liberalization in other products, such as wheat and soybeans, as well as provide better access to the Colombian market for its pork exports (Villarreal, 2014).

The agreement on agriculture turned out to be asymmetric in favor of the US. The estimated impact of the agreement, by at least one account (Salamanca *et al*, 2009), was not going to be positive on small farmers in Colombia, which provided significant employment in the agricultural sector. In fact, as a consequence of the PTA, pork and chicken producers in Colombia, in particular, were going to incur losses. As a result of the agreement, more than half of US farm exports to Colombia (representing 77 per cent of tariff lines), including wheat, barley, soybeans, high-quality beef, bacon, almost all fruit and vegetable products, cotton, and the vast majority of processed products, were to become duty-free immediately upon the implementation of the agreement, while virtually all of the remaining tariffs were to be eliminated in 15 years. The PTA also provided for tariff rate quotas on a number of agricultural

products, including standard beef, chicken leg quarters, dairy products, corn, and, rice.<sup>74</sup> At the same time, 89 per cent of US agricultural tariff lines for imports from Colombia were to become duty-free immediately upon implementation of the agreement (USITC, 2006a).

While Colombia was not allowed to exclude any agricultural product lines from liberalization and had to provide unconditional access for key US agricultural exports to its market, certain agricultural product lines important for Colombia, such as sugar and some high-sugar-content products, were excluded from tariff phase-out program in the US. Meanwhile, the elimination of non-tariff protection of other product lines important for Colombian exporters, such as beef, dairy products, fruits and vegetables, remained uncertain as the US maintained a good part of its domestic support for production (Salamanca *et al*, 2009).

Colombia would phase out all agricultural tariff lines and tariff rate quotas in periods ranging from 3 to 19 years. Quotas and over-quota tariffs were to be eliminated in 12 years for corn, 15 years for dairy products, and 19 years for rice. Notwithstanding the longer phase-out periods, however, the US-Colombia PTA showed its negative effects on the Colombian agriculture in its first year of implementation. This was reflected in the growing concerns among Colombian farmers and agricultural producers, who, unable to compete against subsidized US exports, staged mass protests and nationwide strikes in 2013 against the US-Colombia PTA (Villarreal, 2014).

Agriculture was an important component of the US-Colombia negotiations. On the one hand, the agricultural sector was an important job creator in Colombia, hence Colombian negotiators intended to shield it from competition from the US by favoring moderate liberalization. On the other hand, agriculture was where US businesses saw big opportunities in and wanted enhanced

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<sup>74</sup> USTR account of the US-Colombia PTA, available at <http://www.ustr.gov/uscolombiatpa/facts> (accessed 3 December 2015).

access to the Colombian agricultural market in par with other countries, most notably Canada. As a result of the negotiations, the US managed to get almost every possible concession from Colombia, notwithstanding the anticipated adverse effects of deep agricultural liberalization in Colombia. At the same time, the US was able to shield some of its sensitive agricultural products from liberalization. This largely asymmetric outcome is, to a large extent, a result competitive pressures felt by Colombia that were compelling it to strike a deal with the US in the shortest period of time. Competition with its peers in terms of preferential access to the US market made Colombia ready for painful compromises in a number of areas, including agriculture. Colombia could not afford to depend on unilateral, albeit significant, concessions by the US, while its competitors in the Andean region were negotiating permanent bilateral preferential measures with the US (Interview 11).

### **Government Procurement**

Unlike the US, Colombia was not a member of the WTO GPA at the time of the PTA negotiations. The PTA was intended to expand government procurement opportunities for the parties by expanding the list of central and sub-central government entities covered in procurement provisions and by providing national treatment to each other's firms (Article 9.2).<sup>75</sup> The government procurement chapter of the US-Colombia PTA provides a wide list of central and sub-central government entities covered under government procurement provisions. Moreover, among other entities, Colombia's legislature, courts, and a number of key government enterprises, including its oil company, became subject to the agreement (Villarreal, 2014). The government procurement provisions of the US-Colombia-Peru PTA provide access to the

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<sup>75</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

procurements of both central and sub-central government entities.<sup>76</sup> Annex 9.1 of the US-Colombia agreement lists the thresholds of procurement contacts as follows:

**Table 4.4.1. Government procurement thresholds of the US-Colombia PTA**

Procurement by Central government entities, in USD	Procurement by sub-central government entities, in USD	Construction contracts by Central government entities, in USD	Construction contracts by sub-central government entities, in USD
64,786	526,000	7,407,000	7,407,000

Source: Annex 9.1 of the US-Colombia PTA<sup>77</sup>

### Trade in Services

The liberalization of trade in services was quite comprehensive in the US-Colombia PTA, which provided for market access in most services, with only a few exceptions, and went much beyond the WTO GATS agreement. Among other things, US financial services suppliers and portfolio managers acquired equal rights with local firms for establishing branches and subsidiaries in Colombia, as well as got access to the privatized social security market in the country (USITC, 2006a; Villarreal, 2014). Moreover, unlike the WTO GATS agreement, the US-Colombia PTA calls for a ‘negative list’ approach in the liberalization of services sectors, which extends the coverage of the agreement over services sectors, such as real estate services, construction services, environmental services, and pipeline transport services, not covered under the GATS agreement. The agreement was to provide favorable environment for US services providers that enjoyed a competitive edge in most services sectors (USITC, 2006a).

<sup>76</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

<sup>77</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

The liberalization in services, too, were mostly in line with US preferences. The US was able to get from Colombia the measures it sought, notwithstanding Colombia's preference for a less ambitious services chapter. However, Colombia had to compromise and accept US proposals, largely motivated by the urge to complete the deal as soon as possible (Interview 11).

### **Investment Measures**

The investment chapter of the US-Colombia PTA goes much further than the TRIMS agreement to provide for the protection of all forms of investment and full compensation in cases of expropriation (Villarreal, 2014). More specifically, Articles 10.3 and 10.4 of the US-Colombia PTA establish provisions regulating investment-related measures, calling for 'National Treatment' and 'Most-Favored Nation Treatment' that establish the treatment of investors of a Party no less favorably than their own investors, as well as investors from a non-Party.<sup>78</sup>

Article 10.7 prevents any direct nationalization or expropriation of investment or indirect measures 'equivalent to expropriation or nationalization,' except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on the payment of compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay and be fully realizable and freely transferable. Unlike NAFTA and like many post-NAFTA US PTAs, Annex 10-B of the US-Colombia PTA asserts that a government's nondiscriminatory regulatory actions directed towards the protection of public welfare, including public health, safety, and the environment, do not constitute indirect

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<sup>78</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

expropriation.<sup>79</sup> This is an important factor, for, as noted earlier (Public Citizen, 2005), environmental measures have been regarded as ‘tantamount to expropriation’ by rulings in relation to PTAs, such as NAFTA, with significant policy and monetary implications for governments.

In addition, Article 10.9 prohibits performance requirements, including export requirements, domestic content requirements, export-to-import ratio requirements, and technology transfer requirements.<sup>80</sup> Most importantly, Section B of Chapter 10 of the US-Colombia PTA provides for investor-state dispute settlement clauses, whereby investors can submit direct claims for damages against nation-states at ICSID or UNCITRAL arbitration tribunals.<sup>81</sup> This provision, according to the Advisory Committee for Trade Policy and Negotiations on the US-Colombia PTA, applies not only to investments made after the conclusion of the agreement, but also to many types of investment that were made before the agreement went into effect.<sup>82</sup>

## **IPRs**

The US-Colombia PTA goes beyond the TRIPS agreement and provides a strong protection of all forms of IPRs. The agreement effectively limits the grounds on which a patent can be revoked and provides for a strong and state-of-the-art protection of test data (Villarreal, 2014). In general,

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<sup>79</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

<sup>80</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

<sup>81</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

<sup>82</sup> The Advisory Committee for Trade Policy and Negotiations report to the President, the Congress, and the USTR, of 20 September 2006, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Colombia\\_FTA/Reports/asset\\_upload\\_file920\\_9821.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Colombia_FTA/Reports/asset_upload_file920_9821.pdf) (accessed 3 December 2015).

‘[t]he intellectual property rights (IPR) provisions of the U.S.-Colombia TPA will likely benefit U.S.-based industries that rely on IPR protection and enforcement’ (USITC, 2006a:6-14).

The strict IPRs rules of the US-Colombia PTA were a result of Colombia’s significantly reduced bargaining power vis-à-vis the US, as in wake of Peru’s conclusion of a bilateral deal with the US, Colombia had to follow suit and agree on a deal, albeit with restrictive IPRs clauses dictated by the US (von Braun, 2012). As recounted by a USTR official (Interview 11), IPRs were a contentious issue during the negotiations and one of the reasons for the collapse of the US-Andean talks. After the collapse of the US-Andean negotiations, however, Peru’s willingness to conclude a bilateral deal with the US made Colombia follow suit, as it could not afford to be left out. This was perceived by the US as willingness to compromise and was well exploited by the US to extract concessions in IPRs that were hitherto perceived by Colombian negotiators as non-negotiable.

More specifically, Article 16.10 of the US-Colombia PTA provides undisclosed test data exclusivity period for at least ten years for new agricultural chemical products and five years for new pharmaceutical products. In addition, the article also prohibits the approval of new pharmaceutical or agricultural chemical products based on data submitted in another country without the consent of the patent holder.<sup>83</sup> In fact, test data exclusivity was a contentious issue during the negotiations, whereby the US wanted to secure stricter WTO-plus provisions, while Colombia would have been better off with terms that resembled more those in TRIPS. Thus, the outcome that is strictly WTO-plus reflects the asymmetry of power between the parties, which was in part enabled by competitive pressures (von Braun, 2012). The US-Colombia PTA also prohibits the approval of generic drugs based on test data available in other countries. Moreover,

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<sup>83</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

‘if a patent expires before the end of these periods of exclusive data use, the government cannot approve competitive entry of generic versions.’ This clause could effectively extend the patent duration beyond the initially approved period (Maskus, 2006:150-151).

Article 16.9.6(b) provides that ‘[e]ach Party shall provide the means to and shall, at the request of the patent owner, compensate for unreasonable delays in the issuance of a patent.’<sup>84</sup> In addition, the US-Colombia agreement also provides that Colombia implement measures in its marketing approval process ‘to prevent generic drugs from being approved during the term of the patent covering the pharmaceutical product (*i.e.*, “linkage”) and requires the mandatory disclosure of the identity of the generic applicant seeking marketing approval during the patent term’ (USITC, 2006a:6-17).

After the negotiations were completed, however, a new majority in Congress prompted certain changes in the agreements with Colombia and Peru. In line with a document entitled ‘A New Trade Agenda for America,’ amendments to the texts of the agreements were made to mitigate some of the restrictive language initially incorporated in the IPRs sections of the agreements. The changes particularly referred to the abolition of the protection of ‘second-use’ patents and reference to the Doha Declaration (von Braun, 2012).

#### **4.5. The US-Peru PTA**

The importance of the US-Peru PTA for the Peruvian side was highlighted by the visits of Peruvian President Alan Garcia to the US during the early 2000s to meet with President Bush and Members of Congress on several occasions and stress the importance of the agreement for

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<sup>84</sup> The text of the US-Colombia PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (accessed 3 December 2015).

Peru (Villarreal, 2007). The agreement's importance for Peru derived from, among other things, the possible negative consequences of the US-Colombia PTA on the Peruvian economy. The Peruvian government was originally hesitant to start PTA negotiations with the US, but after the US began PTA talks with Colombia, the Peruvian government understood that it could not afford to be left out (Shadlen, 2008). After the US and Colombia announced to begin their negotiations on 18 May 2004,<sup>85</sup> Peru and Ecuador expressed their desire to join the trade talks for a US-Andean agreement.<sup>86</sup> However, the US-Andean negotiations came to a stalemate, and Colombia and Peru negotiated separately with the US (Villarreal, 2007).

After the collapse of the US-Andean negotiations, Peru decided to negotiate further, although it realized that this was going to diminish its negotiating power vis-à-vis the US. As a result, Peru concluded its bilateral negotiations with the US in less than a month after the collapse of the US-Andean talks. The final steps of the negotiations took place with the participation of high-rank politicians from Peru, who endorsed the final deal 'with a presidential promise that it would bring six million jobs' (von Braun, 2012:136). One of the reasons for such a speedy conclusion of talks between Peru and the US was that Peru urgently needed the agreement and could not risk jeopardizing the deal, fearing that a US deal with its peers in the Andean region would put Peru in an unfavorable situation. As a result, Peru's bilateral negotiations with the US successfully concluded in December 2005, and an agreement was signed in April 2006. After ratification in both countries, the US-Peru PTA entered into force in February 2009.<sup>87</sup>

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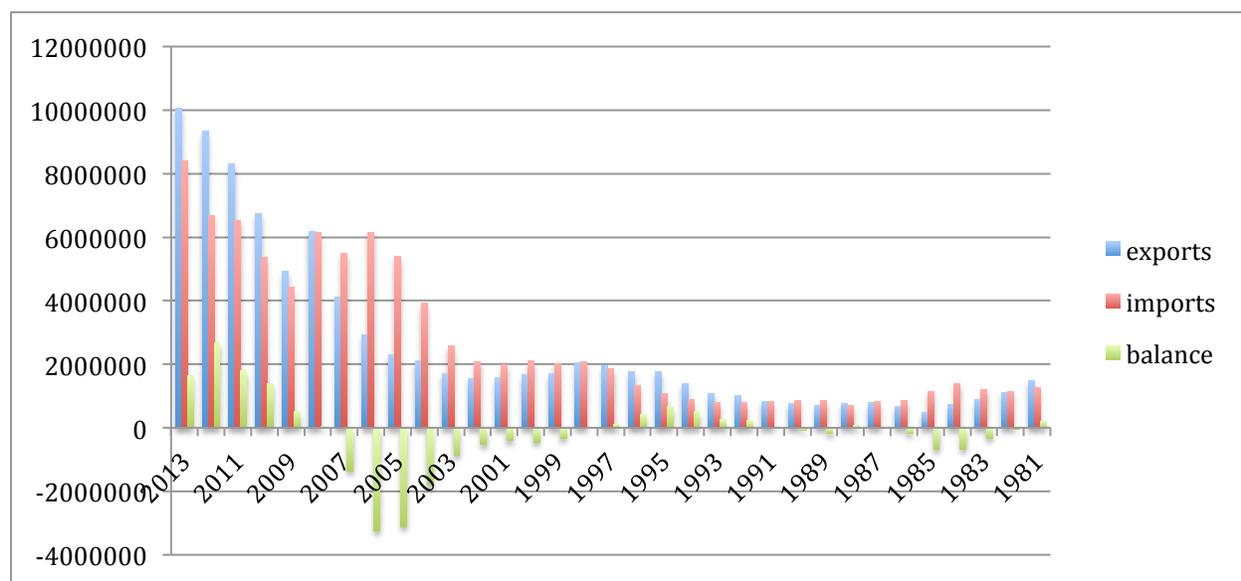
<sup>85</sup> USTR press release, of 23 March 2004, available at <https://ustr.gov/about-us/policy-offices/press-office/press-releases/archives/2004/march/us-and-colombia-begin-fta-negotiations-may-> (accessed 3 December 2015).

<sup>86</sup> USTR Press Release, of 3 May 2004, available at <https://ustr.gov/about-us/policy-offices/press-office/press-releases/archives/2004/may/peru-and-ecuador-join-colombia-may-18-19-laun> (accessed 3 December 2015).

<sup>87</sup> USTR: <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa> (accessed 3 December 2015).

Notwithstanding certain minor changes from the initial US position, as accounted by García (2008), the US-Peru PTA largely reflects the US position in the US-Andean negotiations that failed to be concluded due to irreconcilable differences between the negotiating parties. According to the Advisory Committee for Trade Policy and Negotiations, the US-Peru PTA ‘is strongly in the interest of the United States,’ which exceeds the achievements in other US North-South PTAs, such as those with Chile and Central America. The achievements of the agreement have been significant enough for the Committee to recommend them as a model for future PTAs.<sup>88</sup>

**Figure 4.5.1. US trade with Peru, in thousand USD, 1981-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 13 November 2014)

Despite its ambitious tariff and non-tariff liberalization, however, due to the small amount of trade between the two countries relative to the size of the US economy, the economic effects of

<sup>88</sup> The Report of the Advisory Committee for Trade Policy and Negotiations on the US-Peru PTA, of 1 February 2006, p.1, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Peru\\_TPA/Reports/asset\\_upload\\_file628\\_8962.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Peru_TPA/Reports/asset_upload_file628_8962.pdf) (accessed 3 December 2015).

the US-Peru PTA were estimated to be very small for the US (0.02 per cent of GDP), while for Peru it was estimated to be more significant (3.29 per cent of GDP) as the US was Peru's leading trading partner, with 23 per cent of Peru's exports going to and 16 per cent of Peru's imports coming from the US in 2006 (Villarreal, 2007; USITC, 2006b). The dynamics of US-Peru trade is presented in Figure 4.5.1 above.

The rest of the section looks at the negotiations and outcome of the US-Peru PTA with a particular focus on a number of key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment provisions, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

Given that Peru already enjoyed preferential unilateral tariff concessions from the US under the Andean Trade Preference Act and GSP, tariff elimination as a result of the PTA was going to give greater benefits to US exporters compared to their Peruvian counterparts (USITC, 2006b). As a result of the US-Peru PTA, duties on 80 per cent of US exports to Peru were going to be eliminated immediately. Duties on additional 7 per cent of US exports were to be eliminated in a 5-year period, while the remaining duties were to be eliminated in 10 years after the agreement entered into force. In addition, 99 per cent of US industrial and textile tariff lines were to be brought down to zero immediately (including the conversion of concessional zero tariffs to a permanent measure) (USITC, 2006b; Villarreal, 2007).

Subject to the agreement's rules of origin provisions, all textile and apparel products became duty free immediately. This was especially significant for Peru, for the textile and apparel industry, which experienced rapid export growth as a result of unilateral duty concession

programs granted by the US, was a major employer in the country. As of 2004, two years before the signing of the US-Peru PTA, the industry directly employed 150,000 people and indirectly 350,000. The agreement also provides for a ‘special textile safeguard’ provision for the parties in case textile and apparel import surges threaten to damage domestic producers (Villarreal, 2007).

## **Agriculture**

Agriculture was a contentious issue throughout the negotiations that prompted the US to appoint a special agricultural negotiator in the negotiations with Peru to resolve the final provisions related to agriculture.<sup>89</sup> In addition to the average applied tariff level of 10 per cent, the Peruvian government applied a ‘temporary’ tariff surcharge of 5 per cent on agricultural products, in an attempt to protect the domestic industry. The Peruvian agricultural industry also benefited heavily from the unilateral duty-free schemes granted by the US. As a result, Peruvian agricultural exports rose during the first half of the 2000s, and Peru became the world’s leading exporter of certain agricultural products, such as asparagus and paprika (Villarreal, 2007).

As a result of the agreement, the US unilateral concessions would become permanent, and the US farmers would gain preferential access to the growing Peruvian market.<sup>90</sup> More specifically, two-thirds of US agricultural exports to Peru, including high quality beef, cotton, wheat, soybeans, and certain fruits and vegetables, were going to become duty-free immediately upon the implementation of the agreement, while virtually all of the remaining tariffs, including rice and poultry, were going to be eliminated in 15-18 years. At the same time, including the

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<sup>89</sup> Summaries of the rounds of US-Peru (US-Andean) PTA negotiations provided by the Organization of American States, available at [http://www.sice.oas.org/TPD/AND\\_USA/per\\_usa\\_e.asp](http://www.sice.oas.org/TPD/AND_USA/per_usa_e.asp) (accessed 3 December 2015).

<sup>90</sup> A statement by USTR Schwab on the signing of the US-Peru PTA, December 14, 2007, available at [https://ustr.gov/archive/Document\\_Library/Press\\_Releases/2007/December/Statement\\_by\\_USTR\\_Schwab\\_on\\_todays\\_signing\\_of\\_the\\_US\\_Peru\\_Trade\\_Promotion\\_Agreement.html](https://ustr.gov/archive/Document_Library/Press_Releases/2007/December/Statement_by_USTR_Schwab_on_todays_signing_of_the_US_Peru_Trade_Promotion_Agreement.html) (accessed 3 December 2015).

temporary unilateral tariff concessions that would become permanent as a result of the PTAs, 89 per cent of US agricultural tariff lines for imports from Peru were going to become duty-free immediately upon the implementation of the agreements. Protection on most of the remaining product lines was to be phased out over 10 to 17 years. Certain agricultural products in the US, however, would have permanent protection, which were not to be affected by the US-Peru agreement. Sugar, for example, was going to be protected by tariff-rate quotas in the US even after the full implementation of the US-Peru PTA (USITC, 2006b; Villarreal, 2007).

### **Government Procurement**

Unlike the US, Peru was not a member of the WTO Government Procurement Agreement (GPA) at the time of the PTA negotiations. Thus, the government procurement provisions of the US-Peru PTA were going to produce new commitments, especially for the Andean country. More specifically, the PTA intended to expand government procurement opportunities for the parties by expanding the list of central and sub-central government entities covered in procurement provisions and by providing national treatment to each other's firms (Article 9.2).<sup>91</sup> The government procurement chapter also includes the purchases of state-owned enterprises in Peru, including the country's oil company and public health insurance agency, a major buyer of pharmaceuticals (Villarreal, 2007).

Government procurement clauses of the US-Peru PTA are covered under Chapter 9 and Annex 9.1, which provide access to the procurements of both central and sub-central government entities. The threshold for the procurement of goods and services for central governmental entities is about four times higher than in other US North-South PTAs, such as with Chile,

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<sup>91</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

Singapore, and Central America, and about twice higher than in the agreement with Korea.<sup>92</sup>

Annex 9.1 of the US-Peru PTA lists the thresholds of procurement contacts as follows:

**Table 4.5.1. Government procurement thresholds of the US-Peru PTA**

Procurement by Central government entities, in USD	Procurement by sub-central government entities, in USD	Construction contracts by Central government entities, in USD	Construction contracts by sub-central government entities, in USD
193,000	526,000	7,407,000	7,407,000

Source: Annex 9.1 of the US-Peru PTA<sup>93</sup>

### Trade in Services

The liberalization of trade in services in the US-Peru PTA was comprehensive, going much beyond the WTO GATS agreement. The agreement calls for a ‘negative list’ approach in services liberalization, which extended the coverage of the agreement over services sectors, such as real estate services, construction services, environmental services, and pipeline transport services, not covered under the GATS agreement (USITC, 2006b).

Among other things, US financial services suppliers and portfolio managers acquired equal rights with local firms to establish branches and subsidiaries in Peru, as well as access to its privatized social security market. Other key industries affected by the agreements include telecommunications, financial services, energy services, transport services, construction and engineering services, professional services, and environmental services. In telecommunications, for example, the US-Peru PTA prevents local companies from having preferential access to

<sup>92</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

<sup>93</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

telecommunications networks, and calls for guaranteed reasonable and non-discriminatory access for all network users<sup>94</sup> (USITC, 2006b; Villarreal, 2007).

The liberalization of services was quite comprehensive and an achievement for the US, as it was going to reap major benefits from free trade in services. Extracting concessions from Peru in trade in service turned out to be not as problematic, for driven by the urge of completing a deal with the US as soon as possible, Peru was willing to concede in areas where the US had special interests, including in trade in services (Interview 11).

### **Investment Measures**

Peru's investment laws had some limitations that concerned US investors. Among other things, Peruvian law required majority ownership of broadcast media to Peruvian citizens and a limit (to 30 per cent) of foreign workers employed in local companies. The US-Peru PTA was to liberalize investment measures through TRIMS-plus provisions among the parties (Villarreal, 2007). The US-Peru agreement successfully tore down all the barriers concerning US investors, providing comprehensive investment provisions. The US-Peru PTA goes further than earlier concluded US North-South PTAs by, among other things, providing for 'third party arbitration for investor-state disputes not only for investments concluded after the agreement goes into effect, but also for many types of investments that pre-date the agreement.'<sup>95</sup>

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<sup>94</sup> USTR summary of the US-Peru PTA, available at [http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset\\_upload\\_file672\\_13066.pdf](http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file672_13066.pdf) (accessed 3 December 2015).

<sup>95</sup> The Report of the Advisory Committee for Trade Policy and Negotiations on the US-Peru PTA, of 1 February 2006, p.5, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Peru\\_TPA/Reports/asset\\_upload\\_file628\\_8962.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Peru_TPA/Reports/asset_upload_file628_8962.pdf) (accessed 3 December 2015).

More specifically, Articles 10.3 and 10.4 of the US-Peru PTA establish provisions regulating investment-related measures, calling for ‘National Treatment’ and ‘Most-Favored Nation Treatment’ that establish the treatment of investors of a Party no less favorably than their own investors, as well as investors from a non-Party.<sup>96</sup> Article 10.7 prevents any direct nationalization or expropriation of investment or indirect measures ‘equivalent to expropriation or nationalization,’ except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on the payment of compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay and be fully realizable and freely transferable. Unlike NAFTA and like many post-NAFTA US PTAs, Annex 10-B of the US-Peru PTA asserts that a government’s nondiscriminatory regulatory actions directed towards the protection of public welfare, including public health, safety, and the environment, do not constitute indirect expropriation.<sup>97</sup> In addition, Article 10.9 prohibits performance requirements, including export requirements, domestic content requirements, export-to-import ratio requirements, and technology transfer requirements.<sup>98</sup>

Most importantly, Section B of the Chapter 10 of the US-Peru PTA provides for investor-state dispute settlement clauses, whereby investors can submit direct claims for damages against nation-states at ICSID or UNCITRAL arbitration tribunals.<sup>99</sup> This provision, according to the Advisory Committee for Trade Policy and Negotiations on the US-Peru PTA, applies not only to

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<sup>96</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

<sup>97</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

<sup>98</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

<sup>99</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

investments made after the conclusion of the agreement, but also to many types of investment that were made before the agreement went into effect.<sup>100</sup>

Although Peru was initially reluctant to provide such heavy concessions in investment protection fearing that strong PTA provisions would undermine national laws regulating investment, it eventually agreed, especially after the negotiations went bilateral in the wake of the collapse of the US-Andean talks. The swiftly concluded bilateral talks entailed lots of concessions from the Peruvian side, including in investment measures, as Peru was determined to conclude the talks with the US as soon as possible, fearing of being frozen out of integration with the US, if its competitors got ahead of it and signed preferential deals with the US (Interview 11).

## **IPRs**

The IPRs were among the most contentious issues in the US-Andean negotiations and the US-Peru talks that derived from it.<sup>101</sup> The IPRs chapter of the US-Peru PTA was designed to provide a state-of-the-art protection of all forms of intellectual property, including stronger protection of patents and tougher punishment for piracy and counterfeiting.<sup>102</sup> The terms agreed on as a result of the US-Peru negotiations in the wake of the breakdown of the US-Andean talks turned out to be quite in line with US preferences and with possible negative consequences for the Peruvian

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<sup>100</sup> The Report of the Advisory Committee for Trade Policy and Negotiations on the US-Peru PTA, February 1, 2006, p.5, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Peru\\_TPA/Reports/asset\\_upload\\_file628\\_8962.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Peru_TPA/Reports/asset_upload_file628_8962.pdf) (accessed 3 December 2015).

<sup>101</sup> The summaries of the rounds of US-Peru PTA negotiations provided the Organization of American States, available at [http://www.sice.oas.org/TPD/AND\\_USA/per\\_usa\\_e.asp](http://www.sice.oas.org/TPD/AND_USA/per_usa_e.asp) (accessed 3 December 2015).

<sup>102</sup> USTR summary of the US-Peru PTA, page 6, available at [http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset\\_upload\\_file672\\_13066.pdf](http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file672_13066.pdf) (accessed 3 December 2015).

public healthcare sector. According to a staff member of the Peruvian Ministry of Health, the Minister, realizing she could not prevent the ratification of an unfavorable agreement, ‘agreed to endorse the agreement under a condition of a side payment’ from the Presidency that was to compensate the public health sector for medicine price increases as a result of the PTA. The Presidency, motivated by inking a deal with the US as soon as possible, agreed to make painful concessions, including in IPRs, notwithstanding the anticipated negative consequences on public health (von Braun, 2012:136).

Article 16.10 of the US-Peru PTA provides undisclosed test data exclusivity period for at least ten years for new agricultural chemical products and five years for new pharmaceutical products. In addition, the article also prohibits the approval of new pharmaceutical or agricultural chemical products based on data submitted in another country without the consent of the patent holder.<sup>103</sup> The cost of the adoption of a full data exclusivity regime in Peru was estimated to be more than USD 34 million during the first year alone, USD 29 million of which was to be covered by the consumers. This number was estimated to reach as high as USD 170 million by year 13. These are considerable amounts compared to the size of the Peruvian pharmaceutical market, which was at around USD 650 million at the time of the impact estimation (Health Ministry of Peru, 2005; von Braun, 2012).

The US-Peru PTA provides for a mechanism, according to which, ‘[i]f Peru relies on U.S. FDA approval of a given drug, and meets certain conditions for expeditious approval of that drug in Peru, the period of data protection will be concurrent with the term of protection provided in

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<sup>103</sup> The text of the US-Peru PTA, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (accessed 3 December 2015).

the United States.’<sup>104</sup> Notwithstanding the shift in US trade policy towards greater sensitivity to public health concerns in global IPR rules, especially in the PTAs with Peru, Panama, and Colombia, other TRIPS-plus elements in the US-Peru PTA were not improved substantially and mostly resemble the restrictive clauses found in other US North-South PTAs, such as CAFTA-DR (Fink, 2011).

Debates on the restrictive nature of the IPRs section of the US-Peru PTA highlighted the harsh data exclusivity clauses of the agreement that ‘would have delayed the availability of generic pharmaceuticals in the Peruvian market for at least five years, even if the patent had already expired’ (Villarreal, 2007:16). It was estimated that the US-Peru PTA would limit access to medicine in Peru by limiting the share of more affordable generic drugs in the country. Moreover, in thirteen years after the implementation of the agreement, the prices of some medical products would increase by as much as 132 per cent, and within the first five years of the implementation of the agreement, ‘between 700,000 and 900,000 people will be excluded each year from receiving medicines’ (Health Ministry of Peru, 2005:3).

The negotiations over IPRs were arguably the most contentious during the negotiations. IPRs were the main point of disagreement that caused the stalemate and eventually the collapse of the US-Andean talks. The Peruvian side did not want to concede in this area, given the estimated negative consequences of the IPRs measures on public health in Peru. For the US, on the other hand, as the main producer of intellectual property, strong IPRs clauses were of huge importance. The stalemate was eventually resolved in the favor of the US, after the Peruvian government, feared of being left out in case the US signed preferential deals with its competitors, expressed strong commitment for a bilateral deal with the US in the wake of the collapse of the

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<sup>104</sup> USTR summary of the US-Peru PTA, page 6, available at [http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset\\_upload\\_file672\\_13066.pdf](http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file672_13066.pdf) (accessed 3 December 2015).

US-Andean talks. The US took advantage of the situation and extracted the concessions it needed to incorporate IPRs measures in the agreement in line with its preferences, notwithstanding their estimated negative effects on Peru (Interview 11; von Braun, 2012).

#### **4.6. Concluding Remarks**

The US interest in regional and bilateral trade agreements emerged in the late 1980s, as a result of which NAFTA was signed in the early 1990s. The bulk of the US regional and bilateral trade agreements, however, were signed during the 2000s, when USTR Robert Zoellick took advantage of the TPA Act of 2002 and concluded a number of North-South PTAs, including with Chile, Korea, Colombia, and Peru. This was largely motivated by the stalemate in multilateral trade liberalization starting from the early 2000s. A new era of US active engagement in regional trade negotiations appears to have emerged in 2015, whereby bolstered by the passage of the TPA Act of 2015, the US concluded the TPP with 11 other Pacific Rim countries on October 5, 2015 and has been actively negotiating the TTIP with the EU (Sahakyan, 2015).

The US has largely been a path-breaker in promoting trade liberalization in other parts of the world, with a pro-active approach to sign North-South PTAs to get ahead of other developed economies and establish preferential trade rules in line with its preferences and priorities (Schott, 2001). This has been the case in the first-order negotiations with Mexico, Korea, Colombia, and Peru, while in the second-order negotiations with Chile, the US was, among other things, motivated by redressing its declining positions in Chile that had resulted because of Chile's active involvement in preferential trade relations with a range of third parties, most importantly the EU.

This chapter has provided a comprehensive assessment of the US first-order negotiations with Mexico (NAFTA), Korea, Colombia, and Peru, as well as the second-order negotiations with Chile. Based on the assessment conducted in this chapter, Table 4.6.1 provides a measure of restrictiveness of the five US North-South PTAs from the standpoint of US counterpart developing and emerging economies. Based on the assessment, a value from 1 to 10 (1 is least restrictive, 10 is most restrictive) is assigned to each area of North-South cooperation discussed in Chapter 3 and outlined in the table.

**Table 4.6.1. An overview of US North-South PTAs**

PTA	Order of the PTA	Tariffs (including agriculture) and Related Measures	Government Procurement	Services	Investment	IPRs
NAFTA	first	9	9	10	10	10
US-Chile	second	4	7	9	9	8
US-Korea	first	9	5	10	9	10
US-Peru	first	10	10	10	9	10
US-Colombia	first	10	10	10	9	10

The overall picture of the outcomes of US North-South PTAs depicted in Table 4.6.1 represents the agreements' general restrictiveness for developing and emerging economies. Such outcomes do not appear surprising as the negotiations of most US North-South PTAs took place against the backdrop of vivid asymmetry between the negotiating partners. This asymmetry has been efficiently exploited by USTR Robert Zoellick (2002) to foster 'competitive liberalization' among US trading partners contrary to their prior policies.

The politics of competitive liberalization have been characterized by pressures on Southern countries to sign deals with industrialized Northern countries under the threat of losing vital access to the markets of rich economies while their competitors enjoy preferential treatment. As

a result of this pressure, Southern countries have been forced to give up policy autonomy in a number of areas and end up with restricted policy space under North-South PTAs in return to vital access to the markets of Northern countries. Hence the restrictive nature of the US North-South PTAs discussed in this chapter and outlined in Table 4.6.1.

NAFTA is a vivid example of a PTA with strong asymmetry between the negotiating parties, negotiated under the pressure of ‘competitive liberalization.’ Mexico’s decision to join the NAFTA agreement was, among other things, largely determined by the power asymmetry between the US and Mexico, whereby the US managed to marginalize Mexico, making it choose between a restrictive NAFTA agreement (which would squeeze its development policy space) and being left out while its competitors enjoyed preferential access to the lucrative US market. Mexico could not afford the latter option and had to agree to a NAFTA agreement on terms largely dictated by the US (Gruber, 2000). The Mexican government initially did not view NAFTA positively, which as late as 1988, was a policy option it did not even consider. The change of attitude inspired by the fear of being left out of North American integration not only made Mexico embrace NAFTA, but also made it agree to hitherto unacceptable provisions largely dictated by the US. More specifically, Mexico conceded in a number of key provisions, including duty drawbacks and other tariff-related areas, government procurement, trade in services, investment measures, and IPRs. As a result, NAFTA turned out to be strictly WTO-plus with outcomes that clearly favored US interests. Such an outcome was possible by the setting of the negotiations, whereby the US efficiently exploited Mexico’s fear of being left out of North American integration and pushed for deep liberalization in line with its priorities (Maxfield and Shapiro, 1998; Cameron and Tomlin, 2000; Hufbauer and Schott, 2005; Interview 10).

The second-order US-Chile PTA, on the other hand, was negotiated in a different setting. Having completed the negotiations with the EU, Chile approached the second-order talks with the US, having already secured preferential access to the EU market. In such conditions, feeling left out was not a major concern for Chile, although it was hugely interested in a PTA with the US. The US, on the other hand, approached the talks with Chile with a priority to level the playing field for US exporters and investors in Chile vis-à-vis, first of all, their European competitors.<sup>105</sup> The declining US share in Chilean imports was a primary motivation for US negotiators to conclude a deal with Chile as soon as possible.<sup>106</sup>

The US-Chile agreement turned out to be restrictive for Chile in a number of areas, including government procurement, trade in services, investment protection, and IPRs. However, Chile managed to secure favorable conditions in tariff measures, including in agriculture. Moreover, notwithstanding the general restrictive nature of the agreement, Chile managed to counter US negotiators in a number of areas, including in investment and IPRs, whereby Chile managed to push the US to mitigate some of the strong wording seen in other US North-South PTAs. Most importantly, Chile insisted on and managed to secure some leeway in IPRs provisions that appear to be lighter in the US-Chile agreement compared to other US North-South agreements negotiated simultaneously. Some of these ‘shortcomings’ of the US-Chile PTA were also acknowledged by USTR officials.<sup>107</sup> Chile’s ability to counter some of the US

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<sup>105</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October, 2014).

<sup>106</sup> A statement by the US House of Representatives (Statement on How the United States-Chile Free Trade Agreement Serves the Interests of United States Commerce), available at <http://waysandmeans.house.gov/media/pdf/chile/hr2738docbenefitschilefta.pdf> (accessed 8 October, 2014).

<sup>107</sup> USTR Trade Advisory Committee Report, p.2-3, Feb 2003, available at [https://ustr.gov/archive/assets/Trade\\_Agreements/Bilateral/Chile\\_FTA/Reports/asset\\_upload\\_file799\\_4936.pdf](https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Chile_FTA/Reports/asset_upload_file799_4936.pdf) (accessed 3 December 2015).

initial positions and extract compromises was, among other things, attributed to its enhanced bargaining power that was enabled by its wide network of PTAs, including with the EU, and the determination of US negotiators to seal a deal with Chile as soon as possible, to redress the declining positions of the US in Chile (Roffe, 2004; Interview 10).

The first-order US-Korea PTA was negotiated under conditions similar to that of NAFTA, whereby Korea felt the compelling need to sign a PTA with the US in order to counter competitors that had started to challenge it in the American market. An agreement between the US and Korea was long overdue, given the considerable trade volumes between the countries, but the talks were held back by the lobby from uncompetitive industries in Korea, such as agriculture and financial services (Koo, 2006). The US was not hurrying to start talks with Korea either, for Korea was not ready to compromise in important areas, such as agriculture (Schott *et al*, 2006). The mounting competitive pressures, however, eventually made Korea consider painful concessions, including in sensitive areas, as the absence of preferential access to the US market was becoming increasingly costly for competitive businesses in Korea. As a result, taking advantage of the favorable circumstances enabled by Korea's urge to complete the trade talks as soon as possible, the US managed to achieve most of its negotiating targets, including in agriculture, trade in services, and IPRs, notwithstanding the fact that some of these concessions were estimated to have negative economic consequences in Korea (Interview 12).

As reflected in Table 4.6.1, the outcomes of the US-Colombia and US-Peru PTAs have been almost identical with similar restrictive impact on the policy space in the two Andean countries. The negotiations of the first-order US-Colombia and US-Peru PTAs took place against the backdrop of competitive pressures brought about by stiff competition between the Andean countries. The US-Colombia talks triggered action from Peru and Ecuador, who could not afford

to be left out, while Colombian exports enjoyed preferential access to the US market. As a result, the three Andean countries started to negotiate an Andean agreement with the US (Shadlen, 2008). After the US-Andean talks came to a stalemate and collapsed due to irreconcilable differences between the priorities of the parties, the US went bilateral first with Peru and then with Colombia. Peru's willingness to complete its bilateral talks with the US, motivated by the need to establish preferential trade ties with the US as soon as possible, triggered actions from Colombia. Both countries were very wary that the resumption of the talks, albeit bilateral, with the US was going to diminish their bargaining powers and they would have to concede in a number of important areas, including in agriculture and IPRs, where they had been successful to confront the US during the US-Andean talks (von Braun, 2012). However, being left out for either of the Andean countries, given the other's conclusion of talks with the US, was the least acceptable outcome, which neither Colombia nor Peru could afford. As a result, the US was swift to extract the concessions from both Colombia and Peru it failed to achieve during the US-Andean talks. More specifically, both Colombia and Peru made painful compromises in important areas, such as agriculture, trade in services, investment, and IPRs, notwithstanding the Andean countries' initial stance of more moderate liberalization in these areas (Interview 11).

## 5. An Assessment of EU North-South PTAs: A Comparative Overview

The EU's trade policy has change dramatically over the last quarter century. During the 1990s, a decade that saw the completion of the Uruguay Round of negotiations and the formation of the WTO, the EU was a strong supporter of multilateral trade liberalization. With some exceptions, such as the agreements with Mexico and Chile which were motivated by the relative decline of the EU's positions in Latin America vis-à-vis the US and negotiated in the late 1990s and early 2000s, the EU's regional and bilateral options were put 'on hold.' Once multilateral talks stalled and the prospects of the Doha Round of negotiations became gloomy in the early 2000s, the EU started to look at bilateral and regional alternatives to multilateral trade liberalization (Interview 1; Interview 4; Interview 7).

Initially, the EU prioritized region-to-region negotiations with established regional blocs, such as ASEAN and Mercosur, over bilateral talks with individual countries. However, this approach, termed 'interregionalism' by Aggarwal and Fogarty (2004), did not prove very successful. With ASEAN, for example, the negotiations started in 2007 but failed to be concluded because of the different levels of development among the ASEAN countries, which led to diverging priorities and expectations from an agreement with the EU. The negotiations with the bloc eventually stalled in 2009. Starting in 2010, the EU pursued bilateral agreements with individual ASEAN countries. The negotiations with Singapore<sup>108</sup> and Malaysia started in 2010 and with Vietnam in 2012. The negotiations with Mercosur, another well-established regional bloc, did not prove to be successful either. Launched in 1999, the trade talks with Mercosur stalled in 2004. Although the EU did not go bilateral with the members of Mercosur,

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<sup>108</sup> The negotiations of the EU-Singapore PTA were concluded on 16 December 2012 (European Commission Memo of 16 December 2012, available at [http://europa.eu/rapid/press-release\\_IP-12-1380\\_en.htm](http://europa.eu/rapid/press-release_IP-12-1380_en.htm) (accessed 3 December 2015)).

the negotiations with the bloc resumed only six years later in 2010 and are still under way (Interview 4; Interview 5; Interview 7; Interview 8).

The EU approach, a synthesis of ‘market-driven globalism and politically-driven regionalism,’ has been shaped by factors such as the interests of domestic actors and competition with other major powers (Aggarwal and Fogarty, 2004: 2; Woolcock, 2007). As discussed in earlier chapters, the proliferation of North-South PTAs during the last quarter century has created competition between developed economies in third markets. The expansion of US PTAs starting from the 2000s has produced competitive pressures and has triggered a reaction from the EU, which, in order to protect the interests of its firms in third markets, has negotiated its own North-South PTAs (Interview 1; Interview 4; Interview 6). Given the high volume of EU preferential trade starting from the mid-2000s, a vector of discriminative pressure has emerged, pointing towards the US. The EU trade policy shift towards regionalism coincided with the expiration of the TPA in the US in 2007, which hindered the process of concluding trade agreements for the US.<sup>109</sup> The EU’s proactive stance has left the Obama Administration with the need for counter measures to avoid losing an export market share to the EU (Ahearn, 2011; Economist, 2014a).

The EU trade policy is multi-layered. The motivations behind trade policy towards future EU members and close neighbors, as well as near-bordering countries (*e.g.*, the Balkan and Mediterranean countries), are both economic and political, such as helping countries prepare for possible EU accession and ensuring political stability at the EU’s doorstep. In addition, the EU extends unilateral one-way preferences to least developed countries in the Africa, Caribbean, and Pacific regions and provides concessions through the GSP. On the other hand, the agreements with distant countries and regions—the main focus of this thesis—aim at neutralizing adverse

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<sup>109</sup> The TPA legislation was renewed only eight years later, in June 2015, with the view to complete the TPP and TTIP negotiations (Press Statement of the US Department of State, available at <http://www.state.gov/secretary/remarks/2015/06/244361.htm>, accessed 3 December 2015).

effects of other North-South PTAs and levelling the playing field for European multinationals in their overseas operations (Panagariya, 2002; Ahearn, 2011).

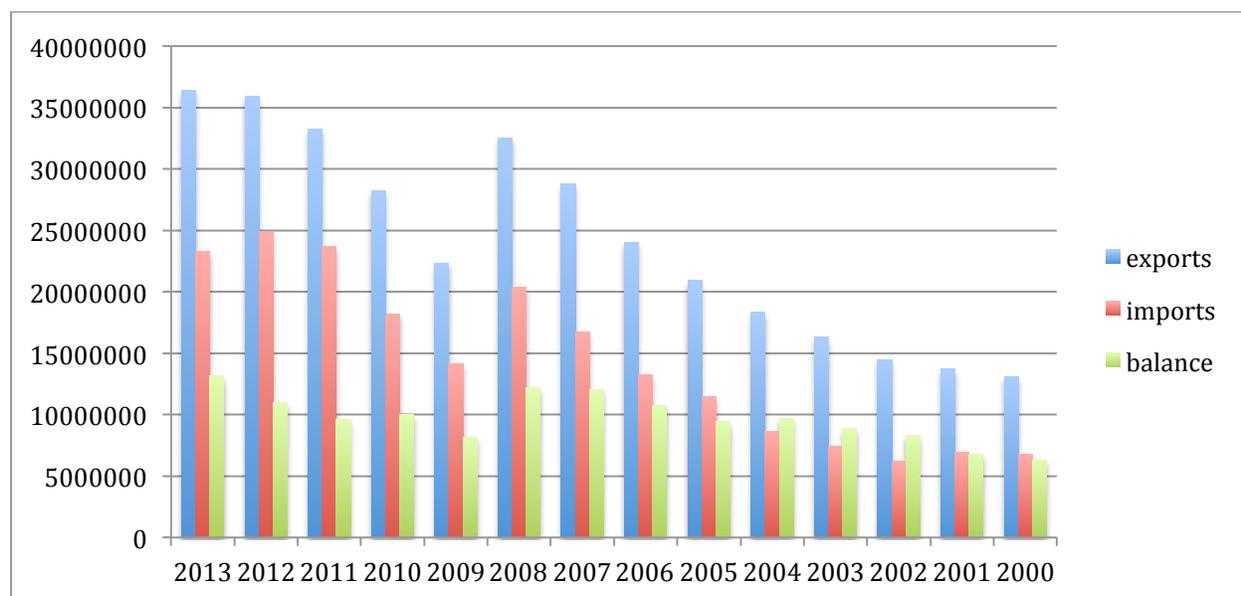
The objectives of the EU's new trade agenda, as outlined in the European Commission's 'Global Europe' Communication released on 4 October 2006, include opening up new markets through PTAs by moving beyond the reduction of tariffs and tackling non-tariff barriers in the 'new areas of growth,' including IPRs, investment, and services. With stronger provisions in these areas, the new PTAs 'need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalization' (European Commission, 2006:11). This agenda, as noted above, has been pursued against the backdrop of discriminative pressures induced by the proliferation of North-South PTAs. Moreover, by reacting to such pressures and pursuing its own counter-agreements, the EU has itself put pressure on other developed countries, particularly the US and Japan, thus augmenting the discrimination-driven proliferation of PTAs (Interview 1; Interview 6).

The remaining parts of this chapter attempt to account for the role of discriminative pressures in EU PTA negotiations with emerging and developing countries, particularly Mexico, Chile, Korea, Colombia, and Peru, and assess the outcomes of the EU's first-order and second-order North-South PTAs from the viewpoint of EU trade partners. The assessments seek to establish whether second-order agreements are substantively different from first-order North-South PTAs and whether the differences in second-order agreements, if any, are due to the availability of first-order North-South PTAs. The evaluation of the contents of the EU's first-order and second-order North-South PTAs is carried out based on the criteria outlined in Chapter 3 and is summarized in Chapter 5.5.

## 5.1. The EU-Mexico PTA

The PTA negotiations between the EU and Mexico started in the mid-1990s and an agreement was signed in 1997, entering into force in 2000. Among the EU's primary motivations behind an agreement with Mexico was to level the playing field for European multinationals competing with American companies in the region, which, enabled by the NAFTA provisions, were enjoying a 'significant competitive advantage' over European firms (Dür, 2007:842; Ahearn 2011). The EU was worried about potential 'considerable trade diversion' as a result of NAFTA that would especially affect the services, auto, and chemical industries in the EU. The lobbying from these industries was among major factors behind the EU's willingness to sign its first PTA across the Atlantic (Manger 2009:15). Figure 5.1.1 below illustrated the dynamics of the EU-25–Mexico trade.

**Figure 5.1.1. The EU-25 trade with Mexico, in thousand USD, 2000-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 21 November 2014)

The EU's share of Mexico's total trade slipped from around 11 per cent in the beginning of the 1990s to about 6.5 per cent in 2001 (Reiter, 2003; Espach, 2006). Ironically, the trade between the EU and Mexico grew in absolute terms more in the second half of the 1990s, when NAFTA was already in force, than in the early 1990s, but in relative terms it was steadily declining throughout the 1990s (Reiter, 2003). According to Dür (2007:838), NAFTA was one of the 'key causes' of the EU's declining share in Mexico's imports during the 1990s.

European firms exporting to or operating in Mexico felt the discriminative effects of NAFTA<sup>110</sup> and mobilized to push the EU to sign a trade deal with Mexico. As a result, the EU declared that 'the existence of NAFTA risks hampering or even eroding economic relations with Mexico in the medium term' (cited in Dür, 2007:842), thus the need for a counter-agreement became more compelling (Dür, 2007). According to EU trade officials (Interview 1; Interview 2), NAFTA had a significant impact on the EU's intentions to start trade talks with Mexico and conclude the negotiations as soon as possible. On the one hand, NAFTA gave EU negotiators an idea of the type of liberalization they could demand from Mexico. On the other hand, however, the 'NAFTA factor' enhanced Mexico's negotiating position, which it exploited very well.

Mexico, on the other hand, was willing to lessen its dependence on the US economy, which had historically been very high even before NAFTA (see Figure 4.1.1 in Chapter 4.1). The diversification of Mexico's trade away from the US and towards other regions, including Western Europe and East Asia, failed in the late 1980s, leading Mexico to reinforce its economic ties with the US by signing the NAFTA agreement in 1992 (Feinberg 2003). After NAFTA completed, however, other developed countries, particularly the EU, felt their positions in

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<sup>110</sup> According to Busse et al. (2000:8), the share of the EU-15's trade with Mexico diminished from 15.5 per cent in 1990 to 6.4 per cent in 1998, and this 'dramatic decline' was reflecting NAFTA's coming into effect.

Mexico deteriorating and, lobbied by local export industries, put every effort to sign an agreement with Mexico to, among other things, level the playing field for their multinationals vis-à-vis American firms (Manger 2009; Interview 1; Interview 2).

Thus, the negotiations of the second-order EU-Mexico PTA took place against the background of the EU losing its market share in Mexico because of NAFTA. Meanwhile, Mexico, unlike during the NAFTA negotiations, was not feeling any competitive pressures it could not ignore. The EU not only did not have the means to exert power over Mexico by threatening to preclude Mexico's preferential access to its market, but was itself feeling under pressure because of its diminishing market share in Mexico. The rest of the section looks at the process and outcome of the EU-Mexico PTA negotiations in a number of key areas, including tariff and related measures, agriculture, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

The EU-Mexico agreement called for the immediate abolition of 82 per cent of EU tariff lines for Mexican manufacturing exports, while the remaining 18 per cent were to be phased out by 2003. In return, Mexico was to eliminate its customs duties in a slightly longer period of time. 47 per cent of the tariff lines were to be abolished immediately, another 5 per cent by 2003, while the remaining tariffs were to phase out by 2007. Although Mexico had a slightly longer phase-out period for tariff elimination, it agreed to cap its tariff levels for manufactured imports from the EU at 5 per cent by 2003. A slightly different schedule was agreed for auto tariffs. Mexico agreed to reduce them from 20 per cent to 3.3 per cent immediately, and abolish them altogether by 2003 (Schott and Oegg, 2001; Villarreal, 2012).

## **Agriculture**

The agricultural industry in Europe, which has been relying on the EU's protection, lobbied against trade liberalization with countries and trade blocs, such as Mercosur, that had big and competitive agriculture and agro-processing industries. It rather preferred bilateral deals with smaller countries, such as Chile, and countries that had a less competitive agriculture sector, such as Mexico (Faust, 2004). Agricultural liberalization was partial in the EU-Mexico PTA, mostly due to the opposition from the strong agricultural lobby in the EU. Only about 60 per cent of agricultural product lines were to be eliminated in the EU within ten years, while the remaining product lines, including sugar, dairy, beef, and grains, were kept out of the agreement. Mexico, on the other hand, was to liberalize 68 per cent of its agricultural tariff lines within ten years, keeping the rest out of the agreement. However, limited liberalization of key export categories, such as wine and spirits for the EU and concentrated orange juice and avocados for Mexico, was also included in the agreement (Schott and Oegg, 2001; Cheong and Cho, 2007; Villarreal, 2012). Notwithstanding the opposition in the EU, however, agricultural liberalization went beyond what the EU initially intended and it played an important role in the conclusion of the agreement. Given the importance of agricultural market access for Mexico and the push from pro-PTA industries in the EU, which were feeling their positions in Mexico deteriorating as a result of NAFTA, the EU had to agree on a number of important concessions in agriculture. Thus, although the EU initially opted for strictly modest concessions in agriculture, it had to go much further than that as the need to secure a deal with Mexico was becoming much compelling (Interview 2; Interview 9).

In sum, although agricultural liberalization was only partial due to strong opposition in the EU and the sensitivity of certain agricultural products in both parties, Mexico managed to win important agricultural concession from the EU, which was compelled to provide them under the pressure from EU export-oriented industries lobbying for an expedited conclusion of the EU-Mexico PTA to level their playing field with competitors from the US (Interview 2; Interview 9).

### **Government Procurement**

The government procurement chapter of the EU-Mexico PTA did not turn out to be very ambitious. It left out sub-federal government entities, which was an achievement for Mexico, as, unlike the EU, it was not a member of the WTO GPA, which covers both federal and sub-federal procurements (Reiter, 2003). The thresholds for Mexico turned out to be similar with those found in NAFTA. The only difference was that the threshold for the procurement of federal government entities was negotiated twice higher than in NAFTA, which was to provide additional protection for local bidders in Mexico. The government procurement thresholds of the EU-Mexico PTA are presented in Table 5.1.1 below.

**Table 5.1.1. Government procurement thresholds of the EU-Mexico PTA**

	Procurement by federal government entities	Procurement by federal government enterprises	Construction contracts by federal government entities	Construction contracts by federal government enterprises
For the EU	SDR 130,000	SDR 400,000	SDR 5,000,000	SRD 5,000,000
For Mexico	USD 100,000	USD 250,000	USD 6,500,000	USD 8,000,000

Source: Annex X of the EU-Mexico PTA<sup>111</sup>

<sup>111</sup> Annex X of EU-Mexico PTA, available at [http://www.sice.oas.org/Trade/MEX\\_EU/English/Decisions\\_Council/Dec2\\_Annexes\\_e/Annex\\_10\\_e.pdf](http://www.sice.oas.org/Trade/MEX_EU/English/Decisions_Council/Dec2_Annexes_e/Annex_10_e.pdf) (accessed 3 December 2015).

## Trade in Services

The EU-Mexico agreement goes beyond the GATS agreement and has been argued to provide European service providers access to Mexico that is on par with NAFTA in a number of areas, including financial services, energy, telecommunications, and tourism (Reveles and Rocha, 2007; Villarreal, 2012). In addition to including ‘MFN treatment’ and ‘national treatment’ clauses, as well as strong market access provisions, the EU-Mexico Joint Council decision includes strong wording on the definition of ‘service suppliers’ as a ‘person of a Party that seeks to provide or provides a service.’<sup>112</sup> In a number of areas, however, the agreement falls short of matching NAFTA provisions. Pursuant to Article 6 of the EU-Mexico PTA, a decision of the EU-Mexico Joint Council provides for explicit exclusion of certain type of services (*e.g.*, audio-visual services), while the question of inclusion or exclusion of specific services was to be concluded at a later stage through additional negotiations of commitments<sup>113</sup> (Mattoo and Sauv e, 2011), thus leaving much of the regulation of trade in services to the GATS agreement.

Trade in services was one of the sectors, which the EU was especially interested in. This was one of the sectors where the EU had to push for NAFTA-like clauses, acknowledging that it could concede in other areas, such as agriculture, where the stakes for Mexico were high. Nevertheless, EU negotiators could not go all the way and break Mexico’s resistance to stricter NAFTA-like causes in trade in services and had to agree on a final deal that does not entirely reflect its initial intentions. An important factor for the EU’s failure to secure the provisions it initially intended was the combination of the increasing pressure on EU companies and Mexico’s

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<sup>112</sup> Decision N  2/2001 of the EU-Mexico Joint Council of 27 February 2001, available at [http://www.sice.oas.org/Trade/MEX\\_EU/English/Decisions\\_Council/2\\_2001\\_e.asp](http://www.sice.oas.org/Trade/MEX_EU/English/Decisions_Council/2_2001_e.asp) (accessed 3 December 2015).

<sup>113</sup> The EU-Mexico agreement, unlike most PTAs that adopt either positive or negative list approach in the liberalization of services, has produced a standstill over the negotiations of services. As a result, services were agreed to be negotiated at a later stage (Mattoo and Sauv e, 2011).

enhanced bargaining power, both of which were a direct result of NAFTA (Interview 2). As a result, the EU-Mexico PTA turned out to have strong services provisions favoring EU interests but it failed to match the NAFTA provisions.

### **Investment Measures**

The investment component of the EU-Mexico PTA turned out to be quite weak. Article 15 calls for the creation of ‘an attractive and stable environment for reciprocal investment,’ through, among other things, the development of an appropriate legal environment that promotes and protects investment and prevents double taxation, harmonized administrative practices, and mechanisms for joint investments.<sup>114</sup> Certain investment-related clauses are regulated by an EU-Mexico Joint Council decision, which calls for investment promotion between the parties, establishes safety valves that may restrict capital movements in cases of balance of payment difficulties, in accordance with the parties’ multilateral commitments under the WTO and IMF.<sup>115</sup>

As stated by Reiter (2003:77), ‘[t]he final result, however, was that the EU-Mexico FTA is left without any real substantive or procedural commitments on investment.’ Indeed, investment provisions in the EU-Mexico PTA are far from those in NAFTA. There is an opinion that the shortcomings of investment clauses under the EU-Mexico PTA are explained by the EU’s intentions to negotiate Investment Promotion and Protection Agreements with Mexico and other Latin American countries with, supposedly, more investor-friendly conditions (Reveles and Rocha, 2007). The fact, however, is that investment provisions of the EU-Mexico agreement

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<sup>114</sup> The text of the EU-Mexico PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>115</sup> Decision N° 2/2001 of the EU-Mexico Joint Council of 27 February 2001, available at [http://www.sice.oas.org/Trade/MEX\\_EU/English/Decisions\\_Council/2\\_2001\\_e.asp](http://www.sice.oas.org/Trade/MEX_EU/English/Decisions_Council/2_2001_e.asp) (accessed 3 December 2015).

hardly go beyond the WTO commitments. The failure to negotiate more ambitious investment provisions with Mexico was acknowledged by an EU trade official. The EU failed to incorporate strong investment protection clauses in the agreement, which were opposed by Mexico, and was hoping to incorporate stronger investment provisions at a later stage, either through the PTA or through other mechanisms. However, ‘as of now, investment remains one of the weakest points of the EU-Mexico trade agreement’ (Interview 2). In addition, the EU-Mexico PTA does not include any provision for investor-state arbitration. It instead makes recourse to government-to-government dispute settlement, compatible with WTO provisions.<sup>116</sup> According to an EU trade official (Interview 2), the reasons for such weak investment measures are multiple, ranging from the EU’s intention to incorporate strong investment provisions at a later stage to the pressing need to conclude a deal with Mexico and hence being soft on issues Mexico attached higher priority to. Given the pressing need to conclude an agreement with Mexico as soon as possible, the EU had to go soft on a number of measures prioritized by Mexico, including investment.

In sum, in the EU-Mexico PTA, investment remains ‘the biggest disappointment’ for the EU (Reiter, 2003:87). The investment clauses of the PTA fail to be classified as WTO-plus and are not in par with other North-South PTAs, particularly those negotiated by the US. One of the main reasons for such an outcome was the pressure induced by NAFTA that made the EU conclude a deal with Mexico as soon as possible and compromise on a number of issues as a result.

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<sup>116</sup> The text of the EU-Mexico PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

## **IPRs**

The IPRs provisions in the EU-Mexico agreement are very short and mostly do not go beyond the WTO (Fink, 2011). Article 12 of the EU-Mexico PTA reaffirms the importance of IPRs and calls for their ‘adequate and effective protection in accordance with the highest international standards,’<sup>117</sup> while an EU-Mexico Joint Council decision reaffirms the parties’ obligations under the TRIPS agreement and a number of earlier IP conventions, such as the Paris Convention, Berne Convention, and the Patent Cooperation Treaty.<sup>118</sup>

Like it was the case with investment-related clauses, the EU failed to negotiate strong IPRs provisions with Mexico. Although such clauses were in the agenda of EU negotiators during the negotiations, they failed to push them through. This was, among other things, explained by the need for an expedited completion of the EU-Mexico PTA negotiations. Thus, the EU had to refrain from pushing its agenda to its fullest, including in IPRs, and give in to Mexico’s priorities, in order to complete a deal as soon as possible (Interview 2).

## **5.2. The EU-Chile PTA**

Signed in 2002, the EU-Chile PTA was the EU’s second PTA with a Latin American country after the agreement signed with Mexico in 1997. While the agreement with Mexico was largely a counter-reaction to NAFTA, that with Chile was to allow the EU to fully enjoy the privileges of enhanced access to the Chilean market and the country’s liberalized investment regime, while competitors, such as the US, dealt with Chile on WTO terms (Interview 1; Interview 2). With an

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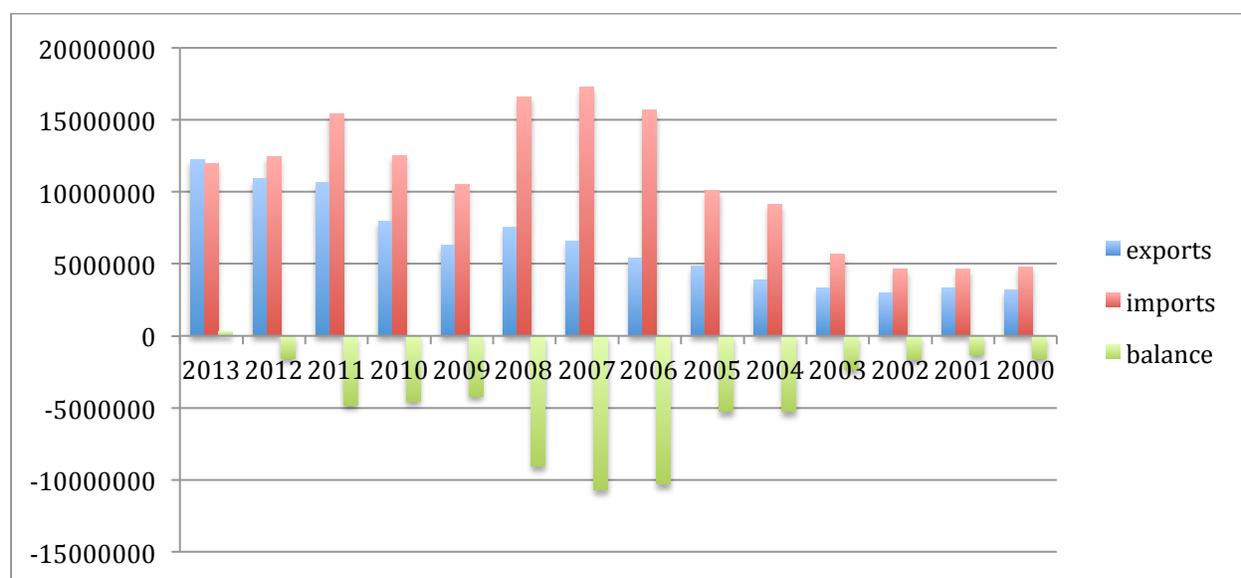
<sup>117</sup> The text of the EU-Mexico PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f95ad1a3-795e-4fb0-84e1-28351b99415c.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>118</sup> Decision N° 2/2001 of the EU-Mexico Joint Council of 27 February 2001, available at [http://www.sice.oas.org/Trade/MEX\\_EU/English/Decisions\\_Council/2\\_2001\\_e.asp](http://www.sice.oas.org/Trade/MEX_EU/English/Decisions_Council/2_2001_e.asp) (accessed 3 December 2015).

open economy with a flat average MFN tariff rate of 7 per cent, Chile had been dependent on external trade and investment. Multilateral liberalization would have been ideal for Chile, but due to the stalemate in multilateral talks and the proliferation of regional agreements, Chile had to consider bilateral agreements to keep its open and export-oriented economy developing and reduce its vulnerability to disruptions of trade and investment flows (Rosales, 2004).

Chile's exports to the EU during the 1990s, as percentage of total exports, were in the range of 25-28 per cent, while its imports from the EU comprised 19-26 per cent of the total (Kuwayama, 2003). The figure did not change in 2003, when 25 per cent of Chile's total exports went to the EU, while 19 per cent of its imports came from the EU. As of 2003, mining (predominantly copper) had the largest share of Chilean goods exports to the EU (46 per cent), while agriculture, farming, forestry and fishery products came second at 13 per cent (Nowak-Lehmann *et al*, 2007). The dynamics of the EU-25–Chile trade since 2000 is presented in Figure 5.2.1 below.

**Figure 5.2.1. The EU-25 trade with Chile, in thousand USD, 2000-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 21 November 2014)

At the time of the EU-Chile PTA negotiations Chile did not have PTAs with other Northern countries. Thus, because of the absence of discriminative pressures, the negotiations with Chile did not proceed under the type of duress seen during the EU-Mexico negotiations. An EU-Chile agreement would give the EU a first-mover advantage and boost the competitiveness of European firms in Chile, as well as improve their prospects in numerous countries and regions Chile had preferential trading arrangements with. Given the absence of discriminative pressures, the EU intended to conclude a comprehensive deal with Chile and achieve during the negotiations what it failed to achieve in the agreement with Mexico (Interview 1; Interview 2).

The rest of the section looks at the process and outcome of the EU-Chile PTA negotiations in a number of key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

The EU-Chile PTA established tariff-free trade in goods in all sectors (Article 58.2) with relatively short transition periods. Article 65 of the EU-Chile PTA calls for the elimination of duties in the EU on industrial products originating in Chile immediately or within three years after the implementation of the agreement in three instalments, while Article 66 calls for the elimination of customs duties on industrial products originating in the EU in a longer phase-out period, lasting up to 7 years.<sup>119</sup> By 2008, five years after the agreement entered into force, 82 per cent of Chilean exports to the EU would become duty-free, while the remaining 18 per cent would still face positive tariffs. As a result of the tariff cuts, the average tariff on EU exports to

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<sup>119</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

Chile fell from 6.7 per cent in 2002 to 0.6 per cent in 2008, which was a lower figure compared to the EU tariffs for Chilean exports (Jean *et al*, 2014).

## **Agriculture**

Agriculture had been an important sector for both sides of the agreement. Although the agreement was estimated to boost Chile's food-related exports to the EU, which faced strong protection in the EU (Nowak-Lehmann *et al*, 2007), agricultural liberalization (especially in the EU), as per Annex I and Annex II of the EU-Chile PTA,<sup>120</sup> was scheduled to take place gradually over a ten-year period and through tariff rate quotas for certain products. Duties on fishery and agricultural products originating in Chile were to be eliminated in the EU during various phase-out periods of up to 10 years.

Chilean duties on EU fish and fishery products were to be eliminated immediately (Article 69), although some products, such as certain types of salmons and other fish, were to have tariff rate quotas as defined in Annex II. Chilean duties on agricultural products were to be eliminated in phase-out periods of up to 10 years, while a limited number of products, such as certain types of cheese, would retain tariff rate quotas.<sup>121</sup> In addition, apart from general safeguard clauses set out under Article 92, Article 73 provides for 'emergency clauses' in case of import surge of agricultural products that may harm domestic industries. In such cases, the parties can suspend further reduction of tariffs or increase the duties up to the MFN levels.<sup>122</sup> The EU had its 'red lines' in agricultural liberalization, which were incorporated into the agreement with Chile, while

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<sup>120</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>121</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>122</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

special agricultural safeguard measures were there for further protection of sensitive agricultural tariff lines in case of import surges. Safeguards were an important tool for Chile as well, but it had a less protected agricultural sector with lower tariff and non-tariff barriers than in the EU, hence safeguard clauses were backed largely by the EU and were seen as beneficial first of all for the EU (Interview 2; Interview 9).

### **Government Procurement**

As opposed to the EU, Chile was not a member of the WTO GPA at the time of the negotiations of the EU-Chile PTA, and the liberalization of the government procurement sector was going to have greater effect on Chile. Article 138(b) of the EU-Chile PTA includes ‘central, sub-central or local government entities, municipalities, [and] public undertakings’ as entities covered under government procurement measures. Moreover, Article 138(c) provides a broad definition of ‘public undertakings’ as ‘any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.’<sup>123</sup> The procurement thresholds of the EU-Chile PTA are presented in Table 5.2.1 below.

**Table 5.2.1. Government procurement thresholds of the EU-Chile PTA**

Procurement by Central government entities, in SDR	Procurement by sub-central government entities, in SDR	Construction contracts by Central government entities, in SDR	Construction contracts by sub-central government entities, in SDR
130,000	200,000	5,000,000	5,000,000

Source: Annex XI of the EU-Chile PTA<sup>124</sup>

<sup>123</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>124</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

## **Trade in Services**

The EU-Chile PTA provides for ‘national treatment’ (Article 98) and strong market access provisions for the parties’ services providers (Article 97 and Article 118), through a GATS-stile ‘positive list’ approach to the liberalization of services, albeit with a broad coverage of services sectors. Moreover, Article 96(c) defines a ‘services supplier’ as ‘any legal or natural person that seeks to supply or supplies a service.’<sup>125</sup> The wording ‘seeks to supply’ broadens the scope of the agreement providing for a greater coverage of the services provisions.

## **Investment Measures**

The EU-Chile PTA does not have a separate investment chapter, and investment provisions of the agreement are covered in Title III (Trade in Services and Establishment), under establishment provisions that refer either to the creation of a new firm in the host country or the acquisition of an existing firm. Establishment provisions, a critical market access component, define the conditions, under which foreign investment is made, and thus the scope and depth of these rules define the scope of the PTA. (Miroudot, 2011). The most notable achievement for the EU in the EU-Chile investment provisions is the strong commitments on pre-establishment of investments (Reiter, 2003). As opposed to post-establishment, which guarantees foreign investors national treatment and MFN treatment once there are admitted, pre-establishment allows the establishment of investments, which automatically start to enjoy national treatment and MFN treatment. In addition, pre-establishment prohibits the imposition of performance requirements, as a condition for the establishment of the investment. Given the strong market access provisions

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<sup>125</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

of the EU-Chile PTA and the shortcomings of the EU-Mexico PTA, especially in investment, one commentator (Reiter, 2003:90) described the EU-Chile PTA as an agreement that ‘thoroughly filled the gaps in the EU-Mexico FTA,’ most notably in investment, trade in services, and government procurement.

The strong wording on market access and establishment provisions notwithstanding, and unlike most US PTAs, the EU-Chile PTA is not explicit with strong provisions on direct and indirect expropriation, nor does it include investor-state arbitration mechanisms, thus leaving investment-related dispute settlement to the WTO DSU.<sup>126</sup>

## **IPRs**

The IPRs provisions of the EU-Chile agreement are very short and do not go much beyond the WTO. Article 170 of the EU-Chile PTA calls for ‘an adequate and effective implementation of the obligations’ arising from a number of multilateral agreements, such as TRIPS, the 1967 Paris Convention, and the 1971 Berne Convention.<sup>127</sup>

### **5.3. The EU-Korea PTA**

The negotiations of the EU-Korea PTA started in 2007. It was signed in 2010 and entered into force in 2011. In the words of Karel De Gucht, the EU Commissioner for Trade, ‘[t]he EU-Korea FTA is the most ambitious trade agreement ever negotiated by the EU’ and the EU’s first PTA with an Asian country that, after transitional periods, was to establish tariff-free trade in all

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<sup>126</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

<sup>127</sup> The text of the EU-Chile PTA, available at [http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC\\_2&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF) (accessed 3 December 2015).

industrial and almost all agricultural trade between the parties, as well as to significantly reduce non-tariff barriers to trade, including related to IPRs, services, and government procurement (European Commission, 2011:1, CRS, 2011).

One of the main driving forces behind the EU's motivation to sign a PTA with Korea was to level the playing field for European exporters to Korea before the discriminative effects of the US-Korea agreement<sup>128</sup> became visible. Moreover, European companies had been among major investors in Korea, and it was important for the EU to make sure its multinationals had an equal footing vis-à-vis their competitors from the US. Thus, the agreement with Korea was, among other things, a defensive response by the EU to the strengthening positions of the US in the Korean market (Interview 6). As argued by Elsig and Dupont (2012), one of the main objectives of EU negotiators with Korea was to secure a level playing field with the US. In addition, Korea, a dynamic and fast-growing economy, fitted well with the 'Global Europe' criteria and emerged as a priority in EU trade negotiations. Korea also was an ideal point of entry for the EU's future bilateral and regional trade relations in East Asia (European Commission, 2006; Pollet-Fort, 2011).

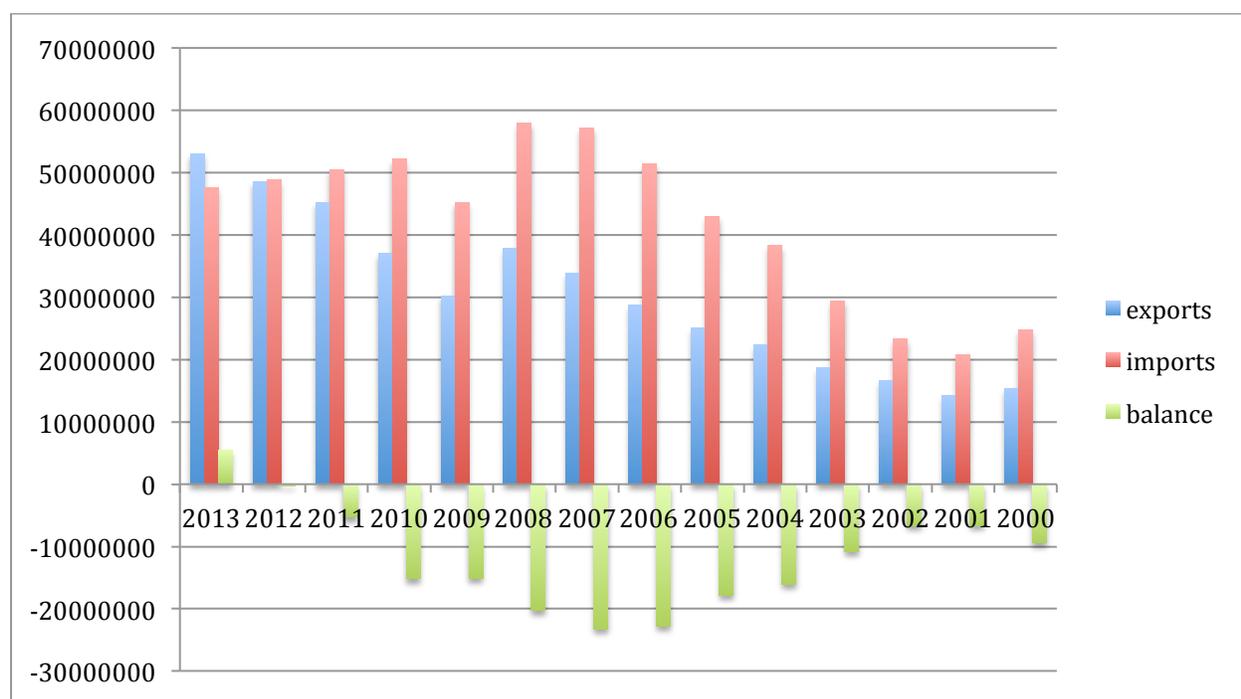
Korea, on the other hand, became enthusiastic about PTAs in general and one with the EU in particular as a result of the 1997 Asian financial crisis and the stalemate in WTO negotiations. The main factors behind Korea's motivation to enter into a PTA with the EU included the EU market size and high volume of trade between the countries, as well as the diversification of trading partners, which seemed especially timely after the completion of the US-Korea PTA (Francois, 2007; Pollet-Fort, 2011).

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<sup>128</sup> The US-Korea PTA was signed in 2007 but was not ratified until 2011.

According to the European Commission,<sup>129</sup> as of 2014, Korea was the EU's eighth largest export destination, while the EU is Korea's fourth largest export destination, after China, Japan, and the US. The trade flow between the countries reached again the benchmark of USD 1 trillion in 2011 (after a slowdown as a result of the 2007 financial crisis). The dynamics of the EU-25–Korea trade since 2000 is presented in Figure 5.3.1 below.

**Figure 5.3.1. The EU-25 trade with Korea, in thousand USD, 2000-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 21 November 2014)

Studies estimated that the EU-Korea PTA would increase the Korean GDP by 1-2 per cent,<sup>130</sup> while the EU GDP would increase less than 0.05 per cent. Because the Korean economy was considerably smaller than that of the EU and trade barriers in Korea were higher, too, the longer-

<sup>129</sup> European Commission: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/> (accessed 3 December 2015).

<sup>130</sup> Other accounts put the GDP growth as a result of the PTA at 3 per cent (Lee, 2009).

term impact of the agreement was estimated to be higher for Korea (CRS, 2011). According to Francios (2007), two-thirds of the total gains from the EU-Korea PTA would go to Korea.

As noted, the negotiations of the second-order EU-Korea PTA were largely determined by the US-Korea agreement. Worried about their worsening positions in Korea as a result of the US-Korea PTA, European businesses pushed the EU to sign a counter-agreement and redress the possible negative consequences of America's deepening trade relations with Korea. Thus, the negotiations of the EU-Korea PTA took place in settings similar to those during EU-Mexico negotiations, whereby the EU felt the pressure to complete the talks and sign a final deal as soon as possible (Interview 6).

The rest of the section looks at the process and outcome of the EU-Korea PTA negotiations in a number of key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

The EU-Korea PTA was to eliminate close to 99 per cent of all tariff lines (in terms of trade value) and create Euro 19 billion worth of trade opportunities for the EU and close to Euro 13 billion for Korea. Most tariff lines were to be eliminated within five years, while for a limited number of highly sensitive product lines in agriculture, such as frozen pork belly, the transitional period was set longer than seven years; other sensitive agricultural product lines, such as rice and rice products, were excluded from the agreement (European Commission, 2011). EU service providers, especially in transportation and finance, as well as exporters of pharmaceuticals, auto parts, industrial machinery, electronics parts, and some agricultural goods are expected to be among the main beneficiaries of the PTA. Meanwhile, the manufacturers of cars, wireless

telecommunications devices, chemical products, and imaging equipment in Korea were expected to expand their exports to the EU and gain as a result of the agreement (CRS, 2011).

One specific feature of the EU-Korea PTA is that drawbacks—the subsidy-like provisions that provide import tax rebates on goods used as inputs for exports—although restricted in most North-South PTAs, are allowed under the EU-Korea PTA. Under this provision, a Korean car manufacturer, for example, could use low-cost inputs from countries, such as China, and claim duties back when end product vehicles are exported to the EU, provided the third-country inputs comply with the rules of origin<sup>131</sup> provisions (CRS, 2011; Elsig and Dupont, 2012). The *de facto* duty-free deployment of low-cost components from third countries could potentially boost the competitiveness of Korean car producers, which, according to Pollet-Fort (2011), was one of the initial demands from Korean negotiators, who wanted the EU rules of origin provisions to become more flexible to consider Korea's integration in East Asian production networks.

As the course of the negotiations demonstrated, Korea preferred drawbacks, as it had an industrial structure that benefitted from tariff refunds that comprised more than 21 per cent of all tariff collection; meanwhile, the EU opposed them (Lee, 2009). Auto industry representatives in the EU argued that having duty drawbacks in the agreement with Korea would set a wrong precedent for future negotiations, and thus lobbied EU negotiators to take the clause off the negotiation agenda. Korean negotiators, however, were firm in their position and were quick to let their European counterparts know that duty drawbacks in the automobile industry were not negotiable (Elsig and Dupont, 2012). This provision proved controversial among European car

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<sup>131</sup> For automobiles, the use of foreign components is limited to 45 per cent, which was risen from lower than 40 per cent on Korea's demand (Lee, 2009).

producers<sup>132</sup> that were worried that Korean producers could relocate parts of their production to low-cost destinations, such as China, and flood the EU car market with vehicles with significant Chinese components. Notwithstanding the possibility of capping the amount of drawbacks to 5 per cent in case of a ‘notable increase’ in foreign sourcing, the provision was of serious concern for the European auto industry (CRS, 2011).

The main reason why EU negotiators did not manage to successfully push for the elimination of duty drawbacks, despite the urge from the auto industry in Europe, was that duty drawbacks were strongly favored by Korea, and the EU could not jeopardise the negotiations because of one particular—albeit important—provision. The EU was under pressure to sign a deal with Korea in the shortest possible period of time, in order to provide EU companies with an equal footing in the Korean market vis-à-vis their US competitors. Thus, in order to achieve this aim, the EU had to concede in a number of important areas, including in drawbacks. In fact, Korea exploited the ‘US factor’ very well and played its hand efficiently, to extract maximum concessions from the EU (Interview 6).

## **Agriculture**

Agricultural liberalization in the agreement was quite substantial. Average annual EU agricultural exports to Korea exceeded Euro 1 billion, of which only 2 per cent entered Korea duty-free before the agreement. The PTA eliminated tariffs on nearly all EU agricultural exports to Korea, albeit with transition periods up to 10 years for the most sensitive products, such as frozen pork. The weighted average duty on EU agricultural exports to Korea was 35 per cent,

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<sup>132</sup> The automobile industry in the EU was one of the industries reluctant about a potential PTA with Korea in the first place (Pollet-Fort, 2011). Opposition to the Korean duty drawbacks scheme was voiced by the German, Italian, Czech, Spanish, Portuguese, and Hungarian governments that were lobbied by low- and middle-price car producers. These voices, however, failed to change the course of the negotiations adopted by the European Commission’s Directorate-General for Trade (Elsig and Dupont, 2012).

which was expected to fall by Euro 380 million annually after the signing of the agreement. The need for EU access to the Korean agriculture market was among other things motivated by Korea's PTA negotiations with competitive agricultural exporters, such as Chile, Canada, the US, and Australia (European Commission, 2011). The EU imported little in agricultural products from Korea. The agreement acknowledges Korea's sensitivity over certain agricultural products, a few of which either retained high tariffs and quotas or were excluded from the PTA altogether. Rice and rice products, for example, were excluded from the PTA as they also were from the US-Korea agreement (Lee, 2009; CRS, 2011).

Duty-free trade in agricultural products has been a higher priority for the EU, given its high volume of agricultural exports to Korea, comprising USD 1.4 billion in 2009. Despite the lengthy transitional periods for most sensitive products, 30 per cent (worth USD 430 million) of European agricultural exports were set to enter the Korean market duty-free immediately. This figure, however, was far less compared to the immediate reduction of tariffs for US agricultural exports to Korea at 62 per cent (worth USD 2.7 billion), as a result of Korea's PTA with the US (CRS, 2011). Import quotas that Korea deployed to protect its sensitive agricultural sectors were set at much lower levels for the EU than they were for the US, for example. Effective in 5 years after the implementation of the US-Korea PTA, the natural honey quota for the US, for instance, was set at a level more than 5 times higher than that for the EU as per the EU-Korea PTA (225 metric tons to 54 metric tons). Preferential quotas for other products, such as dairy, would eventually be capped for the EU, whereas in the case of the US, the quotas for the same products would rise 3 per cent annually. This difference, however, may have been a reflection of the fact that the EU had been a smaller supplier of such agricultural products than the US (CRS, 2011).

According to EU trade officials (Interview 6), in agriculture, the EU's deal with Korea did not compare to that negotiated by the US, whereby the US secured far better access to the Korean agricultural market than the EU. Among reasons for such an outcome was the EU's determination to secure a deal with Korea in the shortest possible time, which hindered its bargaining position in many areas, including in agriculture.

### **Government Procurement**

Because both parties were signatories to the WTO GPA, which covers government procurement by central and (certain) sub-central entities, the EU-Korea PTA was going to build on existing multilateral commitment. The EU-Korea PTA goes beyond the WTO GPA to provide additional coverage in EU public works concessions and Korean 'build-operate-transfer' (BOT) contracts. The provision guarantees access to BOT contracts beyond the threshold of SDR 15,000,000 (Euro 17,000,000) from all central and sub-central public procuring entities (European Commission, 2011; Pollet-Fort, 2011). In contrast, Korea's agreement with the US goes further beyond the GPA, lowers the thresholds, and expands the eligibility of contracts, thus, expanding government procurement opportunities in bilateral trade between the countries (CRS, 2011).

### **Trade in Services**

The agreement provides substantial coverage of trade in services that encourages FDI in Korea and ensures that EU suppliers and investors are not discriminated vis-à-vis their Korean counterparts. The EU-Korea PTA 'is by far the most ambitious' in relation to services in terms of both sectoral coverage and depth of market access that the parties had ever concluded (European Commission, 2011:16). In addition, Article 7.5 of the EU-Korea PTA provides for strong market

access provisions for the parties' cross-border service providers. In addition, the chapter on services calls for 'national treatment' (Article 7.6) and 'MFN treatment' (Article 7.8).<sup>133</sup>

Given the priority of the EU in trade in services, it pushed for and ensured far-reaching liberalization of services that can be regarded as WTO-plus. Despite the broad coverage of services, however, the EU-Korea PTA uses a 'positive list' approach in services liberalization. This clause in the EU-Korea PTA differs from that in Korea's agreement with the US, which employs a 'negative list' approach (CRS, 2011; Pollet-Fort, 2011). It is worth noting that the adoption of a 'positive list' approach happened contrary to the recommendation by the European Services Forum (2006), a network of high-level representatives from the European services sector lobbying for the liberalization of international trade in services that advised the Commission to opt for a 'negative list' approach in the liberalization of services in EU PTAs, including with Korea. Despite its broad coverage, some of the shortcomings of the services chapter for the EU can be attributed to the EU's willingness to give in to Korean negotiators in order to secure an expedited completion of the negotiations (Interview 6).

### **Investment Measures**

The EU-Korea PTA, unlike Korea's agreement with the US, does not cover investment protection<sup>134</sup> and does not have a general investment chapter (CRS, 2011; Pollet-Fort, 2011). Certain investment-related provisions are covered under Chapter 7 (Section C - Establishment). Establishment provisions, referring either to the creation of a new firm in the host country or the acquisition of an existing firm, define the conditions, under which foreign investment is made,

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<sup>133</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accessed 3 December 2015).

<sup>134</sup> Korea, however, had BITs with twenty European countries (CRS, 2011).

and thus the scope and depth of these rules define the scope of the PTA (Miroudot, 2011). Section C (Establishment) of Chapter 7 includes some strong wording in the definition of investor as ‘any person that seeks to perform or performs an economic activity through setting up an establishment’ (Article 7.9(b)). In addition, the agreement provides strong market access provisions (Article 7.11) and calls for ‘national treatment’ (Article 7.12) and ‘MFN treatment’ (Article 7.14). However, in establishment, too, the agreement adopts a ‘positive list’ approach and extends the market access provisions to the list of sectors included in Annex 7-A, while all other sectors are excluded from the agreement.<sup>135</sup> Most importantly, the EU-Korea PTA does not include any provision for investor-state arbitration, thus leaving investment-related dispute settlement to the WTO DSU.<sup>136</sup>

## **IPRs**

In relation to IPRs, the EU-Korea PTA reaffirms and builds upon the TRIPS agreement and in a number of areas goes beyond the WTO. More specifically, the PTA (Article 10.35) provides for the extension of patent terms to compensate for delays of up to 5 years that may occur during the administrative process of patent registration.<sup>137</sup> In addition, Article 10.36 calls for the protection of data submitted to obtain a marketing authorization for pharmaceutical products for at least five

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<sup>135</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

<sup>136</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

<sup>137</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

years. Article 10.36.2 makes a reference to TRIPS Article 39, which refers to ‘undisclosed test or other data,’<sup>138</sup> thus limiting the scope of the article to the TRIPS definition.<sup>139</sup>

Article 10.4 of the PTA states that the parties are ‘free to establish its own regime for the exhaustion of intellectual property rights.’<sup>140</sup> The exhaustion of IPRs is important for determining the possibility of parallel importation. According to Maskus and Chen (2005), under international exhaustion, parallel importation is allowed because the right to control distribution is exhausted upon first sale. Whereas, under national exhaustion, IPRs holders can restrict parallel importation because sales within a specific nation exhausts only national distribution rights to control distribution. Thus, the freedom to establish one’s own regime of IPRs exhaustion provides for the possibility of parallel importation of patented products, like it is allowed under TRIPS but is restricted in many North-South PTAs. Moreover, the agreement (Article 10.34) makes recourse to the 2001 Doha Declaration reaffirming measures to protect public health, as well as adopts clauses on the criminal enforcement of IP rules (Sub-Section b of Chapter 10). Meanwhile, Article 10.18 calls for protection of the geographical indicators (GIs) included in Annex 10-A and Annex 10-B of the agreement.<sup>141</sup>

The IPRs section of the EU-Korea PTA turned out to be much deeper than in the EU’s agreements with Mexico and Chile. The reason for such an outcome was that the EU was concerned about Korea’s higher capacity to replicate know-how and free ride on innovation.

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<sup>138</sup> WTO TRIPS Article 39, available at [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips\\_04d\\_e.htm](http://www.wto.org/english/docs_e/legal_e/27-trips_04d_e.htm) (accessed 3 December 2015).

<sup>139</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

<sup>140</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

<sup>141</sup> The text of the EU-Korea PTA, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN> (accesses 3 December 2015).

Although the IPRs section of the EU-Korea PTAs went further than those with Chile and Mexico, it turned out to be a far cry from the IPRs provisions of the US-Korea PTA. Again, the reason for failing to fully accomplish its initial targets can at least partially be attributed to the setting of the negotiations, whereby the EU could not afford to jeopardise the negotiations by pushing its agenda too far in the areas where Korea did not want to concede. Hence, in order to secure a deal as soon as possible, the EU had to concede in a number of areas, including IPRs (Interview 6).

#### **5.4. The EU-Colombia and Peru PTA**

The EU, in line with its preference for region-to-region agreements over individual PTAs, started to negotiate a trade deal with the Andean bloc, comprising of Colombia, Peru, Bolivia, and Ecuador. In the course of the negotiations, however, the governments of Bolivia and Ecuador backtracked, and the EU decided to go with Colombia and Peru and signed a trilateral PTA in 2012, while leaving the door open for Bolivia and Ecuador. By doing so, the EU would level its positions with the US in Colombia and Peru and, by providing Colombian and Peruvian exports preferential access to the EU market, would put pressure on non-participating Bolivia and Ecuador not to fall behind their Andean neighbours and join the bandwagon<sup>142</sup> (Interview 1; Interview 3).

Levelling the playing field with the US was an important objective for the EU. Among other things, the PTA with Colombia and Peru was to redress the economic disadvantages of EU

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<sup>142</sup> In fact, after the agreement with Colombia and Peru was completed, Ecuador re-evaluated its position in relation to joining the EU agreement with Colombia and Peru and resumed the negotiations, with the first formal round of talks held in January 2014 (European Commission Press Release of 16 June 2014, available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1091>, accessed 3 December 2015).

multinationals vis-à-vis their US counterparts in the two Andean countries that had arisen or could potential arise as a result of the US-Colombia and US-Peru PTAs, both signed in 2006 (Interview 1; Interview 3). Given the tiny share (0.6 per cent) of Colombia and Peru in the total EU exports, as well as the close to zero projected effect of the agreement on the EU GDP (European Parliament, 2012), other factors behind the EU's interest in the agreement, such as levelling the playing field with the US, become more plausible.

Colombia and Peru, on the other hand, wanted to make the EU unilateral concessions under the GSP+<sup>143</sup> scheme permanent. 'Almost all Colombian and Peruvian exports' were covered under the GSP+ scheme before the signing of the PTA, which allowed the duty-free entry of Colombian and Peruvian goods to the European market. Future reviews of the GSP+ schemes could potentially deprive both Colombia and Peru of this privilege, thus both countries were eager to establish a permanent mechanism of duty-free access to the EU market (European Parliament, 2012).

Signed in 2012, the EU-Colombia and Peru PTA entered into force in 2013 and was expected to boost trade and investment between the EU and the two Andean countries. As of 2013, the EU was Colombia's third largest source of imports, while the EU was Colombia's second biggest export destination.<sup>144</sup> Similarly, the EU was Peru's third largest source of imports, too, but the

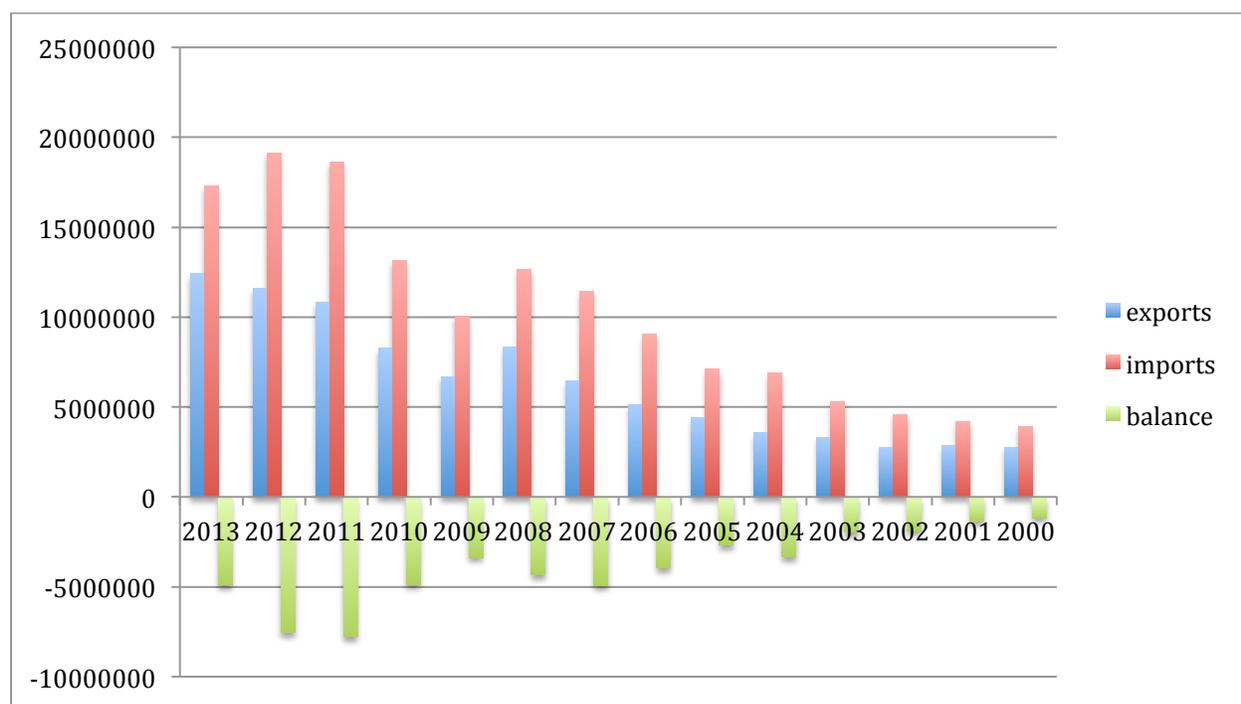
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<sup>143</sup> As opposed to the GSP scheme that provides for the 'partial or entire removal of tariffs on two thirds of all product categories,' the GSP+ scheme calls for a full removal of tariffs on essentially the same product categories as those covered under the GSP (European Commission website, available at <http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences/>, accessed 3 December 2015).

<sup>144</sup> European Commission Press Release of 26 July 2013, available at [http://europa.eu/rapid/press-release\\_IP-13-749\\_en.htm](http://europa.eu/rapid/press-release_IP-13-749_en.htm) (accessed 3 December 2015).

EU was Peru's main export market.<sup>145</sup> The dynamics of the EU-25–Columbia and Peru trade since 2000 is presented in Figure 5.4.1 below.

**Figure 5.4.1. The EU-25 trade with Columbia and Peru, in thousand USD, 2000-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 21 November 2014)

As noted above, the negotiations of the second-order EU-Colombia and Peru PTA were largely a reaction to the US-Colombia and US-Peru agreements signed in 2006. Thus, the negotiations took place against the background of EU's losing market share in Colombia and Peru and its determination to urgently sign a deal with the two Andean countries to level the playing for its multinationals vis-à-vis their American counterparts in the Andean region (Interview 1; Interview 3).

<sup>145</sup> European Commission Press Release of 28 February 2013, available at [http://europa.eu/rapid/press-release\\_IP-13-173\\_en.htm](http://europa.eu/rapid/press-release_IP-13-173_en.htm) (accessed 3 December 2015).

The rest of the section looks at the process and outcome of the EU-Colombia and Peru PTA negotiations in a number of key areas, including tariffs and related measures, agriculture, government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

As a result of the EU-Colombia and Peru PTA, 80 per cent of tariffs on EU industrial and fishery exports to Peru and 65 per cent of exports to Colombia were to be eliminated immediately. These tariffs were to be fully liberalized in 10 years after the agreement's entry into force (European Commission, 2012). In addition, Article 43 reaffirms the rights and obligations under the multilateral safeguard provisions under Article XIX of the GATT 1994, as well as bilateral safeguard provisions (Article 48) which are in line with measures adopted by the EU in other PTAs (European Parliament, 2012).

### **Agriculture**

As a result of the EU-Colombia and Peru PTA, 85 per cent of EU agricultural exports to Colombia and Peru would eventually become duty free, albeit during phase-out periods of up to 17 years. Although this falls short of matching the agricultural concessions provided by Colombia and Peru to US exporters, the liberalization was estimated to result in modest gains for the EU (European Parliament, 2012). Despite the long phase-out periods, most agricultural products would become duty free in 10 years, while others, such as wine, which had been a key product for the EU, would have immediate duty-free access to the Colombian market; meanwhile Peru would allow duty-free entry of European wine into its market in 5 years after the

implementation of the agreement (European Commission, 2012).

Notwithstanding the overall modest gains, however, in certain sectors the EU was estimated to experience negative sectoral change in output. In vegetables, fruits and nuts, for example, the output in the EU was estimated to decrease by 1.5 per cent, while Colombia and Peru were to experience 11 per cent and 0.7 per cent increase, respectively (European Parliament, 2012:29). Notwithstanding the strong agricultural lobby in the EU, the EU negotiators did not manage to shield the agricultural sector in the EU from possible negative consequences as a result of the PTA. In fact, the concessions in agriculture from the EU side were an important tool, in order to get concessions from the Andean countries in other sectors that were of high priority for the EU and had to be included in the final text of the agreement. Forced by the pressure to sign a deal with Colombia and Peru as soon as possible, the EU had to prioritize and compromise more than it initially intended, to make sure an agreement with the Andean countries was inked in the shortest possible time (Interview 3).

Moreover, in addition to general multilateral and bilateral safeguard provisions (Article 43 and Article 48), Article 29 of the EU-Colombia and Peru PTA provides for ‘special agricultural safeguard measures’ for Colombia and Peru in the event of agricultural import surges from the EU exceeding the predefined (in Annex IV) levels. In addition, according to Article 30, both Colombia and Peru maintained their right to use ‘price band systems,’<sup>146</sup> which had been aimed at reducing the volatility of agricultural prices and could constitute a trade barrier for the EU.

## **Government Procurement**

In contrast to the EU, neither Colombia nor Peru was a member of the WTO GPA at the time of

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<sup>146</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf). Annexes available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=691> (accessed 3 December 2015).

PTA negotiations, thus the liberalization in government procurement was going to have a more significant impact on the two Andean countries (European Commission, 2012). Government procurement clauses of the EU-Colombia and Peru PTA are covered under Title VI and Annex XII, which provide access to the procurements of both central and sub-central government entities, including local municipalities in Colombia and Peru (European Parliament, 2012). The procurement thresholds of the EU-Colombia and Peru PTA are presented in Table 5.4.1 below.

**Table 5.4.1. Government procurement thresholds of the EU-Colombia and Peru PTA**

Procurement by Central government entities, in SDR	Procurement by sub-central government entities, in SDR	Construction contracts by Central government entities, in SDR	Construction contracts by sub-central government entities, in SDR
130,000	200,000	5,000,000	5,000,000

Source: Annex XII of the EU-Colombia and Peru PTA<sup>147</sup>

### Trade in Services

The EU-Colombia and Peru agreement provides for strong market access provisions in services and a broad sectoral coverage. It, however, adopts a ‘positive list’ approach in services liberalization in contrast to the ‘negative list’ approach adopted in the US agreements with Colombia and Peru, which broadens the scopes of the US agreements (European Commission, 2012; European Parliament, 2012). The adoption of a ‘positive list’ approach, in fact, happened contrary to the recommendation by the European Services Forum (2006), which advised the Commission to opt for a ‘negative list’ approach in the liberalization of services in EU PTAs, including with Colombia and Peru. The EU-Colombia and Peru agreement adopts NAFTA-like language in the definition of service suppliers, defining them as a ‘natural or juridical person of a

<sup>147</sup> Annex XII of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147723.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147723.pdf) and [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147724.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147724.pdf) (accessed 3 December 2015).

Party that seeks to supply or supplies a service’ (Article 108).<sup>148</sup>

Market access measures of the EU-Colombia and Peru agreement are provided under establishment provisions (Title IV, Chapter 2).<sup>149</sup> Referring either to the creation of a new firm in the host country or the acquisition of an existing firm, establishment provisions define the conditions, under which foreign investment is made, and thus the scope and depth of these rules define the scope of the PTA (Miroudot, 2011). The EU-Colombia and Peru PTA grants establishment rights in ‘almost all’ services (and non-services) sectors. Key services sectors covered by the agreement include telecommunications, maritime transport, banking and insurance, distribution, environmental, and certain professional services (European Commission, 2012:15). More specifically, Article 119 of the agreement provides for strong market access provisions, while Article 120 calls for ‘national treatment.’ In line with the ‘positive list’ approach, these market access measures are, however, applied to a fixed, albeit broad, ‘list of commitments’ under Annexes VII and VIII of the agreement.<sup>150</sup>

The services chapter of the EU-Colombia and Peru agreement does not compare with US-Colombia and US-Peru agreements, which call for more enhanced market access for American service providers. The differences US and EU achievements in pushing their agenda with Colombia and Peru are, among other things, due to the settings of the negotiations, whereby, unlike the US, the EU had to compromise more, in order to ensure a fast conclusion of the agreement with the Andean countries, given the urgency of levelling the playing field for European multinationals vis-à-vis their competitors (Interview 3).

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<sup>148</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

<sup>149</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

<sup>150</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

## **Investment Measures**

The EU-Colombia and Peru agreement does not include a separate investment chapter. Investment measures are instead covered under establishment provisions of the agreement (Title IV, Chapter 2).<sup>151</sup> The PTA adopts strong establishment provisions for a wide range of services and non-services. It calls for strong market access (Article 112) and national treatment (Article 113) provisions in par with the US agreements with the two Andean countries (European Parliament, 2012; European Commission, 2012). However, unlike the US agreements with the two Andean countries, the EU-Colombia and Peru PTA does not cover investment protection. A footnote to Article 111 (Scope of the Application) under Chapter 2 (Establishment) explicitly states that ‘[f]or greater certainty, and without prejudice to the obligations set out therein, this Chapter does not cover provisions on investment protection, such as provisions specifically relating to expropriation and fair and equitable treatment, nor does it cover investor-State dispute settlement procedures.’<sup>152</sup> Furthermore, investment provisions covered under establishment clauses of the EU-Colombia and Peru agreement employ a ‘positive list’ approach. In addition there are a number of general exceptions that allow Colombia and Peru to deploy investment policies in the interests of socially and economically disadvantaged minorities and ethnic groups (European Parliament, 2012).

Like it was the case with the provisions on services, the investment-related provisions of the EU-Colombia and Peru PTA turned out to be much weaker compared to the deals secured by the US with the two Andean countries. These differences too are to a great extent attributed to the

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<sup>151</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

<sup>152</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

settings of the negotiations, whereby the EU had to compromise more in order to expedite the negotiations (Interview 3).

## **IPRs**

The IPRs chapter of the EU-Colombia and Peru PTA builds upon the WTO TRIPS agreement. It has strong provisions on GIs and calls for test data protection of pharmaceutical and chemical agricultural products for at least 5 years and 10 years, respectively (European Commission, 2012). More specifically, the IPRs section of the agreement calls for ‘national treatment’ (Article 198) and ‘MFN treatment’ (Article 199), while Section 2 of Chapter 3 provides for strong protection of GIs.<sup>153</sup> In addition, Article 231 calls for the protection of ‘undisclosed test or other data related to safety and efficacy of pharmaceutical products and agricultural chemical products, in accordance with Article 39 of the TRIPS Agreement,’ for 5 years for pharmaceutical products and 10 years for chemical agricultural products.<sup>154</sup> It should be noted that the wording ‘undisclosed test or other data’ and reference to the TRIPS agreement provide a more limited scope of the protection, as opposed to the wording ‘information’ or ‘data’ (whether undisclosed or not) seen in a number of US agreement, including with Korea and Singapore.

Moreover, Article 200 provides that ‘Each Party shall be free to establish its own regime for exhaustion of intellectual property rights, subject to the provisions of the TRIPS Agreement.’<sup>155</sup> The exhaustion of IPRs is important for determining the possibility of parallel importation. According to Maskus and Chen (2005), under international exhaustion, parallel importation is

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<sup>153</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

<sup>154</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

<sup>155</sup> The text of the EU-Colombia and Peru PTA, available at [http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc\\_147704.pdf](http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147704.pdf) (accessed 3 December 2015).

allowed because the right to control distribution is exhausted upon first sale. Whereas, under national exhaustion, IPRs holders can restrict parallel importation because sales within a specific nation exhausts only national distribution rights to control distribution. Thus, the freedom to establish one's own regime of IPRs exhaustion, provides the possibility of parallel importation of patented products, like it is allowed under TRIPS but is restricted under many North-South PTAs. Overall, as accounted by Maskus (2014), the EU-Colombia and Peru PTA generally recognizes the importance of policy flexibility in IPRs, hence being more development-friendly than other North-South PTAs.

## **5.5. Concluding Remarks**

The EU's preferential trade relations with Mexico, Korea, Colombia, and Peru have been largely influenced by discriminative pressures induced by the proliferation of North-South PTAs in Latin America and East Asia. Having felt its economic interests threatened in Mexico, Colombia, Peru, and Korea mostly as a result of the US PTAs with these countries, the EU was compelled to seek counter-agreements and level the playing field for its multinationals vis-à-vis their competitions from the US. The relations with Chile, on the other hand, followed a different logic. The EU trade policy toward Chile was motivated by establishing enhanced access to the Chilean market and the country's liberalized investment regime, while competitors, such as the US, dealt with Chile on WTO terms. This would give the EU a first-mover advantage and boost the competitiveness of European firms in Chile, as well as improve their prospects in numerous countries and regions Chile had preferential trading arrangements with (Interview 1; Interview 4; Interview 6).

The results of the assessment of the EU’s first-order North-South PTA with Chile and second-order North-South PTAs with Mexico, Korea, and Colombia and Peru are presented in Table 5.5.1 below. Based on the assessment conducted in this chapter, Table 5.5.1 provides a measure of restrictiveness of the four EU North-South PTAs from the standpoint of EU counterpart developing and emerging economies, by assigning a value from 1 to 10 (1 is least restrictive, 10 is most restrictive) to each area of North-South cooperation discussed in Chapter 3.

**Table 5.5.1. An overview of the EU’s North-South PTAs**

PTA	Order of the PTA	Tariffs (including agriculture) and Related Measures	Government Procurement	Services	Investment	IPRs
EU-Mexico	second	5	4	6	1	1
EU-Chile	first	7	8	7	7	1
EU-Korea	second	3	4	5	1	7
EU-Colombia and Peru	second	5	8	8	4	5

As seen from Table 5.5.1, the second-order EU North-South PTAs with Mexico, Korea, and Columbia and Peru did not turn out to be restrictive for the EU’s counterpart emerging and developing countries. This appears to be in line with the hypothesis of this thesis, whereby the negotiating power of Southern countries are enhanced during second-order North-South PTA negotiations due to stable access to Northern markets, as well as discriminative pressures on Northern countries as a result of first-order North-South agreements. The first-order EU-Chile PTA, on the other hand, somewhat diverges from the main hypothesis of the paper. Although overall a more restrictive agreement than the second-order PTAs, it turned out to be not restrictive in IPRs-related measures.

The second-order EU-Mexico PTA is one example where the negotiations took place against the backdrop of the EU losing its market share in Mexico, and European companies pushing EU negotiators to sign a deal with Mexico in the shortest possible time, to counter the ‘significant competitive advantage’ enjoyed by US companies as a result of NAFTA (Dür, 2007:842). The EU-Mexico PTA, although considered a successful one for the EU with broad coverage of goods and services, short transition periods, and NAFTA-parity clauses in certain spheres (Reiter, 2003; Reveles and Rocha, 2007), did not turn out to be WTO-plus in some key aspects of the agreement. This was, among other things, because Mexico managed to play its ‘NAFTA card’ well and resists restrictive measures proposed by the EU, while the EU, constrained by the urge of completing the negotiations as soon as possible, had to compromise more than it had initially intended (Interview 2). In the word of one commentator (Reiter, 2003:83), the EU-Mexico PTA reveals ‘some serious shortcomings from an EU point of view in terms of establishing WTO-plus commitments.’ This refers to a number of key provisions affecting the policy space in developing and emerging countries, including in tariff measures, government procurement, trade in services, investment, and IPRs, where the EU-Mexico PTA turned out to be a good deal for Mexico and considerably less restrictive than NAFTA.

More specifically, notwithstanding the strong agricultural lobby in the EU, Mexico managed to win important agricultural concession from the EU, which was compelled to provide them under the pressure from EU export-oriented industries lobbying for an expedited conclusion of the EU-Mexico PTA. The EU was willing to compromise in agriculture, to provide better provisions for its competitive industries in Mexico. However, the deal did not turn out to be as favorable for competitive sectors, such as services, either. Despite the initial attempts to establish NAFTA-parity provisions in trade in services, the negotiations came to a stalemate, and the

liberalization in services was left to further negotiations, thus leaving certain provisions on services to the GATS agreement (Mattoo and Sauvé, 2011). Mexico opposed stricter services provisions and the EU could not afford to jeopardize the entire agreement because of one specific issue. In fact, this was exactly the case during the negotiations of government procurement clauses, investment, and IPRs. Given the opposition by Mexico for stricter NAFTA-like investment provisions, ‘the EU-Mexico FTA is left without any real substantive or procedural commitments on investment’ (Reiter, 2003:77). The EU was hoping to incorporate stronger investment provisions at a later stage, either through the PTA or through other mechanisms. However, ‘as of now, investment remains one of the weakest points of the EU-Mexico trade agreement’ (Interview 2). Meanwhile, the IPRs section of the EU-Mexico PTA merely reaffirms the parties’ commitment to IPRs protection under multilateral agreements and fails to establish any substantial WTO-plus commitments.

The negotiations of the second-order EU-Korea PTA were a result of the EU’s deteriorating positions in the Korean market. Although the size of the Korean economy and its level of development were by themselves a valid reason to establish deeper trade relations with the country, one of the main incentives behind the EU’s move to pursue a PTA with Korea was to level the playing field for European exporters to Korea before the discriminative effects of the US-Korea agreement made themselves visible. Hence, the negotiations, largely pushed for by competitive EU industries that were concerned about their deteriorating positions in the Korean market, happened in settings similar to those in the EU-Mexico negotiations, whereby the EU felt the pressure to complete the talks as soon as possible (Interview 6).

As also seen from Table 5.5.1, the EU-Korea agreement turned out to be not as restrictive for Korea and not much in line with EU preferences in a number of policy areas outlined in Chapter

3. Despite the intentions of EU negotiators to conclude an agreement that is in par with the US-Korea PTA, the EU-Korea agreement fell short of meeting that objective. More specifically, Korea insisted on duty drawbacks to be incorporated in the agreement, because it would handsomely benefit its auto industry by allowing it to use low-cost inputs from third countries, such as China, and claim duties back when end product vehicles are exported to the EU. Although the EU, backed by the European car producers, viciously opposed this particular clause, Korea managed to incorporate it in the final deal anyway. The EU had to agree on duty drawbacks because Korea attached a high priority to this particular provision, while the EU could not afford to delay or jeopardize the negotiations, as the provisions of the US-Korea PTA were starting to hurt EU businesses in the Korean market (CRS, 2011; Elsig and Dupont, 2012). The EU was under pressure to sign a deal with Korea in the shortest possible time, in order to provide EU companies with an equal footing in the Korean market vis-à-vis their US competitors. In fact, Korea exploited the ‘US factor’ very well and played its hand efficiently, to extract maximum concessions from the EU in other aspects of the agreement, too, including in trade in services, government procurement, and IPRs. The EU had to give in and substantially compromise in these areas, in order to achieve its higher priority, *i.e.*, an expedited conclusion of the talks with Korea (Interview 6).

Similarly, the negotiations of the second-order EU-Colombia and Peru PTA was motivated by the signing of the US-Colombia and US-Peru agreements. Thus, the negotiations took place against the background of the EU’s determination to urgently sign a deal with the two Andean countries to level the playing for its multinationals vis-à-vis their American counterparts in the Andean region. Forced by the pressure to sign a deal with Colombia and Peru as soon as possible, the EU had to compromise more than it initially intended (Interview 3; Interview 9). As

a result, the outcome of the agreement turned out to be in line with the preferences of the two Andean countries in a number of key areas, especially agriculture, investment measures, and IPRs.

The negotiations of the first-order EU-Chile PTA, on the other hand, followed a different logic. The EU approached the negotiations with Chile with the intention to establish preferential trade relations with the Latin American country in order to get a first-mover advantage and enjoy preferential access to the Chilean market, while its competitors dealt with Chile on WTO terms. Given the favorable conditions in the form of the absence of discriminative pressure during the negotiations, the EU intended to achieve in the negotiations with Chile what it failed to achieve with Mexico (Interview 1; Interview 2). In fact, the EU-Chile PTA turned out to be more in line with EU preferences than the EU-Mexico agreement. More specifically, the EU managed to achieve better provisions in agriculture and government procurement, as well as in the regulation of services and investment (Reiter, 2003).

## **6. An Assessment of Japan's North-South PTAs: A Comparative Overview**

Japan had long avoided preferential trade liberalization and had instead favored multilateral liberalization through the GATT/WTO. In the late 1990s and early 2000s, however, Japan adopted a more inclusive 'multi-layered' trade policy that was to adapt to the new challenges posed by the Chinese economic rise and the proactive bilateral trade policies of the US and EU (METI, 2000; MOFA, 2002; Hatakeyama, 2002a; 2002b; Economist, 2007; Vio, 2010). Japan's PTA strategy that was adopted in the early 2000s emphasized the need for PTAs that were to 'strengthen the free trade system' and contribute to 'the attainment of its economic interests as a mechanism to complement the multilateral free trade system centering on the WTO' (Ono, 2015:218).

In fact, as admitted by a MITI Vice-Minister right before Japan started negotiating its first PTA with Singapore, 'if Japan were to rely only on the WTO, we will not be able to liberalise for the next few years until the next global round of trade talks. Japan will be left behind in terms of competitiveness' (cited in Terada, 2006:13). Redressing the trade diverting effects of the proliferating trade agreements elsewhere was indeed an urgent task for Japan (Solís, 2003). According to Wall (2002:34), more than 60 per cent of Japanese trade in 1997 was with countries that were members of major regional trade blocs. As a result of the formation of these trade blocs, Japan's external trade had suffered significantly. If not for the third-party regional trade blocs, Japanese total trade would have been 11 per cent higher than it actually was in 1997; exports and imports would have respectively been higher by 13 and 8 per cent.

To counter the trade diverting effects of third-party PTAs, Japan had to initiate PTAs of its own. It started by negotiating deals with smaller countries with relatively open economies.

Although the already low tariffs of such countries would have limited the gains from PTAs, the agreements would allow the Japanese government to earn preferential access to other countries' markets, while protecting its sensitive sectors, such as agriculture (Solís, 2003; Pekkanen *et al*, 2007; Corning, 2009). Japan's first PTA was signed with Singapore, which came into force in November 2002. Ever since, the Japanese government has been active in pursuing preferential trade deals in the Asia-Pacific, as well as cross-regionally with Mexico, Chile, and Peru (Pempel and Urata, 2006; Gonzalez-Vigil and Shimuzu, 2012). The recent completion of the TPP talks between 12 Pacific Rim countries, including Japan and the US, is yet another major step by Shinzo Abe's government towards preferential trade liberalization.

There were a number of factors behind Japan's move toward regionalism. Firstly, Japanese industries needed new markets. If Japanese exporting industries were to remain competitive in the world market, Japan had to pursue regional and bilateral PTAs, of which it did not have any until the beginning of the 2000s. Secondly, Japan could use the countries it signed PTAs with to expand to other networks of trade. This was the case with Singapore, which was used by Japan to expand to other ASEAN countries. Lastly, PTAs would incentivize important domestic structural reforms in a quicker and less painful manner (Hatakeyama, 2002a; 2002b; MOFA, 2002; Pempel and Urata, 2006; Solís, 2008; Vio, 2010).

Another important factor was the considerable amount of Japanese FDI, which was particularly concentrated in Mexico and Southeast Asia. As a result of the appreciation of the Japanese Yen in the 1980s, Japan expanded its investment in Mexican *maquiladoras*, as well as in Southeast Asia. The dearer Yen reinforced the need for Japanese multinationals to cut costs domestically and establish production networks in low-cost-labor countries, as the appreciated Yen had made investment abroad less costly (Koido, 1991:64, Szekely, 1991). Thus, to protect

its increasing investments in countries and regions, such as Mexico and ASEAN, and secure preferential treatment in par with those granted to US and EU multinationals, Japan started to seek preferential deals first of all with its major FDI recipients (Prasirtsuk, 2006).

Japanese negotiators emphasized a number of WTO-plus commitments in Japan's future PTAs, including in services, IPRs, government procurement, and investment protection. Other key issue of the Japanese approach were economic cooperation and the asymmetry in tariff elimination, whereby Japan had been trying to shield its sensitive sectors, most importantly in agriculture, from outside competition (Solís, 2008).

The move toward regionalism did not occur without domestic opposition, however. The Japanese economy was characterized by the so-called 'duality,' in which extremely competitive exporting industries (*e.g.*, automobiles, machineries, and electronics) had been cohabiting with inefficient industries surviving at the expense of government subsidies and protectionist policies (*e.g.*, agriculture, construction, retail). Of the latter industries, agriculture had historically been one of the most politically powerful sectors in Japan and had been exerting pressure on government policies since World War II, despite its ever declining share in Japan's GDP.<sup>156</sup> As a result, despite being one of the uncompetitive and low-productivity sectors in the Japanese economy and despite lacking promising prospects, agriculture had been provided government support and had been sheltered from external competition for decades (Mulgan, 2000; Pempel and Urata, 2006).

The reasons why the Japanese agricultural sector exerted significant influence on Japanese politics can be traced back to the country's organizational, electoral, and party-political traditions. Farmers have historically been well-mobilized and well-represented in the Diet, the

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<sup>156</sup> The share of agriculture, forestry, and fishery sector reached as low as 1.5 per cent of Japan's GDP by 2005 (Terada, 2006; Ando and Kimura, 2008).

Japanese parliament. As a highly politicized industry in Japan, agriculture ‘has been too electorally powerful, too highly organized, too visible publically and too well represented in the Diet and in the ruling party for the government to ignore the political ramifications of any major decision on agricultural policy’ (Mulgan, 2000:645). If the benefits of policy change are widely spread, individual beneficiaries do not have incentives to spend resources lobbying for it. By contrast, if benefits are concentrated, spending heavily on lobbying pays off as the promoted policies (agricultural protection, in this case) enable transfers from the many to the few. Hence, producer groups have been dominating the lobbying scene, as each of the vast number of consumers that would have felt only a tiny portion of the benefits of lower prices as a result of trade liberalization lacks the motivation to lobby for it (Hillman, 1989).

Ando and Kimura (2008:2) mention three tiers of agricultural protection in Japan. The products under the first tier ‘structural protection,’ including rice, beef, pork, and chicken, enjoy comprehensive and resilient protection. The second tier products, including, sugar, molasses, barley, and pineapples, fall under ‘local protectionism.’ The third tier includes ‘sectors being liberalized’ as a result of trade negotiation, namely the Uruguay Round. The products under this category include vegetables, fruits and seafood, such as pepper, melon, asparagus, coffee, tuna, salmon, and shrimp.

Given the strong agricultural protection, it is not surprising that Japan chose the sequence of its PTA partners in a way that would not inflict much cost on anti-liberalization domestic sectors, including agriculture. For this reason, Singapore was an ideal country for Japan to sign its first PTA with, since the exports from Singapore did not conflict much with protectionist forces in Japan. Once Japan started rolling in the path of preferential trade liberalization, new countries were included and new concessions were demanded from anti-liberalization sectors (Solís, 2003;

Pempel and Urata, 2006). The biggest test for *Keidanren*, Japan's main business lobby, and other pro-liberalization forces in the country had been to ensure concessions from the farmers during the TPP negotiations (Economist, 2013c).

As a result of the push from outside, however, there are signs that agricultural policy in Japan is changing 'as many of the features of the old model are eroding.' Most importantly, the share of the agricultural electorate in the national electorate decreased six-fold from almost 48 per cent in 1950 to close to 8 per cent in 2003 (Mulgan, 2005:262, 265). PTAs push for agricultural liberalization in two ways. Firstly, pro-liberalization forces, usually in export-oriented competitive industries, push for an end in agricultural protection. Secondly, political leaders start shifting their positions toward valuing the broader benefits of PTAs and not just the narrow interests of the agricultural sector (Mulgan, 2008). It seems increasingly likely that the determination of Shinzo Abe's Liberal Democratic Party (LDP) to commit to TPP-induced liberalization may become a shifting point in the close ties between the LDP and the agricultural lobby that, according to (Mulgan, 2000; 2005), had been among the main impediments of agricultural liberalization in Japan (Economist, 2013a).

*Keidanren* has been one of the most prominent pro-liberalization forces promoting the interests of the export-oriented efficient industries in Japan. Given the key interests of Japanese businesses in Singapore and Mexico, the first two countries Japan signed PTAs with, *Keidanren* was heavily lobbying for these and other agreements, opening prospects for expanding market access for Japanese businesses. The lobbying also included talks with anti-PTA forces, such as the Japanese Ministry of Agriculture, Forestry and Fishery (MAFF), to work out optimal and mutually acceptable solutions regarding Japan's PTA policy (Yoshimatsu, 2005; Mulgan, 2005; 2008).

Thus, Japan's move towards regionalism was largely a result of the trade-diverting effects of the proliferating PTAs in the region and across the Atlantic, while PTA negotiations were largely characterized by domestic cleavages between pro-free trade efficient industries and backward sectors with political power, which opposed trade liberalization. The Japan-Mexico PTA, for example, emerged as a reaction to NAFTA and was made possible by the push from domestic pro-free trade industries and Japanese firms with strong presence overseas as 'Japanese firms with vertically integrated operations in the host country emerge as key supporters of FTAs, in particular when their profits are under threat from FTAs signed by other countries.' Export-oriented firms with significant FDI abroad had to fight the powerful agricultural lobby in Japan, thus emphasizing the importance of pro-PTA forces in the shaping of the Japanese foreign trade policy (Manger, 2005:805).

The rest of this chapter attempts to account for the impact of trade-diverting third-country PTAs on the negotiations of Japan's North-South PTAs with emerging and developing countries, particularly Mexico, Chile, and Peru. The following sections attempt to assess the outcomes of Japan's selected North-South PTAs, all of which happened to be second-order agreements, from the viewpoint of Japan's counterpart Southern countries. The assessment aims to determine whether the outcomes of these agreements are explained by the sequential order of the PTAs. The evaluation of the contents of Japan's North-South PTAs is carried out based on the criteria outlined in Chapter 3 and is summarized in Chapter 6.4.

## 6.1. The Japan-Mexico PTA

Prime Minister Koizumi and President Fox formally announced the start of the Japan-Mexico negotiations for a bilateral trade agreement in October 2002,<sup>157</sup> which was concluded in March 2004.<sup>158</sup> The economic ties between Japan and Mexico have been developing since the second half of the twentieth century. With the establishment of Mexico's *maquiladora* industry with the Border Industrialization Program in 1965, Japan had been a significant non-American investor in *maquiladoras*. Nissan, a Japanese carmaker, opened its first plant in Mexico back in 1966 in a hope to gain increased market share in a highly protected economy. By 1991, the year NAFTA negotiations officially initiated between Mexico and the US, Japanese corporations owned around seventy *maquiladoras*, compared to only eight in 1979. In 1991, Japanese *maquiladoras* employed around 25,000 Mexican workers or 6 per cent of the total *maquiladora* workforce. The 70-odd Japanese *maquiladoras* comprised only a modest number among the total of 1,924, but they did compare well against non-US *maquiladoras* and were of high significance because of their concentration in important industries, such as electronics and automobile (Koido, 1991, Szekely, 1991).

The spectacular rise of the Japanese *maquiladoras* during the 1980s was due to a number of reasons. Firstly, Mexico, and specifically its *maquiladora* system, had become an attractive cheap-labor destination for multinationals facing intense price competition. Mexico became especially attractive for its low labor costs after the 1980s debt crisis and the collapse of the Peso

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<sup>157</sup> Ministry of Foreign Affairs of Japan (MOFA): [http://www.mofa.go.jp/policy/economy/apec/2002/joint\\_me.html](http://www.mofa.go.jp/policy/economy/apec/2002/joint_me.html) (accessed 3 December 2015).

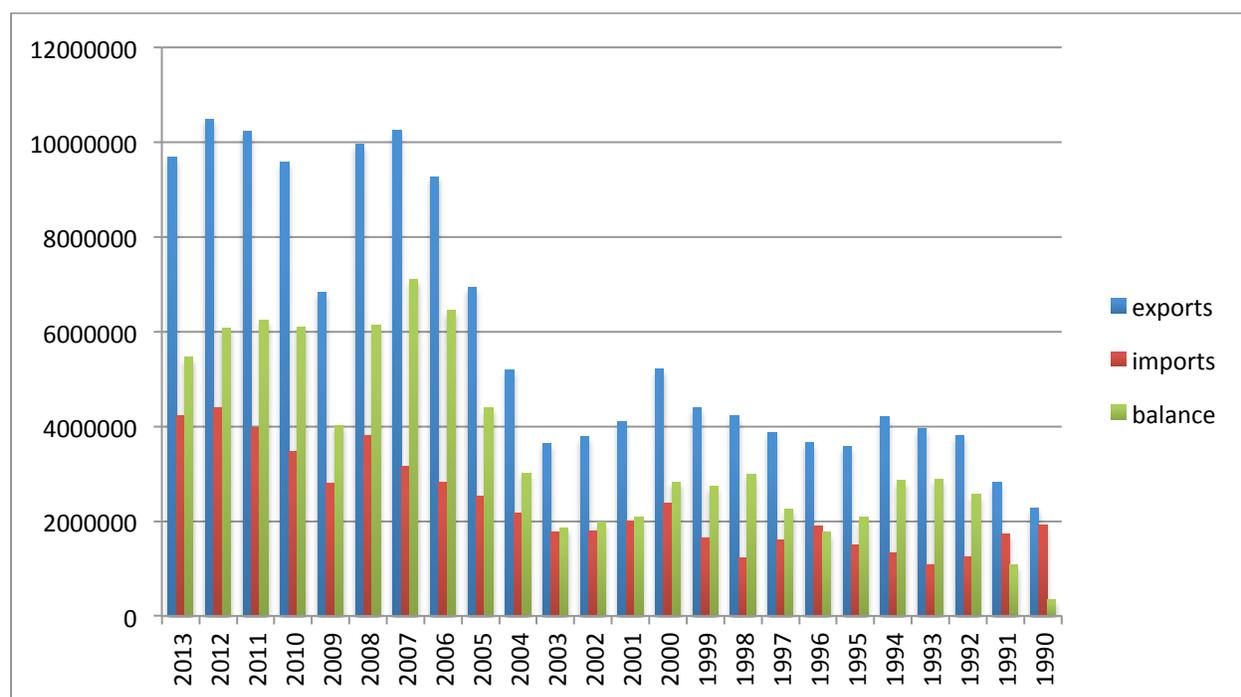
<sup>158</sup> The Japanese Ministry of Economy, Trade and Industry (METI) Joint Press Statement, available at [http://www.meti.go.jp/policy/trade\\_policy/1\\_america/mexico/j\\_mexico/data/press\\_e.pdf](http://www.meti.go.jp/policy/trade_policy/1_america/mexico/j_mexico/data/press_e.pdf) (accessed 3 December 2015).

that followed it. Secondly, Mexico's proximity to the US and the integration of its production processes into the global production chain added onto Mexico's attractiveness as a global production site. Thirdly, a more strategic factor behind the expansion of Japanese *maquiladoras* in the 1980s was the drastic appreciation of the Japanese Yen against the dollar in the mid-1980s, which reinforced the need for Japanese multinationals to cut costs domestically and establish in low-cost-labor countries. As a result of the appreciation of the Japanese Yen, 'by the summer of 1987 more than half of Japanese color television manufacturers had established *maquiladora* operations along the U.S.-Mexican border' (Koido, 1991:64). Thus, Mexico became a major exporter of color television sets by 1989. It became the leading exporter of color television sets to the US in the same year, accounting for more than 65 per cent of US sales, including complete sets and subassemblies (Koido, 1991; Szekely, 1991).

As a result of the surge of Japanese investment in Mexico during the 1980s, Japanese total trade with the US, Canada, and Mexico doubled from USD 75 billion in 1981 to USD 150 billion in 1989 (Szekely, 1991). However, as a result of NAFTA (in force since 1994) and the EU-Mexico PTA (in force since July 2000), Japanese exporters were feeling left out of the Mexican market, to which American and European firms were enjoying preferential access. While Mexican tariffs were waning out for American and European firms as a result of NAFTA and the EU-Mexico PTA, Japanese exporters faced an average Mexican import tariff of 16.2 per cent in 2000, which was a significant obstacle for Japanese exporters to Mexico. Tariffs were only part of the disadvantage, however. Preferential treatment of American and European investments, as well as the effects of other trade-related aspects of the respective PTAs, put Japanese firms into a disadvantaged position vis-à-vis their European and American counterparts (Keidanren, 1999; 2001; 2003; JETRO, 2000; 2005; Hatakeyama, 2002a; 2002b; MOFA, 2002; Solís, 2003;

Yoshimatsu, 2005; Manger, 2005; Pempel and Urata, 2006; Solís and Urata, 2007; Villareal, 2012). The dynamics of the Japan-Mexico trade is presented in Figure 6.1.1 below.

**Figure 6.1.1. Japan’s trade with Mexico, in thousand USD, 1990-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 21 November 2014)

According to the estimates of the Japanese Ministry of Economy, Trade and Industry (METI) and *Keidanren*, the absence of a PTA with Mexico, given the latter’s agreements with the US and EU, dropped the share of Mexico’s imports from Japan from 6.1 per cent in 1994 to 3.7 per cent in 2000. This cost Japan close to USD 3.5 billion (which transformed into a USD 5.5 billion decline in the Japanese GDP) and added some 30,000 workers on its soaring unemployment figure (Yoshimatstu, 2005; Solís and Katada, 2007b; Vio, 2010). Japanese steel product exporters to Mexico were predicted to incur losses of USD 300 million annually as a result of the removal of tariffs on EU steel product exports to Mexico (Keidanren, 1999; Yoshimatsu, 2005).

Industrial giants like Toyota and Nissan saw the prospects of their future FDIs in Mexico tied to a PTA, while Canon had to close a plant in Mexico in 2002 due to lack of progress in the Japan-Mexico PTA negotiations (Manger, 2005).

Japanese automakers were especially concerned about the high rules of origin in NAFTA. They were facing a dilemma between holding back investment, which was in a disadvantaged position vis-à-vis the US firms operating in Mexico, and using more local content to comply with the rules of origin requirements. Due to the lack subcontracting networks in the region, however, Japanese automakers found it hard to comply with NAFTA's rules of origin requirements (Szekely, 1991, Solís and Katada, 2007b). Other factors too, such as the abolition of the special treatment within the *maquiladora* system in the end of 2000 and the unfavorable condition of Japanese firms competing for government procurement in Mexico, accelerated Japan's move towards starting PTA negotiations with Mexico (Hosono and Nishijima, 2001; Keidanren, 2003; Yoshimatsu, 2005).

Hence, a PTA with Mexico had become an urgent matter for Japanese export-oriented companies, which pushed the Ministry of Foreign Affairs to launch PTA negotiations with Mexico 'as soon as possible' (MOFA, 2002). The urgency around Japan's negotiations with Mexico, according to Solís and Katada (2007b) and Katada and Solís (2010), made the domestic pro-PTA forces in Japan more mobilized, which eventually pressed the Japanese government to sign a PTA with Mexico. Mexico's emergence as a priority for the Japanese government to strike an agreement with as soon as possible was not accidental. In theory, an agreement with Korea, for example, should have been easier to conclude, given Mexico's higher share of agricultural trade with Japan (21.8 per cent) compared to that of Korea (8.5 per cent) on the background of Japan's sensitivity to agricultural liberalization. In practice, however, the agreement with Mexico

was inked in a relatively short period of time, while the agreement with Korea is yet to be concluded. This, according to Katada and Solís (2010), was due to the fact that the loss-making pro-liberalization industries in Japan were more likely to mobilize and push for the desired outcome with Mexico. Meanwhile, an agreement with Korea was for future potential gains and not of vital urgency.

Thus, unlike during the NAFTA negotiations, whereby Mexico was threatened to be marginalized, while its competitors enjoyed preferential access to the lucrative US market, the Japan-Mexico PTA was negotiated in a completely different light. Japan was the party of the negotiations that felt the negative consequences of Mexico's North-South PTAs with the US (*i.e.*, NAFTA) and EU, while Mexico did not feel a vital need to have preferential access to the Japanese economy, for it was already enjoying preferential trade relations with the US and EU. In such a setting, as hypothesized in this thesis, the negotiations were to produce outcomes that would be more favorable for Mexico compared to the bargain it got during its first-order negotiations with the US in the framework of NAFTA.

The remaining of this section looks at the process and outcome of the second-order Japan-Mexico PTA negotiations in key areas, including tariffs and related measures, government procurement, trade in services, investment, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

As a result of the Japan-Mexico PTA, Mexico agreed to liberalize all its imports from Japan, while Japan agreed to open up its market for 84 per cent of product lines imported from Mexico (Urata, 2005). Despite the incomplete liberalization from the Japanese side, however, Mexico managed to secure lower tariffs and greater tariff quotas for sensitive agricultural products such

as pork, beef, oranges, and orange juice that comprised a huge part of Mexico's agricultural exports to Japan (Yoshimatsu, 2005; 2006; Ando and Kimura, 2008).

## **Agriculture**

Agricultural liberalization in the Japan-Mexico negotiations was high on the agenda of Mexican negotiators, who wanted to ensure preferential treatment for Mexican key agricultural products, including meat and orange juice (Espach, 2006). Japan sought the liberalization of trade in manufactured goods but wanted to leave agricultural tariff reductions for sensitive products, such as beef, pork, chicken, fruits, and sugar, for later discussion. In fact, MAFF had initially intended to keep agriculture immune from liberalization in PTAs and leave it for further WTO negotiations. This was an especially significant issue during the negotiations with Mexico because the latter was a relatively big agricultural exporter, with 20.6 per cent of its exports to Japan consisting of agriculture-related products in 2001. Japanese proposals to keep agricultural liberalization off the agreement, however, were 'flatly rejected' by Mexico, and notwithstanding the lack of desire from MAFF to include agricultural liberalization in the PTA with Mexico, the liberalization of agriculture proved to be unavoidable. As a result of the negotiations, Mexico was able to achieve 'a policy change away from the absolute exclusion of agricultural products to their inclusion in the FTA' (Yoshimatsu, 2005:271; Pempel and Urata, 2006:89-90).

The policy change was enabled, among other things, by the settings of the negotiations, whereby Japanese export-oriented industries were discriminated in the Mexican market because of NAFTA and the EU-Mexico PTA and were committed to push the Japanese government to sign a redressing agreement with Mexico as soon as possible. As a result of the push from the pro-PTA forces, represented by the Japanese Ministry of International Trade and Industry

(MITI), 'the Japanese agricultural lobby did make a substantial concession from its original position of negotiating exclusively at the multilateral level,' albeit certain sensitive sectors were shielded from complete liberalization (Solís and Katada, 2007b:297). The parties broke the deadlock during the negotiations in October 2003 when MAFF agreed to make considerable concessions regarding agricultural liberalization, including on pork and orange juice, which were among Mexico's key interests and Japan's list of politically sensitive products (Yoshimatsu, 2006).

Indeed, the agreement with Mexico 'became the first FTA to affect Japan's agriculture sector.' The agreement reduced tariffs on Mexico's imports of sensitive agricultural product, such as pork, chicken, and oranges, and within 10 years was going to make 90 per cent of trade between the countries tariff-free (JETRO, 2005). Japan was to liberalize 52 per cent of its agricultural tariff lines within 10 years, some of them becoming in effect immediately. Some 8 per cent of product lines would take a longer phase-out period, while the remaining 40 per cent were to be excluded from the agreement (Cheong and Cho, 2007). Despite the sensitivity of the sector and Japan's limited concessions in agriculture to its other PTA partners, such as Singapore, Malaysia, and the Philippines, Mexico managed to extract significant compromises from Japan in agriculture. In pork, beef, and avocado, which together comprised more than a half of Mexico's agricultural exports to Japan in 2005, Mexico managed to secure considerable tariff cuts (up to a half of the MFN tariff) or gradually eliminate them altogether (Ando and Kimura, 2008:8).

The PTA called for an immediate lowering of tariffs on Mexican pork through low-tariff import quotas. Similar low-tariff quotas were introduced for other sensitive agricultural products, such as chicken, beef, oranges, and orange juice (JETRO, 2005). As a result of formal

negotiations in October 2003, tariffs on pork were slashed by more than a half (from 4.3 to 2 per cent) for some 80,000 tons of Mexican pork, twice as much as Mexico was at the time exporting to Japan. Mexico added new demands regarding provisions for low-tariff exports of Mexican orange juice to Japan. Japan was not ready to provide more concessions in 2003 but in 2004 had to eventually agree on a low-tariff quota of 6,500 tons of orange juice annually. Additionally, the 10-ton quota for chicken was to grow to 8,500 tons, the 10-ton quota for beef to 6,000 tons, and the 10-ton quota for oranges to 4,000 tons in five years, representing a 400-650-fold increase in low-tariff quotas for key Mexican exports. The 4,000-ton quota for orange juice was to grow to 6,500 tons in five years. Nevertheless, over a thousand tariff lines, including rice, sugar, apple, pineapple, wheat, nectarines, potatoes, and sausages, were excluded from the agreement (Yoshimatsu, 2005; 2006; Solís and Katada, 2007b:298).

According to Solís and Katada (2007b), Japan made substantial concessions on agricultural tariffs covering 43 per cent of tariff lines and more than 99 per cent of agricultural trade volume, most of the reductions taking effect immediately. The reduction of tariffs and quotas for the so-called ‘five fingers’—five key agricultural export items for Mexico: pork, chicken, beef, oranges, and orange juice—was particularly significant.

### **Government Procurement**

Government procurement clauses of the Japan-Mexico agreement were of greater importance for Mexico as, unlike Japan, Mexico was not a signatory of the WTO GPA during the time of the negotiations. The *de facto* exclusion of Japanese companies from bidding from government procurement in Mexico had been a major concern for Japanese firms, especially given the Mexican economic revitalization program of May 2003 that was to further limit the participation

of foreign firms from countries that did not have a PTA with Mexico in lucrative government procurement programs in Mexico, including a PEMEX-related modernization project valued at USD 1.6 billion (Keidanren, 2003).

Government procurement provisions of the Japan-Mexico PTA cover only central/federal government entities (Annex 11), while no local/sub-federal entity is subject to the government procurement chapter of the agreement. This fact provided Mexico the opportunity to give priority to local firms on the sub-federal level. This achievement is spectacular given that firms interested in government procurement, together with electronics and automobile industry, were among the main lobbyists in Japan for a PTA with Mexico (Keidanren, 2003; Yoshimatsu, 2005; Solís and Katada, 2007b). The government procurement thresholds of the Japan-Mexico PTA almost identically mirror those in the EU-Mexico agreement and do not cover sub-federal government entities.

**Table 6.1.1. Government procurement thresholds of the Japan-Mexico PTA**

	Procurement by federal government entities	Procurement by federal government enterprises	Construction contracts by federal government entities	Construction contracts by federal government enterprises
For Japan	SDR 130,000	SDR 130,000	SDR 4,500,000	SDR 4,500,000
For Mexico	USD 100,000	USD 250,000	USD 6,500,000	USD 8,000,000

Source: Annex 15 of the Japan-Mexico PTA<sup>159</sup>

## Trade in Services

The Japan-Mexico negotiations over the provisions in trade in services were contentious, whereby Mexico was concerned about keeping the services provisions in line with its GATS commitment, while Japan sought GATS-plus measures to secure strong market access provisions

<sup>159</sup> Annex 15 of Japan-Mexico PTA, available at <http://www.mofa.go.jp/region/latin/mexico/agreement/annex15.pdf> (accessed 3 December 2015).

for its developed services sectors, in par with those provided to American and European companies (Solís and Katada, 2007b).

The services chapter of the Japan-Mexico PTA calls for ‘national treatment’ (Article 98) and ‘MFN treatment’ (Article 99) and prohibits the parties to require local presence in the forms of representation or any other type of enterprise to be eligible to provide cross-border services. Although the agreement adopts a ‘negative list’ approach in the liberalization of trade in services, the parties restrict the automatic application of the provisions to future activity types by reserving ‘[. . . ] the right to adopt or maintain any measure relating to new services other than those services recognized [. . . ] at the time of entry into force of this Agreement [. . . ],’ as per the provisions under Annex 7 of the Japan-Mexico PTA (Fink and Molinuevo, 2008:278).

### **Investment Measures**

The investment chapter of the Japan-Mexico PTA (Chapter 7) turned out to be quite broad and comprehensive. It calls for ‘national treatment’ (Article 58) and ‘MFN treatment’ (Article 59), and has strong wording on expropriation (Article 61) that prohibits direct or indirect expropriation through measures ‘tantamount to expropriation or nationalization,’ except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and on payment of compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay. Article 65 prohibits performance requirements, while Section 2 of Chapter 7 provides for investor-state arbitration that allows firms to bring lawsuit directly against governments before arbitration tribunals operating under the arbitration rules of either ICSID or UNCITRAL.<sup>160</sup>

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<sup>160</sup> The text of the Japan-Mexico PTA, available at <http://www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf> (accessed 3 December 2015).

## IPRs

The IPRs provisions of the Japan-Mexico PTA turned out to be quite weak. In fact, the Japan-Mexico PTA does not include a separate chapter on IPRs, referring to IPRs in a single article (Article 73) under the chapter on investment. Given the MFN clause under the TRIPS agreement (Article 4<sup>161</sup>), which states that ‘with regard to the protection of intellectual property, any advantage, favor, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members,’ it could be argued that, by virtue of being a WTO member, Japan could simply claim a not less favorable treatment from Mexico than one provided to the US under NAFTA (Correa, 2004). Similarly, Fink and Reichenmiller (2005) and Fink (2011) state that, unlike some other agreements of the WTO, TRIPS does not provide for an exception to the MFN principle for PTAs. Thus, given the fact that both Japan and Mexico are members of the WTO, Japan can be entitled to all IPRs-related privileges that Mexico grants to US and Canadian nationals under NAFTA.

The Japan-Mexico PTA, however, is not just silent on many IPRs provisions, but it also incorporates clauses that prevent the agreement from being interpreted as WTO-plus by virtue of the TRIPS agreement’s MFN clause. Article 73.2 of the Japan-Mexico agreement, with somewhat controversial wording, states:

Nothing in this Chapter shall be construed so as to oblige either Party to extend to investors of the other Party and their investments treatment accorded to investors of a non-Party and their investments by virtue of multilateral agreements in respect of protection of intellectual property rights, to which the former Party is a party.<sup>162</sup>

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<sup>161</sup> The text of the WTO Agreement, available at [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips\\_03\\_e.htm](http://www.wto.org/english/docs_e/legal_e/27-trips_03_e.htm) (accessed 3 December 2015).

<sup>162</sup> The text of the Japan-Mexico PTA, available at <http://www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf> (accessed 3 December 2015).

Leaving the interpretation of the (in)consistency of this clause with TRIPS Article 4 to legal scholars, it can be concluded that this clause provides Mexico a justification to exclude Japanese firms from privileges granted to American and Canadian nationals under NAFTA. Article 73.2 of the Japan-Mexico PTA might have, among other things, been drafted to keep IPRs-related disputes out of the ICSID jurisdiction and resolve such disputes under the WTO dispute settlement body in a government-to-government format. In general, Article 73.2 seems to be incorporated to prevent the Japan-Mexico PTA from becoming TRIPS-plus.

Annex 9 of the Japan-Mexico PTA is particularly noteworthy. It provides exceptions to the MFN provision for treatments accorded under all international agreements in force prior to January 1, 1994.<sup>163</sup> This provision effectively excludes any treatment under pre-TRIPS agreements (including most of the big conventions under the World Intellectual Property Organization) that Mexico may provide to any non-party from being automatically extended to Japanese nationals. The pre-TRIPS agreements are quite ambitious in their nature but they lack efficient enforcement mechanisms, like the Dispute Settlement Understanding in the WTO (Shadlen, 2004), thus keeping them off the Japan-Mexico PTA can be regarded as an important step towards preventing restrictive IPRs clauses from being applied.

## **6.2. The Japan-Chile PTA**

The negotiations of the second-order Japan-Chile PTA started in 2005 and, after five rounds of negotiations, an agreement was signed in 2007, which entered into force the same year (Wehner,

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<sup>163</sup> The text of the Japan-Mexico PTA, available at <http://www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf> (accessed 3 December 2015).

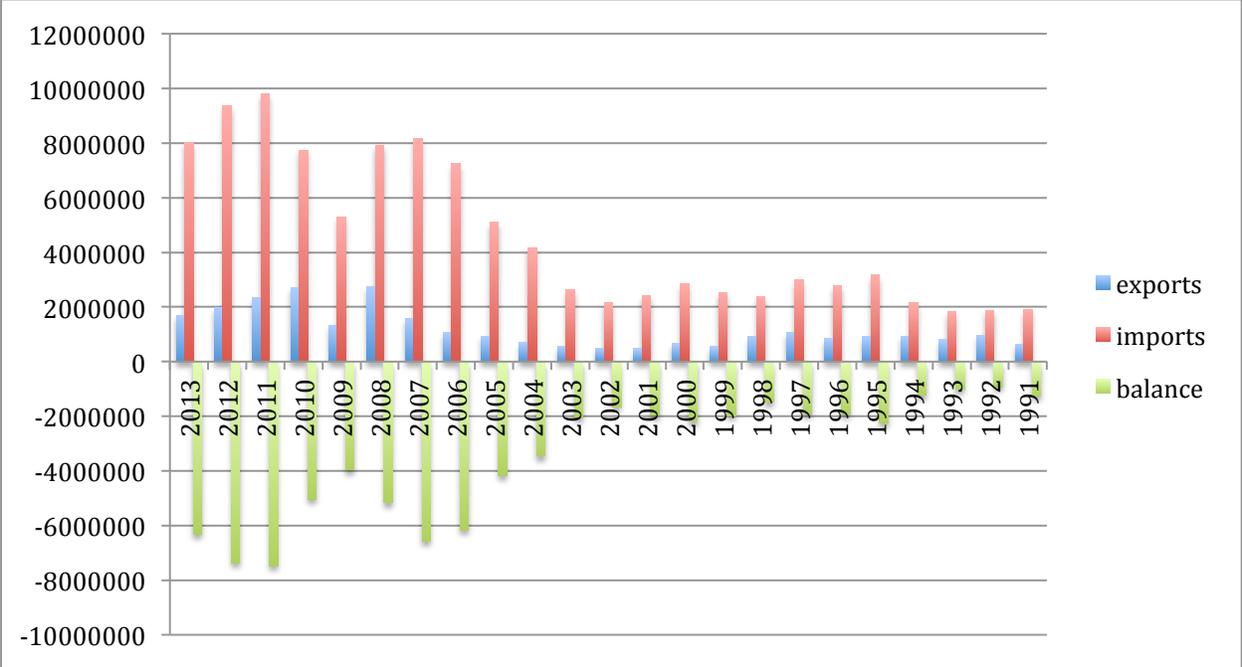
2007). Levelling the playing field for Japanese firms operating in Chile was among the main reasons behind Japan's move to start PTA talks with Chile. The disadvantages and forgone opportunities that Japanese businesses had experienced due to Chile's increased participation in PTAs in the Americas and the potential negative effects of Chile's North-South PTAs with the EU and US that were under negotiations in the early 2000s made JETRO conclude that a comprehensive agreement with Chile 'should be concluded as soon as possible' (JETRO, 2001). As also argued by Hosono and Nishijima (2001), the potential discrimination of Japanese companies vis-à-vis their American and European counterparts was among the main drivers behind Japan's shift towards considering PTAs with both Chile and Mexico.

Although the overall impact of the agreement was going to be significantly greater for Chile than for Japan, which might imply that Chile should have been keener to conclude the talks with Japan, the Japanese side was under pressure to complete an agreement as soon as possible because of the trade diverting effects of the US-Chile and EU-Chile PTAs on the Japanese auto industry. According to the Japan Times (2006), 'Japanese firms [mostly in the auto industry] have complained about disadvantages they face in competing with Chile's FTA partners in the Chilean market and urged the government to speedily sign the pact.' As a result, while the Japan-Chile PTA 'was motivated by the loss-aversion behaviour of important Japanese domestic groups, which saw how their main competitors from other countries were getting preferential positions in the Chilean market,' the liberalization of the auto industry was a number one priority for Japan (Wehner, 2007:80-81). Hence, domestic pro-liberalization lobbies led by the auto industry eventually pushed the Japanese government to sign an agreement with Chile in the shortest possible time (Wehner, 2007). As a result, the negotiations of the second-order Japan-Chile PTA took place against the backdrop of Japanese firms, especially in the auto industry,

being discriminated in the Chilean market by their peers from the US and EU. Thus, one of the main motivations behind Japan’s move to start trade talks with Chile was to level the playing field for its auto and other competitive industries in the Chilean market.

In 2004, a year before the negotiations started, Japan’s share of Chile’s total imports was 3.2 per cent, while some 11.6 per cent of Chile’s total exports went to Japan. On the other hand, Chile’s share of Japan’s total imports was 0.9 per cent, while some 0.1 per cent of Japanese exports went to Chile in 2004.<sup>164</sup> The dynamics of the Japan-Chile trade are presented in Figure 6.2.1 below.

**Figure 6.2.1. Japan’s trade with Chile, in thousand USD, 1991-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 6 December 2014)

<sup>164</sup> Report of the Joint Study Group on Japan-Chile Economic Partnership Agreement/ Free Trade Agreement, November 2005, available at <http://www.mofa.go.jp/region/latin/chile/report0511.pdf> (accessed 3 December 2015).

As also seen in Figure 6.2.1, Chile has had a big trade surplus with Japan, which was largely a result of Chile's export of natural resources to Japan, comprising predominantly of copper ores and concentrates, lithium carbonates, and molybdenum ores and concentrates. Agriculture and, especially, fish and fishery products have comprised another large share of Chilean exports to Japan.<sup>165</sup>

The effects of the Japan-Chile PTA were estimated at almost 0.5 per cent of GDP for Chile and a negligible 0.002 per cent for Japan. These estimates would make the Japan-Chile PTA one of the most economically desirable agreements for Chile, while it would not be economically as significant for Japan compared to Japan's other North-South PTAs.<sup>166</sup> Other studies, too, identified Chile as the primary beneficiary of the Japan-Chile PTA. Brown *et al* (2010), for example, using the Michigan Computable General Equilibrium (CGE) Model of World Production and Trade, estimated the welfare effects of the agreement on Japan to be USD 2.8 billion (0.1% of GNP), while on Chile it was estimated to be USD 0.9 billion (1.0% of GNP).

The remaining of this section looks at the process and outcome of the second-order Japan-Chile PTA negotiations in key areas, including tariffs and related measures, government procurement, trade in services, investment, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

As a result of the Japan-Chile PTA, some 70 per cent of Chilean exports to Japan, and some 90 per cent of Japanese exports to Chile, were to become duty-free immediately. Given the relatively low level of pre-agreement tariff rates in most sectors, however, the bargain during the

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<sup>165</sup> Report of the Joint Study Group on Japan-Chile Economic Partnership Agreement/ Free Trade Agreement, November 2005, available at <http://www.mofa.go.jp/region/latin/chile/report0511.pdf> (accessed 3 December 2015).

<sup>166</sup> Report of the Joint Study Group on Japan-Chile Economic Partnership Agreement/ Free Trade Agreement, November 2005, available at <http://www.mofa.go.jp/region/latin/chile/report0511.pdf> (accessed 3 December 2015).

Japan-Chile PTA negotiations was around the attempts to exclude sensitive product lines from liberalization. In return to the exclusion of certain sensitive agricultural product lines by Japan, Chile excluded certain iron and non-alloy steel products and sensitive footwear products from the agreement, as well as got longer transition periods for other steel products (Wehner, 2007).

### **Agriculture**

Japanese imports from Chile have had a high share of agricultural products, particularly fishery. In 2005, about 35 per cent of all imports from Chile were of agricultural nature (Ando and Kimura, 2008:13). Thus, given Chile's competitive advantages in agriculture and its sensitivity in Japan, agriculture was probably the most important aspect of the Japan-Chile PTA negotiations. Japan intended to exclude a broad range of agricultural products from the agreement, while Chile intended to secure a better deal for its agricultural exporters. The final deal did exclude certain sensitive product lines, including rice, wheat, oranges, mandarins, dairy products, and plywood, but it included a number of other important product lines, such as pork, chicken, beef, apples, grapes, and grapefruits. Most importantly, the agreement included the liberalization of salmon, albeit through progressive tariff removals over ten years, which was a key export category for Chile (Wehner, 2007).

In fact, unlike a number of other countries of the global South that had negotiated PTAs with Japan, such as Singapore, Malaysia, Thailand, and the Philippines, Chile managed to secure significant tariff cuts for its agricultural exports to Japan. About a third of Chile's agricultural exports to Japan comprised of trout and salmon with a pre-PTA tariff range of 3.5-10 per cent. Chile's exports were dominated by fresh fishery that fell under the 3.5-per cent category. As a result of the PTA, these tariff lines were to be gradually eliminated in 10 years. Moreover, tariffs

on wine, with pre-PTA levels of 15 per cent were to be gradually abolished in 12 years, and tariff quotas were to be introduced on pork, one of the most sensitive agriculture product lines (Ando and Kimura, 2008:13).

### Government Procurement

Unlike Japan, Chile was not a member of the WTO Government Procurement Agreement (GPA) at the time of the PTA negotiations, thus the government procurement provisions of the PTA were going to be more significant especially for Chile. Chapter 12 of the Japan-Chile PTA covers government procurement-related measures between the countries. It provides for ‘national treatment and non-discrimination’ that obliges the Parties to provide treatment to the goods, services, as well as the suppliers of the other Party ‘no less favorable than that it accords to its own goods, services and suppliers.’<sup>167</sup> The PTA excludes sub-central government entities and relies heavily on the WTO GPA agreement. More specifically, Annex 14 of the Japan-Chile PTA lists the thresholds of procurement contacts as follows:

**Table 6.2.1. Government procurement thresholds of the Japan-Chile PTA**

Procurement by Central government entities, in SDR	Procurement by sub-central government entities, in SDR	Construction contracts by Central government entities, in SDR	Construction contracts by sub-central government entities, in SDR
100,000	Non-applicable	5,000,000 (Chile) 4,500,000 (Japan <sup>168</sup> )	Non-applicable

Source: Annex 14 of the Japan-Chile PTA<sup>169</sup>

<sup>167</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 12 December 2014).

<sup>168</sup> The PTA refers to the threshold under WTO GPA.

<sup>169</sup> Annexes of Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/annex.pdf> (accessed 3 December 2015).

## **Trade in Services**

The Japan-Chile PTA regulates trade in services through a ‘negative list’ approach, although the liberalization of financial services adopted a ‘positive list’ approach (Mattoo and Sauvé, 2011). It provides for ‘national treatment’ (Article 107) and ‘MFN treatment’ (Article 108), while Article 114 provides for safeguard measures in case of serious balance-of-payments and external financial difficulties.<sup>170</sup> In addition, Article 116 of the Japan-Chile agreement defines a service supplier as ‘a person that seeks to supply or supplies a service.’<sup>171</sup> As it was the case with the EU-Chile and US-Chile PTAs, the wording ‘seeks to supply’ broadens the scope of the agreement providing for a greater coverage of the services provisions.

## **Investment**

The Japan-Chile PTA provides for ‘national treatment’ (Article 73) and ‘MFN treatment’ (Article 74) of cross-border investment, as well as investment protection from strife (Article 76). Moreover, Article 77 prohibits performance requirements, including export requirements, local content requirements, export-to-import ratio requirements, and technology transfer requirements.<sup>172</sup> In addition, Article 82 of the Japan-Chile PTA prevents any direct nationalization or expropriation of investment or indirect measures ‘equivalent to expropriation or nationalization,’ except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on the payment of compensation, which is equivalent to the fair market value of the expropriated investment and should be paid without delay and be fully

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<sup>170</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

<sup>171</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

<sup>172</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

realizable and freely transferable.<sup>173</sup> And finally, Section 2 of Chapter 8 of the Japan-Chile PTA provides for investor-state dispute settlement clauses. Under Chapter 8, investors can submit direct claims for damages against nation-states at ICSID or UNCITRAL arbitration tribunals.<sup>174</sup>

## IPRs

The IPRs provisions of the Japan-Chile PTA draw heavily on the TRIPS agreement, with no separate article on patents, an area of IPRs where the policy space in developing and emerging economies is circumscribed the most.<sup>175</sup>

### 6.3. The Japan-Peru PTA

After seven formal rounds of negotiations during 2009-2010, the second-order Japan-Peru North-South PTA was signed in 2011 and entered into force in 2012.<sup>176</sup> Like it was the case with Mexico and Chile, the negotiations with Peru were motivated by Japan's diminishing positions in its counterpart Southern country. A Japan-Peru PTA was to, *inter alia*, level the playing field for Japanese multinationals with their American and European rivals in the Peruvian market (Gonzalez-Vigil and Shimuzu, 2012).

Together with the diminishing Japanese share in the exports and imports of Latin America, Japan's trade with Peru was decreasing, too. While Japan's share in Latin American imports

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<sup>173</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

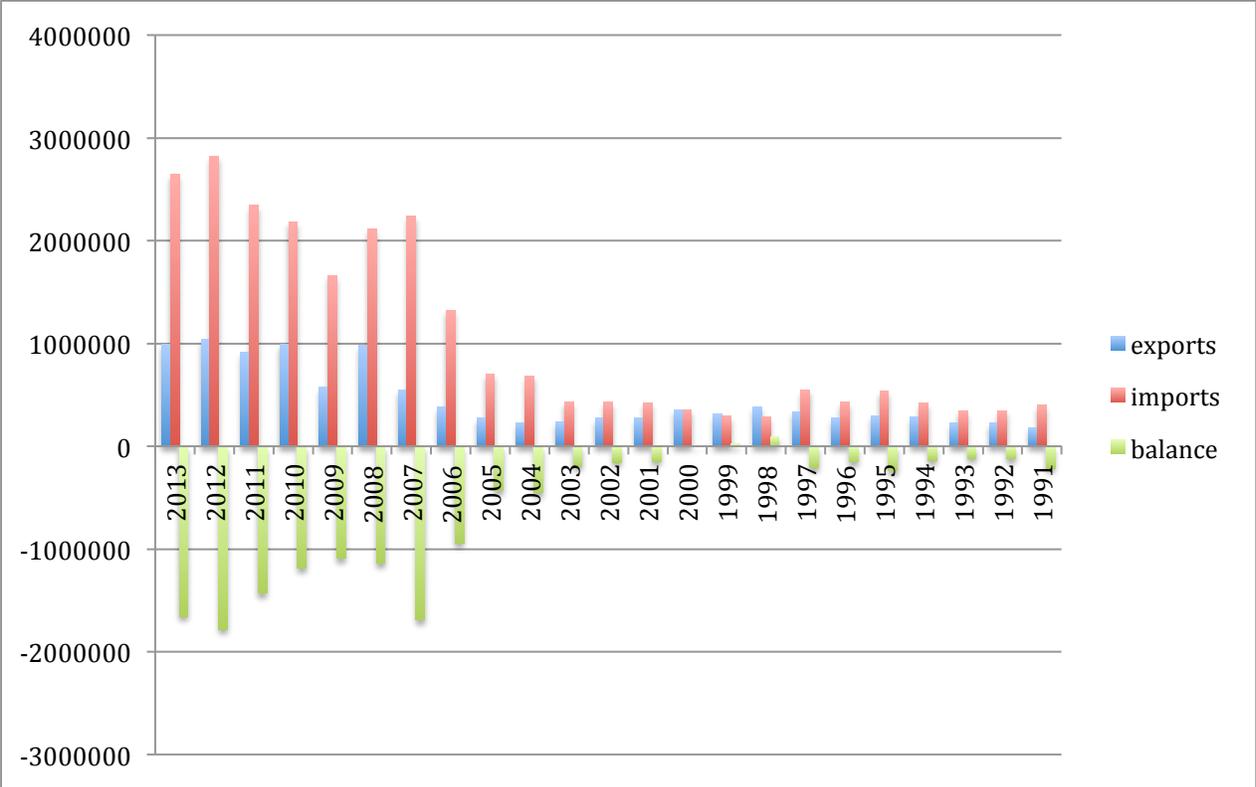
<sup>174</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

<sup>175</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

<sup>176</sup> MITI: [http://www.meti.go.jp/policy/trade\\_policy/epa/epa\\_en/pe/](http://www.meti.go.jp/policy/trade_policy/epa/epa_en/pe/) (accessed 3 December 2015).

decreased from 60 per cent in 1990 to less than 21 per cent in 2006 (Gonzalez-Vigil and Shimuzu, 2012, Table 1, p.4), Japan’s share in Peru’s total imports, fluctuating around 6-8 per cent during the 1990s, fell from more than 6.5 per cent in 2000 to 3.3 per cent in 2013.<sup>177</sup> This, together with diminishing FDI flows between the nations, was among the reasons why Japan and Peru sought and completed a PTA (Gonzalez-Vigil and Shimuzu, 2012). The dynamics of Japan’s trade with Peru is presented in Figure 6.3.1 below.

**Figure 6.3.1. Japan’s trade with Peru, in thousand USD, 1991-2013**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) data, available at <http://www.cepal.org/en> (accessed 6 December 2014)

The remaining of this section looks at the process and outcome of the second-order Japan-Peru PTA negotiations in key areas including tariffs and related measures, agriculture,

<sup>177</sup> Author’s calculations based on data from the Economic Commission for Latin America and the Caribbean (ECLAC), <http://www.cepal.org/en> (accessed 6 December 2014).

government procurement, trade in services, investment measures, and IPRs, as outlined in Chapter 3.

### **Tariffs and Related Measures**

The Japan-Peru PTA calls for the elimination of 99 per cent of existing tariffs, within a 10-year phase-out period (Gonzalez-Vigil and Shimuzu, 2012).

### **Agriculture**

The Japan-Peru PTA calls for the immediate elimination of Japanese import tariffs on fresh asparagus<sup>178</sup> and wood, while tariff rates on other products, such as pork, chicken, and corn, were going to be reduced in a 10-year period. However, some 749 sensitive tariff lines were excluded by Japan from the agreement. The number of excluded tariff lines, however, is much smaller compared to those under Japan's agreements with Mexico (1,300 items) and Chile (1,200 items), and thus Japanese concessions to Peru appear to be greater than those provided to Mexico and Chile (Gonzalez-Vigil and Shimuzu, 2012). In addition, as per Article 28, Peru reserved the right to maintain its Price Band System with respect to certain agricultural goods, aimed at reducing the volatility of agricultural prices,<sup>179</sup> which can potentially constitute a trade barrier for Japan.<sup>180</sup>

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<sup>178</sup> Asparagus was an important agricultural export product for Peru, as it had become the world's leading exporter of asparagus by the mid-2000s (Villarreal, 2007).

<sup>179</sup> The text of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_ba\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_ba_e.pdf) (accessed 3 December 2015).

<sup>180</sup> An agricultural price band (or price range) system is employed to stabilize local prices via the use of import duties that vary with international prices (Saggi and Wu, 2015).

## Government Procurement

Unlike Japan, Peru was not a member of the WTO Government Procurement Agreement (GPA) at the time of the PTA negotiations, thus the government procurement provision of the PTA were going to be especially significant for Peru. The government procurement clauses of the Japan-Peru PTA are covered under Chapter 10 and Annex 9, which provide access to the procurements of both central and sub-central government entities.<sup>181</sup> The procurement thresholds of the Japan-Peru PTA are presented in Table 6.3.1 below.

**Table 6.3.1. Government procurement thresholds of the Japan-Peru PTA**

Procurement by Central government entities, in SDR	Procurement by sub-central government entities, in SDR	Construction contracts by Central government entities, in SDR	Construction contracts by sub-central government entities, in SDR
130,000	200,000	4,500,000 (Japan) 5,000,000 (Peru)	15,000,000

Source: Annex 9 of the Japan-Peru PTA<sup>182</sup>

## Trade in Services

The Japan-Peru PTA provides for strong market access provisions in services (Article 106), calling for ‘national treatment’ (Article 104) and ‘MFN treatment’ (Article 105) via a ‘negative list’ approach. Meanwhile, Article 102.1(j) adopts a NAFTA-like definition of a service supplier as ‘a person that supplies or seeks to supply a service.’<sup>183</sup>

<sup>181</sup> The text of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_ba\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_ba_e.pdf); Annex 9 of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_x09\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_x09_e.pdf) (accessed 3 December 2015).

<sup>182</sup> Annex 9 of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_x09\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_x09_e.pdf) (accessed 3 December 2015).

<sup>183</sup> The text of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_ba\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_ba_e.pdf) (accessed 3 December 2015).

## Investment Measures

The Japan-Peru PTA does not include a chapter on investment, which may have been a result of signing a BIT between the parties in 2008 (Gonzalez-Vigil and Shimuzu, 2012). The agreement does not specifically address investment-related measures in other chapters either.<sup>184</sup>

## IPRs

The IPRs chapter of the Japan-Peru PTA is quite limited in scope and mostly draws on the TRIPS agreement. More specifically, the patent protection clauses consist of just one article (Article 174) that relates mostly to computer programs, while Article 179 calls for the protection of test data with no time period specified, ‘in accordance with Article 39 of the TRIPS Agreement.’<sup>185</sup>

## 6.4. Concluding Remarks

Japan’s trade policy shift towards considering regional and bilateral trade liberalization as a complement to multilateral liberalization through the GATT/WTO, took place in the late 1990s and early 2000s and was largely determined by the trade diverting effects of North-South PTAs signed by the US and EU. Pushed by the need for opening up new markets and providing level playing field for its exporters and investors in third markets vis-à-vis their competitors, Japan, supported by *Keidanren* and other pro-free trade lobbies, had to embrace the option of pursuing

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<sup>184</sup> The text of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_ba\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_ba_e.pdf) (accessed 3 December 2015).

<sup>185</sup> The text of the Japan-Peru PTA, available at [http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa\\_ba\\_e.pdf](http://www.mofa.go.jp/region/latin/peru/epa201105/pdfs/jpepa_ba_e.pdf) (accessed 3 December 2015).

North-South PTAs both in the region and, most importantly, in Latin America (Wall, 2002; Solís, 2003; Prasirtsuk, 2006; Vio, 2010).

This chapter has provided a comprehensive assessment of Japan’s second-order North-South PTAs with Mexico, Chile, and Peru. The results of the assessment are presented in Table 6.4.1 below, which provides a measure of restrictiveness of Japan’s three North-South PTAs from the standpoint of Japan’s PTA partners, by assigning a value from 1 to 10 (1 is least restrictive, 10 is most restrictive) to each area of North-South cooperation discussed in Chapter 3.

**Table 6.4.1. An overview of Japan’s North-South PTAs**

PTA	Order of the PTA	Tariffs (including agriculture) and Related Measures	Government Procurement	Services	Investment	IPRs
Japan-Mexico	second	5	4	7	8	1
Japan-Chile	second	5	5	7	8	1
Japan-Peru	second	5	8	9	1	1

As seen from Table 6.4.1, Japan’s second-order North-South PTAs with Mexico, Chile, and Peru turned out to be not as restrictive for the three Latin American countries, especially when compared to their first-order North-South PTAs. The lack of primary data on the negotiations of Japan’s agreements, which is one of the shortcomings of this thesis, does not allow the establishment of a direct link between the sequential order of the agreements and their outcomes, through the mechanism outlined in Chapter 2. However, as was the case with the US and EU agreements, the setting of the negotiations enabled by the sequential order of the agreements hints on the link between the order of an agreement and its outcome. In the case of Japan, the second-order negotiations with Mexico, Chile, and Peru took place against the backdrop of

Japan's diminishing positions in the three Latin American countries and the push from Japan's competitive pro-free trade industries to complete the negotiations as soon as possible.

The negotiations of the Japan-Mexico PTA took place against the background of Japanese firms losing market share in Mexico, which was resulting in billions of dollars of lost profits for Japanese companies and deteriorating employment in Japan (Yoshimatstu, 2005; Solís and Katada, 2007b; Vio, 2010). With NAFTA and the EU-Mexico PTA coming into effect, Japanese exporters and investors in Mexico saw the absence of a Japan-Mexico PTA as a significant obstacle for Japanese firms that were being heavily discriminated against by the falling tariffs and other trade and trade-related barriers between Mexico and the US and Mexico and the EU, while Japanese exports faced an average import tariff of 16.2 per cent in Mexico in 2000. As a result, a PTA with Mexico had become an urgent matter for Japanese export-oriented companies, which pushed the Ministry of Foreign Affairs to launch PTA negotiations with Mexico 'as soon as possible' (Keidanren 2001; JETRO, 2000; 2005; MOFA, 2002; Solís, 2003; Yoshimatsu, 2005; Manger, 2005; Pempel and Urata, 2006; Solís and Urata, 2007).

Given the setting of the negotiations, Mexico demonstrated increased bargaining power during the talks. It managed to counter Japanese negotiating priorities, causing policy shifts in Japan's approach to PTAs and securing outcomes in line with its negotiating priorities, including in agriculture, which in 2001 comprised 20.6 per cent of its exports to Japan. More specifically, Mexico managed to 'flatly reject' Japanese proposals to keep agricultural liberalization off the agreement and achieve 'a policy change away from the absolute exclusion of agricultural products to their inclusion in the FTA' (Yoshimatsu, 2005:271; Pempel and Urata, 2006:89-90). In other areas, too, including government procurement, trade in services, and especially IPRs, the

agreement turned out to be not as restrictive for Mexico. The only exception was perhaps investment measures that provide state-of-the-art protection of all forms of investment.<sup>186</sup>

The second-order Japan-Chile agreement, too, was negotiated in a setting whereby levelling the playing field with competitors was a major factor behind Japan's intentions to start and conclude the PTA talks. The potential discrimination of Japanese companies vis-à-vis their American and European counterparts in Chile was among the main drivers behind Japan's shift towards considering a PTA with the Latin American country (Hosono and Nishijima, 2001). As a result of the push from the pro-liberalization lobby in Japan, JETRO (2001) concluded that a PTA with Chile 'should be concluded as soon as possible.'

Thus, in line with the hypothesis of this thesis, the second-order Japan-Chile PTA produced outcomes in major policy areas, including agriculture, government procurement, trade in services, and especially IPRs, that favor Chilean priorities and are not as restrictive as Chile's other North-South PTAs. Like it was the case in Japan-Mexico PTA, the only exception was investment protection, which turned out to be quite restrictive with strict investment protection and investor-state arbitration clauses.<sup>187</sup>

The second-order Japan-Peru agreement, too, was negotiated against the backdrop of the diminishing positions of Japanese businesses in Peru vis-à-vis their American and European rivals. Thus, the negotiations with Peru had the mandate to level the playing field for Japanese multinationals in the shortest possible time (Gonzalez-Vigil and Shimuzu, 2012). As it can be seen from Table 6.4.1, Peru managed to take advantage of the settings of the negotiations, which

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<sup>186</sup> The text of the Japan-Mexico PTA, available at <http://www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf> (accessed 3 December 2015).

<sup>187</sup> The text of the Japan-Chile PTA, available at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf> (accessed 3 December 2015).

increased its bargaining position, and secure a deal with Japan that is far less restrictive than its first-order North-South PTA with the US.

## 7. Conclusion

This thesis has contributed to the debate of what are the policy preferences of Northern and Southern countries in North-South trade relations and how these preferences are advanced or constrained during North-South preferential trade negotiations. More specifically, it has addressed the zero-sum problem of who gets what share of the increased welfare pie brought about by non-zero-sum preferential trade liberalization through North-South PTAs. It has argued that, contrary to the conventional argument, North-South preferential trade relations are not ubiquitously decided by North-South power asymmetries that produce asymmetric outcomes in favor of Northern countries. The thesis has advanced a novel approach that takes a differentiated and longer-term view on North-South preferential trade relations by distinguishing between first-order, *i.e.*, Southern countries' first, and second-order, *i.e.*, Southern countries' subsequent, North-South PTAs. The thesis claims that there is sufficient evidence to suggest that the 'order' of an agreement affects the outcome of North-South PTA negotiations, whereby first-order agreements improve the bargaining positions of Southern countries in subsequent, *i.e.*, second-order, negotiations.

North-South power asymmetries are better utilized in first-order North-South PTA negotiations. In this case, the 'no agreement' outcome of North-South preferential trade negotiations is costlier for the Southern country, as it cannot afford to be left out while its peers gain preferential access to a Northern market. As a result, the Southern country becomes vulnerable to discriminative pressures and is 'forced' to agree to a first-order North-South PTA on terms largely dictated by the North. Notwithstanding the restrictive nature of first-order agreements for developing and emerging economies, these agreements make Southern countries

immune to marginalization and help them exert pressure on Northern countries during second-order North-South PTA negotiations. In second-order PTA negotiations, the ‘no agreement’ outcome becomes costlier for the Northern country, for its firms lose out in the competition with multinationals from other developed countries in third markets, while the Southern country is not easily marginalized because it has stable preferential access to a Northern market through a first-order North-South agreement.

As it can be seen from Table 7.1 below, Mexico, Chile, Korea, Colombia, and Peru, five countries of the Global South that have been active in North-South preferential trade negotiations, improved their bargaining positions during second-order North-South PTA negotiations, albeit to varying extents, and secured much better deals in second-order PTAs compared to their first-order agreements.

**Table 7.1. An overview of first-order and second-order North-South PTAs**

PTA	Order of the PTA	Tariffs and Related Measures	Government Procurement	Services	Investment	IPRs
NAFTA	first	9	9	10	10	10
EU-Mexico	second	5	4	6	1	1
Japan-Mexico	second	5	4	7	8	1
EU-Chile	first	7	8	7	7	1
US-Chile	second	4	7	9	9	8
Japan-Chile	second	5	5	7	8	1
US-Korea	first	9	5	10	9	10
EU-Korea	second	3	4	5	1	7
US-Colombia	first	10	10	10	9	10
US-Peru	first	10	10	10	9	10
EU-Colombia and Peru	second	5	8	8	4	5
Japan-Peru	second	5	8	9	1	1

*Table 7.1 is the combination of Tables 4.6.1, 5.5.1, and 6.4.1 that illustrate the restrictiveness of the US, EU, and Japanese North-South PTAs from the standpoint of Southern countries by assigning a value from 1 to 10 (1 is least restrictive, 10 is most restrictive) to key policy areas in North-South PTAs.*

The effect of the ‘order’ of an agreement is especially significant when a Southern country’s first-order agreement is with the US. Having signed first-order North-South agreements with the US, albeit on terms largely dictated by American negotiators, Mexico, Korea, Colombia, and Peru considerably improved their bargaining positions during second-order North-South PTA negotiations with the EU and Japan. This helped them resist restrictive terms and push for their negotiating priorities during second-order negotiations.

The findings for Chile, which signed its first-order North-South PTA with the EU, depicted a picture that is somewhat divergent from the central argument of this thesis. The provisions of the second-order US-Chile PTA in trade in services, investment, and IPRs turned out to be much more stringent and went much further beyond the WTO than those under the first-order EU-Chile agreement (see Table 7.1). A few generalizations, however, stand out. Firstly, although the second-order US-Chile PTA turned out to be more restrictive than the first-order EU-Chile PTA, it should be noted that the first-order EU-Chile PTA happens to be more in line with EU preferences than, for example, the second-order EU-Mexico PTA, which in a number of important aspects did not go as far as the EU would have preferred. The discriminative pressure felt by the EU during the negotiations with Mexico, which was absent during the talks with Chile, can explain the difference in the outcomes of the first-order EU-Chile and second-order EU-Mexico PTAs. The prevailing logic behind the EU’s negotiations with Mexico was to counter the negative consequences of NAFTA by signing an EU-Mexico deal as soon as possible, which gave Mexican negotiators additional bargaining power as they exploited the ‘NAFTA factor’ very well. The talks with Chile, on the other hand, took place under different circumstances, whereby no pressure was present on the EU as it sought to secure a first-mover advantage in Chile and fully enjoy the privileges of enhanced access to the Chilean market and the country’s

liberalized investment regime, while competitors, such as the US, dealt with Chile on WTO terms. As a result, as observed by one commentator (Reiter 2003:90), the EU-Chile PTA thoroughly ‘filled the gaps’ in the EU-Mexico PTA (Interview1; Interview 2).

Secondly, although clearly a much more restrictive agreement than the EU-Chile PTA, the second-order US-Chile North-South PTA seems to be a better deal for the Southern party of the agreement compared to other US North-South PTAs, such as the first-order US-Columbia and US-Peru PTAs. This difference too, among other things, can be explained by the fact that, unlike in the first-order US-Columbia and US-Peru negotiations, in the second-order US-Chile North-South negotiations the Southern country, *i.e.*, Chile, empowered by its preferential trade ties with the EU, resisted more stringent clauses, most specifically in IPRs, initially proposed by the US. Meanwhile, during the negotiations of the first-order US-Colombia and US-Peru North-South agreements, the fear of being left out played an important role in forcing the Southern parties, *i.e.*, Colombia and Peru, to agree on restrictive provisions in every single policy area outlined in this thesis (Interview 2; Interview 11).

Chile’s deviation from the overall picture may be explained by the fact that, although the EU-Chile agreement is technically a first-order North-South PTA, it was negotiated almost simultaneously with the second-order US-Chile North-South PTA. In fact, the negotiations of the US-Chile agreement were completed (December 2002) only a month after the signing of the EU-Chile PTA (November 2002), which may have diminished the effect of the first-order agreement on the second-order PTA. In fact, as recounted by Dür (2007), the EU-Chile negotiations were affected by the potential consequences of US engagement with Chile either through a bilateral PTA or Chile’s possible accession to NAFTA.

The divergence of Chile from the main hypothesis points both to some of the limitations of this research and to how it can contribute to broader research agendas on the question of North-South PTAs. The parsimonious approach adopted by this thesis may have neglected other variables that could have affected the outcomes of North-South PTAs. First, there may have been differences between Northern countries. Unlike the EU and Japan, the US may have been much more efficient in projecting power and utilizing North-South asymmetries due to its economic and political prominence and the specifics of its trade policy. The boost in Southern countries' bargaining positions during second-order negotiations may have been sufficient to bend the negotiating priorities of Japan and the EU but not those of the US, given the greater economic and political weight the latter possesses. Second, the EU's 'underachievement' in investment protection in most of its North-South PTAs may have been alternatively explained by the lack of mandate, for before the ratification of the Lisbon Treaty in 2009, investment was dealt with through BITs that were negotiated by individual member-states and not through EU trade agreements. Although this factor may not explain EU agreements negotiated after 2009, it may explain some of the outcomes of the agreements negotiated before 2009. Another limitation of the thesis is the lack of primary data on Japan's PTA negotiations. Unlike in the cases of the US and EU, no interviews were conducted with Japanese trade officials, which leaves the analysis short of sufficient causal links between the sequential order of Japanese agreements and their outcomes. In sum, this thesis argues for the importance of the 'order' of a North-South PTA, which affects the outcomes of North-South negotiations. However, a more complete picture involves a range of arguments that go from the sequential order of North-South PTAs to other possible factors that open a prospect for further research on the question of North-South trade relations.

This research has important theoretical and practical implications. From the theoretical point of view, the findings of this thesis imply that the ‘influence effect of foreign trade,’ which according to Hirschman (1969:17) raises the bargaining power of economically stronger countries, is mitigated when the sequential order of North-South PTA negotiations is taken into consideration. Hence, the new dimension in North-South relations, namely the ‘order’ of a North-South PTA, can potentially redefine these relations by downplaying the somewhat exaggerated role of power asymmetries in North-South preferential trade relations.

From the viewpoint of practical policy considerations, on the other hand, this thesis has serious implications for both developed and developing countries. Given the strategic importance of first-order North-South PTAs, the bulk of the developing and least developed countries, which are yet to complete their first full-fledged North-South PTAs, besides the more obvious benefits of these agreements, will have to also consider the agreements’ potential implication on their bargaining powers in subsequent PTA negotiations. This will be something to be factored in Northern countries’ calculations, too, when they decide to pursue new North-South PTAs. Because, as this study suggests, first-order agreements are more favourable for Northern countries, these agreements will not only provide developed countries with a first-mover advantage in Southern countries but will also serve as an attractive venue for furthering their policy preferences in international trade. This may provide an additional impetus to initiate new agreements and thus augment the discrimination-induced proliferation of PTAs.

## **Appendix I. List of Interviewees**

**Interview 1.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 2.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 3.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 4.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 5.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 6.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 7.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 8.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 9.** Trade official at the European Commission Directorate-General for Trade, Rue de la Loi 170, 1049 Brussels, Belgium, December 2012

**Interview 10.** Official at the Office of the US Trade Representative, 600 17th Street NW, Washington, DC 20508, United States, April 2012

**Interview 11.** Official at the Office of the US Trade Representative, 600 17th Street NW, Washington, DC 20508, United States, April 2012

**Interview 12.** Official at the Office of the US Trade Representative, 600 17th Street NW, Washington, DC 20508, United States, April 2012

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