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BEYOND MARKET ACCESS

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Economists have repeatedly warned against them, nongovernmental organizations (NGOs) have fought them, and some governments have signed them begrudgingly (at least in appearance). Yet in the past 20 years, preferential trade agreements (PTAs) have multiplied unremittingly. What is even more striking is that their scope has broadened at the same time as their numbers have grown. Deep integration provisions in PTAs have become ubiquitous.

This first chapter looks at the background of the drive toward deep integration PTAs and at how they differ, in content and implications, from traditional market access agreements. It then discusses the theoretical and practical motivations behind today's deep PTAs. Finally, it highlights key areas for policy makers to consider as they contemplate their future PTA strategies.

A Preference for Deep Integration

Gaining market access or preserving a level playing field has remained an important motivation for entering into PTAs. But with the liberalization of trade around the world and the related diminishing size of preferential rents, the growing success of PTAs cannot be explained by traditional market access motives alone (even factoring for the possible substitution of tariffs for less transparent forms of protection). Countries are also interested in a host of other objectives—importing higher policy standards, strengthening regional policy coordination, locking in domestic reforms, and even addressing foreign policy issues (see Schiff and Winters 2004; Hoekman, ch. 4 in this volume).

All this translates into a beyond-market-access vision for PTAs that includes a broad set of rules and disciplines governing areas such as investment regimes, technical and sanitary standards, trade facilitation, competition policy, government procurement, intellectual property, environment protection, migration, labor rights, human rights, and other "behind the border" issues.

This vision is expressed in two ways in recent PTAs. The first is the pursuit of what can be termed a "WTO+" agenda, focusing on disciplines already espoused by the World Trade Organization (WTO) but often expanding their depth and breadth and seeking enforceability. The second is through rules and disciplines that are not covered by the WTO, or are covered very imperfectly (WTO extra). In practice, PTAs often pursue both objectives, to varying degrees. North American PTAs, for instance, focus more on WTO+ disciplines, while adding a few WTO extras to the mix. By contrast, European PTAs include numerous WTO-extra aspects. Horn, Mavroidis, and Sapir (2010) identify no fewer than 38 areas in U.S. and European Union (EU) PTAs that aim to go beyond WTO disciplines.

The proliferation and deepening of PTAs may offer developing countries vast opportunities to modernize and upgrade their rules and disciplines with a view to greater economic efficiency. At the same time, these trends pose a serious challenge for policy makers, especially in low-income countries, because of the added burden of covering an increasingly large and complex set of issues with limited administrative resources for negotiation and implementation, and frequently with no preexisting experience.[1]

Indeed, PTAs are increasingly addressing policy areas that are entirely new to developing countries. These broader agreements may deeply affect countries' development processes. To take an often-cited example, it is possible that the inclusion in PTAs of the most advanced forms of intellectual property rights (IPR) protection may require an alternative economic development model whereby knowledge and know-how are no longer acquired through imitation and reverse engineering (as happened with the generic pharmaceutical industries in middle-income countries), but through a less optimal, more demanding, and yet-unproved process of accumulation of capital and knowledge.

The deep integration commitments in new PTAs, with their concomitant challenges, stand in sharp contrast to

older trade agreements, which chiefly had to do with dismantling barriers to trade and making trade policy simpler to administer. Although multilateral trade agreements under the WTO have pursued a similar path toward greater complexity—for instance, with the 1994 agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement—nowhere is the policy ambition as sweeping as in PTAs, under which regulatory disciplines are spreading to nontrade areas.

Before looking at the issues in detail, it is useful to try to capture the essence of the difference in the nature of the liberalization challenge posed by the new disciplines in PTAs. The trade literature usually characterizes this process in terms of positive versus negative integration and of behind-the-border versus at-the-border integration.

Positive versus Negative Integration

The first Nobel laureate in economics, Jan Tinbergen, articulated the notions of positive and negative integration in characterizing the process of international economic integration (Tinbergen 1954). Negative integration refers to the removal of trade barriers and the principle of nondiscrimination. This is the traditional remit of trade negotiations.[2] Tinbergen defines positive integration as

> [the] creation of new institutions and their instruments or the modification of existing instruments. . . . More generally, positive integration should consist of the creation of all institutions required by the welfare optimum which have to be handled in a centralized way. (Tinbergen 1954, 79)

Analysts have often retained the first part of the definition—that integration is not just about removal of barriers to trade flows but about "rule making" to facilitate these flows. Interestingly, though, Tinbergen offers in the second part of the definition a vision that suggests that the creation of intergovernmental public goods could also be welfare enhancing. This is an important aspect, to which we will return.

Various interpretations of the Tinbergen characterization have survived in the literature (e.g., Pelkmans 1984; Hoekman and Kostecki 2009; Ortino 2004, 18–34; Torrent 2007). We take from Tinbergen's definition the basic intuition that positive integration calls for public intervention to tackle market failures that would otherwise prevent economically optimal levels of integration.

Positive and negative integration have substantively different implications for the process of integration. Negative integration would mainly seek the prohibition of a narrow set of policies, as well as joint surveillance and, eventually, mechanisms for redress, whereas positive integration requires taking active steps toward integration by defining common policies and setting up the legal and administrative framework to implement them. The difference is, however, not as clear-cut as it appears at first (see, e.g., Ortino 2004; Torrent 2007). In both cases, a certain degree of legal alignment is required, as is the establishment of minimal common institutions. For instance, agreeing on new rules that limit the way governments can intervene in markets could be seen as an instance of either positive or negative integration.[3]

Nevertheless the distinction remains useful for thinking broadly about important characteristics of deep integration, because new dimensions of PTAs clearly imply greater retooling of legal frameworks at the domestic level. Positive integration can be conducted in various ways, depending on how it is legally instrumentalized. Torrent (2007) notes, for instance, the substantive differences between U.S. and EU agreements regarding procurement provisions. The U.S. approach is more normative in that it inserts the rules in the agreement, whereas the EU adopts a more progressive approach by defining the rules through specialized organizations such as expert committees. Relative to negative integration, positive integration entails substantial differences in the drafting of language in agreements (the instruments of implementation being more complex) and therefore in negotiations and, probably, in the predictability of implementation. For instance, when tackling trade facilitation issues, it is not sufficient to agree on items that should be prohibited (e.g., the use of consular fees) or on simple positive obligations such as transparency; countries must also agree on standards for procedures, such as use of risk management screening at borders, and must monitor agency conduct. These obligations are not easily incorporated into normative commitments in trade agreements—Messerlin and Zarrouk (2000), for example, take the view that they should not be. Beyond adopting new policies designed to open markets, positive integration also seeks coordination of policies with trading partners, which may imply some form of institutional arrangements.

Behind-the-Border versus At-the-Border Policies

Another important dimension is characterized in the literature as behind-the-border versus at-the-border measures. National treatment and uniformization of obligations indeed differ in substance from most favored nation (MFN) obligations in that they require countries to change policies that affect internal transactions that are not necessarily related to trade.

The question of the impact of domestic regulations on trade is not new and is well recognized in the WTO. Domestic policies have the potential to be designed so as to discriminate against foreign producers. Article III of the General Agreement on Tariffs and Trade (GATT) accordingly requires that internal regulations comply with the national treatment principle, which states that other nationals should be treated the same as one's own. Beyond addressing discrimination per se through the national treatment principle, there is also a desire on the part of policy makers to reduce the costs of having to comply with multiple and heterogeneous requirements. As the world economy becomes more integrated and supply chains incorporate sourcing from many countries, the calls for some uniformization are growing. This is an area in which PTAs play an increasing role.

Behind-the-border policies directly affect domestic transactions and thus have obvious direct welfare implications that differ from the indirect effect through prices and volumes of trade goods. Their effect also implies a different political-economy equilibrium. Moreover, as we will see later, the notion of behind-the-border measures could be expanded to measures that are included in trade agreements not because of their direct or indirect effects on trade, but merely because trade agreements provide a convenient vehicle for international negotiation or enforcement.

In sum, deep integration measures may impinge on domestic policies that are not necessarily directly trade related. They require more advanced reform of the legal environment and, generally, a more complex set of instruments for implementation. They also may involve active supranational coordination. It is not hard to imagine how demanding and complex liberalization of these measures might be.

Motivations for Deep Integration

The reality of the new PTA landscape raises questions about the motives for entering into regional agreements. Why would policy makers around the world invest time, political capital, and resources in negotiating trade arrangements that discriminate among trading partners and offer uncertain welfare benefits, when a multilateral approach of nondiscriminatory market access provides a superior solution? The answer can only be that policy makers are looking for benefits that extend beyond market access for goods and services.

Krugman (1993) assumed that one reason for the success of PTAs was the convenience of dealing with the variety, complexity, and opacity of modern trade barriers in a bilateral or regional setting rather than at the multilateral GATT or WTO level. Implied by his analysis was a sense that the removal of traditional trade barriers was not necessarily solving the issue of market access. Schiff and Winters (2004) subsequently reviewed alternative rationales for PTAs. These rationales, either nonstandard or not well represented by traditional theoretical models, include domestic policy anchoring, importation of good regulatory practices, supranational coordination to achieve regional policy goals, export of regulatory standards by hegemons, and foreign policy considerations. These economic, societal, and political-economy motives for concluding a PTA are discussed in detail next.

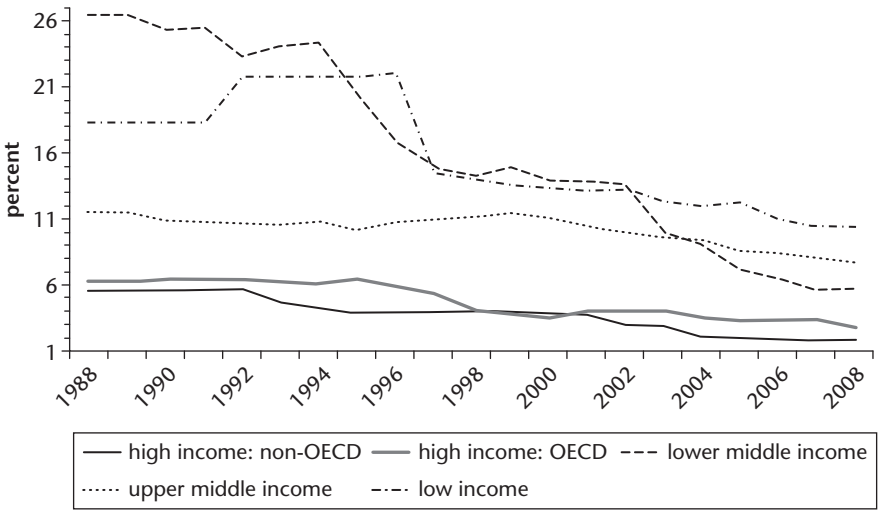
Economic Motives

Market access mercantilism is the traditional force behind the push for trade liberalization. Led by the false logic that import barriers should be lowered only if reciprocal access for exports is granted, countries mutually agree to liberalize their markets, and in most cases, the result is welfare-enhancing liberalization. In a globalized world, countries seek to gain competitive advantage over their neighbors by negotiating special (preferential) market access with key destination markets.

Several facts challenge this traditional explanation. Preferences, to start with, may not be as important as in the past. Tariffs have been falling worldwide (figure 1.1), and in a very general sense, even the most protected markets now tend to exhibit tariff levels that are moderate compared with those of 15 years ago. There are obviously many exceptions at the product level. Developed economies and middle-income countries exhibit, on average, lower levels of protection than low-income countries.

Moreover, as PTAs grow in number, so does the number of recipients of preferences, leading to the erosion of the preference margins held over competitors. Carrère, de Melo, and Tumurchudur (2010) construct an adjusted market access measure of what countries receiving EU preferences actually enjoy when the preferences given to other partners are taken into account. When this measure is compared with the unadjusted measure of preference over the MFN tariff, it turns out that real market access is often much lower—for example, less than half for Cambodia, a recipient of the EU's Everything But Arms (EBA) preferences. In some instances, as in the case of a generalized system of preferences (GSP) recipient, such as Indonesia, there is no effective market access preference at all. As noted by Levy (2009), the reciprocal incentive apparently fails to explain the rationale behind asymmetric North-South types of agreement. Many developing countries

Figure 1.1. Most Favored Nation (MFN) Tariff Rates, Weighted Mean, All Products



Source: World Bank, World Development Indicators database, http://data.worldbank.org/data-catalog/world-development-indicators.
Note: OECD = Organisation for Economic Co-operation and Development.

already benefit from very good market access in their northern partner countries.

To sum up: there is a tendency toward diminishing MFN tariffs; preference margins are actually smaller than they appear; and some developing countries already enjoy virtually tariff-free access to major markets under the GSP, EBA, and other preferential regimes. Under those circumstances, can market access incentives alone explain reciprocal liberalization in the PTA context?

Market access may persist as a motive in North-North and South-South agreements. In the global South, in particular, tariffs remain fairly substantial. Other incentives may also be in play. Countries at the periphery of a network of agreements (for instance, the partners of the EU and the United States) may suffer because industries shift toward the hub of the network and away from peripheral countries (the spokes) and because of erosion of the outlying countries' preferential access, since location in the hub provides preferential access to many more markets. This reality is what has led countries such as Chile, Mexico, and Singapore to pursue "spoke-spoke" strategies by mirroring their large trading partners' PTA policies and pursuing agreements with the same partners, even though their trade with such distant partners might be small. The strategy of the European Free Trade Association (EFTA) in parallel to the EU, and the accession of new countries to the EU, might be seen as being driven by a similar motive (see Baldwin 1994). Bhagwati (2008) also argues that even modest margins of preference have a sizable impact in a globalized world in which overall transaction costs are decreasing and sources of comparative advantage can be found in small cost differences ("thin" margins of comparative advantage). Even preferences that are small on paper may become attractive for prospective partners.

Market access conditions are not determined only by tariffs. First, customs procedures and other domestic policies, such as standards, may affect foreign exporters' costs of access to the market. As noted by Bagwell and Staiger (2001), when governments choose these policies unilaterally, there is a possibility that market access might be set at a lower and less optimal level than under reciprocal liberalization negotiations.

Second, the market access question is not limited to goods. Foreign investment is another way of gaining access to foreign markets, and the inclusion in agreements of disciplines relating to investment can be an additional motive for reciprocal liberalization commitments.[4] Many PTAs now include investment disciplines that go beyond those of the WTO. WTO rules are limited to the supply of services following an investment (commercial presence), as specified in the General Agreement on Trade in Services (GATS), and to the trade-related investment measures (i.e., the Trade Related Investment Measures [TRIMS] agreement). Moreover, GATS relies on an "enterprise-based" definition of investment, whereas bilateral rules generally refer to a broader "asset-based" definition that covers portfolio investment and different forms of tangible and intangible property (Miroudot, ch. 14 in this volume).

Third, because traditional PTA analysis focuses on trade in goods, trade in services is often omitted from the

discussion. Yet the services sector represents the largest, and a growing, share of gross domestic product (GDP) in many developed and developing countries; many services (e.g., electricity, telecommunications, transport, and professional services) are key inputs into the production of goods and other services; and the information technology (IT) revolution has increased the tradability of services. In these circumstances, services liberalization may offer considerable gains, both from increased trade flows and from reduced input costs for firms.[5] For some country groupings, such as South-South agreements, preferential integration in goods may bring little benefit; small countries with similar production structures and with small and inefficient manufacturing sectors might not have much to gain from engaging in goods-only PTAs. A promising next step might be to explore other integration dimensions in which complementaries might be beneficial, such as services (Mattoo and Sauvé, ch. 12 in this volume), investment (Miroudot, ch. 14 in this volume), and labor mobility (Stephenson and Hufbauer, ch. 13 in this volume). Hoekman and Sekkat (2010) examine this option in the case of the Pan-Arab Free Trade Area (PAFTA).

Yet the reality is that even if some limited sectoral advances (on movement of professionals, for instance) have been recorded in recent agreements, PTAs have made only modest inroads where access to services markets is concerned. Regulatory policies tend to pursue noneconomic objectives along with economic concerns (such as lowering the costs of barriers and compliance), and this, Hoekman, Mattoo, and Sapir (2007) remark, makes for a particularly complex political-economy calculus. As with tariffs, the transaction costs imposed by deep integration policies will lead incumbent services industries sheltered by regulatory protection to resist liberalization.

The bias against liberalization can be reinforced in the case of services by reluctance on the part of consumers and government. Consumers may fear that regulatory liberalization will affect their well-being—for instance, through slacker standards and lower quality of products and services.[6] Government and regulatory agencies may also view liberalization reluctantly, for several reasons: (a) regulation may be a source of indirect taxation, in that governments benefit from rents generated by regulatory protection (as is common in the area of standards); (b) governments may fear that their latitude to pursue regulatory objectives will be curtailed because cross-border supply could undermine local suppliers while being subject to different (lower) regulatory requirements; and (c) governments also pursue redistribution objectives by, for instance, imposing requirements for universal provision (e.g., in water supply, telecommunications, and postal services) and for pricing below cost for the poorest customers in such services sectors as water, electricity, finance, and transport. Hoekman, Mattoo, and Sapir (2007) observe that not only do political-economy calculations become more complex in this environment, but also the usual reciprocity mechanism of trade liberalization may not work any more because of the difficulty of clearly separating measures that promote market access from measures that pursue legitimate regulatory objectives.

Aside from market access considerations, PTAs have a role to play in transnational regulation. This involvement reflects the standard economic-efficiency motive for regulation—addressing market failures. Three often-cited market failures are in the areas of monopoly power, externalities and the provision of public goods, and information asymmetries.

1. *Monopoly power and supranational competition.* Economies of scale and, more generally, market failures give rise to the possibility of monopoly power and abusive conduct by private firms. Trade liberalization may go some way toward creating competition by making markets contestable, but this will not always be sufficient. Domestic enforcement of competition rules is linked to market access. If, in a national jurisdiction, competition is weak because of lack of enforcement, market concentration and collusion in the domestic market may deter entry by foreign suppliers. In such instances, competition policy should complement trade liberalization to secure the gains from the opening of markets.

The threats of market power and abusive conduct may not justify the inclusion of competition rules and discipline in a PTA on economic grounds alone. After all, countries can individually opt to implement competition policies unilaterally. But such policies may not be effective in dealing with the risk of cross-border externalities and the abusive behavior of exporters abroad. Competition rules may be particularly relevant in PTAs where the risk of abuse of market power or collusive practice involves more than one national jurisdiction and where international legislation and cooperation could effectively curb anticompetitive behavior. For instance, a firm may use its market power in one market to extract monopoly rents in another; a dominant position may span several countries (as with Microsoft), potentially leading to anticompetitive market conduct; or firms may have agreed in one jurisdiction to collude in another, making it necessary for authorities to cooperate in order to collect evidence.

Because such competition issues are related to trade and investment, there are complementarities in dealing with them in the same forum as trade arrangements. PTAs offer a scope for creating disciplines that the WTO does not.

Arguably, the degree of cooperation in international competition arrangements will depend on the size of individual economies, the level of trade, and the enforcement capacity of the actors.

2. *Externalities and provision of public goods.* An externality (or transaction spillover) is a cost or benefit, not transmitted through prices, which is incurred by a party that did not participate in the action causing the cost or benefit. As the examples of climate change and the depletion of fish stocks show, externalities are not necessarily confined within the borders of a given country. In some cases, externalities may be best tackled by a small group of countries; for instance, river management and some transport issues should involve neighboring countries. Externalities are closely related to the need to provide public goods—that is, goods that are nonrivalrous and nonexcludable.[7] In the presence of externalities, markets may not spontaneously provide goods, such as clean air, that are socially desirable.

Addressing regional externalities should logically be a priority of regional PTAs, given the need for some form of supranational coordination to help internalize the externalities or share them fairly. Coordination can take several forms:

- *Alignment (for instance, through mutual recognition agreements) or harmonization of policies.* These measures eliminate segmentation of markets and duplication of the costs generated by barriers at the border.
- *Alignment and harmonization of policies to avoid leakage.* Leakage is a concern when, for instance, one jurisdiction in the PTA has lower regulatory standards that might undermine the regulatory efforts of its trading partners. An example is a country's deficient control of animal epizooties or pests that spill over to neighbors. (Animal border crossings cannot be totally controlled.)
- *Alignment and harmonization of policies to create networks and to facilitate information exchange.* This method essentially refers to the adoption of common standards and regulatory language in order to facilitate flows within the region (for instance, ensuring interoperability of national networks at a regional level). Such alignment is of particular relevance for services sectors such as finance and insurance, IT, professional services, transport, and electricity.
- *Pooling of efforts to create infrastructure or pooling financial and human resources to provide a regional public good.* For example, combined financing might be needed for a large infrastructure serving a region, such as a hydroelectric dam, or for a large port.
- *Joint decision making to ensure that national policies are coordinated at the regional level (e.g., management of food stocks*).
- *Transfer of resources to solve externality problems when contributions by individual member states are required.* A common instance is when institutions are weak and capacity building is needed to bring a partner country to a higher standard for the regional common good (e.g., customs enforcement).

Regional externalities should arguably be dealt with in those jurisdictions in which they occur, and they therefore require transnational mechanisms of cooperation. It is not entirely clear whether regional externalities (positive or negative) should necessarily be addressed in the specific context of a PTA (Schiff and Winters 2002). There is always the possibility (as for all commitments agreed in PTAs) of addressing these issues through dedicated agreements and transnational institutions such as bilateral customs or water management agreements. Historically, many such problems have been addressed in this way.

3. *Information asymmetries.* Sometimes goods characteristics may not be discernible to buyers before consumption. Credence goods do not—for example, chemicals may be harmful to health, unbeknownst to the people exposed to them; thus regulation is needed to inform consumers before purchase. Information asymmetries may affect producers themselves in situations where consumers' characteristics are hidden (e.g., in the insurance market). In most instances, the market itself deals with these information asymmetries through information dissemination and brand signaling. When, however, the asymmetries are not addressed, the market outcome is suboptimal. The problem of information is particularly acute for services because of their intangibility, which makes it harder for the buyer to learn about quality prior to consumption (Hoekman, Mattoo, and Sapir 2007). Regulation may then be called for—perhaps through licensing or the imposition of compulsory standards. International cooperation may help reduce the overall complexity of the regulatory framework for international traders by aligning and harmonizing regulations. Failure to tackle issues of this kind in a coordinated fashion may generate negative externalities.

In the specific PTA context, the challenge will be to assess whether information asymmetry problems are best tackled at the bilateral or regional level, rather than in other international forums. In most instances, this will be a question of judging the trade-offs between the transaction costs of cooperating with a limited number of countries, as against the international community, and between the

benefits of coordination at the PTA versus the global level. There is a clear risk, for example, that regional standards in PTAs may exclude third, nonadhering, countries. Nevertheless, it may be much easier to agree on a common approach with a small number of countries and with countries with similar preferences. Finally, in some cases (e.g., regional epizooties), a neighboring-country approach will be appropriate.

Societal Motives

Beyond the economic motives, a PTA can be driven by societal motives or, as Bhagwati (2008) calls them, value-related demands. Each society has moral and social norms and preferences that may be undermined by market forces left to operate on their own. For instance, trade in dangerous weapons or in morally or religiously reprehensible material may need to be restricted. What is considered dangerous or morally reprehensible will vary significantly according to country and culture.

Social norms and values may be undermined by trade liberalization; after all, it is easier to control borders than to control a whole territory, and foreign producers may not hold themselves to a particular country's standards. This issue has long been recognized in multilateral trade agreements, leading to the inclusion of safeguard provisions and general exceptions (on moral grounds, for instance). Safeguard mechanisms and the language of general exceptions may, however, prove insufficient, and countries may want to negotiate sector-specific conditions in PTAs, such as reservations concerning universal provision of services.

Conversely, trade agreements may help further societal objectives. Development policy concerns, for example, are increasingly present in agreements such as the EU-sponsored economic partnership agreements (EPAs). Northern partners also push for provisions related to good governance, democracy, labor rights, and human rights (Elliott, ch. 20 in this volume; Aaronson, ch. 21 in this volume).

What is the specific value added of PTAs in helping to achieve these objectives? One motivation might be that threats to societal preferences are localized in a limited number of partners, and thus it makes sense to deal with those countries directly. Some PTAs, for example, have been specifically linked to measures for fighting narcotics production and trafficking; an example is the Central America Free Trade Agreement and the U.S. stipulations concerning narcotics in that PTA (Hornbeck 2003).

PTAs might be seen as a locus of positive spillovers between trade and societal policy issues. For instance, provisions on governance (e.g., open and transparent procedures) in international flows arising from the trade agreement would spill over into other domestic areas.[8] Clearly, in the case of trade and development, there are complementarities between openness and poverty-alleviating growth, and PTAs help target specific countries. In other instances, and more prosaically, there might merely be a quid pro quo between market access in the North and concessions on other fronts in the South.

Another motivation relates to the search for the best available forum for promoting the international sharing of societal norms, focusing on issues that are not already present in other agreements such as the WTO (for instance, labor rights or environment protection) or pushing for higher standards than currently exist in the international community. (See also "Institutions for reform," below.) This is a clear objective of the new U.S. trade policy of pursuing PTAs that was initiated under the George W. Bush administration. In a 2001 speech, Robert Zoellick, then U.S. trade representative, noted that "we need to align the global trading system with our values. . . . We can encourage respect for core labor standards, environmental protection, and good health . . . And we must always seek to strengthen freedom, democracy and the rule of law" (quoted in Evenett and Meier 2008). Related to this objective is the desire to use every trade forum to reaffirm these choices, with a view toward mutual complementarity and reinforcement between the different instruments.

Political-Economy Motives

Beyond the need for coordinating policy making with trading partners, PTAs also serve as forums for policy objectives that are strictly related neither to exchanges nor to the preferential nature of PTAs. PTAs can be seen as efficient forums for achieving broader geopolitical, institutional, and policy-anchoring objectives.

Geopolitical objectives. Geostrategic considerations have historically commanded the formation of PTAs. There are numerous examples of trade agreements that have been used to promote peace. Chief among them is the EU, which was born from the desire to prevent war from happening again in Europe. Winston Churchill called in 1946 for a "United States of Europe," but it was with economic integration and the 1951 European Coal and Steel Community that European integration began (Winters 1997; Baldwin 2008).[9] Other examples of agreements used for stability purposes, as noted by Bergsten (1996) include the Southern Cone Common Market (Mercosur, Mercado Común del Sur) and Asia-Pacific Economic Cooperation (APEC). More recently, the push by the United States to

conclude PTAs has had foreign policy motives (Bhagwati 2008; Evenett and Meier 2008), as has Europe's neighborhood policy (European Commission 2007).[10]

Thus, PTAs can contribute to delivering peace and stability as a regional public good (Schiff and Winters 2004; World Bank 2005, box 2.6). Two mechanisms may come into play. First, trade exchanges increase economic interdependence and, thus, act as a disincentive for conflict. They may also help increase familiarity and trust and defuse trade-related disputes.[11] Second, and more specific to PTAs, institutions themselves serve as a conduit for diplomacy, allowing for frequent and repeated interaction among officials and for better exchange of information (Haftel 2007). Deep PTAs seem more attractive in this respect because they have more sophisticated institutions.

Empirically, Mansfield and Pevehouse (2000) have found that membership in a PTA significantly decreases the likelihood of armed conflict. More recently, Lee and Pyun (2009) provide statistically significant evidence that PTA institutions decrease the probability of conflict between members, whereas WTO membership seems only marginally significant. Martin, Mayer, and Thoenig (2010) test the interaction between conflict and PTAs over the period 1950–2000 and find that the hypothesis of geopolitical motivations behind the agreements is supported by evidence. Yet for PTAs to help ease the probability of conflict, there must be sufficiently large trade gains between the partners. Economics and political motives thus complement each other.

Institutions for reform. By offering a different set of institutions and related services from those of other forms of international agreements, PTAs provide an infrastructure for institutional dialogue and cooperation. As noted by the World Bank (2005), many issues covered by PTAs, such as the externality problems described earlier, could well be handled without a trade agreement. If PTAs are used, this must be because they are perceived as offering a good framework for achieving progress.

PTAs are relatively flexible instruments insofar as they allow for various levels of legal commitment and offer nearly infinite ways of creating policy space. For example, the options with dispute settlement are numerous: there may be no mechanism at all, or one or several dispute settlement mechanisms (Porges, ch. 22 in this volume). Each PTA can come with its own ad hoc instruments, which may be sector specific or may refer to external mechanisms such as international arbitration or WTO dispute settlement. Various ways of reaching settlement before recourse to formal dispute settlement are available, such as good offices, third-party mediation, and conciliation. Indirect evidence of legal flexibility is also provided by Horn, Mavroidis, and Sapir (2009), who show that binding and nonbinding provisions coexist in agreements on nearly all the issues covered. Such flexibility, it should be noted, might appear as a virtue to policy makers but may not necessarily contribute to factual reform.

In contrast to multilateral forums, PTAs often feature innovative institutions. One innovation is the involvement of the private sector, from participation in stakeholder forums to the possibility of lodging complaints in, for example, the European Court of Justice, the General Secretariat of the Andean Community, or under the investment provisions of the North American Free Trade Agreement (NAFTA). Some PTAs offer more substantial transfers of sovereignty. Governments can also opt to devolve some of their authority to institutions created by PTAs, such as regional competition authorities, as described by Dawar and Holmes (ch. 16 in this volume).

The transaction costs of agreement are lower in PTAs with a small number of participating countries. In addition, small PTAs do not lend themselves to free riding, which is a practice that poses a key obstacle to successful global liberalization (Krugman 1993). Lower transaction costs allow for more binding constraints on each partner (noncooperation is more difficult) and for legal flexibility. Since the number required to reach consensus is lower, the agreement could be amended and revisited more often than is the case with multilateral agreements. A smaller number of participant countries enables more frequent and probably less formal interactions, which can contribute to problem solving and deeper relations. That seems an important feature for the regulatory aspects, which require agreement on complex issues (such as mutual recognition arrangements) and the setting up of expert bodies. This is the road followed by the EU under the Florence Forum.[12]

Resource transfers are more likely to occur in the framework of PTAs than in other international agreement settings. Many PTAs—North-South ones, in particular—do incorporate such transfers. Agreements signed by the EU are the most striking examples; other cases include U.S. free trade agreements (FTAs) with Latin American partners and South-South agreements such as the Common Market for Eastern and Southern Africa (COMESA). Resource transfers matter, in particular, for deep and asymmetric PTAs. Arguably, deep integration places heavier demands on capacity. Less developed trade partners may have difficulties in, for example, meeting the regulatory standards of their partners and thus obtaining effective market access. They may lack capacity to compensate for some of the adjustment costs of reform; to contribute effectively to the production of regional public goods; and, even more

broadly, to help achieve geopolitical and societal objectives (development, conflict prevention, and so on).

Policy anchoring. A traditional political-economy explanation for a country's entering into binding international trade commitments is the pursuit of a domestic reform agenda and the use of external commitments to lock in progress and prevent future reversals. The opportunity to lock in is also a motive for including behind-the-border aspects in agreements. PTAs may be perceived as more effective lock-in mechanisms than other international agreements, and they may complement other external instruments in the process of reinforcing and consolidating domestic reforms.

By extending their reach to regulatory issues, PTAs offer a way of improving policy credibility (Hoekman, ch. 4 in this volume). What are the differences, then, between the sort of anchor offered by PTAs and that provided by the WTO? Aside from the obvious point that PTAs may offer commitments in WTO+ and WTO-extra areas, they may have specific advantages. The possibility of picking a partner may help reinforce credibility, as the partner of choice may be perceived as a strong proponent of reform. The EU, the United States, and other developed countries do, in fact, promote various agendas through their respective PTAs. Picking a partner or a group of partners may also signal a preference for a certain regulatory approach. In addition, lock-in through PTAs can be complemented by transfers of finance and knowledge.

An argument put forward by Schiff and Winters (1998) is that PTAs may actually be well suited for locking in policies because of the credibility of enforcement in these agreements. Incentives to enforce commitments are greater in a PTA because there is less possibility of free riding and fewer of the coordination problems that may arise in multilateral forums. In addition, there is more scope for retaliation because concessions in a PTA may go beyond just tariffs. Schiff and Winters note, however, that the disciplining effect is limited to the partner countries in the PTA, not third-country members. (They cite the peso crisis of 1994–95, when Mexico raised its tariffs on 500 items for non-NAFTA suppliers.) These dynamics are echoed by the conclusion reached by Prusa (ch. 9 in this volume), that PTAs tend to discipline the use of contingent protection measures among partners while, at the same time, the use of protection against third countries seems to be increasing.

There are several recent examples of countries that have used PTAs to pursue an ambitious domestic agenda; Schott (2003) cites Mexico and Chile. Similarly, the accession of Eastern European countries to the EU was strongly motivated by the desire to break irrevocably with socialism and consolidate market economy reforms. More recently, Costa Rica and Peru used their FTA negotiations with the United States to push domestic reforms. Levy (2009) does not find much in the way of market access motives for Peru, except a desire for greater certainty about future access (trading temporary preferences for more permanent ones), but the agreement did help the country cement its economic policy reforms. Some of these reforms, notably in the areas of services and investment, were part of the FTA implementation program, but the agreement also helped lock in prior policy reforms, such as tariff reductions. Another motivation for signing the FTA with the United States, Levy notes, may have been the hope that it would generate broader positive spillover effects on Peru's governance and the rule of law. By imposing good disciplines to protect foreign investors and market access, the FTA would signal a commitment to a better legal environment, in general.

In sum, there are strong rationales for policy makers to embark on deep and comprehensive PTAs, but the relative merits of regional integration are also issue specific and country specific. The choice of whether to include regulatory aspects in PTAs is essentially dictated by a dual concern: securing market access and addressing market failures, whether national (through the lock-in effect of policy reform and policy upgrading) or regional. Market failures will be of different natures and will involve different sets of countries, depending on the sector and the issue at hand—hence the need, as with any regulation, for a case-by-case approach. Other noneconomic considerations, such as fostering societal choices, may apply to some issues of a regulatory nature. Finally, specific institutional characteristics and advantages may motivate the choice of PTAs as adequate forums for reform.

Specificities of Deep Integration

The increased scope and depth of PTAs create opportunities but also pose extra challenges to policy makers as they negotiate and implement the complex market-access and regulatory web of these agreements. Policy makers may have to reevaluate their approach when negotiating and implementing deep integration PTAs. In particular, to what extent are the multiple goals of PTAs consistent and congruent? Do the new disciplines incorporated in PTAs create a different category of obligations? Does the deepening and popularity of PTAs create new challenges for the multilateral trading system? In this section, we suggest four major areas of emphasis for policy makers, especially in developing countries, as they refine their regional trade strategies: reexamining the question of discrimination and preferential access, adopting a holistic approach, building in flexibility, and focusing on implementation.

Preferences

Are the traditional concerns of discriminatory liberalization valid for the new areas of deep commitments in PTAs? Do deep integration measures generate trade diversion? Can they harm the liberalizing country? Do they act as stumbling blocks to further liberalization? These issues—in particular, those related to the impact of deep integration on multilateral architecture—have generated considerable interest as of late (OECD 2003; Baldwin, Evenett, and Low 2009; Estevadeordal, Suominen, and Teh 2009), thanks to mounting evidence provided by new PTAs. The new regulatory commitments found in today's PTAs are discussed here in light of the three classical economic concepts for analyzing market access discrimination in PTAs: trade diversion, third-party effects, and systemic effects.

Trade diversion. Discrimination in deep integration agreements can secure the benefits of market access without generating the potential cost of trade diversion. In this sense, regulatory discrimination does not raise the same concerns as tariff discrimination would. The certitude that better market access will be beneficial and that no diversion costs will occur leads to an important consideration for policy makers: all things being equal, PTA partners will unambiguously gain in preferential deep integration efforts. This may explain why deep integration issues are winning popularity in PTAs. (See Baldwin, ch. 3, and Baldwin and Freund, ch. 6, in this volume.)

Protection afforded by lack of regulatory openness is not necessarily protectionist in intent. Regulatory requirements often impose a transaction cost on the exporter without generating rents for the home country.[13] A case in point is superfluous or antiquated border controls, which create additional costs without any corresponding benefits.[14]

In such instances, liberalization of services, harmonization of standards, trade facilitation, investment liberalization, and openness of government procurement can generate benefits even if carried out preferentially. It is, however, important to stress that this positive effect only occurs if there is no sizeable rent transfer from domestic to foreign producers.[15] In trade in services, for instance, the impact of preferential liberalization will be determined by the nature of the regulatory barriers present. If lack of competition is an issue, regulatory liberalization may well replace a domestic monopolist practice with a foreign one (Mattoo and Sauvé, ch. 12 in this volume). Similarly, where access to services markets is subject to some form of licensing, rents may arise, and with them, the cost of trade diversion. In the case of government procurement, there is an additional aspect at work: restrictive and discriminatory government procurement rules do not affect the market as a whole, and therefore, exclude suppliers only from serving the public share of the domestic demand (Dawar and Evenett, ch. 17 in this volume). Depending on the size of public markets, this may not be enough to exclude foreign suppliers from the market altogether.

Impact on third parties. The standard effect of discrimination will still be harmful for third parties (the excluded countries). This is, for instance, the case when countries adopt European standards instead of international ones (Maur and Shepherd, ch. 10 in this volume; Stoler, ch. 11 in this volume). It is important to ask, however, whether preferential measures are always discriminatory.

An important characteristic of regulatory measures is that de jure preferential treatment might be difficult to apply, making de facto MFN liberalization a preferable option. That is, devising a new regulatory regime applicable to each PTA may be impracticable, or the concept of rules of origin that applies to product characteristics simply cannot be as easily applied to regulations or intangible transactions.[16] For instance, provisions on protection of intellectual property rights apply equally to all origins, including domestic ones. Carving out specific regimes for some countries (as in the case of the WTO Article 6 exception for least-developed countries) requires complex legal and practical arrangements. Similarly, for customs procedures, although trade rules may differ depending on the origin of the product, it makes sense to maintain, as much as possible, similar procedures regardless of the origin of the good because most objectives of border controls apply to all imports. Those examples show that the concern about negative impact on excluded parties can largely disappear in the case of deep commitment provisions and that preferential liberalization could generate positive externalities for third countries.[17]

This is, however, not a universal rule. A characteristic of deep integration liberalization is that there are instances in which discrimination is inevitable and even necessary. The main illustration of this conclusion is provided by mutual recognition agreements (MRAs). MRAs can be negotiated in any regulatory area and are basically a way of lowering barriers to entry into the domestic market for foreign producers without outright harmonization of rules, thus preserving regulatory diversity and allowing countries to maintain national objectives and preferences. Under this principle, parties agree, in essence, to maintain their own regulatory procedures provided that they meet minimum common objectives. Recognition can be agreed both for regulatory standards and for their testing and can be applied in several areas: services (e.g., professional standards and transport), trade facilitation (e.g., declarations

made with foreign customs), and technical trade barriers and phytosanitary measures. Another instance in which discrimination is needed relates to customs controls. Modern and efficient, risk-based border management calls for the selective control of imports, focusing on categories that present the highest risk of noncompliance. Risk criteria discriminate, for instance, by product category, country of origin, and identity of shipper, allowing simplified controls for authorized economic operators and express shippers.

Finally, the fact that liberalization in preferential settings could de facto lead to MFN liberalization has profound implications for overall liberalization negotiating strategy. Concessions given to one partner cannot be offered again to another when they are nondiscriminatory and are implicitly offered to the rest of the world. One implication might be that such liberalization is more difficult to achieve because it is more likely to be resisted by domestic firms that would lose not only to the preferential partners, as would be usually the case in a trade-diverting PTA, but also to the world as a whole (Krishna 1998). The reciprocity rationale for signing North-South agreements would also be undermined because offsetting market access preferences for goods (the objective of the South) against deep regulatory commitments (the objective of the North) seems to make little sense for developing countries. Preferences are bound to be eroded over time, but regulatory commitments are both permanent and MFN. Alternatively, as argued by Limão (2007), this asymmetry could provide an incentive for PTAs to maintain high barriers against third countries (through high preferences), in order to provide greater incentives for cooperation in nontrade areas and postpone to a distant future the threat of preference erosion.

Another related consideration is that parties that want to export a certain regulatory model—one more advantageous to their own firms—could gain from being the first to negotiate with a given country. This may be one aspect of the competitive liberalization framework described by Bergsten (1996).

Systemic effects: Deep integration as a building block. Are deep commitments in PTAs building blocks or stumbling blocks with respect to multilateral liberalization? This is a legitimate question, given that the slew of new commitments in PTAs makes these agreements much more invasive and, by adding new dimensions, may create even more hurdles for the welfare-superior objective of multilateral liberalization. Even when the more traditional aspect of tariff preferential liberalization is considered, the answer to this question is not entirely clear, with some analysts arguing that PTAs fundamentally undermine the multilateral system (Bhagwati's "termites") and others seeing in PTAs a component of an overall dynamic of liberalization (Baldwin and Freund, ch. 6 in this volume).

In the context of deep integration, similar concerns prevail. How do complex and largely ad hoc PTAs touching on services and behind-the-border measures interplay with the multilateral order? Part of the answer was provided in the previous section, where the point was made that liberalization is often MFN in nature, thereby removing concerns about stumbling-block effects in these instances. There is also more to this story, as discussed by Baldwin, Evenett, and Low (2009) and in OECD (2003). Several mechanisms that support further liberalization are actually found in PTA provisions:

- PTAs may enforce or encourage adherence to international standards in, for example, sanitary and phytosanitary measures and technical barriers to trade (Lesser 2007). Numerous PTAs also refer directly to WTO rules.
- Third-party, nonparty MFN clauses are often found in services provisions (Fink and Molinuevo 2007) and in government procurement (Baldwin, Evenett, and Low 2009). According to third-party MFN rules, future and more advantageous commitments with other partners should be granted to PTA partners as well, thus triggering automatic liberalization. A benefit of such rules is that small countries avail themselves of the bargaining power of more powerful countries with common trade partners and so gain increased market access (Baldwin, Evenett, and Low 2009).
- When regimes operate under liberal rules of origin (ROOs) or liberal "denial of benefits" provisions, the provisions are applied not only to preferential trade in goods but also in any instance requiring the establishment of the origin of the partner subject to preferential rules. There are various instances in PTAs; they include access by third parties to MRAs, ROOs that apply to foreign firms that establish local presence in the partner country (Mattoo and Sauvé, ch. 12 in this volume),[18] and government procurement (Dawar and Evenett, ch. 17 in this volume). ROOs applying to regulations often happen to be liberal either because they otherwise become complex to administer or because, as we saw earlier, it does not make sense to operate parallel regulatory systems instead of an MFN system.
- The diffusion of identical and liberalizing rules in PTAs has been particularly noted in "contiguous" PTAs having one partner in common. This occurrence can be seen in investment provisions in agreements in North and South America, in procurement provisions, and in contingent protection (Baldwin, Evenett, and Low 2009). There could, however, be a downside, as large

trading powers export their own—and not necessarily compatible—vision of a liberalization agenda. Prusa (ch. 9 in this volume) describes a phenomenon of rules diffusion in which the EU and the United States act as spokes in their respective networks. More broadly, template approaches to liberalization are often used in PTAs. Rules relating to investment, services liberalization, or standards tend to replicate one of two or three existing models.

In sum, discrimination in the implementation of deep commitments in PTAs should not be underestimated, but there are ways of dealing with it. It should not be underestimated because deep integration creates stealthier and more complex ways to discriminate. Trade partners can push for specific regime designs with the aim of carving out more favorable market access conditions. One example is the insistence by the United States on including customs rules in its FTAs that allow for preferential treatment for express carriers—an industry in which the United States is well represented. However, the parallel with the tariff analysis of preferential liberalization does not necessarily hold because there is less risk of trade diversion, and the welfare implications of preferential liberalization are then necessarily positive. In such cases, PTAs would contribute to overall welfare gain. Moreover the rather complex nature of regulation tends to work to the advantage of MFN liberalization because managing multiple regulatory regimes to create specific preferences is often too complicated.

Policy Complementarities: Taking a Holistic Approach

The expansion of PTAs into new disciplines implies that policy makers are confronted with multiple policy choices with different objectives and complex interactions. In essence, new PTAs capture a broader paradigm than traditional ones. Evans et al. (2006) characterize one aspect of this expanded paradigm by pointing out that, unlike traditional trade liberalization that focuses chiefly on goods trade, deep integration aims at broad factor mobility, including liberalization of investment (capital movement), trade in services, and migration and labor standards. Perhaps nowhere are all the liberalization dimensions explored as deeply and comprehensively as in PTAs. The complementarities created might explain the attraction of PTAs (Mattoo and Sauvé, ch. 12 in this volume). A good example is the trade facilitation agenda, which embraces such goals as the streamlining of numerous border measures (all of which have specific regulatory objectives in sectors such as health, immigration, and security controls); the inclusion of services sectors that facilitate trade (transport, logistics, insurance, and so on); rules concerning movement of persons; and standards policies.

The other aspect of the broader agenda is, of course, the regulatory one and the inclusion of domestic and other policies that have the objective not of protection but of remedying some sort of market failure. Such policies are included in PTAs at least in part because trade liberalization interacts with their objectives in ways that may often seem to make these objectives more difficult to achieve. Trade policies can no longer be designed on the assumption of their separability from other policies.[19]

Deep integration is as much about trade as it is about other dimensions of economic management and public policy. Starting with liberalization of services, all deep integration policies meet specific objectives, and the liberalization question cannot be divorced from the consideration of these goals. Policy makers should carefully think about why and how trade agreements should serve these objectives in the specific context of PTAs. Table 1.1 offers a snapshot of the variety of such objectives.

In *Termites in the Trading System* (2008), Bhagwati pointedly mocks the ever-expanding notion of trade-related policies: "If I sneeze and use imported cough syrup, that immediately affects imports; if I use domestic cough syrup, that potentially reduces exports of the syrup I have used up." It is true that by pushing the logic ad absurdum, every issue becomes trade related and has a trade effect. Although this does not mean that the impact of non-trade-related policies on trade (and vice versa) should be ignored, it is important to be clear about the primary objectives of policies and how to achieve them. The question for regulatory issues, which are, in essence, behind the border and not unique or specific to traded goods, is of three orders:

1. What are the issues of true international dimension that can *only* be addressed through international agreements?
2. How should behind-the-border rules in PTAs be designed to minimize trade-distorting effects?
3. How should policy makers prepare themselves to negotiate or resist such rules?

The first two questions roughly ask, what is the actual link with trade issues? On the first question, as was seen earlier, market failures and externalities of a supranational nature can be addressed using PTAs; for instance, international transit is a trade facilitation concern that clearly has a regional dimension. Arguably, these issues can also be addressed in separate, dedicated agreements such as bilateral cooperation treaties for competition law or stand-alone transit agreements (see Maur 2008; Dawar and

Table 1.1. Types and Scope of Regulatory Objectives in Selected Areas Covered by Trade Liberalization Agreements

Area	Regulatory objectives
Services	Universal provision (access, prices) Standards (professional, safety, interconnection of networks) Prudential regulations (banking) Cultural exceptions (media)
Standards for goods	Human, plant, and animal health Safety Network economies
Intellectual property rights (IPRs)	Innovation and creativity
Trade facilitation	Fiscal revenue Border security Prohibitions Immigration control Enforcement of domestic laws with respect to foreign goods Transit
Government procurement	Preference for national goods Protection of sensitive sectors (defense)
Consumer law	Consumer information and protection
Labor and human rights	Minimum standards
Environment	Public goods Minimum standards
Movement of persons	Immigration management

Source: Authors' compilation.

Holmes, ch. 16 in this volume). International trade may be an important source of market failure—for instance, with respect to environmental protection (Anuradha, ch. 19 in this volume).[20] Because of the binding nature of international agreements and the international trade dimension of externalities and market failures, there is a space for regulatory frameworks in the context of PTAs. Issues that were previously dealt with under dedicated bilateral instruments, such as bilateral investment treaties, customs cooperation agreements, and cooperation on competition policy, are now increasingly incorporated into PTAs. Although the jury is still out as to the most effective instrument for implementation, PTAs may be superior because of the possibility of issue links and institutional-savings costs, given that one body serves several purposes (Devlin and Estevadeordal 2006).

On the second question, that of reducing distortionary effects, the approach should be to minimize the conflicts between regulatory and trade liberalization objectives. For instance, harmonization to a low standards level would maximize trade liberalization objectives but clearly would not meet regulatory objectives. (Low standards may not meet a country's preferred level of enforcement.) An obvious approach is to ensure that the clarity of regulatory objectives is such that protectionist intents cannot hide themselves behind the disguise of rules. Hidden protectionism operates by raising the costs of (foreign) rivals, by imposing discriminatory rules at home (e.g., by designing standards in such a way as to exclude foreign products), or by raising standards abroad (e.g., by exporting new regulatory requirements that increase the cost of production abroad and shift comparative advantage patterns).

On the third question, that of negotiating or resisting such rules, a first step is to clarify the policy-making process involved in making future commitments—to begin with, by involving the key ministries and administrations that oversee the nontrade objectives and by ensuring mutual understanding and coherence of objectives. Historically, PTA negotiations have typically been led by finance, foreign affairs, or trade ministries. These ministries would seldom coordinate with other ministries or specialized bodies of government, and sometimes their understanding of the issues at stake is limited. Another step is to minimize the costs of meeting the regulatory objectives, with reasonable statistical confidence. This step is often not done; instead, solutions that meet the objective of regulation irrespective of the costs caused by trade distortions are chosen. The notion of risk is often not embedded in the regulatory design because agencies have no direct interest in considering the costs borne by other parts of the economy in meeting their objectives and naturally opt for regulatory solutions that minimize risk rather than costs. An example is border controls, where 100 percent checking of consignments is not rare, to the exclusion of economically efficient methods of targeting only risky shipments. The marginal costs of meeting regulatory objectives (in particular, the

costs for trade) should be balanced against the marginal expected benefits. (Maur and Shepherd, ch. 10 in this volume, discuss this issue in the context of standards.)

An important aspect that may justify resisting the incorporation of regulatory objectives into PTAs is the importance of national endowments and preferences, which will differ among countries. Bhagwati (2008) suggests that the rationales for different labor standards apply to countries that are at different stages of development and have different economic contexts. Although harmonization eliminates the costs associated with duplication and complexity, it can undermine national objectives by departing too much from these aims, and in the case of upward harmonization to stricter regulatory levels, it can raise the costs faced by some countries—often, the poorest ones. The exportation of (higher) regulatory standards and practices has been flagged in the recent literature as integral to the strategy of the two biggest proponents of PTAs, the United States and the EU (Maur 2005; Bhagwati 2008; Horn, Mavroidis, and Sapir 2009). A closer examination of PTA disciplines suggests that template approaches to PTA liberalization are indeed promoted by both hubs. This is worth highlighting because the EU and U.S. approaches generally differ quite substantially. In this volume, the influence of the EU and U.S. hubs is noted, for instance, for contingent protection rules (Prusa, ch. 9), the use of mutual recognition versus equivalence for standards (Maur and Shepherd, ch. 10; Stoler, ch. 11), differing areas of focus regarding IPR protection (Fink, ch. 18), and the diffusion of procurement and investment rules (Miroudot, ch. 14; Dawar and Evenett, ch. 17). PTAs—and bilateral agreements in general—offer a means of dealing with heterogeneity of preferences through the principle of equivalence, which often takes the form of mutual recognition, as was discussed earlier.

Flexibility and Customized Problem Solving

The flexibility offered by PTAs in terms of tailoring the level of ambition of given disciplines to particular trading partners is one finding from the early work on the new wave of PTAs (Heydon 2003). Although special and differential treatment and policy space are important features of modern trade negotiations involving developing countries, here we take the logic farther, arguing that it is not only the nature of partner countries and their capacity that dictate the need for such flexibility but also the regulatory issues themselves.

Many of the new policies captured in the latest generation of PTAs do not lend themselves to reduction to standalone legal language in a trade agreement. Rather, deep integration requires flexibility and customization in the way provisions are drafted:

- Provisions in the agreement compose only one of the building blocks of broader cooperation, which may include institutional arrangements, whether hard (e.g., a common institution) or soft (e.g., expert consultations), as well as technical assistance and capacity building.
- Gradual implementation is advisable, as reform may not be carried out overnight and will present unique challenges in a given country context.
- Flexibility is necessary for joint projects such as harmonization work and creation of common regional tools.
- Areas of cooperation will need to be reexamined as regulatory needs change over time.
- Deep integration areas will have to be revisited as understanding of how best to address regulatory dimensions evolves.
- Implementation of policy has to be monitored.
- Recourse to venues other than dispute settlement is needed.

Reliance on a rigid interpretation of an international agreement and on enforcement through dispute settlement is insufficient for the deep integration dimensions of liberalization (Hoekman, ch. 4 in this volume). Deep integration requires a combination of hard and soft law and enhanced capacity. The reasons for this are (a) practicalities, (b) uncertainty, and (c) political economy.

The first problem is practical and procedural: the appropriate implementation of behind-the-border policies requires a set of actions, ranging from enactment of legal provisions to establishment of adequate structures, including appropriate governance and rules, material and personnel for operationalizing the policies, and reporting mechanisms. All this is highly complex and is difficult to specify in full in an international agreement, and it might as well be left to domestic authorities to work out.

The second problem arises from the fact that there is uncertainty about the most appropriate design for regulatory policies and their implementation, since these aspects probably depends on country circumstances. A good example is the variety of competition provision rules and setups in PTAs (Dawar and Holmes, ch. 16 in this volume). Configurations of common competition regimes and provisions are greatly influenced by national regimes and by partners' size and level of development. Another source of uncertainty is time, because technological changes, for instance, may fundamentally affect the nature of the goods and services exchanged and the way markets, market operators, and government bodies conduct their work (in,

for example, telecommunication services, standards policies, and border controls).

Finally, the political economy of PTAs that rely on soft-law mechanisms might be more supportive of actual liberalization than is the case with a top-down approach in which rules are rigidly imposed by a powerful trade partner. Ownership can be enhanced through cooperation and stakeholder involvement, which would be part of a process of identifying appropriate regulatory solutions for liberalization (Hoekman, ch. 4 in this volume). This is related to respect for country preferences while reducing differences with a view toward mutual recognition of regulations.

Thus, flexibility seems to be an important dimension to be considered in deep integration. This recognition gives rise to a recommendation for "living agreements" that incorporate a work program and for associated institutions that establish a pathway allowing deeper integration over time and the resolution of standards issues. Hoekman (ch. 4 in this volume) similarly argues in favor of a constructive rather than adversarial process in North-South PTAs. A problem with purely adversarial procedures is that they tend to leave unaddressed public good issues, whereas supranational institutions have an incentive to pursue such matters. PTAs then become instruments of cooperation, in addition to integration, and can provide a problem-solving forum for countries that are undertaking reform and upgrading their regulatory capacities.

Another aspect of the flexible approach toward deep integration is the implication for approaches to dispute settlement. On the one hand, negotiating and implementing deep integration dimensions is costly, creating a motive for ensuring a return on this investment by the establishment of strong dispute settlement mechanisms (Porges, ch. 22 in this volume). This may explain the observed trend toward more legalistic forms of dispute resolution, replacing the more diplomatic approaches of older agreements. In this regard, WTO-like ad hoc panels (which, among other things, permit recourse to the expertise of specialists) are often preferred. On the other hand, dispute settlement is only one of the several mechanisms in PTAs contributing to enforcement. Panel-type disputes only occur in exceptional cases, and smaller disagreements are resolved through other channels established in the PTAs. The latter approach is what can be described as soft law. In this respect, common institutions play an important role, allowing technical and ad hoc approaches to solving what are often complex issues and facilitating the involvement of third parties, such as the private sector.

As has already been indicated, the extent to which a PTA is symmetrical or not—that is, the degree to which the partners are equal or similar in level of development or economic size—has implications for the choice of degree of flexibility and informality. In this sense, a flexible approach can be seen as a building block for more formal arrangements down the line. Porges (ch. 22 in this volume) notes that dispute settlement tends to become more legalistic when the relationship is symmetric, whereas when it is asymmetric, political and diplomatic approaches are preferred. Although the softer structure may be seen as a way of affording flexibility to smaller partners and as reflecting the unequal balance of power, it leaves the solving of disputes to less transparent conduits in which power may be more easily wielded.

Implementation

The inadequacy of a solely legalistic approach to commitments implies that negotiations will not settle every issue and that, in addition to the ex ante work of negotiators, an important ex post agenda awaits countries signing PTAs. It can be argued that the implementation agenda is *on paper* more important in the case of PTAs than in the WTO. There are essentially two reasons for this. The first is that PTAs commit parties to effective liberalization, whereas the WTO often merely commits parties to bind only maximum levels of protection and provides numerous exemptions and exceptions for developing countries.[21] The second reason is that deep PTAs cover newer and more ambitious ground than does the WTO.

In some areas, the track record of PTAs in implementation has been relatively poor. Reviews of services (Mattoo and Sauvé, ch. 12 in this volume), and of competition provisions (Dawar and Holmes, ch. 16 in this volume) suggest unimpressive results, while in areas that have seen more pressure toward implementation, such as IPRs, the evidence shows much more substantial changes (Biadgleng and Maur forthcoming). The different treatment for IPRs is the direct result of the greater prominence of implementation and enforcement in recent PTAs involving the United States and Europe.

Dealing with deep integration issues requires preparedness that goes well beyond the negotiation stage, and most likely it entails the dedication of some permanent resources to managing the agreement. The resource and policy implications of deep integration agreements are likely to be, in part, unforeseen, as Hoekman (ch. 4 in this volume) suggests, and the problems may be compounded by countries' lack of preparedness. Examples of possible unintended consequences of commitments include incompatibilities between PTA commitments and the existing (domestic and international) legal environment;[22] political-economy constraints, where commitments are not accepted by

domestic constituencies, including legislators who may have to vote on new laws; limitations on regulatory freedom; inefficiency in implementing the new regulatory environment; and economic implications that are less beneficial than initially thought.

Beyond the principle of liberalization agreed in the PTA, a work program of implementation must be devised in order to make liberalization a reality. The implementation of the provisions of an agreement may require different levels of intervention. First, institutional changes may be necessary because the implementation of new areas of policy may call for the establishment of new regulatory agencies or the reorganization of existing institutions. Second, new laws for regulatory reform will be required to reflect PTA commitments. The need for such legislation will vary, depending on the legal standing of international commitments in domestic law: some commitments require translation into domestic law, while others have direct effect, and some law systems rely more on a case law approach. The third dimension of implementation consists of the administrative, procedural, and operational changes required to comply with the new regulatory framework. This can include the management of the agreement itself, including transparency and monitoring requirements. Finally, enforcement of the newly adopted regulations needs to be considered; the requisite staff and resources will have to be allocated. Attention should be given to the quality of enforcement and to measures for assessing the effectiveness of the application of the laws (Biadgleng and Maur forthcoming).

The text of the PTA is only one initial element of the process of integration. Implementation issues must also be carefully examined to determine whether liberalization is effective. Monitoring and accountability matter. This is a more complex process than verifying that trade barriers are effectively dismantled, and the necessary information is often not readily available. In general, implementation in PTAs is not a very transparent process, and sustained attention to implementation is rare. This is an additional reason for the constructive cooperative approach recommended by Hoekman (ch. 4 in this volume), given the complementarity between information generation and exchange and the process for discovery of the best trade-facilitating regulatory solution.

In spite of some evidence that monitoring is taking place, information about implementation remains scarce, and most of the analysis of PTAs rests on the evidence provided by the agreements themselves and on some measures of outcomes such as trade flows.[23] Although such analysis provides useful insights, the policy recommendations that can be drawn from it are limited. Little is known about which liberalization strategies work best as agents of change and which of the hard-law–soft-law approaches, or combinations thereof, contribute most to liberalization. The inference from the above discussion is that although many examples and many distinctive approaches to integration now exist, there is still relatively little basis for recommendations on how to appropriately implement deep integration provisions in PTAs, beyond a core set of principles.

For developing countries, one attraction of PTAs with more developed partners, at least in theory, is the prospect of access to capacity building and transfer of resources. Yet whether and how development assistance contributes to implementation is generally difficult to assess, and is even more so in the context of PTAs, given the naturally nontransparent nature of institutions.

An important issue that appears prominently in the discussion on competition policy, government procurement, and standards is to what extent the process of implementation should be run from the center. For instance, competition regimes in PTA contexts range from regional institutions to national institutions that cooperate on international issues. Several considerations affect whether the implementation process will be left to national government or devolved to a transnational body (Dawar and Evenett, ch. 17 in this volume).

The first, obvious point is that a prerequisite for common institutions or rules is the willingness of trade partners to abandon some of their sovereignty. When this does not happen (often, in the context of North-South agreements), only "lighter" options remain, and only core principles guaranteeing good policy and governance can be agreed. This is the solution chosen for procurement provisions. A related concern is the choice between maintaining national preferences and adopting international standards. In this area, the answer to the question of harmonization versus recognition depends on whether the benefits of harmonization outweigh the costs of loss of preferences. National ability to issue regulations is also a parameter to be taken into account. In particular, one motivation for preserving diversity in regulation and implementation is to derive the benefits from competition between different regulatory solutions and procedures. Messerlin and Zarrouk (2000) advocate less centralization in the context of conformity assessment in order to promote competition between different conformity bodies and their services (e.g., testing, surveillance, inspection, certification, etc.).

A second point is the degree of coordination that is required by the integration policy. For some transnational public goods, common institutions and a top-down approach may be preferable in order to solve the coordination problems that lead to inadequate supply of the goods.

Beyond public goods per se, common institutions appear particularly necessary when frequent interactions, decision making, adjudication, and exchange of information are needed, as in customs unions. (See Andriamananjara, ch. 5 in this volume.) A related dimension is the desire to achieve certain scale or efficiency effects. Competition policy illustrates the possibility of opting for a common, centralized competition regime—as in the cases of the EU, the Caribbean Community (CARICOM), COMESA, and the Andean Pact—when parties to a PTA do not differ much in their preferences regarding the type of competition enforcement.

For developing countries in particular, a top-down approach may prove attractive. A first incentive might be to improve governance. By decentralizing decision making within a PTA, member countries may be better able to shield policies from the risk of reversal and guarantee their independence. This strategy may be helpful, for example, for competition policy, where it might be difficult in some countries to escape the influence of particularly large firms and to discipline them. More generally, as discussed earlier, countries with weak judicial systems might find it advantageous to rely on supranational judicial institutions as a way of anchoring or locking in policies. Poor administrative resources at the country level could also motivate the pooling of resources among a group of countries—something small island countries have done.

Finally, a third consideration is efficiency motives, which may lead some countries to seek to replace their existing regulations with superior systems "imported" from partner countries and, through the institutional mechanisms of the PTA, to obtain access to the superior expertise and systems of the partner country.

Conclusions

Modern PTAs are evolving rapidly. They are increasingly deep, and they affect all countries and regions of the world, including the most remote quarters. As academics and policy makers try to deal with this new generation of PTAs, four tentative conclusions can be suggested regarding this changing landscape.

1. *Deep integration introduces a change of paradigm.* To be sure, PTAs still have to do with preferences, discrimination, and exclusion. They may lead to suboptimal outcomes and could complicate and even undermine progress toward a more open, rules-based, and nondiscriminatory multilateral trading system. More worrying than discrimination, perhaps, is the additional inherent complexity that is created by the overlapping and conflicting regulatory regimes promoted by myriads of PTAs. This concern has already been clearly articulated, and a call for multilateralizing regionalism has been voiced in the WTO (Baldwin and Low 2009). The concern that PTAs "compete" with multilateral negotiations for the attention of negotiators and represent an untidy way of proceeding to liberalization remains legitimate.

Yet, an important emerging lesson is that the economic paradigm of shallow PTAs does not necessarily apply to deep and comprehensive PTAs. "Old" concepts such as mercantilist reciprocal liberalization, trade creation and diversion, or a textual approach to negotiating PTAs may still underpin the reasoning of many policy makers but are often archaic or incomplete for deep integration liberalization. Failure to understand the new paradigm of preferential integration may, in turn, explain why most PTAs either have not fully exploited the liberalization opportunities of behind-the-border measures or have not prioritized the opportunities closest to the parties' interests—although it might be naïve to attribute lack of progress solely to a lack of understanding.

2. *Deep integration PTAs are potentially powerful tools for pushing wide-ranging government-owned reforms.* Beyond market access, deep integration PTAs create opportunities to complement trade liberalization with other behind-the-border reforms. In addition, they offer unique instruments for promoting bilateral or plurilateral cooperation and resource transfers, transparency mechanisms, mutual equivalence, informal mechanisms for dispute resolution, in-depth and expert dialogue, and deeper liberalization among the willing parties. These are not approaches that can be easily, if at all, replicated in the large and formal setting of multilateral institutions.

Yet PTAs are worthwhile only if governments are themselves committed to reform and liberalization. PTAs offer a variety of mechanisms by which the process of reform will become more effectively and irremediably set in motion, but a prerequisite is that meaningful commitments be agreed to in the first place. Deep integration PTAs should therefore strive to provide open access to regulatory rules and disciplines in order to ensure equality of treatment of all members and nonmembers and so minimize the occurrence of "regulatory preferences." This means—beyond national treatment—liberal rules of origin, transparency, and the availability of due process. Good regulatory practice should lead de jure preferential liberalization to become, in effect, MFN liberalization. The question of discrimination in deep PTAs is likely to remain convoluted. Discriminatory regulations could take many forms, whether codified in rules or not. De facto preferences can arise from rules that look nonpreferential on paper, or from preferential enforcement. Furthermore, discrimination may, paradoxically,

be the only form of acceptable liberalization, as parties mutually agree to accept each other's rules.

3. *Deep integration should be pursued strategically and selectively.* Another answer to complexity that is, in our view, not sufficiently considered by developing countries, is selectivity. (This is also suggested by Hoekman and Sekkat 2010.) Liberalization is a complex matter, not only from a capacity standpoint but also from a political one. The political economy of deep integration involves many (often opposing) interests and a large set of potential stakeholders. Overloading the negotiating agenda (which will later become the implementing agenda) diverts the focus from what may be achievable and from the areas where gains may be the most important. Agreements bloated by too many issues may lose significance and fail to achieve much.

Picking meaningful issues with the right partner, along with having adequate technical assistance and a cooperative approach, may bring about substantial progress on liberalization and serve as a positive signal or trigger for more challenging areas. Market access should not be the only item on the agenda of negotiators, especially those of developing countries, since deep integration really entails thinking about a domestic reform strategy. Prioritization of core objectives and sequencing should be central concerns of negotiators. Sound regulatory practice should underpin liberalization to minimize the prevalence of regulatory preferences and ensure the overall consistency of liberalization and regulatory objectives.

4. *There is no one-size-fits-all model of deep integration.* As policy makers more and more integrate these new dimensions, we can expect that they will use PTAs more intensively to further liberalization objectives—it may be hoped, in a way complementary to multilateral efforts. Liberalization in any sector is not a simple matter. It escapes easy characterization, as well as one-size-fits-all types of answers. This complexity means that there are few universal rules to follow; rather, carefully designed and specific solutions are needed. Deep integration is essentially a sui generis process, as is illustrated by Winters (2010) in the case of the EU. Yet complexity means that some core principles should be followed in order to promote, to the extent possible, market-based solutions.

The dynamics of North-South, South-South, and North-North PTAs differ considerably. Asymmetric agreements make cooperation less easy and may provide less scope for transnational public goods and mutual recognition but offer more prospects for lock-in and greater access to imported regulatory regimes, when needed. Market access considerations will be paramount for the small partner, whereas the larger partner will seek, beyond market access, to diffuse its regulatory norms, including values norms, and to trigger competitive liberalization effects in partner countries. A related logic can be observed in the EU, which, as Maur (2005) notes, is attempting to leverage its PTAs to shape South-South agreements in its recent wave of agreements with the Mediterranean countries, the Balkans, and the African, Caribbean, and Pacific (ACP) countries.

Notes

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1. In a WTO working paper, Fiorentino, Verdeja, and Toqueboeuf (2006) note that country negotiating resources are being shifted away from multilateral negotiations toward negotiations on PTAs.

2. The General Agreement on Tariffs and Trade (GATT) architecture was historically built, essentially, around the notion of negative integration and the prohibition of the most detrimental policies through elimination of border trade barriers and the espousal of nondiscrimination principles (Hoekman and Kostecki 2009). Recently, however, new forms of economic integration have been included in the multilateral trade framework, starting with the Kennedy Round and the General Agreement on Trade in Services (GATS) in 1979 and continuing with the WTO (and the incorporation of TRIPS, in particular). The WTO incorporates much more significant elements of positive integration than previously. PTAs follow the same trend and go even further in many instances.

3. Torrent (2007) provides the following example: "The European Community directives on the liberalization of movements of capital seem to be a clear example of 'negative' integration, but they were enacted according to what, in Tinbergen's terms, would be a clear example of 'positive integration' (and they would be defended in this way by many in the European Commission). In political terms, NAFTA's [North American Free Trade Agreement's] Chapter XI on investments would be looked at by many around the world as a typical example of 'negative integration' that sharply reduces the capacity of Governments to intervene in the economy. It is also an example of 'positive integration' that creates common rules that go beyond the liberalization of access (for example on protection of investments)."

4. According to Ethier (1998) and, subsequently, Levy (2009), attracting foreign direct investment (FDI) is one of the main incentives for entering into PTAs.

5. Technology allows services to be traded under several modal forms; for instance, medical diagnostics can now be provided at a distance, thanks to electronic imagery.

6. Note that well-being can be understood in broad terms as including not only economic welfare but also value-related preferences.

7. In economics, nonrivalry means that consumption of the good by one individual does not reduce the availability of the good for consumption by others. Nonexcludability means that no one can be effectively excluded from using the good.

8. According to Levy (2009), several mechanisms could be in play: (a) once a bureaucracy commits to good governance in a trade agreement, it may make little sense to maintain a different attitude for the domestic market; (b) good governance with respect to international flows could serve as a signal, spurring reform on the domestic front; and (c) if the rule of law is not followed within the country, there might be costly and adverse reputational spillovers that could affect the decisions of foreign investors and traders.

9. The decision to focus on coal and steel came about not only because of the economic importance of the two sectors but also because these materials were considered the main inputs for making weapons. "The pooling of coal and steel production should immediately provide for the setting up of common foundations for economic development as a first step in the federation of Europe, and will change the destinies of those regions which have long been devoted to the manufacture of

munitions of war, of which they have been the most constant victims" (Robert Schuman, Declaration of 9 May 1950).

10. "The EU can make an important contribution by working around the conflict issues, promoting similar reforms on both sides of the boundary lines, to foster convergence between political, economic and legal systems, enabling greater social inclusion and contributing to confidence building" (European Commission 2007).

11. World Bank (2005), however, notes that some wars began partly as trade disputes; examples are the U.S. Civil War (1861–65) and the Soccer War of 1969 between El Salvador and Honduras.

12. The Electricity Regulatory Forum, or Florence Forum, was set up to discuss the creation of a true internal electricity market in the EU. Since 1998, the forum has met once or twice a year, formerly in Florence and now in Rome. Further information on the Florence Forum is available on the Web page of the European Commission's Directorate General for Energy; see http://ec.europa.eu/energy/gas_electricity/forum_electricity_florence_en.htm. A similar body, the Madrid Forum, has been established for natural gas markets.

13. Thus, regulation does not necessarily generate positive terms-of-trade effects for the home country (e.g., customs duties revenues, in the case of tariff protection).

14. In most cases, the situation is not that clear-cut. Regulatory burdens often create additional jobs for administrations and provide opportunities for graft.

15. In normal circumstances, there should be no prior rent capture by domestic interests, since the objective of regulatory controls is not to raise revenue or afford protection.

16. The distinction is often blurred, and when identification methods are imperfect, origin is often used as a very imperfect proxy for other characteristics (as is country of citizenship for migrants).

17. This claim was tested empirically by Czubala, Shepherd, and Wilson (2009) in the context of adoption of international standards.

18. Baldwin, Evenett, and Low (2009) cite the example of ROOs in East Asian PTAs as particularly liberal, since they only require incorporation under the laws of the trade partner and do not impose any other nationality requirements on the entity, regarding, for example, the nationality of the people controlling the firm.

19. Although separability never really existed in practice, the traditional approach was to consider trade policy in relative isolation from other policies, including other economic policies.

20. Environmental externalities could also stem from purely domestic economic activities.

21. In terms of liberalization, PTAs will at least lock in the status quo if disciplines in an area are included. This is furthered by the use of negative-list approaches, as in some services provisions. Thus, the value of commitments in PTAs is higher than in the WTO. In this sense PTAs are more rigid. This may be a reason developed countries have intensively used PTAs with smaller developing countries as a way to lock in liberalization in a way that was not necessarily happening in the WTO. But with stricter commitments looming, resistance to liberalization may also be stronger.

22. Biadgleng and Maur (2010) cite the example of commitments made by the Arab Republic of Egypt with the EU to ratify, in contradiction to its own law, the Convention for the Protection of New Varieties of Plants established by the International Union for the Protection of New Varieties of Plants (UPoV).

23. Examples of different approaches to monitoring implementation are seen in the United States, which "certifies" implementation of FTAs before congressional approval; the EU, which reports regularly in the case of accession and in more ad hoc fashion with other partners on implementation; APEC implementation action plans; and South-South agreements such as COMESA, for which the secretariat monitors country progress.

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