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Direct Investment and the Future Agenda of the World Trade Organization

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1. Introduction

A key question facing the member nations of the WTO is whether, in coming years, to negotiate and implement within the Organization a new Agreement on Direct Investment (ADI). There is widespread feeling that, in light of the growing importance of foreign direct investment and the linkages between the operations of multinational firms and international trade, such an agreement will be a desirable addition to international commercial law.

Such an agreement would help to foster free flows of direct investment across national boundaries. Direct investment is important not, however, so much in its own right as because it is the primary (but not the only) means by which business firms extend their activities internationally.[1] Seen in this light, what really matters is not the magnitude of the annual flow of direct investment[2], but rather the business activity that this investment generates. At the end

[1]Otherwise put, the main importance of direct investment lies apart from the fact that it is a "long term capital flow" figuring in a country's balance of payments.

[2]These were $227.5 billion in 1994, the most recent year for which data are available and the highest flows ever recorded in a single year. Previously, the highest flows in a single year were $211.4 billion in 1990.

of 1994, the total stock of foreign direct investment worldwide was over $2.37 trillion, invested in over two hundred thousand affiliates of multinational firms.[3] These affiliates generated about $5.24 trillion in net sales, a figure somewhat greater than the total value of all exports of goods and nonfactor services in that year (about $4.8 trillion). During the past ten years, the rate of growth of FDI and related activity[4] has consistently grown faster than world trade, and world trade has grown faster than world output.

The benefits of FDI and related activities are almost without dispute. Among these are increased competition within national markets, transfer of technology, and spillovers associated with this transfer.[5] The lattermost of these is of special note. The existence of spillovers implies that FDI is associated with increases in productivity of domestic firms. These domestic firms can be suppliers, distributors, or even competitors of the multinational firms.

Such benefits are of particular relevance to developing nations. In particular, it is demonstrable that those developing countries having strong international investment and trade ties with the OECD nations tend to have higher productivities and higher rates of growth than do countries with weaker such ties.[6] Because, however, trade ties between developing nations and the OECD nations tend to be strongly correlated with investment ties, it is difficult to determine causality from international comparisons: the higher productivities and growth rates could be the result of technology transfer by MNEs, of importation of capital goods embodying

[3]UNCTAD 1996.

[4]I.e., whether measured by flows or stocks of FDI or by activity of overseas affiliates of multinational firms.

[5]A review of the evidence is provided in Graham 1996, Appendix 1.

[6]See, e.g., Borzenstein et al. 1994 and Coe et al. 1994.

the newest and best technologies, or of some combination of the two. Exactly what is the mix of the two is not clear, but "micro" studies confirm that the effects of technology transfer are significant, including the effects of spillovers associated with this transfer. Some of the strongest evidence indicating that direct investment indeed does generate significant spillovers comes from China, where town and village enterprises (TVEs) located in areas with a heavy foreign investor presence tend to outperform TVEs located in areas without such a presence.[7]

Recognition of these benefits has led a worldwide shift in the official attitudes of these nations towards direct investment and multinational enterprises. Twenty years ago, the developing nations as a group were almost unanimous in their condemnation of multinational firms, which were viewed as agents of western imperialism. Today, however, in light of the very favorable economic performance of a number of developing nations that have maintained open policies towards inward direct investment, many nations that were only recently hostile to this investment now welcome it with open arms. The result has been a shift in policies of theses countries from restrictive regimes to regimes that are relatively open.[8]

One unfortunate consequence of the move to open policy regimes is that there is an increasing potential that governments' policies will actually conflict with one another in ways that are harmful to overall economic gains. One possibility is that governments will increasingly compete for direct investment and its benefits by offering subsidies to direct investors, subsidies that have the potential to distort the benefits of the activity of these investors. Governments

[7]Wei 1996

[8]Policy liberalization in the developing nations is discussed in some depth in UNCTAD 1994.

might also use other measures (e.g., performance requirements) that are designed to tilt the benefits of direct investment to their economies but at the expense of some other economy. Finally, governments might attempt to use multinational firms as vehicles for achieving political ends, for example, via efforts to apply law and policy extraterritorially. The latest example of such an effort is the US Helms/Burton law, which would sanction certain non-US firms for doing business in Cuba. International rules could help to prevent or to attenuate such potential conflicts.

In recognition of the importance of direct investment, its contribution to the welfare of nations, and the need to head off conflicts between governments over direct investment and the activities of multinational firms, the member nations of the Organisation for Economic Cooperation and Development (OECD) have already begun to negotiate a "Multilateral Agreement on Investment" (MAI). This not-yet-finished agreement would, however, be flawed on at least two counts: (i) it would be a stand-alone instrument (i.e., not explicitly linked to the various existing agreements of the WTO) and (2) it would hardly be "multilateral"; it is doubtful whether many non-OECD member nations will join it, although the intention is for membership to be open, i.e., nonmember nations are in principle to be able to join if they so wish. Indeed, it will not even be required that all OECD nations sign it. (Thus, following accepted usage, this agreement should properly be termed "plurilateral" rather than "multilateral".) This second flaw is of particular gravity: Most of the potential benefit of a multilateral agreement on direct investment will result from reform of policy towards this investment by nations whose policies are not in conformity with the requirements of the agreement. As is elaborated below, such nations by and large are ones not currently members of the OECD.

Offsetting somewhat these two flaws, the main arguments for the OECD instrument are: (i) the OECD member nations seem to be willing to obligate themselves to "higher" standards than would be accepted by most non-OECD member nations at the present time (exactly what is meant by "higher standards" is discussed in the next section); and (ii) the MAI, if completed on schedule, could be implemented at a much earlier date than any future ADI within the WTO. There is some circularity in these arguments: the OECD nations, by and large, already have in place relatively liberal policies towards FDI, and hence it is relatively easy for these nations to negotiate to "high" standards. But the benefits of achieving these standards within the OECD are limited, because the OECD nations already largely meet the standards.

Thus, the main point made in this paper is that, in spite of the likely future existence of the MAI, it is desirable that an ADI be implemented within the WTO at the earliest possible date. The rationale for this point is further developed in section 2 of this paper, where also there is a discussion of what should be the main substantive provisions of such an agreement. Section 3 explores two options for developing such an agreement: (i) to allow the OECD MAI to "migrate" to the WTO, i.e., at some future date to incorporate the MAI, modified as necessary, into the WTO framework and, (ii) to negotiate such an agreement in the WTO "from the ground up". The paper ends (section 4) with conclusions and recommendations.

2. Why an Agreement on Direct Investment Would be Desirable Within the WTO and What Should be the Main Provisions of Such an Agreement

To address the issue of why there should be an agreement on direct investment within the WTO, it is necessary to decompose the issue into two components: why should there be multilateral rules on FDI at all, and why should they be in the WTO?

With respect to the first component, it is often asked why it is worthwhile negotiating multilateral rules at all on FDI at a time when, as just noted, a large number of nations are in the process of liberalizing their own policy regimes towards this investment. After all, won't the effect of such policy liberalization be the same as if nations were to bind themselves to international rules?

There are two reasons why such rules are nonetheless desirable at this time, and each of them is compelling. First, policy reforms in nations, even in ones where there is a groundswell moving in the direction of liberalization, are likely to be more profound and enduring if these reforms are backed by international standards than if they are made in isolation. Thus, for example, the negotiation of the investment provisions (chapter 11 part A) of the NAFTA agreement actually helped Mexico to implement policy reforms that Mexican reformers sought under any circumstances. (Indeed, after signing the NAFTA agreement, Mexico announced that it would multilateralize its obligations under chapter 11 part A to investors from all nations.)

Second, international rules (or standards) would serve to lock nations into agreed upon standards and thus might help to check or prevent any future policy "backsliding". It is more difficult for a nation to adopt "deliberalizing" policies if such backsliding would contravene an international obligation than if no such obligation were to exist.

The main reasons why an ADI is specifically desirable within the WTO are to offset the two flaws of the MAI already noted. First, an ADI could (and should) be fully integrated into the existing framework of international commercial law as embodied in the various agreements of the WTO, rather than as a stand-alone agreement. This is desirable because many provisions of existing agreements already complement a future ADI. Such agreements include those on

Trade Related Investment Measures (TRIMs), on Subsidies and Countervailing Measures, and on Trade in Services (GATS). Desirable integration between the ADI and other agreements of the WTO would also include a linkage of the ADI to the WTO dispute settlement mechanism. For reasons to be specified shortly, however, it would be necessary for additional new dispute settlement procedures to be adopted in the context of an ADI over and above those that currently exist. In particular, the linkage would enable trade sanctions to be invoked against a nation found in violation of obligations under the ADI in accordance with WTO dispute settlement procedures. As with any other dispute, sanctions would be allowed only if the putative violations were not remedied in accordance with recommendations of a WTO panel. In contrast, one likely weakness of the MAI will be that violations of obligations undertaken by nations that sign onto the MAI will not be subject to any form of international sanction. Simply put, an ADI would be more enforceable than an MAI because violations could be subject to sanctions.

Second, the number of nations that likely would subscribe to an ADI almost surely will be greater than the number that will sign on to the MAI. As already noted, one rationale for the current negotiation of an MAI is the belief of spokespersons for the OECD nations that "higher" standards can be achieved in the OECD than in the WTO. There is an obvious element of speciousness to this rationale because, after all, the OECD nations could themselves choose to negotiate an agreement within the WTO on a plurilateral basis.[9] If then even a handful of non-

[9]Within the WTO, however, negotiations for the European Union (EU) nations would be conducted by the European Commission whereas in the OECD the negotiators are from each of the individual national governments. It is not clear what difference this would make, although defenders of the OECD have argued that higher substantive standards can somehow be achieved by the OECD negotiators than by an equivalent group where the European national representatives are replaced by negotiators from Brussels.

OECD nations would be willing to join these negotiations on the understanding that these nations would commit themselves to the "high" standards sought by the OECD group, the outcome would be more favorable than that of the MAI.

What are these "high standards"? The MAI is envisaged to obligate all signatories to the following key provisions, all of which should also be required ingredients for an ADI:[10]

1. A broad definition of what constitutes a direct investment, in order to cover the multitude of ways in which multinational business firms establish themselves in host nations, e.g., through the creation of subsidiaries[11], through joint ventures or other forms of strategic alliance, through service and turnkey operations, etc.

2. An obligation of host nations to grant unencumbered <u>right of establishment</u> to foreign investors. Usually this right is considered "good enough" if it is granted on the same basis as that granted to domestic investors (if this is so, it is said that "pre-establishment national treatment" exists for foreign investors). In practice, however, no nation grants full pre-establishment national treatment to all foreign investors. Thus, in practical terms, unencumbered right of establishment implies a minimum of restrictions or conditions on entry by foreign investors, an absence of governmental screening except perhaps for national security reasons, and no pre-establishment "performance

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[10] In what follows, a "host" nation is one that is recipient to direct investment while a "home" nation is the source of such an investment.

[11] These typically are limited liability corporations established under host nation law in which the parent organization or investor has a controlling interest.

requirements" imposed by the host government or any subnational governments.

Much time is being spent in the MAI negotiations on what exceptions will be allowed to this general obligation. Even within the "high standard" OECD nations, sector-specific and other exceptions are rife, and one possible benefit of an MAI could be reductions in these exceptions. However, at this time it is uncertain as to whether the MAI negotiations will actually result in significant liberalization of existing restrictions.

3. An obligation by host nations to grant national treatment to foreign controlled firms and other covered investments. National treatment implies that such firms and investments are granted under law and policy treatment that is no less favorable than that granted to similar domestically controlled firms and investments. Again, no OECD nation grants full national treatment to all foreign controlled firms in all industries and thus, again, the issue before the MAI negotiators is to determine exactly what exceptions will be permitted. There is widespread agreement that some exceptions must be made in the name of national security. Beyond this, little consensus exists as to what exceptions should be allowed.[12]

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[12]These two obligations -- unencumbered right of establishment and national treatment -- can impair the flexibility of governments to pursue specific "industrial policy" goals, and many of the exceptions sought by governments are in furtherance of such goals. To those persons who consider "industrial policy" to be anathema, such exceptions are tantamount to the work of the Devil; to those persons who believe in industrial policy, the exceptions are absolutely necessary. At least one very important sector, telecommunications, is affected by this set of issues.

No effort here is made to take sides in the industrial policy debate; however, it should be noted that efforts to implement specific industrial policies are more widespread in developing nations (including certain of the rapidly industrializing nations) than in most OECD nations, and

4. An obligation by host nations to extend "most favored nation" (MFN) treatment to investments from nations that participate in the MAI. This implies that, should such a host nation grant to any investment from any nation treatment that is more favorable than that to which the nation is obligated under the MAI, that host nation will grant treatment that is no less favorable than this more favorable treatment to any investment from MAI participant nations. Again, the issue of exceptions is of importance. In particular, the specific issue has arisen in the MAI negotiations as to whether MFN exceptions should be granted in the context of agreements establishing "regional economic integration organizations" (REIOs) such as the EU. For example, should one EU nation be allowed to grant preferential treatment to investments of investors from other EU nations without extending this treatment to all investments from MAI participating nations? The logic of the EU is "yes"; the logic of the MAI is "no".

5. An obligation of host and home nations to allow unrestricted transfer of funds -- both at the level of operating funds and of capital funds -- between investors and investments. Certain exceptions to this obligation would be routine (e.g., if the investor or the investment were under suspicion of criminal activity or some other infringement of the law); other exceptions might be allowed for, e.g., balance of payments reasons.

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thus that negotiation of these two obligations likely would be more difficult in the context of a WTO ADI with wide participation than in the context of the OECD MAI. However, the MAI itself is, by all counts, likely to be riddled with exceptions both to right of establishment and to national treatment.

6. Obligations of host governments to grant certain levels of investor protection. The most important of these obligations is that no host nation would be allowed to expropriate a direct investment except for a public purpose, on a nondiscriminatory basis, under due process of law, and with adequate and prompt compensation guaranteed to the investor.

One effect of adoption of these six sets of obligations would be achievement of a high degree of transparency: stated simply, investors would know with a high degree of certainty what exactly are the rules that apply to them in each country that adheres to these obligations.

With respect to these six sets of obligations, there is widespread consensus within the MAI negotiations on language pertaining to the first, fifth, and sixth. Most of the problem areas center around exceptions to right of establishment, national treatment, and most favored nation. This would almost surely continue to be the situation were the negotiation of an ADI to be launched within the WTO. Agreement by a large number of countries on acceptable standards for definition of a direct investment, transfer of funds, and investor protection should be relatively easy to achieve. More difficult to achieve will be consensus on standards for right of establishment and national treatment. As in the MAI negotiations, the stickiest area will be allowable exceptions to these obligations. Exceptions sought by developing nations will in general be more widespread than those sought by most OECD nations.

One approach to handling these exceptions would be to allow developing countries to continue those policies and practices currently in place deemed to be in violation of right of establishment and national treatment obligations, but to require that all such policies and practices be listed and for as many of these as possible to be phased out in accordance with published schedules. This approach was adopted with respect to Mexican policies and practices in the matter of the negotiation of the North American Free Trade Area (NAFTA), for example. Mexico is allowed far more exceptions in the NAFTA than are either Canada or the United States, but Mexico is simultaneously obligated to phase out many of these exceptions over time.

It should be noted that there are some countries that have indicated that they would refuse to accept national treatment even as a principle (i.e., these countries would not obligate themselves to this principle even if they were allowed unlimited exceptions). However, the principle of national treatment is central to an agreement on investment, the purpose of which is to allow to as great an extent as possible unfettered flow of direct investment across national boundaries. Thus, nations holding this view would not be able to participate in an ADI; for this reason, a WTO ADI would have to begin its existence as a plurilateral agreement.

As already noted, one benefit of the ADI would be linkage to the WTO dispute resolution mechanism. However, the dispute settlement procedures would have to be supplemented considerably. This is because many investment related disputes involve a multinational enterprise and a national or subnational government. However, in the WTO, only national governments ("states") have "standing"; no other party (such as a firm) can bring a dispute before the WTO.[13] The need for some sort of "enterprise-to-state" dispute settlement procedure, in addition to a "state-to-state" procedure such as in the WTO, has been recognized in the NAFTA

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[13]Governments could of course act as agents for firms in existing WTO procedures. This would suffer from the obvious flaw, however, that the interests of governments (even the home government of a firm, i.e., the government of the nation in which the firm has its headquarters) and firms may not coincide and hence that the government agent might not in good faith represent the interests of the firm. Indeed, as business continues to "globalize", it is likely that the interests of a global firm and any one government (including the firm's home government) might diverge.

(see the NAFTA Agreement, chapter 11, part B) and is contemplated within the OECD MAI. However, neither of these integrates enterprise-to-state dispute settlement procedures into the existing WTO procedures, something that would be desirable and possible to achieve.

One alternative means to do this would be to create a two stage procedure whereby, after lodging a dispute, a firm would first have to pass a test of "standing". Standing would be granted if the firm could show probable cause that its interests had been damaged as the result of the failure of a government to honor obligations under the ADI. This determination would be made by a panel of jurists trained to hear such cases. The second stage would be consideration of the case by a WTO panel, which would examine the merits of the dispute and to issue a recommendation.[14]

A reasonable question is, what would happen if the panel found against the defendant country and recommended a change in law or policy but the country did not implement the recommendations? In a state-to-state dispute, the plaintiff country would then be authorized to apply sanctions against the defendant country. This would be awkward in the case of an enterprise-to-state dispute; it is difficult at best to imagine a firm, even a very large multinational firm, applying sanctions against a country. One option would be for the home nation of the firm to be allowed to apply sanctions against the defendant country. However, in some cases this might conjure up images of the "gunboat diplomacy" practiced earlier in this century where the interests of large firms were enforced by powerful nations on weak ones. A second option might thus be for the panel to be allowed to award monetary damages to the firm, to be paid by the

[14]As in all disputes before the WTO, the disputants would first attempt to work out a mutually satisfactory resolution via consultation; only failing this could the case be brought to the two stage process.

country, in an amount equal to the damages suffered by the firm as the result of the breach of obligation.[15] The two options do not, of course, mutually exclude each other. For investment disputes, both options might be allowable.

Although it would be necessary to create enterprise-to-state dispute settlement procedures in order to implement an ADI within the WTO, these procedures would supplement rather than displace the existing state-to-state procedures for investment related disputes. It remains entirely possible that a nation's interests could be affected by the investment policies of another nation and that this could result in a dispute being lodged. For example, a nation might believe that its exports were displaced (or threatened to be displaced) by another nation's policies to induce international investors to locate production facilities in its territories. If these policies violated ADI obligations, a dispute could be lodged before the WTO that would be resolved using the existing state-to-state procedures.

Indeed, this example introduces a major lacuna in the MAI. According to reports that have "leaked" from the MAI negotiations, this instrument will not place any limitations on the use by national or subnational governments of "investment incentives". These incentives are subsidy or subsidy-like offerings by governments to firms; the subsidies are meant to induce firms to locate specific production facilities within the territories of the governments. Such subsidies can have distortive effects, e.g., to cause firms to relocate production from a relatively economic to a relatively uneconomic site, where the differences in production costs to the firm

[15]Such a procedure in fact is applied in enterprise to state dispute resolution in the NAFTA, where an arbitral tribunal can award monetary damages to a firm which suffers loss as the result of failure of a nation to honor NAFTA obligations. Indeed, under NAFTA procedures, the tribunal can only award damages; it cannot recommend changes in law or policy.

are compensated by the subsidies. The net effect is to raise the cost to the world of producing the relevant goods or services. In spite of the extra costs (and the deadweight losses these impose upon society), governments often are eager to offer investment incentives in order to increase local employment opportunities. Indeed, competition by governmental agencies to attract investment often leads to these agencies bidding against each other and upping the stakes.[16] The case is thus strong that there should be international agreements to put caps on such incentives or, better, to eliminate most such incentives entirely.[17] For political reasons, however, the MAI negotiators have been reluctant to attempt to deal with this issue.

For this issue, the WTO might be a better venue to achieve "high standards" than the OECD. This is true for two reasons. First, rich nations (and rich subnational governments) can afford to offer more generous incentives than poor ones, for obvious reasons. Thus, limitations or elimination of investment incentives will benefit poorer countries more than richer ones, and hence the developing nations might as a group emerge as a stronger constituency for such limitation or elimination than the OECD nations. Second, WTO law already deals with export subsidies under the Agreement on Subsidies and Countervailing Measures, and a natural

[16]In such a situation, the granting of incentives can take on the character of a classical "prisoner's dilemma" game: collectively, the authorities might be best off if no one offered any incentives at all. However, if just one authority does offer an incentive, every other authority's "best response" is also to offer incentives. Because at least one authority is almost sure to calculate that it can gain advantage unilaterally from offering an incentive, the result is that it does so and causes each other authority to play this "best response".

[17]There may be valid reasons for the granting of subsidies, however, and hence any discipline on investment incentives would have to attempt to distinguish between "good" and "bad" such incentives. Generally the distinction rests on whether or not the subsidized activity generates some tangible positive externality in excess of the cost of the subsidy. However, determination of whether an externality is generated by a subsidy is problematic.

extension would be for this Agreement to be enlarged to cover investment incentives.

An issue often linked to investment incentives is performance requirements. Some such incentives are granted upon the condition that certain performance requirements are met. But also the meeting of performance requirements is often set as a condition for entry. It has already been noted that unencumbered right of establishment implies that no performance requirements should be placed on international firms as a condition for entry. However, it remains to be seen what, if any, restrictions on performance requirements are embodied in the MAI.

The WTO to a limited extent already deals with such requirements in the Agreement on Trade Related Investment Measures (TRIMs). This agreement bans two types of performance requirements, notably local content and export requirements. The reasoning was that these requirements distort trade flows and are inconsistent with GATT article III (national treatment on internal taxation and regulation, not to be confused with national treatment for investments). Other types of performance requirements can easily have trade distortive effects; these include local manufacturing requirements, trade balancing requirements, mandatory technology transfer, etc. Part of the work of the ADI should be to enlarge the range of measures covered by the TRIMs agreement.

The Two Routes to an ADI

As noted in the introduction, the two alternative routes are (1) to use the MAI as the basis for an ADI or (2) to start from scratch and to negotiate an entirely new instrument. It is at the time of this writing truly difficult to evaluate these two alternatives because the MAI is not complete and only sketchy information has been released with respect to its content. Thus, at this time it is not possible to judge the MAI on the basis of its substantive merits. However, it seems a safe bet that the MAI will contain all six of the obligations listed in the previous section (broad definition of investment, right of establishment, national treatment, most favored nation, unencumbered transfer of funds, investor protection). Were the MAI to be adopted (in an adapted version) by the WTO, the task would center around negotiation, nation by nation and sector by sector, of the exceptions to the main obligations. Thus, in practical terms, it in fact might make little difference as to which of the two routes is taken. The yeoman's work in creating such an agreement will not rest on drafting the language of the obligations, but rather on the negotiation of what exceptions will be allowed.

The main problem with the WTO adopting the MAI is summarized in the expression "NIH" ("not invented here"). Those WTO member nations that have been excluded from the MAI negotiations already hold negative feelings about this instrument simply because they had no role in its creation.[18]

Given the "NIH" factor and the fact that eighty percent of the work to negotiate a WTO ADI will be in the hammering out of exceptions, it is likely that the WTO will "start from the ground up". The MAI will be a useful reference point, but it seems unlikely that it will be adopted by the WTO and adapted to the WTO framework.

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[18]This has come out in a number of meetings, in particular one held by the OECD in Hong Kong in March, 1996 to which representatives of representatives of about twenty non-OECD member nations of Asia and Latin America attended and at which the author was present. All but two of these nations spoke against the MAI.

3. Conclusions

The principal reason why negotiations on a multilateral agreement on investment are proceeding at the OECD, rather than at the WTO, is that the OECD member nations collectively have felt that few if any non-member nations were prepared to enter into such negotiations at a serious level. In the end, whether an agreement on investment will be reached at the WTO depends upon at least some of these nations deciding that such an agreement is, after all, in their best interests.

But, one can reasonably ask, is it? The case can be advanced that the answer is unequivocally "yes". The benefits of direct investment, as noted earlier in this paper, are virtually without question. These benefits exist for all nations, but they are especially important to developing nations seeking to "catch up" technologically with the advanced nations. Subscription by a country to a strong multilateral agreement on direct investment would help that country to attract such investment and to capture these benefits.

Why then are many developing countries apparently unwilling to subscribe to an ADI? There are several reasons.

One reason is largely tactical. Developing countries seek action on a number of agenda, including accelerated liberalization of textile and apparel trade and trade in agricultural goods, and hence negotiators from these countries might hold back on agreeing on investment rules, choosing instead to use these as a "bargaining chip." But also, on the substantive side, there remains a residual of 1970s thinking about direct investment and multinational enterprises. Although this residual is, worldwide, in recession, enough of it remains in certain nations to block participation of these nations in an effective ADI.

A third reason for developing nation reluctance is a persistent belief on the part of some national investment development agencies that they can use performance requirements to benefit local economies, often by using these as conditions for entry (and thus the relevant authorities are unwilling to subscribe either to limitations on performance requirements or to an obligation to allow unencumbered right of establishment). This can lead (and very often does) to policies that are shortsighted even from a national point of view: firms tend to demand privileged access to markets in exchange for accepting performance requirements (which can impose additional costs on the firm), and thus the nation loses potential benefits of competition as part of the deal. And, as already noted, the global effect of the performance requirement is distortive: overall, the world loses benefits.

One aspect of an ADI that most developing nations would readily endorse would be an obligation on international firms to obey the laws and policies of the nations in which they do business. Such an obligation in fact would also be in the interests of the firms themselves. In particular, under such an obligation, a subsidiary of a firm in nation A would be obligated to follow that nation's law and policy, even if this were to put it into conflict with the law and policy of some other nation. In a word, the obligation would help to resolve the dilemmas faced by a firm when local law and policy was in conflict with that of another nation which was being applied extraterritorially. Such an obligation in turn might dissuade certain governments from attempting extraterritorial application of law and policy.[19]

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[19]The implicit restriction on extraterritorial application of law and policy should, however, itself be subject to certain exceptions, e.g., nations holding nuclear weapons would be allowed to prevent transfer of relevant technology between overseas subsidiaries of firms based within their sovereign jurisdiction.

Indeed, much of the benefit of an ADI would be to constrain governments from taking actions that are both shortsighted from a national point of view and distortive from a global perspective. However, as long as national leaders believe that selective intervention can serve national interests, the benefits of such constraints will be lost to view.

How lost to view are these benefits? The assumption behind the MAI is that, outside the OECD, the fog is very thick. Given the policy shifts that are occurring in many nations, this seems overly pessimistic. Surely a plurilateral agreement within the WTO is possible, where at least one non-OECD nation joined in the fray. And, who knows, once the ship set sail, the fog might lift.

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Advancing Services Negotiations

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1. Introduction

Negotiated during the Uruguay Round, the General Agreement on Trade in Services (GATS) forms part of the 'single undertaking' of commitments accepted by all WTO members. It is an ambitious agreement. So far, however, it has met with limited success. The extended sectoral negotiations under its auspices during the past eighteen months have been disappointing. The GATS suffers from major structural weaknesses that reduce its ability to facilitate effective trade liberalisation. Developments in some regional arrangements may provide some useful guidance in reviewing it.

2. Framework of the GATS

Although the GATS embraces the key GATT principles of unconditional MFN, transparency, reciprocity, national treatment and negotiated (binding) concessions, there are important differences in the manner in which most of these principles are implemented (Table 1). Unlike the GATT, the GATS permits

1 The views expressed are those of the authors, and should not be attributed to the Industry Commission or the Australian Government. The Industry Commission is currently in the process of amalgamating with the Bureau of Industry Economics and the Economic Planning Advisory Commission to form the Productivity Commission. The authors are grateful for the valuable assistance given by Wenona Bird of the Industry Commission in preparing this paper.

exemptions from unconditional MFN for specified sectoral measures, so long as these were scheduled by 1 January 1995, or unless the relevant sectors were subject to ongoing negotiations.[2] Countries insisted on, and used, MFN exemptions in the GATS to facilitate industry-specific reciprocity.

Under the GATT, national treatment is a general obligation, essentially requiring that once frontier barriers are cleared, imported and domestic like products will be treated equally by governments. As a general rule, an import tariff is the only form of permitted frontier barrier in GATT, though quantitative restrictions are permitted in certain limited and specified circumstances. The tariffs themselves can be at any level until bound under the negotiating processes of the GATT. Under the GATS, on the other hand, any form of barrier to services trade can be maintained or increased in any sector until it is scheduled; only then has "national treatment" any relevance to the services traded in that sector. Not only is national treatment not a general obligation as in GATT (arising only from specific commitments), it is defined more broadly in the GATS to embrace all measures which discriminate between domestic and foreign services — internal as well as frontier. (The distinction between internal and foreign measures is often unclear in services trade.)

In GATS, national treatment is interwoven with "market access", a term not appearing in the GATT. Para. 1 of the market access Article XVI of GATS requires foreign services and service suppliers to be treated in a manner no less favourably than that specified in a member's schedule, for all modes of supply. This would seem to imply that all barriers to market access should be scheduled for any scheduled service sector, even where these barriers apply equally to domestic and foreign suppliers. (There is no corresponding requirement in the GATT.) This para. appears to be directed to market access *in general* and thus

2 Such exemptions are to be reviewed after five years and, in principle, should not exceed ten years. They are to be subject to negotiation.

relates to competition policy, not foreign trade as such. The question arises whether an international agreement in services trade is the best way in which to address problems arising from domestic competition policy. Para. 2 of the market access article prohibits specified quantitative restrictions in those sectors for which market access commitments are undertaken. National treatment in GATS requires that in the sectors scheduled, foreign services and service suppliers be treated no less favourably than domestic services and service suppliers, except as provided in the schedule. It can be seen there is an uncomfortable and somewhat confusing relationship between the national treatment article (XVII) and para. 1 of the market access article.

Commitments to market access and national treatment are therefore both country and sector specific. Members can maintain those trade restricting (non-conforming) measures pertaining to each mode of supply listed in the schedules. However, unless MFN reservations were explicitly specified when GATS came into existence (or under the provisions for extended negotiations for specific sectors), all measures must be applied in a manner which does not discriminate among other members.[3]

GATS implements a so-called 'hybrid' approach to scheduling commitments, combining positive and negative lists (Hoekman 1995). A positive list determines sectoral coverage while a negative list specifies, for each sector and for each of the four modes of service supply, those measures which limit market access and national treatment. A negative list specifying sectors exempt from specific commitments, as was adopted for MFN exemptions, would have been far more transparent and better suited to facilitating future liberalisation, even though the list of exemptions would have been very long.

3 Preferential access may be provided within the context of the provisions relating to economic integration, the GATS equivalent to the provisions for free trade areas and customs unions in the GATT.

While the GATT covers only cross-border trade as a means of supply the GATS includes all modes by which supply may be undertaken: cross border trade itself and the movement of both persons and capital across frontiers for the supply or consumption of services. Thus, commitments under the GATS cover not only the more conventional cross-border trade, but also the much more sensitive areas of movements of suppliers and consumers (temporary movement of people) and commercial presence (foreign investment, particularly direct investment). This breadth of coverage could be a strength if there were a general commitment to reducing all barriers; experience so far raises the question as to whether it would be better for the GATS to focus on cross-border trade *per se*, even though this is quite limited in some services as compared with goods trade, and to leave investment in services *and* goods (and movement of people) to separate negotiations.

While GATS is very broad in principle, in practice the liberalisation which has been achieved is heavily restricted by the sector-by-sector coverage of core commitments on national treatment and market access, as well as those measures exempted from MFN treatment.[4]

3. Sectoral Commitments

Although most developed countries recorded what at first sight appear to be substantial sectoral commitments in more than 70 sectors (with a handful leading the way with more than 100 sectors covered), as compared with a maximum of around 150, this is likely to be a poor indicator of coverage compared to service production. For example, while Australia made commitments on over 80 sectors, only one-fifth of its total production of services is estimated to be covered by liberalising obligations — bound commitments not to maintain non-conforming

4 Services not covered by the GATS are air landing rights and those supplied in the exercise of governmental functions, such as the provision of basic infrastructural services. Also excluded is government procurement of services, on which negotiations are to be held under the GATS by 1997.

measures — and these commitments were skewed heavily towards services already relatively open (Industry Commission 1995, 189-214).[5] Major sectors — at least some of which are known to have highly restrictive trade measures — were excluded from Australia's schedule, or subject to unbound commitments. Other countries' schedules have similar characteristics.

Not surprisingly, the number of measures scheduled in the GATS as violating national treatment and market access and as 'unbound' offers were substantial. Most countries currently maintain extensive trade restrictions on services. For example, an analysis of GATS schedules for APEC economies combined indicates that well over two-thirds of possible service markets — defined as each mode of supply in each service market in each APEC economy — may be impeded (APEC 1995, 72). Cross-border supply is the least restricted mode of supply within APEC economies as a group, while the presence of natural persons is easily the most constrained mode of supply.

4. Structural Problems of the GATS

The liberalisation in trade which has been achieved within the context of GATS is very modest; little more than limited standstill commitments within sectors already open has been achieved even by those countries making significant commitments. The inability to secure more substantial results may be attributable to structural weaknesses of GATS as well as to negotiating attitudes. Of course, the structure of the GATS reflects what was achievable at the time.

Unlike the GATT the GATS is largely a framework agreement, with commitments for sectors left for negotiation. There was always a question of how much in the form of general obligations should be in the framework, and

5 A quarter of Australia's services production, including coastal shipping, was excluded outright from its specific GATS commitments, while those sectors scheduled for which no obligations were made to provide market access or national treatment — thereby enabling existing restrictions and new ones to be introduced — represented a further 55 per cent of Australian services production.

how much left to negotiations. Compared with the GATT the balance in the GATS is strongly away from the general framework and this sectoral focus of the GATS is a fundamental problem. In GATT national treatment is a general obligation, with tariffs as the sole generally sanctioned form of discrimination against foreign supplies. But within GATS national treatment (and market access) is a specific obligation to be negotiated with respect to all scheduled services and all forms of barriers. MFN exceptions were also taken across major sectors so as to negotiate sector-specific and country-specific reciprocity.

The sectoral trade-offs which can remove major stumbling blocks are particularly difficult to secure when negotiations are sector-specific. Such negotiations are highly susceptible to being blocked by vested domestic interests who are able to mount effective campaigns designed to focus attention on the costs to the particular sector of trade liberalisation, rather than the gains to other sectors, and to the economy in general, of such reforms.

The chances of success of sectoral specific negotiations are diminished further by the nature of the barriers to services trade, as well as by the attitudes of key demandeurs (Hoekman 1995). First, tariffs on goods provide a continuum for negotiation — a sixty per cent tariff is negotiable to all levels between sixty and zero. But barriers to trade in services, which are seldom in a price-based form comparable to tariffs on goods, are less quantifiable and with their incidence not as divisible, are often subject to substantial bureaucratic interpretation, and are less transparent. All these characteristics make them more difficult to trade in negotiations.[6] A second, and related point, is that some demandeurs are addressing negotiated reciprocity not in terms of the extent of market opening, as

6 Negotiating impediments to services trade is made more difficult by their largely non-transparent nature, and because they are frequently embedded in domestic regulations. Unlike the GATT and for goods, the main measures restricting services trade do not operate at the border, but are applied internally and are not directed to restricting just foreign access but all access. They are often also justified on other grounds, including consumer protection.

has been the tradition in GATT negotiations, but in terms of market openness. This interpretation of reciprocity places a particularly heavy political-economy burden on countries traditionally having closed service markets.

The so-called hybrid approach to the scheduling of commitments, with a positive listing of sectors covered by specific commitments and a negative listing of trade restricting measures within these sectors, also inhibits liberalisation. This structure facilitates and even encourages a "made-to-measure" approach to liberalisation, that is to limit liberalisation to where, and to the extent that, it does not hurt. Moreover the transparency of barriers has been severely compromised by the ability of members to refrain from scheduling sensitive sectors in which trade restricting measures abound. Negative listing is transparent; positive listing can be, and is, used to obscure.

5. Extended Sectoral Negotiations

While the WTO and hence the GATS became operational on 1 January 1995, negotiations were largely incomplete at that time in the key areas of telecommunications, financial services, maritime transport, and the movement of natural persons.[7] A timetable was established for extending these negotiations. This effectively suspended initial commitments in these areas — they could be amended, along with MFN exemptions, until the negotiations concluded. Major MFN reservations were lodged (or threatened) by key players to 'lever' other countries to improve their offers under GATS. At the same time, it was agreed to 'carve out' certain segments of financial services from the GATS for prudential reasons.

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7 The EU, largely at the insistence of the French Government, excluded the audio-visual sector from MFN treatment. The EU (along with some other members) thus made no sectoral commitments in this sector, and may impose discriminatory or non-discriminatory measures in the entire audio-visual sector. However, it will be the subject of future negotiations.

The poor progress to date in the extended negotiations covering key sectors is disappointing, but hardly surprising. These sectors also have provided difficulties in regional attempts to liberalise services trade where successfully negotiating sectoral trade-offs would be more likely than at the multilateral level. Sector-specific negotiations provide separated foci for sectoral lobbies ensuring that "whole of government" considerations are likely to be overwhelmed in national negotiating stances, and that trade-offs across sectors would receive scant attention within capitals and none at the negotiating tables. Thus, while within the US, for example, there may have been some possibility of setting the global view of the telecommunications industry against the fortress stance of the maritime interests, the structure of negotiations has kept them apart.

The results of the *financial services agreement* — concluded on 28 July 1995 and then only after a one month extension — were unsatisfactory. The US withdrew its offer and invoked an MFN exemption for the entire financial services sector. However, while adopting a conditional MFN stance — of only opening its financial market to trading partners on a reciprocal basis — the US nevertheless agreed to guarantee Japan's MFN status in its financial services market. While the stated objective of the US was to secure improved offers from other countries, in the eyes of some the US is currently free riding on other countries' unconditional MFN commitments.

Only 29 countries (counting the EU as one) of the 76 WTO members which made commitments in the financial services sector, improved their offers during the extended negotiations.[8] Although some concessions were made to relax foreign equity participation and operational restrictions, these remain well below those needed to open financial markets significantly. Most developing countries

8 These offers are to implemented until 1 November 1997, after which members will have 60 days to negotiate further amendments to specific offers on financial services, or to take MFN exemptions.

still have not scheduled all their financial services sectors, and thus many elements of financial services remain completely unbound.

Negotiations were held concurrently on the *movement of natural persons*, aimed at achieving better temporary entry of senior executives and professionals supplying services. These too concluded unsatisfactorily on 28 July 1995. Only a few countries made improved offers in the course of the negotiations. There are no plans to resume them.

Negotiations on *basic telecommunications*, initially due to conclude on 30 April 1996, were recently suspended, and are now due to recommence in January 1997 for completion by mid-February 1997. To the surprise and chagrin of many participating countries, the US withdrew its offer late in April, claiming that only 10 out of the 34 country offers presented were acceptable. Standstill commitments are to apply in the interim. The scheduled date, 1 January 1998, for the telecommunications accord to come into force is still feasible.

The change in stance of the US in the basic telecommunications negotiations can be attributed to strong lobbying at home by the parts of the telecommunications industry. In this case, the pressure came from American companies involved with low-orbiting satellite telephone services. The US was very reluctant to commit to unconditional MFN treatment, which would relinquish its ability to press for reciprocity.[9]

However, if negotiations are concluded successfully so that best offers are retained, the telecommunications accord will significantly improve market access. Most offers proposed reduced limitations on foreign investment in telecommunication companies, although many governments retained restrictions

9 The US industry was particularly concerned that foreign monopoly operators could, by charging high domestic prices to connect overseas phone calls, take unfair advantage of cheap international rates on outgoing calls from the US and other liberalised markets. Washington thus wanted to retain the right to reject applications to operate services out of the US from overseas carriers with a home-country monopoly.

on investment in domestic monopoly carriers. Modest offers were made on satellite communications. Commitments varied considerably between participants — for example, while the US offered to remove foreign ownership restrictions to open its mobile phone market to a significant degree, Thailand and the Philippines offered only standstill commitments.

There is little or no chance of an agreement on *maritime transport services* by the deadline of 30 June 1996. The US has so far refused to make an offer in the negotiations, and there is little chance of this happening until some countervailing forces can be brought to bear against the maritime lobby in that country.

6. Services in Regional Trade Agreements

It is useful to review the provisions regarding services in major regional arrangements — the EU, NAFTA, CER, APEC and AFTA— to see what lessons, if any, emerge. Key features of these regional agreements relating to services are summarised in Table 2.

a. European Union (EU)

The EC-92 internal market program extended the three main liberalising principles affecting services contained in the EEC Treaty — the freedoms to engage in internal cross-border services trade, to rights of establishment and to movement of people. Despite the liberalising provisions for internal services trade in the EEC Treaty, major blockages remained for more than thirty years, due primarily to differences in national regulations and standards among member states.

It was not until the Single European Act of 1987 that a legal and institutional framework was provided for ensuring the free internal movement of goods, persons, services and capital. This process introduced (and extended) concepts of minimum standards and mutual recognition, as well as the development of common EC-wide minimum quality standards.[10] These were mainly applied through commonly-agreed EC directives or regulations. Significant liberalising directives were implemented in financial services, road and air transport, telecommunications and professional services.[11] Greater internal harmonisation of technical standards was also applied, and disciplines on state aids, public procurement and competition introduced.[12]

The EC-92 program demonstrated that achieving full market access in services required national treatment to be complemented by other measures, such as the harmonisation and mutual recognition of standards, and the application and enforcement of competition rules within the common market (Hoekman & Sauvé 1994). EC-92 policies on trade expansion within a common market were retained in the 1992 Treaty on European Union (the Maastricht Treaty).

b. North American Free Trade Agreement (NAFTA)

Many of the features in NAFTA, which came into effect in January 1994, emerged from the Canada-US Free Trade Agreement (CUSFTA). However, in services there were some significant changes in approach, particularly in relation to coverage. In CUSFTA a positive listing was adopted, while in NAFTA there was a change to a negative listing: all services are covered unless they are specifically exempted. Most air and maritime services are so exempted.

While the GATS embraces all modes of service delivery, the services chapter of NAFTA covers only cross-border trade, including access to transportation and distribution systems, and the presence of the service providers of other parties, but excluding financial services. Investment (in the provision of

10 Mutual recognition requires member states to allow goods and services to be traded that are lawfully traded in other member states.

11 Mutual recognition was introduced for diplomas related to pharmacy and professional qualifications in supplying accounting, legal and medical services.

12 However, the emphasis shifted from harmonization of national regulatory differences to form community-wide regulation and standards towards mutual recognition of national standards, a form of conditional national treatment — all community suppliers that meet their government's standards receive national treatment.

both goods and services), temporary entry for business persons, financial services, telecommunications and competition policy are covered in separate chapters, as are services associated with basic petrochemicals.

Most-favoured-nation treatment for parties and (unlike GATS) national treatment are general obligations in NAFTA.[13] Like GATS, NAFTA provides for exemptions of existing measures from MFN as well as from national treatment for both cross border trade and investment. Exceptions to MFN or national treatment at the federal or state (province) level must be scheduled, though not those at the local government level.[14] NAFTA provides a right of non-establishment whereby service providers are not required to have local residence to provide services.

The term "market access" is generally avoided in NAFTA. Its (general) absence in NAFTA, combined with a broad definition of national treatment, is one of the features of NAFTA which makes it easier to understand and apply than GATS.

c. Australia-New Zealand Closer Economic Relations Trade Agreement (CER)

Services were brought within CER in 1989. The Protocol on Trade in Services provided a framework of transparent rules aimed at liberalising services trade. All sectors are covered, subject to a negative list of exclusions, to which MFN treatment must still apply. (Thus, unlike GATS and NAFTA, there are no exemptions to MFN.) Included sectors of each member are subject to standard national treatment provisions (and market access, which is expressed in terms which, unlike GATS, do not confuse the issue) ensuring that domestic and

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13 NAFTA also has as a general commitment non-discriminatory treatment, but this is defined as providing parties the best of national treatment and MFN.

14 Federal measures needed to be scheduled when NAFTA came into force, while those maintained by state (provincial) governments had to be listed within two years (ie. by 1 January 1996).

imported services are treated equally. Persons, defined to include business entities and citizens or residents, are also covered by these same commitments as well as the right to commercial presence, subject to foreign investment policies maintained by each country. Although investment is not covered by the CER, a standstill commitment covers measures that would violate the right of non-establishment. Australia and New Zealand form a common labour market in a separate agreement predating CER. Non-discriminatory licensing and certification measures are encouraged, as is mutual recognition of qualifications.

Sectors excluded cover basic telecommunications, broadcasting, air transport, coastal shipping and postal services. Australia has removed reservations on banking, while New Zealand has done so for radio and television broadcasting, short wave and satellite broadcasting, and stevedoring. Although a Memorandum of Understanding was signed in 1992 to form a single aviation market across the Tasman, including the right to operate in each others' market, from 1 November 1994, Australia decided in October 1994 not to proceed.[15]

In the latest review in 1995, Australia liberalised its inscriptions on postal services and telecommunications, while New Zealand did so on aviation and coastal shipping.

d. Asia Pacific Economic Cooperation (APEC)

APEC economies agreed in the Bogor Declaration of 1994 to achieve free trade in the region, including for goods, services and capital, by no later than 2020 (2010 for developed countries). The 1995 APEC meeting in Osaka endorsed this commitment and developed an Action Agenda to pursue liberalisation and facilitation measures consistent with WTO principles and objectives. In the Agenda, APEC economies adopted a rather weak standstill commitment to endeavour not to introduce new protective measures, including on services.

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15 Discussions between the two governments are to resume in July, with the intention of sealing an agreement on a single aviation market by November 1996.

The Action Agenda is very broad, and the implementation details have not yet been resolved. However, the concept of open regionalism, as enunciated in Osaka in November 1995, embraces MFN treatment to non-APEC economies with no sectors being excluded from the Bogor commitment. At this stage, all services are covered by commitments to reduce restrictions progressively on market access for services trade and to provide progressively for MFN and national treatment. Moreover, members are to contribute positively to the GATS negotiations, by expanding their sectoral commitments on market access and national treatment, and eliminating MFN exemptions. The Agenda treats foreign investment both generically and separately, and calls for the progressive provision of MFN, national treatment and transparency.[16]

The Agenda singles out four service sectors where negotiations on trade facilitation measures have existed for some time. These are telecommunications, energy, transportation and tourism. These sectoral negotiations are looking mainly at harmonising regulations as well as administrative procedures, and improving transparency. The Committee on Trade on Investment is examining the possibility of extending this work to other service sectors.

e. ASEAN Free Trade Agreement (AFTA)

The scope of AFTA does not currently extend to services. However, some preliminary moves were taken at the December 1995 ASEAN summit towards including services and investment, with the first services to be included in 1998. In the meantime, a three-year negotiating process was agreed with the aim of extending free trade in several services sectors, including finance, maritime transport, telecommunications, air transport, tourism, construction and business services. However, while predicting the likely outcome of these negotiations at this stage would be premature, it appears that any gains in these sectors will be

16 The APEC Non-Binding Investment Principles reflect these commitments. Countries are expected to submit individual Action Plans for meeting the Bogor Declaration — under the process of concerted unilateralism — in November in the Philippines.

largely exploratory. ASEAN members (except Vietnam) are, of course, also APEC economies.

7. Lessons from Regional Agreements

There is a broad similarity between the GATS and the main regional agreements in terms of specific rules and disciplines as well as liberalised and excluded sectors (Hoekman and Sauvé 1994). Generally, agreements have excluded or have special provisions for the same range of particularly sensitive sectors: basic telecommunications, broadcasting, air and maritime transport and government services. However, there are important structural differences between the agreements. Of the regional agreements, NAFTA and CER probably provide the best models from which to draw lessons for the GATS. The following are some of these lessons, together with lessons which emerge from a more general consideration of GATT, GATS and the regional agreements. Many of the points are also considered in Hoekman (1995), Hoekman and Sauvé (1994), Sauvé (1995a, 1995b & 1996), Low (1995) and Snape (1994).

a. Sector specificity

The structure of GATS encourages sector specific negotiations and arrangements. Liberalising commitments apply only to scheduled sectors/sub-sectors. This structure is likely to continue to limit the usefulness of GATS in promoting future liberalisation. Experience in multilateral negotiations is that most success in opening markets has been achieved where negotiations have extended beyond individual sectors. Focussing on trade restricting measures, rather than sectors, in such negotiations facilitates trade-offs between losses to certain sectors with the broader gains from such reforms to other sectors and the economy generally. The GATT is a general agreement, general with respect to products and countries. GATS is being implemented not so much as a general agreement, but as a basis for negotiating product (sector) specific agreements. The focus needs to be shifted.

b. Exemptions from MFN

The possibility of exempting sectors from MFN has encouraged sectoral negotiations and product specific bilateral reciprocity: indeed this was the objective of those countries which demanded the allowance of exemptions. The CER agreement (as well as the arrangements within the EU) and the GATT (with the exception of waivers and the Article XXXV provision for non-application between particular parties) do not specifically provide for sectoral exemptions from MFN among the parties. When under GATT such exemptions have been allowed — the Multifibre Arrangements being the prime example — the results have been trade restricting rather than trade liberalising.

c. Negative Listing

The adoption of a negative list approach to sectoral exemptions from national treatment (and market access), as found in CER and NAFTA, would greatly improve the transparency of the GATS. Under negative listing all exempted sectors and all restrictions maintained within sectors need to be clearly outlined in a consistent manner to avoid ambiguities (as they are in NAFTA and CER). Apart from other virtues, a negative list is more conducive to establishing a comprehensive cross-country comparison of restriction levels. This facilitates liberalisation by providing trade negotiators with a clear inventory of what remains to be done (and importantly facilitates domestic analysis of the economic costs of such restrictions). Although arguably more tedious, forming a negative list encourages countries to re-evaluate the desirability of existing restrictions. This approach also facilitates a standstill on restrictions. Unlike a positive listing, a negative list approach prevents countries introducing further restrictions to unbound sectors. A negative list also facilitates liberalisation by automatically including any new service areas that emerge.

d. Market access/national treatment

Given that national treatment is defined to cover all measures which discriminate between domestic and foreign supplies (both internally and at the border) in the GATS, there would be much to be gained in the GATS from integrating the provisions regarding national treatment and market access, preferably dispensing with the latter term. As a specified obligation, market access plays almost no part in the CER or NAFTA, and none at all in GATT. Within the GATS the provisions of the first para. of the market access article seem to overlap with those of national treatment and add nothing (except some confusion, an unnecessary incentive to list measures according to mode of delivery, and intrusion into domestic competition policy) to an interpretation of national treatment that embraced frontier as well as internal measures which discriminate against foreign suppliers of services.

e. National treatment as a general obligation

With a negative listing approach to coverage, national treatment (and market access, whether or not it is merged with national treatment as suggested above) can easily become a general obligation, with exceptions scheduled. This is the approach which has proved successful in NAFTA and the CER.

f. Sanctioned forms of discrimination against foreign services?

The question arises as to whether a restricted category of frontier measures could be allowed as legitimate (and subject to negotiation) discrimination against foreign supplies of services, with all other trade barriers proscribed — parallelling tariffs as the only generally sanctioned exception to the equal treatment of domestic and foreign products under the GATT. Tariff-like measures are one obvious form: the precedent of the Uruguay Round agreement for agriculture relating to tariffication could give some hope here, and there are many barriers to services where tariff-type levies could replace other forms of discrimination against foreign supplies of services (Deardorff 1994). However if this is too much to digest, there could be a small set of other permitted measures which could be generally sanctioned exceptions to equal treatment of domestic and foreign services (Snape 1994). Restricting the allowed forms of discrimination in this way would greatly facilitate negotiation and negotiated liberalisation of an incremental trade opening form (which has been so successful in the GATT), rather than the openness focus which appears to have dominated the stance of some demandeurs.

g. Separate treatment of investment, movement of persons, and competition policy

Compared with goods trade, the arms-length cross-border trade is a minor component of the total trade in services. Nevertheless, there do appear to be advantages in focussing a services agreement on this component of trade, and leaving to separate negotiations and agreements investment (in goods and services), movement of natural persons, and most aspects of competition policy. Many of the above recommendations would be more easily implemented if they were dealt with separately in agreements relating to cross-border services trade, investment (in goods and services) and movement of people. The classification of forms of barriers to services trade according to modes of delivery does not imply that all modes need be covered in the same agreement, as was pointed out around the time that the classification was introduced (eg Snape 1988). There could be more scope for cross sector negotiation and trade-offs if the focus in the GATS was solely on cross-border trade, while similar considerations would apply in a separate investment agreement (possibly plurilateral under WTO auspices rather than multilateral).

Frustration of market access by existing internal restrictions that apply to both domestic and foreign suppliers are best dealt with by competition policy on a broad front (eg relating to legislated monopolies, competitive neutrality, trade practices, and access to essential facilities) rather than in a services-specific agreement which is essentially concerned with foreign access only.[17] A model for this is NAFTA with its separate chapters on cross-border services trade, investment (in goods and services), competition policy and movement of persons. It is also the manner of the CER agreement, except that this agreement effectively does not cover investment.

b. Do some sectors need special provisions?

It would appear that the characteristics of some sectors do need special treatment: the prudential requirements in financial services and perhaps some aspects of telecommunications are prime examples, though much of the latter would seem to be associated with competition policy (monopolies and access to essential facilities) which have as much to do with domestic entry as they do with international trade. To the extent that such special treatment is required, including reasons associated with political muscle, the lessons of regional agreements and of the GATT appear to be that negotiations in these sectors should not be separated from negotiations for other sectors, and certainly should not be left to the representatives of the sectors themselves, including the bureaucracies responsible for them. Countervailing pressures and whole of government (or economy wide perspectives) need to be brought to bear. They seldom are when sectors are negotiated on their own.

17 New barriers to competition that are applied after barriers against foreign services are reduced can be dealt with under nullification and impairment provisions.

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Table 1: Key features of the GATT and GATS

Key features	*GATT*	*GATS*
Most-favoured-nation (MFN) treatment	Exists unconditionally for WTO members, without exceptions.	Exists for WTO members, subject to 'one-off' sectoral exemptions. MFN exempted by US in financial services, maritime transport, and basic telecommunications, pending negotiations.
National treatment	For internal measures: general obligation for all goods. Tariffs are a 'legitimised' frontier measure. Tariff bindings negotiated for goods using a 'positive list'. Non-tariff barriers generally proscribed as violating national treatment.	For internal and frontier measures covers only sectors scheduled by members, and subject to 'bound' commitments not to violate national treatment.
Market access	Term not used in GATT.	Covers only services sectors scheduled by members. Six specified categories of quantitative restrictions are prohibited as restricting market access for scheduled sectors.
Coverage	Addresses only trade in goods and says little on foreign investment.	Addresses trade, investment and movement of people for services through modes of delivery.
Provisions relating to developing countries	Concept of 'special and differential treatment'. Relief from meeting certain obligations.	No 'special and differential treatment'. Developing members may implement certain rules more flexibly.
Regional integration	Allowable exception to MFN arrangements. Must cover 'substantially all trade,' be phased in within a 'reasonable time' (10 years), and involve not increase external barriers to non-participants.	Allowable exception to MFN treatment. Must have 'substantial sectoral coverage', be non-discriminatory and not raise the overall level of third-country barriers within the respective sectors.
Commitments to liberalisation	Major commitments in GATT 1994 to liberalise goods trade; eliminate 'grey area' measures (eg voluntary export restraints); and control distortive agricultural policies. Standstill commitments. High level of tariff bindings. Preamble endorses progressive liberalisation.	No commitments to liberalise services trade. A limited standstill commitment not to introduce new measures violating national treatment or market access in 'bound' scheduled sectors. Successive negotiations, to be held within five years. Preamble endorses progressive liberalisation.
Emergency safeguard measures	Possible when increased imports have caused, or threatened to cause, serious domestic injury.	No measures currently exist. To be implemented within three years.
Dumping and countervailing action	Anti-dumping action permissible against 'dumped' imports if causing, or threatening to cause, material domestic injury. Countervailing duties can offset for certain bounties or subsidies.	No anti-dumping provisions. Negotiations on the appropriateness of countervailing procedures to be held.

Source: Distilled from the Industry Commission (1995).

Table 2: Comparing GATS with Services Provisions of Regional Trade Agreements

Characteristics	GATS	EU	NAFTA	APEC	CER
Sectoral Coverage	Most air services excluded. Negative list for MFN exceptions. Positive list of sectors covered by national treatment and market access by supply mode.	All services covered. Sector-specific directives and regulations.	Universal coverage, except for air services - subject to bilateral air agreements. Negative list of exemptions.	General (Bogor) commitment to free trade in services by 2020 at the latest. Implementation rules yet to be determined.	Negative list of exemptions.
Most-favoured-nation (MFN)	Exists for WTO members, but with sectoral exemptions (to be reviewed after 5 years and eliminated within 10 years).	Extends to all members with no exemptions.	Exists for NAFTA members.	Will extend to members and (probably) non-members.	Exists for members.
National Treatment	Covers only scheduled sectors subject to bound commitments.	Not specifically addressed; general non-discriminatory requirements.	General obligation, subject to listed exemptions.	Action Agenda aims to apply progressively to services and investment.	General obligation, exemptions listed. Exemptions allowed for prudential or consumer protection reasons.
Market Access	Covers all modes of supply for bound commitments; prohibits six types of quantitative restrictions within scheduled sectors.	Not specifically addressed; competition policy relevant.	Not specifically addressed; covered under national treatment and competition policy.	Action Agenda aims to apply progressively to services.	General obligation, exemptions listed. Suppliers can select form of commercial presence; competition policy relevant.

Table 2: Comparing GATS with Services Provisions of Regional Trade Agreements (continued)

Characteristics	GATS	EU	NAFTA	APEC	CER
Sectors subject to special provisions	Financial services, basic telecommunications, maritime transport, movement of natural persons and audiovisual.	Transportation services (air, road and rail).	Maritime transport, financial services, basic telecommunications, and movement of natural persons.	General (Bogor) commitment applies to all sectors. Separate negotiations to continue on trade facilitation and harmonisation, for energy, transportation, telecommunications and tourism.	Air transport, telecommunications and postal services.
Movement of Natural Persons	Included in schedule of specific commitments as a mode of supply; limited commitments. Provisions for mutual recognition of qualifications, etc.	Common labour market; directives on mutual recognition for certain professional qualifications.	Disciplines on temporary entry of business persons and provision of professional services.	Not covered by general (Bogor) commitment. Action Agenda aims facilitate improved mobility of business people engaging in trade and investment.	Common labour market; discussions on mutual recognition for certain professional qualifications.
Treatment of Investment	Commercial presence covered by specific sectoral commitments, as a mode of supply.	Free capital movement.	Separate investment disciplines, covering goods and services.	Covered by general (Bogor) commitment. Action Agenda aims to provide MFN and national treatment progressively; adopt APEC Non-binding Investment Principles.	Not included.

Table 2: Comparing GATS with Services Provisions of Regional Trade Agreements (continued)

Characteristics	GATS	EU	NAFTA	APEC	CER
Government Procurement of Services	Not included, to be addressed in future negotiations.	Disciplines adopted to ensure open public procurement.	Disciplines for a range of entities covered by a positive list.	Action Agenda aims to liberalise government procurement markets, including developing non-binding principles by 2000.	Disciplines for services covered by the Protocol.
Regulatory Standards	Regulatory measures must be non-discriminatory.	Disciplines adopted on mutual recognition of standards and common minimum quality standards.	Detailed information on regulatory impediments required in negative list of exemptions.	Efforts at trade facilitation, including standards, covered in general (Bogor) commitment. Action Agenda to achieve mutual recognition of conformity assessment.	Regulatory measures must be non-discriminatory.
Competition Policy	Limited provisions in the articles on monopolies and exclusive services and business practices. Market access provisions relevant.	Disciplines adopted on competition.	Disciplines adopted regarding competition policy, monopolies and state enterprises.	Not included in general (Bogor) commitment. Action Agenda aims to promote more effective and transparent competition policies.	Monopolies are not to subsidise services in competition with other suppliers.

Source: Regional agreements and the GATS.

Globalizing Free Trade

C. Fred Bergsten

THE ASCENT OF REGIONALISM

ECONOMIC SUCCESS in today's world requires countries to liberalize to attract mobile international investment, which goes far to determine the distribution of global production, jobs, profits, and technology. Success also requires countries to compete effectively in international markets rather than simply at home. A process of competitive liberalization, therefore, has driven the trend toward free trade among a myriad of countries in all parts of the world with very different economic systems, at very different stages of development, and with very different prior philosophies.

Interstate arrangements are usually necessary to implement such liberalization, however, because domestic political opposition frequently blocks countries from abolishing their traditional barriers unilaterally. Entrenched interests fight hard, and often with prolonged success, to maintain their protected positions. Trade reform thus requires mobilizing enough pro-trade interests, especially exporters and others who would gain directly from the opening of markets abroad, to overcome those who resist further market opening. The political economy of trade liberalization in individual countries rests heavily on parallel liberalization in partner countries.

The most assured technique for achieving such parallel action is to insist on reciprocity, through the negotiation of trade agreements with enough existing or potential markets to tip the internal balance

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in favor of the desired liberalization. In seeking reciprocal liberalization, countries could turn either to their respective geographical regions or to the world trading system as a whole. The global approach is superior because it maximizes the number of foreign markets involved and avoids the economic distortions (and political risks) of discrimination among trading partners.

As the urgency of competitive liberalization has accelerated, however, the regional approach has increasingly come to the fore. It is considerably less complicated to work out mutually agreeable arrangements with a few neighbors than with the full membership of the well over 100 countries in the World Trade Organization (WTO). Moreover, regional groupings are demonstrably willing to proceed more boldly: many of them have decided to adopt totally free trade, whereas none of the global conclaves to date has even considered such an ambitious goal.

Regional Free Trade Arrangements Share of World Trade, 1994

EU	22.8
EUROMED	2.3
NAFTA	7.9
MERCOSUR	0.3
FTAA	2.6*
AFTA	1.3
AUSTRALIA-NEW ZEALAND	0.1
APEC	23.7*
TOTAL	61.0

*Excluding subregionals

The desire to overcome traditional political rivalries has also driven several regional economic arrangements. The cardinal goal of the European Union (EU) was to end the historical hostility between France and Germany. Mercosur sought to end the arms race between Argentina and Brazil, including its nuclear dimension. A successful Asia-Pacific Economic Cooperation (APEC) forum would reduce the risk of intra-Asian and trans-Pacific conflicts, which have been so prevalent over the past century—including three wars for the United States.

As a result, about 60 percent of world trade now takes place within free trade agreements or among countries that have decided to achieve free trade by a certain date. The EU has completed its "single internal market" and in 1995 agreed with 12 Mediterranean countries (Euromed) to establish free trade by 2010. The 18 countries of APEC—including the United States, Japan, and China—have committed themselves to "free trade and investment in the region" by 2010 for the higher-income members that make up 85 percent of their trade and by 2020 for the rest. The 34 democracies of the western hemisphere will devise a Free Trade Area of the Americas (FTAA) by 2005, building on the existing North American Free Trade Agreement (NAFTA). A number of smaller arrangements, including the ASEAN Free Trade Area (AFTA) and Mercosur (Argentina, Brazil, Paraguay, Uruguay) in Latin America, augment these totals.

THREATS TO THE TRADING SYSTEM

REGIONAL AND global liberalization initiatives have been mutually reinforcing since the European Common Market was created in the late 1950s. The fears of some observers that regionalism would derail globalism have been overcome to date. But determined leadership has been required to avoid conflicts between the two, like those that have appeared in earlier historical periods with devastating security as well as economic impact. Avoidance of conflict has required the maintenance of effective global trade rules that both define the regional arrangements and govern relations between them, as well as an institution to enforce those rules.

Even so, there have been some close calls—especially when the global system faltered. The major new regional arrangements, particularly NAFTA and APEC, were spawned in part by missed deadlines of the Uruguay Round of GATT and were intended to serve as alternatives to the global regime if needed. An ultimate failure of the round, as nearly occurred, would have discredited the entire global system and raised the specter of competing blocs. By joining East Asia and North America, APEC has eliminated any possibility of the three-bloc world that was so widely feared a few years ago, but a two-bloc world that would convey substantial dangers could still be created instead if APEC and Europe fail to work out satisfactory accommodation.

Moreover, the EU frequently seems to focus so heavily on its regional agenda that it forgets its global responsibilities. The United States is often viewed as preoccupied with NAFTA or APEC—or as turning protectionist more generally, a fear heightened by the early successes of Pat Buchanan in this year's Republican primaries. A subtle threat to the global trading system is posed by the recently suggested Transatlantic Free Trade Area (TAFTA) idea for North America and Europe, which implies that free trade is acceptable as long as it takes place among countries at roughly equal (that is, high) income levels and would have the rich (and white) countries combine to erect new discrimination against the poor (and a few rich Asians).

The "bicycle theory" teaches that failure to move forward toward free trade causes a fall.

The Asian giants, Japan and China, also pose major threats to the continued openness of the trading system. The political economy of liberalization can win domestic support, even in a country as large as the United States, only when its major foreign markets (especially if they are also its toughest competitors) are seen as contributing their fair share to the process. Japan has grudgingly participated in all the GATT rounds, but access to its markets remains extremely truncated.[1] China has not yet committed even to the minimum reforms necessary to join the WTO.

The history of trade policy teaches forcefully that failure to move steadily forward toward liberalization condemns the trading system to tip over or fall backward in the face of protectionist pressures—the "bicycle theory." For example, protectionism scored major successes during the prolonged periods when the GATT went into hibernation in the late 1960s immediately after the successful conclusion of the Kennedy Round and in the early 1980s after the Tokyo Round. Renewed financial crises à la Mexico could, as in the past, produce a wholesale adoption of new import controls.

One of the great advantages of the contemporary regional initiatives is that they have kept the bicycle moving after the conclusion of the Uruguay Round. The round itself helped as well by scheduling future negotiations in a number of sectors, some of which are already under way. But there are strong pressures throughout the world that would seize on any stalling of the forward momentum and try to reverse the trend toward liberalization. Buchanan's success was partly due to the inadequacy of such momentum in 1996.

[1] Yoko Sazanami, Shujiro Urata, and Hiroki Kawai in *Measuring the Costs of Protection in Japan*, Washington: Institute for International Economics, 1995, conclude that the consumer costs of these barriers total at least three to four percent of Japan's GDP and block at least $50 billion in imports annually.

GAINS FROM GLOBAL LIBERALIZATION

IN ADDITION, there are enormous opportunities for further economic gain in eliminating remaining tariff and nontariff border barriers. The Uruguay Round teed up these remnants of traditional protection for decisive action by converting all agricultural quotas into tariffs, phasing out quota protection for textiles and apparel, and binding most tariffs of developing countries. One last big push could condemn these practices to the dustbin of history.[2]

Even more important, new negotiations are needed to enable the global system to catch up with some of the "new problems" that are plaguing international trade relations. Protectionists in all countries are ingenious at staying one step ahead of the judge, and the system needs continuous updating to keep these forces at bay. The goal should be to make all markets contestable with policies on investment, antitrust, and overall regulation as well as trade that open economies fully to global competition.[3]

For example, most complaints about Japan no longer relate to that country's border barriers. They focus instead on the anticompetitive behavior of its firms, with their exclusive supplier or distributor arrangements (vertical *keiretsu* as in auto parts and film, respectively) and domination of particular markets (cartels, as in glass). The United States has been using trade measures, such as Section 301 of the U.S. trade law, to address non-trade problems. There is an urgent need to work out new international agreements on competition policy and corporate behavior.

Investment is a second area in which the international rules have lagged far behind commercial practice. Investment is now an essential element of international trade, especially in services but in traditional manufacturing as well. A few modest covenants on trade-related investment measures and services-related investment were agreed upon in the Uruguay Round. But the major efforts have come in regional groupings, including NAFTA and APEC, and the current discussions

[2]This case is made persuasively by John Whalley in *The Trading System after the Uruguay Round*, Washington: Institute for International Economics, 1996.

[3]This key concept is elaborated in Geza Feketekuty, "The Scope, Implication, and Economic Rationale of a Competition-Oriented Approach to Future Multilateral Trade Negotiations," forthcoming.

among the Organization for Economic Cooperation and Development nations of a Multilateral Agreement on Investment exclude the countries that are growing fastest and maintain the most impediments.

Another pending issue is regionalism itself. The GATT article that governs regional arrangements is extremely weak, and its implementation has been even weaker: the GATT has been notified of more than 100 "free trade agreements" but none have been rejected and only two have been approved. Now that regionalism is so prevalent, the WTO needs to adopt much stronger provisions and procedures to make sure that regional arrangements evolve in an open manner.

A number of other topics must be addressed as well. The numerous linkages between environmental measures and trade need to be sorted out in ways that both protect the environment and avoid providing new excuses for protecting against trade. The relationships between trade and labor standards, and between trade and corruption, need to be seriously discussed.

It would be possible to address all these issues in a series of separate regional negotiations. Indeed, some of the regional agreements have innovated successfully in addressing new topics in the past. The Canada-United States Free Trade Agreement provided a model for some of the services talks in the Uruguay Round, Australia and New Zealand successfully meshed their competition policies in a manner that also enabled then to eliminate antidumping duties, and NAFTA has pioneered investment rules. But there would be a serious risk of inconsistency if such issues were addressed differently in the regional forums. It would be much more efficient to derive worldwide approaches that could be applied by all. The case for globalism is again compelling.

THE GRAND BARGAIN

THE MEMBERS of the WTO should therefore agree to consolidate their regional arrangements into a global commitment to achieve worldwide free trade by a certain date. The date could be 2010, on the APEC and Euromed models, with a possible extension to 2015 or 2020 for the poorest countries.

Such a commitment would rest on a "grand bargain" between two groups of countries: the high-income mature economies of North

America and Western Europe and the rapidly growing, lower-income countries that make up most of the rest of the world (with Japan somewhere in between). The lower-income fast growers (and Japan) owe much of their spectacular success to the openness of the world economy that enabled them to pursue outward-oriented development strategies. Hence they need insurance against any reversion to protection by the old rich, including procedural safeguards against subtle methods of undoing prior market opening. In the regional agreements already adopted, they have demonstrated a willingness to pay the premiums necessary to buy such insurance.

There is a second component of the "insurance motive" in a number of developing countries: insurance that their domestic successors will not reverse the liberalization of their own economies. Such reforms can be locked in by making a country's liberalization binding in international agreements, regional or global. Such bindings apply only to trade and investment policies and directly related domestic measures. But it would be difficult to undo most domestic reforms if it were impossible to raise new external barriers to support a renewed flirtation with dirigisme.

The Asian and Latin American countries have been predominantly concerned about a possible reversion to protection in the United States, by far their largest market, and hence have emphasized trade deals with that country. They are also concerned about Europe, however, so are pursuing that dimension as well, Mercosur through negotiating a trade agreement with the EU, East Asia through its new summits with the Europeans. Neither of these arrangements is likely to produce much substance, however, and they would in any case raise all the problems of duplication and inconsistency cited above. East Asia and Latin America, which are likely to be the two fastest-growing parts of the world economy over the coming decades, would thus benefit greatly from extending to Europe the free trade commitments they have already elicited from the United States. This can be done only through a global effort in the WTO.

The second part of the grand bargain would provide the higher-income countries with full access to the markets of the lower-income but rapidly growing countries around the world (and Japan). Most of this latter group, despite the impressive liberalization of many over the past decade or so, retains substantial trade barriers.

This part of the bargain would be attractive to the rich countries because they too are heavily dependent on export expansion. Such dependence is nothing new for Europe but has also now evolved in a major way for the United States—where the share of trade in the economy has risen by two-and-a-half times over the past generation. As exemplified by the "Big Emerging Markets" strategy of the Clinton administration, this rich country interest focuses primarily on countries with large and rapidly growing markets that still maintain substantial access barriers. Hence the United States and Europe would also benefit greatly from the proposed grand bargain.

> The fast growers need insurance that the old rich will not regress.

There is nothing conceptually new in this proposal that the old rich pledge to avoid new barriers while the rapid growers commit to eliminate theirs. Such asymmetric liberalization lies at the heart of NAFTA, the FTAA, APEC, and the more recent extensions of the EU. In these regional versions of the grand bargain, the poorer countries have bought assured continued access to the markets of the rich states by agreeing to catch up over time with those countries' prior liberalization. The asymmetry is equitable because the willingness of the rich countries to facilitate the outward-oriented growth strategies of the poor was instrumental in enabling the latter to start catching up in terms of living standards.

The novel element here is shifting the context to the global plane via the WTO. This move would consolidate and link the existing regional agreements. It would bring the former Soviet Union, South Asia, Africa, and the few other uncovered parts of the world into the deal. It would keep the bicycle moving forward for some time.

THE PATH TO THE GRAND BARGAIN

THE UNITED States attempted to move in the proposed direction with its "Open Markets 2000" proposal at the Group of Seven summit in Naples in July 1994 but was turned down by the EU. Several EU members reportedly blocked recent proposals by the European Commission that the union negotiate modest trade agreements in Latin America. Given the EU's overarching focus on its own regional concerns, centering on the expansion of its membership to the east and the deepening of its integration, including monetary union, it is doubtful that Europe will be prepared for a leadership role in the global system at any early date.

Nor can the United States forge the next global trade initiative by itself. Its latest effort was rebuffed, as just noted, but so was its similar push to renew global momentum after the Tokyo Round as long ago as 1982. The security leverage that permitted previous American leadership in this area (as so many others) has disappeared with the end of the Cold War. American domestic politics can be brought to support a new global round despite the criticisms of the WTO and trade liberalization more generally, but probably not to provide solo leadership for it.

The alternative is APEC, which includes the world's three largest economies (the United States, Japan, and China) and accounts for half of world output. From its inception in 1989, APEC has proceeded under the mantle of "open regionalism"—a term deliberately chosen to contrast it with the inward-looking regionalism that was feared in both Europe and North America. Every pronouncement by APEC leaders, including the 1994 Bogor Declaration that committed its membership to "free and open trade and investment in the region," has emphasized the group's commitment to further global liberalization and its antipathy toward becoming an exclusionary bloc.

APEC has not defined "open regionalism." Its members have, however, committed themselves to continue reducing their barriers to nonmember countries as they move toward free trade in the region. Some of them might extend their APEC liberalization to nonmembers unconditionally, which they are perfectly free to do, as APEC has no intention of becoming a customs union with a common external trade policy.

Most likely, however, APEC will offer to generalize its regional liberalization to the rest of the world on a reciprocal basis. Since APEC accounts for about half the world economy, global liberalization and hence world economic benefits will double because nonmembers cannot afford to reject the offer. Furthermore, the political economy of trade policy requires the mobilization of domestic export interests by offering them sufficiently enhanced access to foreign markets to induce them to undertake the effort necessary to win national support for liberalization.

APEC thus has the capability and the inclination to initiate the next major episode of global trade liberalization. It has already made a commitment to achieve free trade in its region and is hard at work converting that vision into practical reality. It is in a strong position to assume leadership of the global trading system.[4]

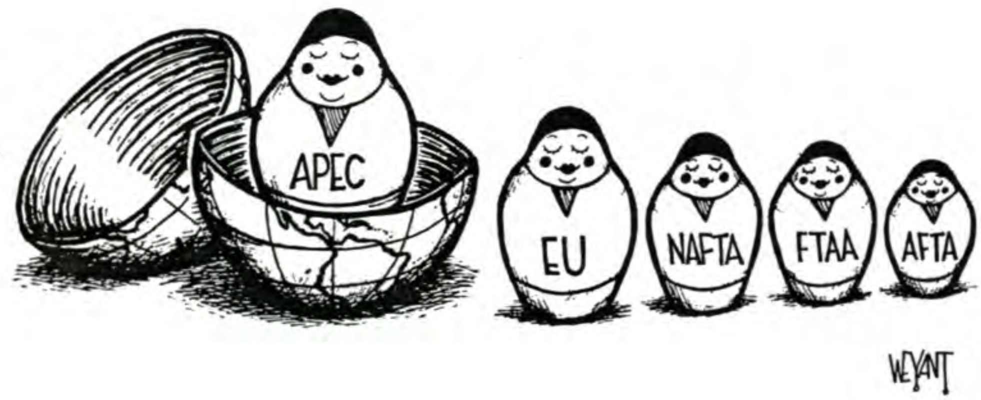
STARTING THE PROCESS

THE WORLD Trade Organization's first ministerial meeting, scheduled for December 1996 in Singapore, would be the natural occasion to begin the process of achieving global free trade in the early part of the 21st century. It would clearly be premature, however, to seek a global free trade pledge at that time. The United States will have just concluded a presidential campaign in which the incumbent, who took a courageous lead in signing and ratifying free trade pacts during his first two years in office, became reluctant to discuss the issue, and his opponents have been equally hesitant if not explicitly hostile. The EU will be preoccupied well into 1997 by the Intergovernmental Conference on the future of its integration process. APEC will probably not yet be far enough along in implementing its own plans to provide the needed inducement for others to join it. Several of the largest trading nations (including China, Russia, and Taiwan) remain outside the WTO.

In determining a role for the Singapore ministerial, however, it is important to set long-term systemic goals and then work backward. An agreement to achieve global free trade by 2010 could plausibly be reached at the succeeding WTO meeting in 1998. To do so, planning needs to proceed on a number of fronts.

First, the biennial WTO meeting in 1998 should be converted into the first global trade summit. The GATT never held a summit meeting. Yet summits have been a regular feature of the European integration process, the rapid evolution of APEC since 1993, the launch of the FTAA, and key subregional trade arrangements including AFTA and Mercosur. The WTO should bring together its heads of government at the last

[4] APEC of course has undertaken several initiatives in addition to trade liberalization, in the areas of trade facilitation, finance, and development cooperation. It will remain an extremely important institution even if its regional trade plans are globalized.



high-level meeting of the world trade body in the twentieth century to set a vision for the global trading system in the 21st.

Second, the Singapore ministerial should appoint a wise persons group to make recommendations for the future of the trading system. A similar group, chaired by Fritz Leutwiler of Switzerland and including U.S. Senator Bill Bradley (D-N.J.), was created by the GATT in late 1983. Its report in early 1985 made an important contribution to the decision to begin the Uruguay Round in 1986. AFTA was proposed by a group of private advisers from the Association of Southeast Asian Nations. The APEC vision was initially proposed by that organization's Eminent Persons Group. It is essential to move outside official circles to produce bold ideas for major initiatives.

Third, Singapore should initiate a work program to tee up the issues that would form the substantive core of the global free trade negotiations. Fortunately, there is already widespread agreement on most points of that agenda. The Uruguay Round itself laid out an ambitious schedule of further negotiations, including telecommunications and maritime services in 1996, financial services (again) in 1997, government procurement in 1999, and agriculture and services in 2000. Consultations among the WTO members have identified an additional set of priority topics along the lines of those outlined above: competition policy, investment, trade-environment linkages, perhaps labor standards and their relationship to trade, and several others.

Another important preparatory step is to complete the membership of the WTO. Singapore should accelerate the effort to bring China, Russia, and the other large nonmembers into the institution in time to participate fully in the proposed negotiations. These countries must of course comply with the organization's requirements to get in, but no move to global free trade can be complete without them.

Finally, the WTO needs to continue establishing its own credibility throughout the world. This effort will require effective implementation of its dispute settlement mechanism, more transparency in its operations so all interested parties can see how they work in practice, and efficient management of the overall organization. Trust in the institution is a prerequisite for giving it the additional responsibilities suggested here, as well as for allaying fears that it violates the sovereignty of member countries.

> The logic of global trade rounds has always prevailed in the past.

Beyond these preparatory steps, a number of key questions remain to be answered before a global free trade pledge can be adopted. For example, how should free trade be defined? It should clearly apply to all tariffs, quotas, and other border barriers—which would require substantial liberalization in many developing countries but not much in most of the industrial world. It should also extend to selected measures behind the border because of the central role they play in blocking contestability of markets, and hence in current and foreseeable trade conflicts with some countries (such as Japan).

Another key issue is the definition of reciprocity or comparability. All agree in principle that any negotiation of this matter must elicit fair contributions from all parties. But it is extremely difficult, in purely intellectual terms even before turning to the politics, to equate concessions across issues as disparate as tariffs and national competition policies. The concept of reciprocity was never very precise and became even more difficult when the GATT turned to negotiating nontariff barriers. Nevertheless, the political economy of trade requires each country to demonstrate that its own concessions were matched by those of its partners, and it is highly desirable to buttress the case with orders of magnitude if not precise estimates.

Another question is whether the goal of global free trade should be achieved via another comprehensive trading round with a single deadline or via continuous negotiations over time on individual issues. At the end of each previous round, including Uruguay, virtually all participants have dismissed the idea of launching such an all-encompassing effort ever again. "Trade fatigue" is fully understandable in those who have had to labor to bring such an effort to conclusion, especially since the latest round took seven years. Moreover, individual negotiations are now occurring in the WTO on a wide range of topics, including financial services and telecommunications, and there is some reason to be encouraged by the results to date.

On the other hand, the logic of rounds has always prevailed in the past. Comprehensive coverage has proved necessary to offer the maximum scope for liberalization across sectors and issues, thereby inducing the greatest number of countries to agree to the largest possible liberalization. Sectoral or issue-specific efforts, by contrast, require intra-issue tradeoffs that tend to minimize the headway that can be made. The current process of issue-specific negotiations should be monitored closely to see if it looks promising as a long-term proposition, at least with respect to rule-making, but the rejection of the financial services package by the United States last year constitutes a warning that broader inducements may be needed with respect to liberalization. The tried-and-true alternative of a round should be kept foremost in mind, especially to achieve global free trade by 2010, which would be the most ambitious multilateral trade initiative ever attempted.

WILL IT FLY?

THE FINAL QUESTION is the most crucial. Is such a proposal politically feasible in the key countries? The doubts and fears outlined above suggest that a herculean effort will be needed to pull it off.

The pivotal actor, as in all past global trade initiatives, will probably be the United States. The Europeans, for all their apparent insularity, have removed all barriers to each other and logically point out that it would be inconsistent for them to impose new restraints on nonmembers. Japan cannot afford to block progress sought by others, as it indicated when it agreed to liberalize rice imports—its politically most sensitive sector by far—at the end of the Uruguay Round. Most developing countries are even more dependent on trade and have been actively engaged for some time in the process of competitive liberalization.

Perhaps surprisingly, there are two reasons why the case for global free trade by 2010 should be eminently salable in the United States. First, increased trade can be a big help in enabling America to solve its most pressing economic and social problem—widespread stagnation of wages, incomes, and standards of living. Export jobs pay 15 percent more than the average wage. Worker productivity at exporting firms is 20 to 40 percent higher. These firms expand employment 20 percent faster than nonexporting firms and are 10 percent less likely to fail. Small and medium-sized exporters do even better than large ones and account for 70 percent of all sales abroad.[5]

Hence a shift to export jobs from import-competing jobs, which would be the net result if trade liberalization had no impact on the American trade balance, would help considerably even though the latter also pay more than the national average. Better yet would be a shift to export jobs from the nontradable (mainly services) sector, in which most of the jobs pay less than most tradables (mainly manufacturing), which would occur if liberalization helped the United States reduce its trade deficit. This reduction is quite feasible without raising major international problems because the United States continues to run annual trade deficits of about $175 billion. An improvement of even $100 billion in America's net external position, lowering the deficit to about one percent of GDP, would create one to two million more of these high-paying export jobs than would be lost to growing imports. Total elimination of the external deficit would have twice as favorable an impact. Such improvement in the country's net external position should thus be a cardinal policy goal of the next administration, primarily because it would be a major boost in dealing with the country's chief domestic problem.

To be sure, substantial adjustments in the United States' internal economy will be required to achieve such a shift. Net national saving must rise by one to two percent of GDP to obviate the need for the net capital inflows that are the counterpart of the current account deficits, but savings will rise by that amount if the budget deficit is eliminated by 2002 or so, even if private savings fail to rebound from their cur-

[5]These and other data are derived in J. David Richardson and Karin Rindal, *Why Exports Matter: More!*, Washington: Institute for International Economics, 1996.

rent historic lows.[6] Individuals will need better education, training, and retraining to compete effectively in the world economy, but they will need those investments to raise their incomes regardless of what happens on the trade front.

These internal efforts would be greatly reinforced if American exports could win full access to foreign markets. Exports have done well in recent years. They have more than doubled as a share of total U.S. output since 1960. They would make an important contribution to solving America's fundamental economic and social problems if they double again by 2010.

Export jobs pay 15 percent more than the average wage.

The second reason global free trade should be salable in the United States is that it would mean a sharp reduction in barriers in most other countries compared with very little liberalization in the United States, where markets are already largely free.[7] But the United States would not receive a totally free ride in such negotiations. Other countries, in both the industrial and developing worlds, would insist that the United States subject its import safeguard measures (such as antidumping duties) and its export promotion tools (such as Section 301) to more stringent multilateral discipline. This is a modest price for the United States to pay, however, and the reduction of actual barriers remains almost wholly asymmetrical.

From the American standpoint, such an initiative is the only way to achieve a truly level playing field across the world economy. Indeed, a push for global free trade is the only way for the United States to achieve fair trade. At a stroke, it would greatly increase and roll into a single package the benefits that otherwise would be provided for the American economy by NAFTA, APEC, and the FTAA.

To be sure, a major political debate will be needed in the United States if such an initiative is to be endorsed. That debate will have to

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[6]These net capital inflows, though essential to fund domestic investment, are a direct cause of the trade deficit because they push up the exchange rate of the dollar and thereby reduce American competitiveness in world markets (including its own).

[7]America's remaining barriers carry a net economic cost of only about $10 billion in an economy of $7 trillion. See Gary C. Hufbauer and Kimberly Ann Elliott, *Measuring the Costs of Protection in the United States*, Washington: Institute for International Economics, January 1994.

come anyway, if not in this year's campaign then in 1997 or 1998 as the administration of the day seeks congressional approval to proceed with the liberalizations already agreed upon in APEC and the FTAA. Globalizing free trade would add only modestly to the needed authority, primarily by adding Europe, with which trade is already largely free.

But the idea of free trade with China and Japan, or even Brazil and Indonesia, will make the NAFTA debate of 1993 pale by comparison. The United States historically has been far more successful with large initiatives than small ones, however, certainly in trade. Sweeping visions, such as the Kennedy Round and its successors, engage the president and Congress in a major national venture. The business community and other supportive constituencies make the investments needed to carry the day. Once launched, the initiatives command sufficient momentum to overcome rearguard efforts to derail or even erode them.

Global free trade by 2010 would enhance the prosperity of all countries by underwriting the ultimate success for competitive liberalization. It would preclude the risk that regional arrangements could develop into hostile blocs. It would terminate any risk of North-South conflict by engaging both sets of countries in a cooperative multilateral enterprise that meets the needs of both. Such a vision should guide this area of international affairs as the world enters the 21st century.