

## Beyond Merchandise Trade: Services, Investment, Intellectual Property, and Labor Mobility

As barriers to merchandise trade have come down and trade has expanded, policymakers and trade negotiators have turned their attention to services and trade-related regulatory issues. Of these, services, investment, intellectual property, and temporary movement of labor arguably have the greatest potential for affecting incomes and trade in developing countries. Agreements on these four issues are now becoming common in bilateral and some preferential regional trade agreements (RTAs).

North-South agreements, notably the bilateral free trade agreements of the United States and of the European Union (EU), have been the important drivers for services, investment, and intellectual property rights (IPRs). In broad terms, the United States, for example, offers access to its large market for goods in exchange for access to services markets in developing countries and their acceptance of rules governing investment and intellectual property rights. The EU market access agreements also cover many of these topics, if less specifically. Labor services—that is, the temporary movement of workers—are largely confined to professional and skilled workers, often intra-corporate transfers. South-South agreements tend to feature services liberalization less prominently, and their rules governing investment, intellectual property, and even the temporary movement of workers, are commonly weak or absent altogether.

From a development perspective, the most potentially beneficial components of this set of issues are provisions that open services markets to additional potential suppliers through foreign subsidiaries (in GATS terminology, Mode 3) and the temporary movement of workers (Mode 4).<sup>1</sup> Services liberalization in preferential arrangements can enlarge the number of competitors and carries fewer risks of income losses than preferential merchandise trade because lifting most common restrictions does not cost the government revenue. Though multilateral liberalization is usually preferable even in services,<sup>2</sup> RTAs in services can be predicted, in general, to increase welfare. Similarly, preferential agreements that widen the scope for the temporary movement of workers have the potential to raise incomes.

In both services and labor mobility, however, agreements have yet to fulfill their development potential. Many of the North-South agreements are between countries with unusually open service sectors, so the additionality to the various parties is limited to a handful of relatively small sectors and to the credibility effects of locking in openness via treaties and “seals of approval” that investors might take as a sign of lower risk. Meanwhile, in many of the South-South agreements, where the potential scope for liberalizing measures is often far greater, RTA-driven additional liberalization has been sporadic. For labor services, both the

North-South and South-South agreements are confined to intra-firm movement of professionals, and neither agreement has substantially widened market access for the temporary movement of labor.

By contrast, North-South agreements regarding investment and IPRs have succeeded in promulgating comprehensive new rules that go beyond multilateral rules in the agreement on Trade Related Intellectual Property Rights (TRIPs). The United States and EU bilateral agreements have enhanced market access through negative-list and positive-list (respectively) pre-establishment rights, and the United States has implemented investor-state dispute settlement mechanisms that empower foreign investors to seek arbitration awards in cases of uncompensated expropriation or other violations of treaties.

Ironically, of the four areas, investment and IPRs are the two where the development potential is largely unproven. The investment provisions that enhance investor's rights have not been shown to increase the flow of investment to developing countries. Nor have stronger IPRs embedded in the TRIPs-Plus agreements been shown to accelerate technological flows to low-income countries—though it may do so for middle-income countries. On the other hand, because free trade areas that result in larger markets do attract additional investment flows, it may be that in combination with large, preferential trade areas, enhanced investor protections and IPRs do have a positive impact—but agnosticism seems warranted.

This chapter begins with a synoptic comparison of agreements and a focus on the regulation-intensive bilateral U.S. and EU free trade agreements (FTAs). Understanding the diversity and reach of these agreements permits us, in a subsequent section, to review the economic consequences of provisions that deal with services, investment, and intellectual property. A final section examines the treatment of movement of temporary labor.

## Services, Investment, and IPRs in Regional Agreements

North-South agreements differ sharply in their coverage of services, investment, and intellectual property. At one end of the spectrum, U.S. FTAs usually involve the most explicit negotiations for market access in services and U.S.-style rules for investment and intellectual property. The EU market access agreements similarly contain market access provision in services, but tend to reinforce prevailing international rules for intellectual property; its Economic Partnership Agreements in Africa use development assistance in combination with trade preferences to promote rules beyond international agreements, including EU-style concerns for competition policy and geographical indications. At the other end of the spectrum, most South-South agreements are focused primarily on merchandise trade, and tend to treat services, investment, and IPRs unevenly, if at all. These distinctions should become clearer when we consider the U.S., EU, and South-South approaches in turn.

### *U.S. FTAs are rule intensive*

Key features of the U.S. FTAs that cover services, investment, and intellectual property rights include:

- Opening services markets to competition from foreign suppliers or locking in prior autonomous liberalization, except in those sectors excluded (i.e., on a negative list). Because most of the countries with which the United States has concluded bilateral FTAs are already open in most sectors, the agreements generally lock in prevailing openness and affect changes in only a few still-restricted activities. Significant market openings took place in the Costa Rican telecommunications and insurance sectors and less dramatic market openings occurred in the banking sector in Bahrain. Provisions range from inclusion of insurance,

**Table 5.1 Services, investment, and intellectual property: A comparison**

Agreements	Services					Investment					Intellectual Property
	National and MFN/Treatment Market Access <sup>a</sup>	Rule of Origin (Nonrestrictive) <sup>b</sup>	Pre-establishment & Limitations Market Access Exceptions	Right to Provide Services w/o establishment <sup>d</sup>	Ratchet Mechanism <sup>e</sup>	National Treatment/MF Post-establishment	Ownership Limitations <sup>f</sup>	Pre-establishment Limitations	Ban on Performance Requirements	Investor-State Dispute Settlement	Intellectual Property
<b>U.S.</b>											
U.S.-Jordan	Yes	Yes	Negative-list	No	No	Yes	Negative-list	Negative-list	TRIMS+	Yes	Yes <sup>h</sup>
U.S.-Chile	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	Yes	TRIPS+
U.S.-Singapore	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	Yes	TRIPS+
U.S.-Australia	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	No	TRIPS+
U.S.-CAFTA	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	Yes	TRIPS+
U.S.-Morocco	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	Yes	TRIPS+
NAFTA	Yes	Yes	Negative-list	Yes	Yes	Yes	Negative-list	Negative-list	TRIMS+	Yes	TRIPS+
<b>EU</b>											
EU-South Africa	No	No	No	No	No	No	No	No	No	No <sup>n</sup>	Yes <sup>i</sup>
EU-Mexico	Yes	Yes	Standstill <sup>c</sup>	No	No	No	No	No	No	No <sup>n</sup>	Yes <sup>i</sup>
EU-Chile	Yes	Yes	Positive-list	No	No	Yes	No	Positive-list	No	No <sup>n</sup>	Yes <sup>i</sup>
<b>South-South</b>											
MERCOSUR	Yes	Yes	Positive-list	No	No	Yes	No	Negative-list	TRIMS+	Yes	No <sup>j</sup>
Andean Community	No	Yes	Positive-list	No	No	-	No	Positive-list	TRIMS+	No	No <sup>k</sup>
CARICOM	Not specified	Yes	Negative-list	No	No	No	No	Positive-list	No	Yes	No
ASEAN	Yes	Yes	Positive-list	No	No	Yes	Yes	Positive-list	No	No	No <sup>l</sup>
SADC	No	No				No	No	None	No	No	TRIPS
COMESA	Yes	No	Positive-list			No <sup>g</sup>	No	Positive-list	No	No	No <sup>m</sup>
<b>Other</b>											
Japan-Singapore	No	Yes	Positive-list	No	No					Yes	Yes
Canada-Chile	Yes	Yes	Negative-list	Yes	Yes					Yes	
Chile-Mexico	Yes	Yes	Negative-list	Yes	Yes					No	

a. Includes fair and equitable treatment.

b. Denial benefits only to juridical person that do not conduct “substantial business” in one of the member countries.

c. Provides for future negotiation of commitments à la GATS.

d. Right of non-establishment, that is no establishment required to supply a service.

e. Autonomous liberalization is automatically incorporated into the agreement.

f. Limits on equity shareholdings for companies in sectors other than those excluded from pre-establishment limitations.

g. COMESA does grant fair and equitable treatment to members, but not to non-members.

h. The IP provisions are considered TRIPS Plus. However the chapter coverage is less specific and comprehensive than other subsequent U.S. free trade agreements.

i. Requires only adherence to international conventions.

j. The MERCOSUR agreement does not include IP, but provides for interparliamentary committees to begin work on harmonization of IP laws.

k. Andean community regulates all patents.

l. ASEAN has a framework agreement.

m. Act 128(e) calls for adoption of new patent laws.

n. EU bilateral investment treaties provide for investor-state dispute resolution.

Sources: Legal treaties; Mattoo and Sauve 2004; te Velde and Fahnbulleh 2003; Mann and Cosbey 2004; Szepesi 2004a, 2004b; Abbott 2004a and 2004b; OECD 2003; information provided by governments.

financial advisory services, and selected telecommunications services to arguably relatively minor changes to the already open regimes, such as the commitment of Singapore to cease cross-subsidies in express mail delivery or the commitment of Chile to open selected insurance services (table 5.2).

- Ratchet provisions and negative-list exclusions. The ratchet clauses mean that new autonomous liberalization will automatically be subsumed under the terms of the agreements. Negative lists ensure that yet-to-be-invented new service areas are guaranteed to be covered by the treaty. Notable for their absence is the exclusion of labor services, except provisional visas for professionals associated with investing firms (discussed in the penultimate section of this chapter).
- Investment rights. Investment rights, with provisions for national treatment, nondiscrimination, pre-establishment provisions for companies based in each others markets, bans on trade-related investment measures (TRIM), and investor-state arbitration of dispute limited only by a negative list of exclusions.
- TRIPs-Plus provisions that provide stronger protections for IPRs than under the TRIPs agreement, with investor-state arbitration dispute settlement permitted in the event of disputes (subject to certain limitations).

Other noteworthy provisions (not the subject of this chapter) include labor protections and environment issues that figured prominently in the CAFTA, Chile, and Singapore agreements, among others. Signatory countries committed to enforcing their own labor laws in five areas: right of association, the right to organize and bargain collectively, prohibitions on forced labor, a minimum age for employment of children, and acceptable working conditions. Complaints can be filed, and if the agreed-on procedures to mediate the dispute fail, a panel of experts would review the case and, if warranted, impose a fine to be used for the enforcement of labor rights; that is to say, trade sanctions are not an agreed-on remedy (Weintraub 2004).

The FTAs involve innovations in trade law in two important areas: investment and IPRs:

*Investment Access and Protections.* The FTAs have incorporated the provisions of bilateral investment treaties (BITs), and in some cases, provided new measures covering investment (table 5.1). Agreements, especially post-NAFTA ones, include broad definitions of investment, comprising not only foreign direct investment (FDI), but also portfolio flows, private debt, and even sovereign debt issues as well as intellectual property (Mann and Cosbey 2004; Vivas-Eugui 2003). The inclusion of short-term debt, together with pre-establishment rights, led the U.S. Treasury to demand that Chile modify its controls on capital inflows that were

**Table 5.2 Additional services liberalization in U.S. FTAs**

	Chile	Australia	Bahrain	CAFTA	Morocco	Singapore
Banking			◆		◆	◆
Insurance	◆		◆	◆	◆	
Telecommunication	◆		◆	◆	◆	◆
Broadcasting & Audiovisual	◆	◆				
Financial Advisory Services and Data			◆			
Retail/Wholesale Distribution				◆		
Restrictions on Foreign Directors & Managers				◆		
Express Mail Delivery						◆
Real Estate						◆
Legal Services						◆

Source: Legal treaties.

designed to curtail destabilizing hot money inflows.<sup>3</sup> Such broad definitions expose countries to dispute settlements across a range of assets that go far beyond multilateral commitments.

All agreements provide for treatment of foreign investors on the same basis as domestic investors (*national treatment*) and have provisos banning discrimination among investors from member countries (*MFN, or nondiscriminatory treatment*). For many of the initial FTA countries, these stipulations had been included in national legislations and/or had been incorporated into bilateral investment treaties, mainly on a post-establishment basis.

What is new is the extension of the *pre-establishment* right to invest in businesses and activities in all sectors, except where expressly prohibited via a negative list.<sup>4</sup> These pre-establishment rights lock in the right of Mexican and Canadian investors under NAFTA to invest in all activities in the United States. Exceptions for the United States include foreign investment with NAFTA guarantees in selected areas of communication, media, transportation, and social services. Pre-establishment rights mark a broad expansion of market access by foreclosing future government policies that would raise barriers to foreign investment. The rationale for accepting such disciplines is that it provides certainty on the rules of the game, which will in turn translate into increased investment inflows.

Another discipline more expansive than multilateral accords is in *trade-related investment measures (TRIMs)*. The WTO TRIMs agreement of 1995 attempted to clarify disciplines on government policies that require foreign companies to establish joint ventures, export in a certain portion of its sales or balance trade, use local inputs to achieve value-added objectives, or hire local staff. However, the agreement failed to provide adequate definitions of disciplines, and it presented poorly formulated implementation periods and inadequate notification and monitoring

procedures; the operation of the agreement was to be reviewed by January 1, 2000, but so far the review has not occurred (Bora 2003). All of the bilateral FTAs ban, in some form, trade-related investment requirements, such as by local content rules, value-added requirements, and restrictions on management. The U.S. bilateral agreements have, in effect, established a “TRIMs-Plus” set of obligations that includes outright bans on certain performance requirements, including exports, minimum domestic content, domestic sourcing, trade balancing, and technology transfer. In general, government procurement, environmental standards, some health measures, and requirements for local research and development (R&D) are all exempt (Te Velde and Fahnbulleh 2003).

Freedom to make transfers is a nontrivial investment right granted under the investment agreements. This assures investors that they will be able to transfer profits, make investments, or lend without government interference.

Finally, all U.S. agreements except the Australian FTA create an *investor-state dispute resolution* provision that permits investors to take foreign governments to dispute resolution for violation of the treaty’s national treatment, nondiscrimination, or expropriation provisions, among others. NAFTA’s Chapter 11 and Chile’s Chapter 10 are the most widely known mechanisms, but these mechanisms are contained in the other bilateral agreements as well.

*Intellectual Property Rights.* The IPR provisions embedded in all recent U.S. FTAs go beyond the multilateral IPR standards established in the WTO’s TRIPS Agreement. “TRIPS-Plus” elements found in many—but not all—of the IPR chapters include:<sup>5</sup>

- Extension of the patent term for delays caused by regulatory approval processes; extension of the term of copyright protection to life of author plus 70 years (compared to life of author plus 50 years in TRIPS).

- A requirement to provide patent protection for plants and animals.
- A limitation on the use of compulsory licenses for national emergencies and as antitrust remedies, and for public non-commercial use.

In the area of pharmaceuticals:

- An obligation to prohibit the marketing approval of generic drugs during the term of the drug patent.
- A five-year period of marketing exclusivity following the submission of safety and efficacy data to drug regulatory authorities (so-called data exclusivity). In addition, marketing exclusivity effectively applies across borders, so that marketing approval in one market—say, the United States—impedes registration of competing products in another market.
- An additional three-year period of marketing exclusivity based on the submission of new clinical data with respect to new uses of previously approved drugs. Exclusivity would also apply to drugs for which the patents have expired (although generic competition for previously approved uses would remain unaffected).
- Imposition of restraints on parallel importation, impeding the possibility that parties to the agreements open their markets to the import of products that have already been sold—possibly more cheaply—in foreign markets.

In the area of digital works:

- An obligation against circumventing so-called technological protection measures—devices and software developed to prevent unauthorized copying of digital content. Rules on the liability of Internet service providers (ISPs) when copyright infringing content is distributed through their servers and networks. These provisions are based on standards found in the U.S. Digital Millennium Copyright Act of 1998.

The inclusion of these services, investment, and IPR issues was a contributing factor to the breakdown in negotiations in the Free Trade Area of the Americas (Nogues 2004). We return to these issues below when considering the economic consequences of these arrangements.

### *EU FTAs take a different approach*

In addition to market access in merchandise, the EU has focused heavily on services in its bilateral FTAs. The earliest (and least specific) is the South African agreement (1999) that contains only the promise of potential liberalization after discussions transpire in 2004 and 2005. In the EU-Mexico FTA, several general provisions were included (many ratifying GATS arrangements), as well as specific liberalization commitments in the financial sector. The EU-Chile agreement went further than the other two and included liberalization of telecommunications and maritime services (Ullrich 2004).

The EU agreements with Mexico and Chile differ from the U.S. agreements in important respects. First, the trade provisions are phrased on the basis of a positive list and implicitly exclude new products. Second, the treatment of intellectual property effectively reaffirms a multilateral approach to IPRs, because the agreements provide only the list of conventions that signatory countries have already ratified, those it intends to ratify, and those that it will consider ratifying in the future.<sup>6</sup> This approach differs from that taken toward the EU-accession countries, in which new entrants were required to apply the rigorous EU standards on data protection and marketing exclusivity; these have a major impact on generic producers.

The treatment of *investment* and capital flows in both agreements does not appear to be extensive. For example, the EU-Mexico agreement simply states that the existing restrictions on investment will be progressively eliminated and no new restrictions adopted; the agreement did not specify particular sectors or set a timeline for liberalization. The

language in the EU-Chile agreement calls for the “free movement of capital relating to direct investments made in accordance with the laws of the host country.” In both instances, the agreements allow for the use of safeguards in the event of monetary or exchange rate difficulties, and although the time limit is set at 6 months for Mexico and 12 months for Chile, it would allow for continuation of the safeguard after the time limit through its formal reintroduction. That said, many of the same investor protections found in U.S. FTAs are also found in EU bilateral investment treaties with developing countries.

The treatment of *dispute settlement* is similar in both agreements. In general, the EU has no special provisions pertaining to investment, but these are covered under the general dispute settlement provisions for all matters in the agreements (Szepesi 2004a and b). Dispute settlement is covered on a state-to-state level and is first attempted through consultations with a Joint Committee (Association Committee in the case of Chile) within 30 days of a party’s request. If this step of “dispute avoidance” proves unsuccessful, the concerned party can forward its request to an arbitration panel comprised of representatives of both parties. The arbitration panel’s decisions are binding, and the panel can also rule on the conformity of any measures undertaken as a result of its decision with the original ruling. Both agreements provide extensive detail on the process of appointing members to the arbitration panel, timelines for the panel’s ruling, and compliance with the panel’s decisions.

### ***South-South agreements focus on expanding trade***

Virtually all of the other major agreements contain references to *services liberalization*. Most agreements allow for national treatment, post-establishment nondiscriminatory provisions (table 5.1). At the other extreme, there are more limited agreements like Association of Southeast Asian Nations (ASEAN) and Southern Common Market Agreement

(MERCOSUR) that have delivered services liberalization additional to levels negotiated multilaterally or determined unilaterally. Regional agreements in services have competed to create complex structures of rules and commitments. But in many cases, the sound and fury of the negotiations has signified limited liberalization. Many agreements do not provide new market access beyond what countries have already scheduled with the GATS. In telecommunications and financial services, the GATS has in fact achieved a higher level of bound liberalization than that offered in most RTAs.

All South-South agreements have a relatively nonrestrictive definition of preferential access; by allowing firms from nonmember countries that have “substantial business” in member countries to invest through subsidiaries based in member countries, the number of potential competitions in the market is enlarged.

Agreements with negative lists have several advantages in terms of market access: they permit automatic liberalization of new service industries; they establish a stronger floor for liberalization by locking in the status quo; they are more transparent; and they may lead to a more productive internal dialogue with sectoral private interests (Mattoo and Sauve 2004). Ratchet mechanisms that allow new autonomous liberalization to be incorporated automatically into treaties are most likely to co-exist with negative list provisions. However, most of the South-South agreements have not liberalized many sectors, and some, like MERCOSUR, have not implemented accords in the way that was anticipated at signing (Nofal 2004).

*Investment provisions* have differed as well. South-South RTAs generally have been less ambitious with respect to investor protections. This is true for the right to provide services without establishing local affiliates. It is also true for investor-state dispute settlement. For the most part, only the United States and EU bilaterals have established sophisticated mechanisms to deal with disputes on

investment. Some agreements provide for investor-state dispute resolution, though these protections are less strong than in the North-South Agreements.

*Intellectual property rights*, while mentioned in South-South agreements, rarely go beyond disciplines negotiated at the multilateral level, and they do not have the tightly formulated provisions that characterize the North-South agreements, notably those with the United States. MERCOSUR, for example, has agreed to establish a commission to examine areas of intellectual property harmonization, while ASEAN has a framework agreement. The Andean community has more detailed restrictions, but these are written less with the view of protecting intellectual property than of eliminating territorial restrictions on the use of patented technology; the restrictions were designed to end the restraints multinational companies put in their technology contracts with their foreign affiliates, which explicitly prevented them from using the patents in export production.

### **Economic Consequences of Services, Investment, and IPR Provisions in RTAs**

#### ***New market access in services could promote growth***

Services liberalization with proper regulation can be a powerful driver of economic growth and poverty reduction. At the sectoral level, removing barriers to competition can lower prices, improve quality, and add variety. Because of the linkage effects—the fact that producers require telephones, use finance, need adequate transportation services, and benefit from business services—improving service sector performance can generate huge economic gains. Mattoo, and others (2001) show that countries with fully liberalized financial and telecommunications sectors grew annually on average about 1.5 percentage points faster than other countries, controlling for other factors. These gains are not automatic—they require adequate regulation and a supportive

investment climate—but the potential gains are large (World Bank 2001).

Realizing these gains requires allowing foreign investors greater *market access*, and this is the most important provision in a preferential arrangement. Countries can open previously closed sectors to RTA partners as part of an agreement. Since today most countries accept, indeed clamor for, foreign investment in manufacturing and natural resources, RTA-driven reductions in entry barriers affect mainly services. Moreover, services now play a larger role in investment flows, and for some countries, such as Mexico, they have dwarfed investments in manufacturing. The great bulk of services investment are market-seeking, horizontal investments. These cover a vast range of large multinationals: Deutsche Bank, WalMart, Starbucks, Microsoft, and so on. These “mode 3” services require the commercial presence of affiliates, branches, or franchises to deliver the service. To be sure, some countries (such as India) have experienced substantial flows associated with call centers and data processing, and this new investment accompanies these cross-border supply (“mode 1”) activities, though these activities remain small in comparison to trade through commercial presence.

Because preferential arrangements permit more suppliers to compete in the market, a country is almost certain to gain from preferential liberalization of the services trade, irrespective of the supplier. This is in sharp contrast to merchandise trade, where the income loss associated with trade diversion can occur with the loss in tariff revenue. In services, barriers to entry usually take nonmonetary forms such as regulatory restrictions on entry, foreign equity limitations, quotas on outputs and foreign service workers, and requirements on legal form of establishment. None of these generate revenue for the government, so removing these restrictions is less likely to produce income losses (with merchandise trade, income losses associated with trade diversion occur because the government loses the tariff revenue as trade is diverted to higher-cost

sources of imports). Moreover, the scope for increased competition and exploitation of scale economies, as well as the possibility of inducing knowledge spillovers, strengthens the presumption that a country would gain from a preferential agreement in services.

Multilateral, nonpreferential liberalization is likely to produce *even larger* gains than preferential regional agreements. This is because multilateral liberalization opens the market to the largest number of competitors and permits consumers maximum choice; it allows imports from the most competitive source. It also leads to a less complex policy regime than a preferential arrangement, and therefore implies lower administration costs for government agencies and lower transaction costs for the private sector. Finally, it is possible that preferences could lead to a higher-cost firm gaining a competitive advantage relative to investors from outside the region. And first mover advantages and barriers to entry can make it difficult for lower-cost suppliers from third countries to enter the market. Inefficient suppliers from member countries might establish positions behind market barriers sufficiently high that new and even more efficient potential competitors would not choose to pay the cost of entry.

Rules of origin for services, as with merchandise trade, can play a significant role in determining the degree to which regional trading arrangements discriminate against nonmember countries, and hence the degree of competition in services associated with an RTA. For example, if one participant has a fully liberalized market, the adoption of a nonrestrictive rule of origin by the other participants can be likened to MFN liberalization. Service suppliers can enter the liberal jurisdiction and from there move to the other partner countries. Many governments take the liberal rules of origin one step further and extend regional preferences on an MFN basis under the GATS. This widens the number of competitors in the market and offers greater opportunities for securing access to the most efficient suppliers—particularly of infrastructural services likely to exert significant

effects on economy-wide performance. Because of the strong potential links to growth (World Bank 2002), the additional market access provided through RTAs could be important. Unfortunately, the actual additional liberalization has not yet matched this promise.

Nonetheless, restrictive rules of origin can limit the potential benefit to liberalization. Participants who seek to benefit from preferential access to a protected market and deny benefits to third country competitors are likely to argue for the adoption of restrictive rules of origin, based on criteria such as ownership or control considerations. This could be the attitude of regionally dominant but globally non-competitive service providers toward third-country competition within a regionally integrating area.

Examples of restrictive rules of origin for services and investment can be found in MERCOSUR and the Andean Pact, both of which limit benefits to juridical persons that are owned and controlled by natural persons of a member country. The Hong Kong-China Free Trade Agreement, for example, features a detailed annex spelling out the set of criteria by which Hong Kong service suppliers may benefit from the terms of the agreement.

#### ***Do RTAs attract more investment?***

RTAs can, in theory, promote more investment through new *trade rules* that create a larger market, new *investment rules that permit market access* by relaxing restrictions on market entry (such as discussed above for services), and *new investor protections*.

New trade rules that eliminate internal barriers create a larger internal market, which can raise the return to investment and create an incentive to invest for members and for third countries. Firms investing in the RTA countries can achieve economies of scale and scope in serving a larger market of potential buyers, may experience reductions in transactions costs, and if services are included, benefit from more efficient financial, telecommunications, and other services (Schiff and Winters 2003). Trade rules can induce greater efficiency in

transactions with the global economy. Markusen (2004), for example, notes that inward investment to reach the local market may also include tapping into lower cost production sites within the new RTA to serve the wealthier parts. Japanese multinational companies might well locate in Mexico to reach the U.S. market, though the net effects might be diluted as U.S. firms also set up in Mexico. Frischtak (2004) found that MNCs in autos, textiles, and electronics reallocated their production to Mexico to serve the U.S. market.

The larger market can also increase productivity in other ways. Aside from economies of scale, a larger market can increase competition among a potentially larger set of suppliers, and take advantage of differing regional factor prices to drive productivity increases and hence more rapid growth; and the more rapid growth provides a dynamic attraction to intra-bloc and extra-bloc investment. If the RTA reduces border protection on investment goods and allows domestic producers to source cheaper and higher technology capital goods, members may benefit.

However, efficient results are not automatic. Even though investment may be destined for a larger market, border barriers may create incentives to invest in high-cost import-substituting

activities that are not internationally competitive. Latin America's early experiments with admitting FDI behind high border barriers produced inefficient investment and a protectionist political economy that took decades to unwind (box 5.1). The formation of RTAs may increase both internal and external investment, but the resulting market size may not be sufficient to realize modern scales, and the high external tariffs drive up the costs of imported inputs. Indeed, the first Andean Pact in the early 1970s and the Central American Common Market in the 1960s failed to generate investment-related productivity gains.

RTAs may include new *investment rules to facilitate market access*. As with services, the decision to lift an administrative barrier impeding manufacturing investment or an investment in natural resources can create an opportunity for investors and hence prompt new investment. Most remaining restrictions today—equity ownerships limitation and bans on foreign investment in particular activities—are not restrictions on manufacturing, but rather on services (e.g., broadcasting, telephony, and airlines in the United States, among other countries) and natural resources (e.g., oil in Mexico). RTAs that reduce market

## Box 5.1 Not all investment is good investment

Trade barriers in preferential arrangements can divert trade to higher-cost sources. No less important is the investment undertaken to produce the new trade. If trade policies provide high protection, they will limit competition, allow for shared monopoly pricing, and incur the inefficiencies of price distortions. This pattern of investment was common—and costly—in the period before high protection was brought down. Lall and Streeten (1977) who studied some 90 foreign investments using a cost-benefit methodology, found that more than 33 percent *reduced* national income; this was mainly from excessive tariff protection that allowed high cost firms to produce for the local market at very high

prices, even though they could have imported much more cheaply. (It turns out domestic firms performed even more poorly.) Encarnation and Wells (1986) found that between 25–45 percent of 50 projects studied (depending on analytical assumptions) reduced national income; again the main culprit was high protection. As average tariff levels have come down, these low-quality type of investments have faded in importance. Trade and tax policy often interact in ways that magnify their competition-restricting effects.

Sources: Lall and Streeten 1997; Encarnation and Wells 1986; Newfarmer 2001.

access barriers associated with restrictions on foreign entry are likely to have greater impact through this channel than through manufacturing.

Granting new *investment rights* may also attract additional investment, though here the case is more contentious. In general, the strongest investor protections entail nondiscrimination among all investors, provisions against expropriation, dispute settlement with eligibility for investor-state suits, and independent arbitration. The legal power granted to investors to sue governments under terms of the bilateral or regional agreements is arguably the strongest new protection in the trade agreements. These provisions differ in detail, but they closely mirror the bilateral investment treaties, even though they are anchored to the trade agreement.

Despite the proliferation of new protections to foreign businesses, the positive economic consequences have yet to be demonstrated. Theory would suggest that sound property rights are a foundation of any country's invest-

ment climate, and, other things being equal, stronger rights would lower risk and entice more investment at the margin. Since investors put money at risk against the promise of returns in subsequent periods, predictable regulation and protection of property rights are integral to the investment decision. However, the evidence for many of the same protections contained in the bilateral investment treaties is that these additional protections have no significant effects on inflows of FDI (box 5.2). To be sure, signing an FTA with new investor protections may enhance the credibility of a reform program, but evidence that these have observable consequences is scarce.

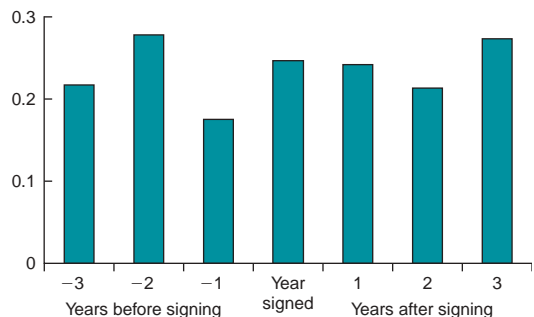
While the benefits of these protections in the form of new FDI inflow are open to question, the costs in the form of investor suits are nontrivial and growing. In NAFTA, for example, as of July 2004, there were 31 cases brought under Chapter 11 (including 14 against Mexico, 9 against Canada, and 8 against the United States). Six cases have been decided in favor of the investor, but the

## Box 5.2 Do more investor protections mean more investment? Lessons from bilateral investment treaties

Does increasing investor protections produce the benefit of high investment? One test of this proposition was Hallward-Dreimeier's (2003) study of the enhanced investor protections through bilateral investment treaties for flows of FDI among signatory countries.<sup>6</sup> Analyzing bilateral flows of OECD members to 31 developing countries over two decades, she found that, controlling for a time trend and other factors, BITs had virtually no independent effect in increasing FDI to a signatory country from a home country. Said differently, countries signing a BIT were no more likely to receive additional FDI than countries without such a pact. Even comparing flows in the 3 years after a BIT was signed to the 3 years prior, there was no significant increase in FDI. This agrees with the findings of UNCTAD (1998) that the number of BITs signed by the host was uncorrelated with the amount of FDI it received.

### BITS do not add much

Share of annual FDI flow



Source: World Bank Global Economic Prospects 2003.

Sources: Hallward-Dreimeier 2003; UNCTAD 1998.

amount awarded has been small compared to initial—and inflated—claims. Tribunal awards have totaled \$35 million, compared to claims of \$1015 billion. Under the similar BITs, 48 alleged BIT violations are under review arbitration at the International Center for Dispute Resolution. Cases have arisen out of the Argentine devaluation, the changes in tax policy perceived as adverse by investors, expropriations following conflict or coups, irregularities in bidding processes, and others (Peterson 2003a). In perhaps the most significant case to date, a tribunal in Stockholm ordered the government of the Czech Republic to pay one company, Central European Media (CME), \$350 million for violation of a bilateral investment treaty that deprived CME from a stake in an English language TV station in Prague.

This amount was 10 times higher than previously known awards under arbitration cases and about equal to the entire public sector deficit of the Czech Republic (Peterson 2003b).

The legal and macroeconomic consequences of investment rights in treaties are largely unknown. They have not been thoroughly analyzed and tested in arbitration cases, and are without precedent. One could certainly speculate about adverse outcomes. For example, new rules for Chile could complicate management of short-term capital flows; in fact, the IMF expressed reservations to the U.S. government that the limitations that the U.S.-Chile bilateral FTA imposed on the Chilean government regarding short-term capital inflows reduced the government's ability to manage a macroeconomic crisis. Similarly, the breadth of definition of investment coverage opens the government to investor-state arbitration in event of default on debt or suspension of payments in emergencies—which may ultimately be unenforceable. For instance, Argentina's default has led investors to file nearly 30 arbitration cases; none of these appear to have been associated with nonpayment of debt. However, these debts are also subject to ongoing discussions between

the government and creditors. By defining intellectual property as an "investment," a foreign investor who claims his intellectual property rights have been abrogated has recourse beyond the national court system to international arbitration proceedings under the investment provisions of the bilateral agreements.<sup>7</sup> These provisions have unquantifiable development benefits—and bring risk, which incurs uncertain costs.

### ***The combination of changes in RTAs may have an effect on investment***

Even if protections by themselves contribute little additional inflows, evidence is mounting that RTAs—that is, the *combination* of appropriate trade rules, liberalized market access, and investor protections—can have positive effects on inflows of foreign investment, provided that the investment climate is supportive and the size of the newly created market is attractive.

Indeed, Lederman, and others (2004) found that RTAs that formed large markets attracted FDI, (controlling for other factors that influence location), but that small markets had no effect. They also found positive effects for NAFTA, although the flow of FDI, even controlling for privatizations, appears to have surged in the first years but has not been sustained. Waldkirch's (2001) study, with less complete annual data, found that NAFTA increased FDI substantially, mostly from the United States and from Canada. Chudnovsky and Lopez (2001) found that FDI increased in the MERCOSUR, largely from outside sources, but that it often entered via acquisition, displaced domestic investment, and was tariff-hopping to produce for the local market—so it probably contributed to less growth less than it otherwise would have. They also found that FDI inflows tended to locate in the larger countries, underscoring the need for stronger institutions and policies in the smaller countries.

Levy Yayati, Stein, and Daude (2004) used a gravity model to analyze the effects of RTAs on FDI inflows in 13 major agreements, and

then applied their findings to a simulation for the FTAA. They found that RTAs have a strong positive impact on inflows, and that if these average magnitudes hold after the signing of an FTAA, the results would be substantial increases in flows to FTAA countries. However, the distribution is uneven, and countries with larger post-RTA market size, low inflation rates, strong domestic institutions, and open economics are likely to be the biggest beneficiaries.

To investigate further whether RTA formation can affect FDI flows in a consistent fashion, we examine the effects of RTA membership and other variables on FDI inflows for a panel of 152 countries over the 1980–2002 period. The sample takes into account 238 RTAs (both regional and bilateral), many of which overlap, that encompass the vast majority of sample countries.<sup>8</sup> In general, countries that are more open (measured as the sum of exports and imports over GDP), growing more rapidly, and are more stable (captured in less volatile inflation rates), attract greater quantities of FDI, controlling for growth rates of FDI to all countries and the world growth rate.<sup>9</sup> RTAs that result in larger markets do attract greater FDI. The interaction of an RTA signing and additional market size associated with the integrated markets is significant and positively related to FDI. On average, a 10 percent increase in market size associated with an RTA produces an increase of 5 percent.<sup>10</sup> This has important policy implementations: If a country seeks to use an RTA to attract investment, it should seek to amalgamate with the largest possible markets; RTAs among small market countries have little effect.

Two important caveats to this conclusion are worth underscoring: First, a preferential trading arrangement cannot compensate for an inadequate investment climate. Stein and Daude (2001) have shown that institutional variables that make up the whole of a country's investment climate—including political stability, government effectiveness, rule of law, and lower risks of expropriation—are all significantly associated with increases in

investment flows, controlling for other determinants of FDI. These wash out the otherwise positive effects of RTAs. If the economy suffers from poor macroeconomic management, high levels of corruption, and poor infrastructure, an RTA by itself will not offset the disadvantages. To be sure, an RTA may help governments through their collective action to improve the investment climate and bring in more investment; but an RTA is no substitute for an adequate investment climate (World Bank 2004). Second, creation of an RTA will not have much effect on investment inflows from outside the region if restrictions on market access are severe and remain unchanged.

#### *How do IPRs affect the price of technology?*

Creation and enforcement of IPRs have an important role to play in development, but neither theory nor available studies provide much guidance on the likely outcomes of implementing in trade agreements the strongest of the IPRs or none at all. On the one hand, stronger IPR enforcement in general is likely to enhance the overall investment climate, especially for high technology firms. On the other, recognizing full patent protection for firms may require poor countries to pay higher prices, with little additional incentive either to innovate or to make investments in the local market.<sup>11</sup> Full enforcement of patents<sup>12</sup> could produce substantial financial flows, estimated roughly at \$19 billion to the United States and \$7 billion to Germany (World Bank 2001). Moreover, the administrative costs of upgrading IPR systems are not trivial (Finger and Schuler 2004).

It was the prospect that developing countries would have to pay higher prices for patented drugs that motivated the international community to agree to clarify flexibilities embedded in the TRIPS Agreement at the WTO Ministerial Meeting in 2001. The resulting Doha Declaration on TRIPS and Public Health reaffirmed the right of WTO members to use the flexibilities of TRIPS in the areas of compulsory licensing and parallel

importation to “. . . *promote access to medicines for all.*”<sup>13</sup> In August 2003, WTO members created a special mechanism under the TRIPS Agreement that allows countries with insufficient manufacturing capacity to effectively use compulsory licenses by importing generic drugs.

At first blush, the TRIPS-Plus portions of the U.S. FTAs seem to circumscribe the policy space provided in the Doha Declaration. In particular, provisions on the link between patent status, marketing approval, and data exclusivity appear to put limits on the spirit of the Doha Declaration, because countries may be prevented from effectively employing compulsory licenses to introduce competition from generic drug producers.<sup>14</sup> To address these concerns, the U.S. bilateral agreements with Bahrain, CAFTA-DR, and Morocco contain side letters that share the understanding that the intellectual property chapters do not affect the ability of governments to “. . . *take necessary measures to protect public health by promoting medicines for all* [. . .].”<sup>15</sup> In other words, government can be justified as protecting public health, as permitted under the three FTAs. The United States Trade Representative office recently clarified: “. . . *if . . . a drug is produced under a compulsory license, and it is necessary to approve that drug to protect public health . . . the data protection provision in the FTA would not stand in the way.*”<sup>16</sup>

Notwithstanding the potential flexibilities provided by these side letters, they raise several questions. How widely will the parties to the three agreements define the “protection of public health”—or, what definitions would an arbitration panel use? Uncertainty in this respect may become itself a barrier to making use of the flexibilities and may open the door for restrictive interpretations by vested interests. Also, several of the other U.S. FTAs do not contain comparable side letters, raising questions about conflicts between intellectual property obligations and public health objectives in at least some of the affected countries.

The welfare effects of stronger and new copyright protection standards are ambiguous.

On the one hand, most countries have industries that rely on copyright protection and that may benefit from strengthened protection. And new technologies that greatly facilitate the copying of digital works pose challenges that policymakers need to address. On the other hand, copyright laws have historically sought to strike a balance between the interests of copyright producers and the interests of the general public. So-called fair use exemptions allow the copying of protected works for educational or research purposes. There are questions that new rules on the technological protection measures and the liability of Internet service providers could diminish the rights of consumers and the general public (CIPR 2002). Ensuring fair use of copyrighted material is particularly important for educational material. The opportunities and gains from the use of digital libraries, Internet-based distance learning programs, or online databases would be limited if access to such tools became unaffordable or otherwise restricted by copyright law.

Evidence is inconclusive about the responsiveness of FDI to intellectual property regimes. Although surveys of foreign investors typically indicate concerns for IPRs, this is often of secondary priority (Mansfield 1995). Maskus (2000) concludes that countries (especially low-income countries) should focus on their overall investment climate to attract more and high technology investment, rather than to fine-tune their IPRs. Nonetheless, some multinational companies (MNCs), when selecting an investment location among middle-income countries, clearly take into account the laws governing intellectual property. Other studies have found that weak laws and weak enforcement deter investment in middle-income countries,<sup>17</sup> but the results for low-income countries are inconclusive. Finger and Nogues (2002), in fact, argue that the introduction of patent protection for drugs in Chile made several multinational pharmaceutical companies stop production and investment and source this market from other locations. In summary, Fink and Maskus (2004) in their

review of the evidence conclude: “. . . countries that strengthen their IPR regimes are unlikely to experience a sudden boost in inflows of foreign direct investment,” but that IPRs can stimulate formal technology transfer through FDI and licensing.

All in all, the general conclusion is that countries have to develop an IPR strategy appropriate to their level of development, and then analyze carefully which if any IPR provisions ought to be contained in trade treaties or RTAs.

## RTAs and Provisions for Movement of Labor

### *Using RTAs to promote movement of unskilled workers*

Walmsley and Winters (2003) estimated that if a temporary visa system were introduced in those developed countries that permitted the movement of up to three percent of their labor force, world incomes would rise some \$160 billion. Some 70 percent of the global welfare gains from increased migration would come from the movement of unskilled workers. To date, progress under the GATS Mode 4 negotiations in easing restrictions on the temporary entry of workers has been limited; the agreement has generally been used for skilled workers, not unskilled.

Regional agreements might offer a more promising venue for realizing the gains from

temporary movement of workers—that is, by going beyond the relatively limited scope of the GATS Mode 4 provisions. Regional agreements are often between countries with historical ties, and former migrants (or their children and grandchildren) tend to support increased opportunities for citizens of their home countries. Working on bilateral or regional levels may provide receiving countries with greater control over the numbers and nationalities of temporary workers. That is, receiving countries that wish to ensure maximum control in immigration decisions may prefer to design their policies without having to negotiate the terms with countries outside the region. Given both labor market and security concerns, this control may make it easier for countries to implement temporary programs for unskilled workers. Close neighbors tend to have a high proportion of immigrants in receiving countries. To what extent have RTAs facilitated labor movement?

Regional agreements treat labor movement in varying ways, ranging from full labor mobility to no provisions at all. As shown in table 5.3, RTAs treat labor in one of four different ways:<sup>18</sup>

- free labor mobility, with limited exceptions;
- temporary market access for certain (usually skilled) groups of workers;

**Table 5.3 Summary of agreements by degree of labor mobility**

Degree of labor mobility under agreement	Agreements
Full labor mobility	European Union, Agreement on the European Economic Area, European Free Trade Association, Australia-New Zealand Closer Economic Relations
Market access for certain groups	Caribbean Community, North American Free Trade Agreement, Europe Agreements, Group of Three, and Canada-Chile, U.S.-Singapore, U.S.-Chile, Japan-Singapore Free Trade Agreements
Based on GATS Mode 4, with additional provisions or limitations	ASEAN Free Trade Area, Euro-Med Association Agreements, New Zealand-Singapore Closer Economic Partnership, Southern Common Market Agreement, and EU-Mexico, EU-Chile, MERCOSUR, and US-Jordan Free Trade Agreements
No effective provisions for labor mobility	Asia Pacific Economic Co-Operation Forum, South Asian Association for Regional Cooperation, Central European Free Trade Agreement, and Common Market for Eastern and Southern Africa

Source: World Bank staff; Nofal 2004.

- temporary movement based on the GATS Mode 4 model, often with additional provisions or limitations;<sup>19</sup> and
- no provision in place for market access (beyond facilitating entry visas), or plans designated to be realized only in the future.

Most agreements do not override migration legislation, and parties retain broad discretion to grant, refuse, and administer residence permits and visas. It should be noted also that the right of labor mobility does not automatically entail the right to practice a certain profession; national regulations regarding licensing and recognition of qualifications are still applied.<sup>20</sup>

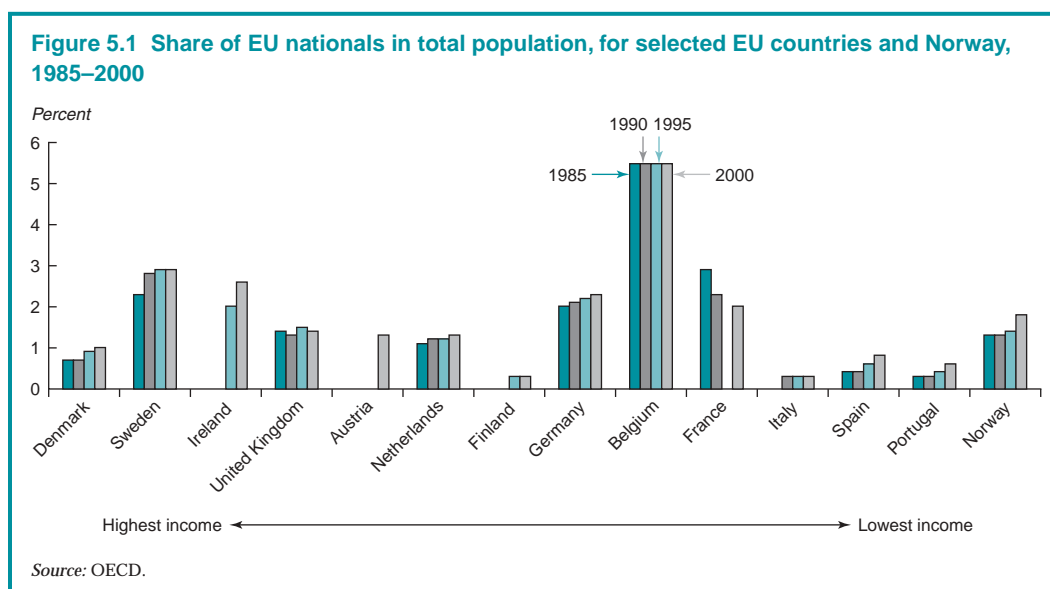
**RTAs with full labor mobility**

The EU, the European Economic Area and European Free Trade Association, and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) allow for free labor mobility, with very limited exceptions.<sup>21</sup> The EU also allows the right to reside (with family), although residence permits are not required for stays of less than

three months. The European agreements include exceptions for public services, public security, and/or public health works. ANZCERTA provides for both full market access and national treatment for all service suppliers, excluding a few sectors.

The migration provisions of these agreements facilitated regional integration by making it easier for firms from one country to transfer personnel to their operations in other countries in the region. The potential for workers to move to higher-paying jobs in other countries may have improved discipline in some labor markets. However, the EU agreements had almost no impact on stocks of permanent migration from other EU countries (figure 5.1), in part because several EU countries had already provided for free labor mobility. In addition, most of these countries are of similar income levels, so the incentive to disrupt family and personal relationships by moving for higher incomes was limited. The entry of less wealthy countries into the EU in the 1980s also did not result in greatly increased migration.

Several factors may explain this: among these, the free movement of workers from the



new member states were subject to transitional periods; the EU's regional funds aimed at developing less prosperous regions combined with the prospect of a positive economic development in the new countries are likely to have thwarted a significant migration of labor. Greece, Portugal, and Spain underwent 6 years of transition, which limited the free movement of people after their entry to the EU. Even the richest EU countries (Denmark and Sweden) experienced only a slight rise in EU nationals as a share of population after the transition periods of the poorest EU countries (Spain and Portugal) expired.<sup>22</sup>

It remains to be seen whether the recent accession of Central and Eastern European countries to the EU will result in substantial migration. While this agreement will ultimately provide for full labor mobility, most of the original EU countries have taken advantage

of provisions that delay this migration for a limited period (renewable up to 7 years). Most studies find that the accession agreements are unlikely to greatly boost migration to Western Europe. Forecasts of the additional migration due to expansion of the EU, which relies on both econometric models and opinion polls, generally find that migration will be limited to about 3–4 percent of residents of the 10 first-round East European nations within a decade of freedom of movement; this amounts to about 4 million people or 1 percent of the current EU population. Additionally, about half of these laborers are likely to return home within the 10-year period, meaning a net migration of 2 million persons (Martin 2003). However, some of the EU countries, particularly those bordering the Eastern European countries like Germany and Austria, could experience larger flows relative to population.

### Box 5.3 Illegal migration: A growing global phenomenon

The number of migrant workers without proper work permits, so-called undocumented or illegal workers, is increasing. The International Organization of Migration estimates that each year, somewhere between 700,000 and 2 million people cross borders to take jobs without legal permission.\* Of this number, up to 500,000 seek entry into Western Europe and 500,000 into the United States, Canada, Australia, and New Zealand. In the United States, the stock of undocumented workers increased from an estimated 3.5 million in 1990 to 7 million in 2000, of which 69 percent were Mexicans (USCIS 2003). In Europe, illegal migrants numbered as many as 3 million by the end of the 1990s.\* Countries in Asia have also experienced an increased number of irregular foreign workers in their labor force. In Singapore, undocumented workers accounted for 4.5 percent of the total labor force in 2000, and in Hong Kong (China), it was 2.3 percent. In Hong Kong (China), Korea, and Taiwan, there is one undocumented foreign worker for every three legal foreign

workers. Thailand is one of the countries most affected by undocumented workers, with nearly 5.5 undocumented workers for each registered foreign worker (IOM 2003). In 2000–01, some 73,000 Chinese irregular migrants were assumed to be living in South Korea, and, in turn, China hosted some 50,000 irregular migrants.

Stricter enforcement of immigration rules may not have been successful in cutting off illegal migration, but it may have contributed to the very high costs involved, particularly between countries that do not have a common border. Today, irregular migrants from China wanting to enter the United States pay up to \$35,000 to smugglers,<sup>†</sup> to Europe they pay in the range of \$10,000–\$15,000, and those seeking entry into Japan up to \$10,000. The “fee” for moving from Lebanon to Germany varies between \$5,000–\$10,000; from India to the United States it is around \$25,000, and from North Africa to Spain it is between \$2,000–\$3,500.

*(Box continues on next page)*

## Box 5.3 (continued)

The vast majority of undocumented workers are unskilled for several reasons. Policies in most receiving countries offer greater opportunities for skilled workers to migrate legally than for unskilled. Many skilled workers, coming from middle- or upper-income households, may be less willing to experience the uncertainty inherent in breaking the immigration law (including the prospect of being jailed temporarily), than persons from lower-income households. Also, employers are more likely to offer unskilled jobs to undocumented workers, whose tenure is relatively uncertain, as skilled jobs may require a greater investment to apply technical backgrounds to the demands of specific jobs.

Efforts to control illegal entry have varied in effectiveness.<sup>‡</sup> Receiving countries have addressed undocumented workers by offering amnesties that generally involve the promise of regularization for undocumented workers who have been in the country for a period of time. For example, the U.S. Immigration and Regularization Control Act (IRCA) of 1986 regularized the status of undocumented workers who had been living in the country since before 1982, as well as undocumented agricultural workers. This program, which took effect mostly in 1989–91, granted a regular status to more than 2.5 million people, mostly from Mexico and Central America. However, this massive regularization program did not prevent Mexicans or other undocumented immigrants from continuing to cross the U.S. border. Similarly, in Europe, approximately 1.5 million undocumented migrants saw their status regularized under amnesty programs implemented by Belgium, France, Greece, Portugal, and Spain during the 1990s.<sup>§</sup>

Source: International Organization for Migration (IOM) 2003.

Regularization programs for undocumented are also present across developing countries. For example, in the 1990s, Argentina regularized undocumented workers from Bolivia, Paraguay, and Peru under bilateral agreements. Thailand had a similar program. Other countries have opted for more drastic measures to address undocumented workers. For example, Malaysia in 2002 deported hundreds of thousands of irregular migrants back to Indonesia and the Philippines, in reaction to rising levels of criminality; however, there was a slowdown in its economy given its dependency on foreign workers.

\*IOM (2003). Unless otherwise noted, the data in this box are based on this document.

\*\*The number may be even higher today. The United Kingdom may have up to one million irregular migrants (UK Immigration Service), France 500,000, Belgium 90,000 (Belgium Antiracist Centre), and Ireland 10,000 (Irish Police). In terms of flows, some 100,000 irregulars are smuggled into Germany each year (German Police Trade Union), and some 95,000 irregulars from Albania, Romania, and Iraq alone enter Greece each year.

†Annually, some 25,000 to 50,000 Chinese irregular migrants enter the United States.

‡Hanson and Spilimbergo (1999) find that additional resources devoted to border enforcement in the United States have yielded only limited results, and Boeri and others (2002) find that tighter controls at a given entry point can be effective, but divert migrants to other points of entry. Worksite inspections can have a greater impact, but in the United States such efforts are very limited.

§Italy regularized 716,000 irregular migrants in three waves; Greece accepted 370,000 people (in 1997–98) mostly from the Balkans and Eastern Europe; Spain regularized 260,000 irregular immigrants mostly from Africa and Latin America; and Portugal regularized 61,000.

Some countries have recognized the need to manage both regular and irregular migration on a regional basis. Regional consultative processes, such as the Manila Process (1996), the Migration Dialogue for Southern Africa (MIDSA 2000), the Puebla Process (1996), and others have emerged—and all of them include consultations to deter human trafficking and

the movement of undocumented workers. However, most of these groups are informal ones that mostly share information on migration-related issues and generally do not impose requirements on the immigration policies of the participating countries. It appears that neither unilateral policies nor consultative arrangements have had significant success in

controlling the substantial pressures for migration to industrial countries.

***Agreements that permit temporary access for certain groups***

Several agreements provide for market access of certain groups of workers, usually the highly skilled. The most recent agreements have focused heavily on intra-corporate transferees, including managers and skilled technical staff.

The Central America and Caribbean Community (CARICOM) allows university graduates to move among member countries without passport requirements and allows university graduates, professionals, skilled persons, and workers from some selected occupations to work without a permit.

NAFTA, along with the Canada-Chile, U.S.-Chile, and the U.S.-Singapore Free Trade Agreements, do not provide for permanent migration, but allow for the temporary movement of business visitors, traders and investors, intra-corporate transferees, and professionals.<sup>23</sup> Visas are still required for all four categories, and work permits are required for all except business visitors.<sup>24</sup> Numeric restrictions on temporary entry are not allowed for the first three categories, but were imposed by the United States on professionals from Chile, Mexico, and Singapore, but not from Canada. U.S. professionals seeking to enter either market are not subject to numerical limits. In the Canada-Chile agreement there are no numerical limits to any of the four categories. Following the NAFTA agreement, the number of professionals entering the United States from Canada and Mexico increased substantially, and although the gap in favor of Canadians remained high, it narrowed considerably by 2002. Similarly, in the treaty traders and investors category, the ratio of Mexican over Canadian admittances into the United States increased from 0.4 in 1996 to 1.1 in 2002.<sup>25</sup>

The EU agreements with Central and Eastern European countries (prior to their 2004 accession to the EU) allowed for temporary entry of workers providing a service,

managers and/or highly qualified employees, and company representatives negotiating for the sale or supply of services. Transition periods as well as restrictions for public service works and sectoral exclusions applied. They are still in force for the nonaccession countries, Bulgaria and Romania. The Japan-Singapore FTA provides for the temporary movement of natural persons for business purposes, including investors, subject to conditions for entry (such as pre-employment for at least one year for intracorporate transferees) and time limits of stay. The Group of Three (Colombia, Mexico, and Republica Bolivariana de Venezuela) facilitates temporary entry for business persons. As in other agreements, GATS Mode 4 restrictions regarding access to the employment market or permanent employment also apply. MERCOSUR also has provisions to facilitate the temporary entry of business persons and the exercise of temporary professional practices, and it is working on the issues relative to a "MERCOSUR National Residency" and a more flexible migratory regulation for MERCOSUR citizens (Nofal 2004). Other agreements among Latin American countries (such as the Mexico-Nicaragua, Mexico-Chile, Mexico-Bolivia, Mexico-Costa Rica, and the agreement between Central America and Dominican Republic) contain similar provisions.

***Agreements based on GATS Mode 4***

Several bilateral agreements, along with the ASEAN Free Trade Agreement (AFTA) and MERCOSUR, base labor mobility provisions on the principles of Mode 4 of the GATS. However, most of these agreements add provisions that allow for labor mobility in categories not covered by the GATS. For example, the U.S.-Jordan agreement facilitates visa arrangements for independent traders and persons linked to investment. The EU-Mexico agreement provides for a standstill and sets common regulations of work, labor conditions, and residency permits for temporary workers in each country. The AFTA since 1998 has covered all modes of supply, including services sectors not

previously covered by the GATS. The Framework Agreement on the ASEAN Investment Area (1998) commits members to support freer flows of skilled labor, professionals, capital and technology among ASEAN members. By contrast, the Euro-Med agreements with Morocco and Tunisia do not provide for preferential access beyond GATS (the case for other Mediterranean agreements as well). The New Zealand-Singapore agreement generally follows the GATS model regarding labor mobility for service suppliers. MERCOSUR (and its agreements with Bolivia and Chile) is limited to the GATS provisions on the movement of

natural persons as services suppliers (Nofal 2004).

**Agreements without effective provisions for market access**

The Asia Pacific Economic Cooperation Forum (APEC), the South Asia Association for Regional Cooperation (SAARC), and Common Market for Eastern and Southern Africa (COMESA) do not provide for labor mobility. However, the first two have taken measures to facilitate business travel. Most of the members of APEC (except the United States and Canada) participate in the Business Travel

## Box 5.4 U.S. temporary admission programs under NAFTA and unilateral policies

The U.S. has several visa categories for the admission of temporary workers. NAFTA provided for the temporary admission of professionals under TN visas and made it easier for Mexicans to take advantage of already existing visa categories for skilled workers and professionals. However, NAFTA made no provision for increasing admissions of unskilled workers to the United States. In contrast, the United States has unilateral programs that do allow for the temporary admission of unskilled workers, and these have grown from from about 14,000 in

1996 to about 66,000 in 2002. Moreover, the largest temporary business visitor program (B1 visa) is limited to six months (renewable, but total time cannot exceed one year), and generally is used for short-term trips to the United States. The other visas can be granted for one year or more, often with extensions. Thus more long-term unskilled Mexican workers have been admitted to the United States under unilateral programs than under programs initiated under, or supported by, NAFTA.

**Temporary entry of Mexican workers to the United States (thousands of persons)**

	1996	2002
<b>Program initiated under NAFTA</b>		
Professional (TN visa)	0.2	1.8
<b>Programs supported by NAFTA<sup>a</sup></b>		
Intracompany transferees (L1 visas)	4.8	15.3
Treaty traders and investors (E1, E2 visas)	1.0	4.0
Business visitors (B1 visas)	309.0	475.0
<b>Unilateral programs</b>		
Professionals with specialty occupations (H1B visas)	5.3	15.9
Agricultural temporary workers (H2A visas)	8.8	12.8
Non-agricultural temporary workers (H2B visas)	5.5	53.0

<sup>a</sup>These visa categories existed before NAFTA and apply to many countries. However, provisions of NAFTA make it easier for Mexicans to use them.

Source: USCIS 2002, INS 1997.

Card Scheme, under which holders of the card receive expedited entry at the airport, and are not required to submit separate applications for business visas. Members of the SAARC adopted a Visa Waiver Scheme in 1992, which exempts 21 categories of persons from visa requirements. Free labor movement is envisaged as a long-term objective of COMESA, to be accomplished by 2025. However, progress has been limited to date.<sup>26</sup>

***To date: Limited labor integration***

Most regional agreements have had little impact on increasing migration. First, the agreements with full labor mobility have been between countries of similar income levels, so there has been little incentive for migration. Most agreements, and particularly those agreements that include both industrial and developing country members, do not allow for permanent migration.

Second, while these agreements often provide for some temporary labor mobility, particularly for the service sectors, the provisions are generally restricted to higher-skilled workers. This is consistent with the trend in industrial countries of changing unilateral migration policies to attract higher-skilled workers—in principle on a temporary basis, but in practice allowing for the possibility to settle after some period of time. For example, the Temporary Immigration Program of Australia allows for unlimited visa renewal for skilled workers. In the United Kingdom, highly skilled temporary workers in certain occupations can settle after 4 years of continuous work. In Norway, temporary workers with special skills can be issued a permanent work permit after 3 years of stay. In Canada, the 2002 Immigration and Refugee Protection Act (IRPA) placed more emphasis on education, job experience, and language ability in allowing entry. This trend toward favoring higher-skilled workers limits the potential global gains from migration.

To the extent that developed countries have permitted entry for unskilled workers from RTA countries, it has occurred through

parallel programs, many of which predated the RTA, such as programs in the United States with Mexico and in the EU with non-members of Southern Europe. Where industrial countries have allowed for some admittance of unskilled workers, the rules differ significantly from those governing admission of skilled workers. Unskilled workers legally entering host countries usually do so under seasonal work agreements, project (or guest) worker agreements, or specific provisions such as the working holiday maker programs (WHMP). Seasonal employment usually allows foreign workers to stay in the host country for periods between three months and one year, with work permits provided to foreign workers only in the event that no domestic labor can do the job and only in some specific sectors (such as agriculture, forestry, and tourism). Project worker agreements allow foreign workers entry for specific projects and usually include limits on the maximum stay and quotas (often determined on the basis of labor market conditions). WHMP allows young people (roughly 18–30 years old) to holiday and work for short periods, provided there is a prior bilateral working holiday agreement among the involved countries.

Developing countries' regional agreements also tend to discriminate in favor of skilled workers when providing for labor mobility. As mentioned above, CARICOM allows for the free movement of university graduates, other professionals, skilled persons, and workers from selected occupations. Several Latin American agreements (Group of Three, Central America-Dominican Republic, and agreements between Mexico on the one hand, and Chile, Nicaragua, Bolivia, and Costa Rica on the other) also provide for the movement of some skilled, not unskilled, workers.

**Conclusions: Beyond Merchandise Trade**

Agreements differ markedly in their treatment—to say nothing of their implementation—of non-merchandise provisions for

services, investment, intellectual property, and temporary movement of workers. Differences between the United States and EU bilateral FTAs and other agreements are particularly vast.

In those areas where RTAs could seriously promote development—services liberalization and temporary movement of workers—results have ranged from mixed to missed opportunities. In general, the U.S. FTAs have prompted some additional services market openings in Bahrain, CAFTA, and Morocco, some changes in Singapore, but relatively few changes in Australia and Chile. To be sure, even those agreements that required no additional market opening could benefit developing countries, because investors may attach credibility to the lock-in effects of the treaty.

In the South, agreements that have substantially improved services access are relatively limited, and those with greater market access often have the most restrictive rules of origin for investor nationality. More common is the lack of progress on services liberalization.

More disappointing from a development perspective is the minimal attention given to creating opportunities for the temporary movement of workers, particularly unskilled workers. In neither North-South nor South-South agreements is there evidence of much activity. In the wake of the September 11, 2001, attacks on the United States, concerns for security have made cross-border movement of all persons subject to greater controls and scrutiny. This atmosphere does not bode well for expanding programs for temporary workers.

At the same time, in those regulatory areas where development benefits are largely unproven, the North-South bilateral FTAs are strengthening their rules. Strengthening the rules governing investment and intellectual property may contribute to better institutional environment, but the greatest gain is to be found in services. Enhancing protections offered to investors has not been shown to increase the flow of investment, and preventing

the erosion of monopolistic returns to the owners of technology through enhanced IPRs is of doubtful development benefit for the average developing country.

Moreover, the downside risks of misjudgments in terms of adverse legal and economic ramifications are nontrivial, especially for unsophisticated governments. International treaty law in these areas is evolving fast and is being set through case laws of arbitration panels, whose judgments at times conflict (Ewing-Chow 2001). Governments may find themselves hauled before arbitration panels and compelled to pay large amounts of compensation for enacting regulations they had considered in their sovereign domain.

Broadly defining investment to include all capital flows and assets, including intellectual property, carries risks. For example, one potential risk, is the set of provisions associated with the U.S.-Chile arrangement. These provisions could limit a less sophisticated government's ability to deal with a financial crisis.

### ***Realizing the promise of services, investment, IPRs, and labor mobility***

Using RTAs as a lever to liberalize services has several advantages. The potential for improving economy-wide performance is often great. Moreover, most services liberalization is inherently multilateral. This is because member governments that open markets want to realize the immediate gain of full competition and so open markets to all comers, or because members adopt lenient rules regarding domicile of investors, thereby permitting external investors to invest in the region through subsidiaries located in member countries. Even if restrictions impede full MFN access, regional agreements can be cost-free stepping stones to open markets insofar as they do not carry the trade-diversion costs of lost revenues associated with tariff reductions for goods trade. More could be done in RTAs, particularly in South-South agreements, to realize these benefits.

Countries have to design strategies toward investment and intellectual property that are appropriate to their development priorities and then analyze carefully which elements, if any, ought to be contained in trade treaties. For some countries, improving other property rights—for example, land rights or small business assets—may have a higher priority than establishing market access rights for investors or rights for patent holders; for other countries, especially middle-income countries, these may indeed be a priority. Once a strategy is in place, it is possible to ascertain which of the new rules customarily associated with regional trade agreements make sense for development.

Evaluating the development benefit of any given RTA cannot rest solely on one component because often rules are accepted in one area to achieve market openings in partner countries in another. For example, the net development benefits of the investment and IPR components hinge critically on their appropriateness for development and the market access granted in product markets of partner countries.

A corollary lesson is that multilateral liberalization in goods markets is essential for reaping any gains from RTAs that contain new rules. Governments wishing to maximize gains from RTAs should ensure that new rules are consistent with extant border protection, and if not, they should consider lowering that protection. If a country has high tariff barriers and forms an RTA with a partner requiring investor protections and TRIPS-Plus, it may end up entrenching the businesses of that partner behind new barriers. It may confer first mover advantages in services and IPR restrictions in drug or other high technology manufacture, with reinforced barriers to parallel imports or new entry from third parties.

Finally, RTAs—and other regional cooperation agreements—do offer some important opportunities for countries to collaborate, especially in South-South agreements. To stimulate investment, particularly in services, they

might adopt common standards that facilitate cross-border competition in services and investment. Adopting common technical standards for telecommunications, for example, has helped integrate markets and opens the way for competition. To adopt international norms regulating technology, new agreements could adopt their own IPR standards, with the advantage of foreclosing additional restrictions motivated by private interest groups in the North. At the same time, some regions may find opportunities to agree on common administration of patent and copyright law.

## Notes

1. Agreements can also increase the number of competitors by allowing cross-border provision of services, Mode 1, such as supplying back-office services. Restrictions on these tend to be less common than on supplying through commercial presence of a foreign subsidiary, Mode 3. One exception is supplying various types of insurance and reinsurance, which can be done cross-border, though a sales affiliate is normally required.

2. RTAs that restrict service providers to member countries by definition limit the number of potential competitors relative to multilateral liberalization. Even if later followed with multilateral opening, RTAs may confer on members first mover advantages, and, if some market barriers to entry remain, they will not be readily competed away; the result is higher prices to consumers.

3. According to the agreement, if Chile chooses to impose restrictive measures on capital flows it considers speculative, then special dispute settlement rules will apply.

4. For some FTA countries, pre-existing BITs had virtually the same rights; however, about half of the countries had no BIT prior to the FTA, and where BITs did exist, pre-establishments were often fewer and less extensive.

5. See Fink and Reichenmiller (2004) for a more detailed review.

6. These include, for example, TRIPS, the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations, and others also contains a list of new conventions that parties are expected to ratify within a specified timeline, such as the Budapest

Treaty on the International Recognition of the Deposit of Micro-organisms for Mexico and the World Intellectual Property Organization (WIPO) Copyright Treaty for Chile. Finally, the list includes several conventions that the member states are expected to ratify “as soon as possible” without mentioning a specific deadline, such as the WIPO Copyright Treaty for Mexico or the Madrid Agreement concerning the International Registration of Marks for Chile.

7. BITs customarily provide a definition of investment coverage, provide investor protections such as against expropriation, require national treatment for post-entry establishments, stipulate compensation for the expropriation of their investments, and provide for a dispute resolution mechanism. The latter usually permit the investor to sue the state for breach of treaty under binding arbitration. In some cases, treaties proscribe any government action that would reduce the value of the private investment, even if it were environmental, and establish grounds for compensation. Such compensation could either entail extensive liabilities for the host government or compel them to refrain from making certain policy choices.

8. The United States initiated the practice of defining investment to broadly include intellectual property in the late 1990s in negotiations of its bilateral investment treaties. See Vivas-Eugui (2003).

9. Some of the problems include the absence of data on implementation and the variable coverage of FDI provisions across agreements, which makes it difficult to distinguish the effects of investment rules from trade rules. Moreover, the absence on FDI data that would enable us to distinguish the effects of RTAs on differing type of investment—vertical or horizontal—limits the analysis. Nonetheless, the regressions are robust to variations in specifications.

10. The regression with fixed effects estimation of net FDI inflows is:

lfdi	Coef.	Std. Err.	t	P> t
lgdp	.9404982	.2065772	4.55	0.000
lgnppc	-.1228465	.2008249	-0.61	0.541
open	.0051226	.0011387	4.50	0.000
growth	.0198651	.0040816	4.87	0.000
cpi	-.0196485	.0060906	-3.23	0.001
lfdiwd	.4472645	.0719058	6.22	0.000
growld	-.0611576	.0432152	-1.42	0.157
lftagdp	.0518633	.0163279	3.18	0.002
R-sq: within = 0.3973    corr(u_i, Xb) = -0.0410				
between = 0.7469    F(28,2003) = 47.16				
overall = 0.6690    Prob > F = 0.0000				
F test that all u_i = 0: F(143, 2003) = 12.79				
Prob > F = 0.0000				

11. As mentioned earlier, this variable contains the sum of the host country’s RTA partners GDP, excluding

the host country itself. Thus if we consider Brazil as the host country and MERCOSUR as the relevant RTA, the variable lftagdp would be the log of the sum of GDP of Argentina, Paraguay, and Uruguay. This variable serves a twofold purpose in the estimation routine. First, since it is equal to zero prior to signing an RTA and carries a positive value afterwards, it measures whether signing an agreement has an effect on FDI inflows (i.e., including a dummy variable for RTA membership would be counterproductive in the presence of this variable, since it will capture the “threshold effect” of signing an RTA). Furthermore, this variable also captures the effects of participating in a larger market following the signing of an agreement. This is particularly important if a country is party to more than one agreement—the variable will then be a sum of all of its partners’ GDP, reflecting the fact that the country has now created a larger market. The fact that this variable is positive and significant shows not only that signing an RTA will generally bring benefits in terms of greater FDI inflows, but also that larger market size of the country’s partners tends to generate more incoming FDI.

12. See Finger and Schuler (2004) for a richer discussion of the the asymmetry in TRIPS; they argue that it protects the knowledge that businesses and individuals have in rich countries and that poor people buy, but not the knowledge that poor people generate and sell to the world.

13. In this sense, full enforcement is equivalent to a TRIPS standard (Maskus 2000, 183–85).

14. See paragraph 4 of the Doha Declaration on TRIPS and Public Health, available at <http://www.wto.org>.

15. Technically, the Doha Declaration does not address questions of marketing approval during the patent term and test data exclusivity. However, the provisions of the bilateral FTAs in these areas can still be seen as being at odds with the spirit of the Doha Declaration, to the extent that they preclude the effective use of compulsory licenses.

16. See the letter from USTR General Counsel John K. Veroncau to Congressman Levin dated July 19, 2004, available at *Inside US Trade*. Moreover, the side letters refer “in particular [to] cases such as HIV/AIDS, tuberculosis, malaria, and other epidemics as well as circumstances of extreme urgency on national emergency.” The language chosen mirrors wording in the Doha Declaration on TRIPS and Public Health, except that the latter employs the term “especially” instead of “in particular” and does not mention “circumstances of extreme urgency or national emergency.” This difference in language may imply a narrower definition of public health and therefore flexibility to issue a compulsory license, but this is subject to

legal interpretation that must await actual cases of dispute settlement.

17. See the letter from USTR General Counsel John K. Veroneau to Congressman Levin dated July 19, 2004.

18. See the excellent studies in Fink and Maskus (2004) including particularly Fink (2004) for the U.S. and German MNCs; Smarzynska Javorcik (2004) for Eastern Europe; and Maskus, Dougherty, and Mertha (2004) for China.

19. The description on agreements that follows is strongly based on Nielson (2003) and a complement, in some cases, to the text of the agreements.

20. GATS (under "Mode 4") covers the movement of some temporary foreign workers among WTO members, specifically individual service suppliers. Although in theory GATS covers services suppliers at all skill levels, in practice WTO members' commitments have been limited to the higher skilled.

21. Some agreements include provisions facilitating mutual recognition (e.g., EFTA), and others have complementary arrangements (e.g., the ANZCERTA Services Protocol, the Trans-Tasman Travel Arrangement, and the Trans Tasman Mutual Recognition Arrangement together provide that persons registered to practice an occupation in one country can practice an equivalent profession in the other country).

22. ANZCERTA does not cover labor mobility other than for services suppliers, but under the Trans-Tasman Travel Arrangement (signed in 1973), nationals of each country have the right to visit, reside, and work in each other's country without time restrictions.

23. Between 1987–97, there was a total increase of 102,000 Greeks in the rest of the (11) European countries, which is an annual average of 10,000 only. In the case of Portugal, the annual average increase of Portuguese immigrants in the rest of the EU countries during 1986–97 was only 7,700.

24. In NAFTA, definitions for business persons and, in particular, a list of professionals are provided, as well as the minimum academic conditions that the latter must satisfy (in general, at least a baccalaureate degree, and sometimes complemented with some years of experience). The other agreements provide for a more flexible requirement, in that instead of listing the professions, they specify the academic and/or experience requirements that professionals must satisfy.

25. Business visitors need to demonstrate though that the proposed activity is international in scope and that they are not seeking to enter the local labor market. They need also to demonstrate that the primary source of remuneration, their principal place of business, and actual place of accrual of profits are from outside the territory they are seeking to enter.

26. Mexicans entering through this category into the United States increased to 4,000 business persons in 2002, from 980 in 1996.

27. Nonetheless, migration flows within COMESA have been substantial. The annual inflow of workers to South Africa from other African countries is estimated to have increased from roughly 500,000 in 1990 to more than 3.5 millions in 1995; most were temporary workers in mining and farming.

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