

Free Trade Agreements and countries outside

- an analysis of market access for non-participating countries

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Proliferation of FTAs



- Agreements grow in number and become deeper
- All countries are third countries to the FTAs of others

The WTO third country neutrality criteria

The purpose of FTA should be to

“facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories”

But can FTAs be neutral?

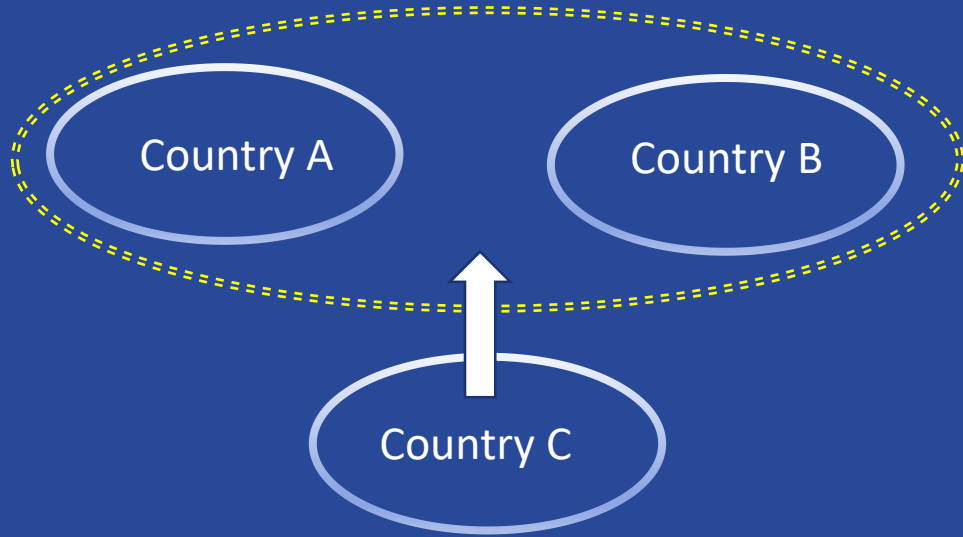
If not, are they always negative for third countries?



The discussion usually centers around

- Effects on GDP and thus demand of the FTAs
- Building blocks and stumbling blocks
- Trade diversion and trade creation
- Multilateralising regionalism
- Open regionalism

What is the question?



- If countries A and B enter into an FTA, what is the effect for country C?
- The effect for *market access* for firms from country C
- How can you make it as positive as possible for market access for country C?

Method

- Mapping exercise, internal peer review
- Neither a legal, nor an economic study
- All kinds of provisions for all areas of an FTA
- Taken into account "unilateral add-ons"
- A generic firm but also discussing SMEs and firms from developing countries (capacity issue)

Contents

AT THE BORDER

- Tariffs
- Rules of Origin (RoO)
- Trade defence instruments (TDI)
- Trade facilitation
- Cross border public procurement
- Cross border services (entering the market)
- Establishment (FDI)
- Temporary movement of natural persons (mode 4)

Contents

BEHIND THE BORDER

- Intellectual property rights (IPR)
- Protecting investments
- Distorted competition
- National regulations affecting trade and establishment (goods and services)
- Sustainable development
- Corruption

For each trade policy area:

- WTO as a basis
- How can FTAs regulate the area?
- Effects for participating countries
- Effects for non-participating countries

The effects for third countries:

 Positive and non-discriminatory in relation to participating countries

 Positive but discriminatory in relation to participating countries

 Discriminatory

 Uncertain effects, depending on...



**Provisions applied
”at the border”**

Tariffs

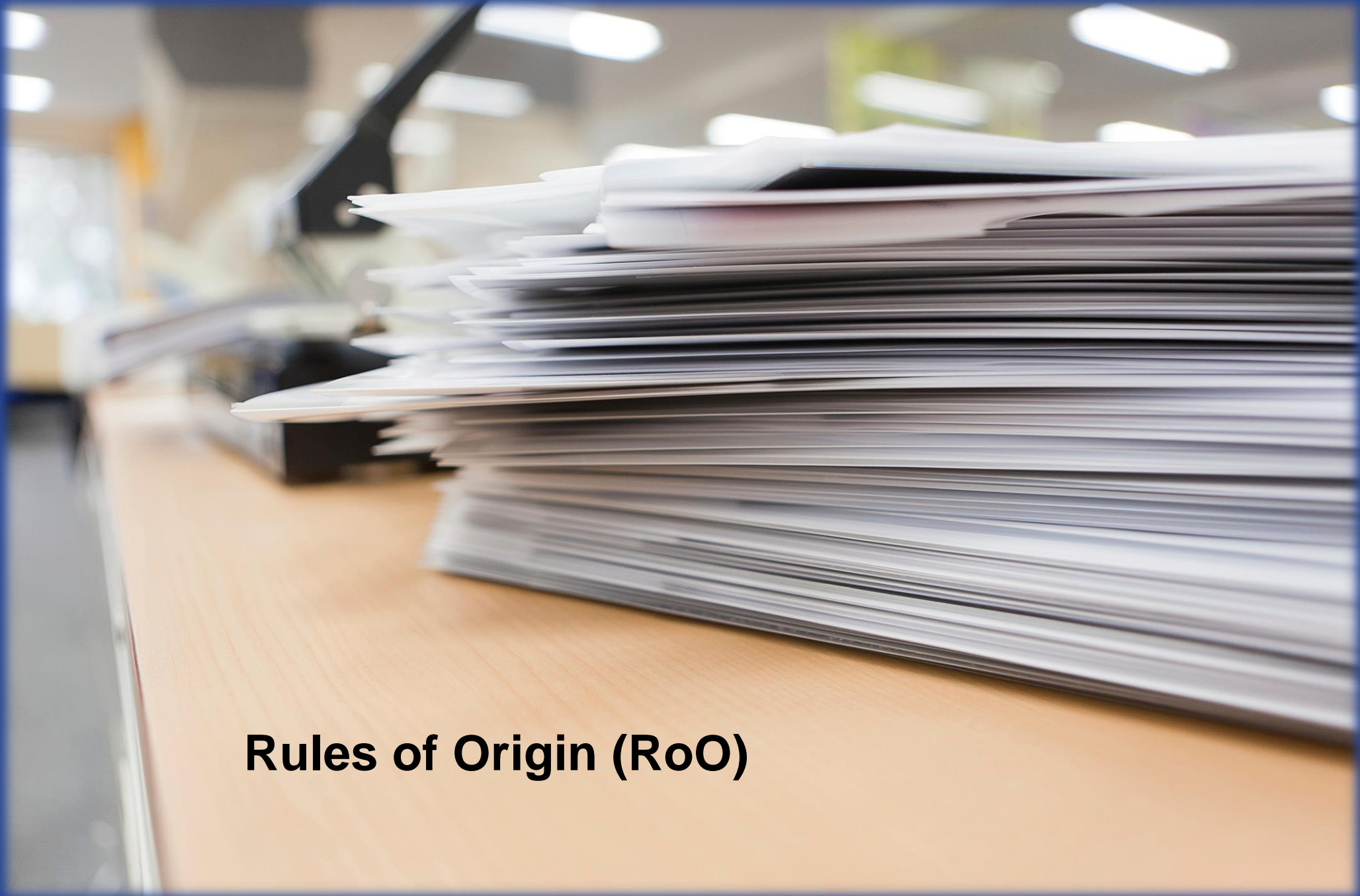


Tariffs

Assuming strict RoO:

- Tariff cuts negative for third countries
 - applies both to applied and bound levels

- The deeper and broader the cuts, the worse
 - but actual effects dependent on price sensitivity



Rules of Origin (RoO)

Rules of Origin

- When “wholly obtained”, no benefits for third countries
 - but this is unusual

Liberal RoO permits third country sourcing and takes GVCs into account

- Tolerance rule
- Value added rule
- Tariff classification rule
- Special technical requirements (for example textiles)

Rules of Origin (RoO) *cont*

- Special rules (for example for fishing vessels)
- Principle of territoriality
- Cumulation

In general, the more liberal RoO for the more products the better for third countries

- but still relative discrimination

And then there is services!

Trade facilitation



Trade facilitation

- Most trade facilitation measures by nature third country friendly
 - as long as they focus on efficiency and transparency

For example contact points, better information, speedier procedures, enhanced legal certainty

- However, measures requiring active cooperation – like AEOs – will not directly benefit third countries

Cross border procurement



Cross border procurement

- The effects on third countries depend on political choices
- Price preferences, local content requirements, entities and sectors covered – all can be reformed in a discriminatory or non-discriminatory fashion
- Almost always positive for third countries: procurement processes and transparency

A hand with white nail polish points towards a world map. The map is overlaid with a network of white person icons connected by solid and dashed lines, representing global connectivity and trade. The background is a blurred image of a person's face.

**Cross border
services trade**

Cross border services (entering the market)

- The effects of services provisions depends on political choices
- Mostly, the provisions are applied in a non-discriminatory fashion
- However, the provisions rarely provide real new market access
 - FTAs only bind present openness

Establishment



Establishment

- Opening up an economy for private investment may be done in a discriminatory or non-discriminatory fashion – it is a political choice
- Mostly, the provisions do not provide new market access
 - FTAs only bind present openness
- Normally, all foreign capital is welcome without regard for the source
- Exceptions: screening mechanisms and local content

Provisions applied "behind the border"



Intellectual Property Rights (IPR)

Intellectual Property Rights (IPR)

- Unconditional MFN-clause extends benefits of any TRIPS plus provisions
- Benefits of stronger IP protection in FTAs not dependent on membership of the FTA
 - It is dependent on development status of a country
 - “IPR-rich” countries and firms in advanced sectors might benefit
 - “IPR-poor” countries and firms with an interest in less stringent IPR may lose

Distorted competition



Distorted competition

- Subsidies, state owned enterprises (SOEs) and competition law
 - overall purpose to make an economy more market oriented
- Provisions rather weak
 - hence, small impact on third countries
- Subsidies have no geographic target
 - Increased transparency or limiting policy space will benefit third country firms

Distorted competition *cont*

- State owned enterprises may be restrained in the domestic market, the partner countries market or all markets
 - most common effect positive for third country firms
- Competition law
 - antitrust activities beneficial for all firms regardless of nationality



National regulations affecting trade

National regulations affecting trade

- Technical barriers to trade (TBT)
- Sanitary and Phytosanitary Measures (SPS)
- Domestic services regulations

The core of the problem: *specific* regulations causing more friction than necessary

Two dimensions of the issue

- Good regulations and regulatory practice
- Formalised regulatory cooperation

Good regulations and regulatory practice

- Provisions in this area usually non-binding
 - hence, effects might be limited

- Most provisions clearly positive for third countries:
 - Legal certainty
 - Public sector efficiency

Good regulations and regulatory practice *cont*

- However, not always clear cut:
 - Regulatory Impact Assessments (RIA)
 - Stakeholder consultations
 - Transparency
- Probably most provisions in this area will benefit firms without any discrimination

Formalised regulatory cooperation

- Effects on third countries depend on level of ambition
 - might be very positive or very negative for third countries
- Regulatory approximation: from dialogue to full harmonisation
- “One set of regulations better than two”
 - but only if that set is the right one for the third country
 - a race to the top?

Formalised regulatory cooperation *cont*

- Advanced cooperation schemes, requiring trust, keeps benefits within the agreement:
 - Multilateral Recognition Agreements (MRAs)
 - Equivalence (SPS)
 - Prelisting of food processing facilities (SPS)
 - Administrative cooperation (for example the EU IMI-system)

Summary and conclusions

Positive and non-discriminatory

| FTA provision | Comment on consequences on third-country firms (TC = third-country firms) |
|---|---|
| Positive and non-discriminatory | |
| “Open transparency” | Transparency, not contained in closed websites or in an exclusive notifications system, regarding regulations and processes for trade facilitation, procurement, subsidies and technical requirements, etc. |
| Administrative reforms | Increased government efficiency, for example, in trade facilitation and granting of licenses |
| Legal reforms | Increased legal certainty, for example, right to redress |
| Competition law reformed and/or better applied | Impossible to discriminate |
| Reducing policy space for providing subsidies | Cannot have a geographic target |
| Reduction/elimination of trade distorting subsidy schemes | Cannot have a geographic target |
| Lowering thresholds for tenders | Impractical to implement in a discriminatory manner |
| MFN clauses in FTAs | Can benefit TC, but only FTA partners (as such benefits are dependent on a previous agreement with one of the parties) |
| Intra-FTA safeguard | Benefits TC more than FTA partner, reduces the value of the FTA for the members |

Positive but discriminatory (RoO)

| Positive but discriminatory | |
|---|--|
| Change in tariff classification rule | The lower the HS level, the better for TC |
| Value added criterion | The higher the percentage, the better for TC. Usually benefits TC. |
| Tolerance rule | The higher the percentage, the better for TC. Usually benefits TC. |
| Relaxing of principle of territoriality | Benefits selected TC |
| Cumulation | Benefits some, usually neighbouring, TC |

Discriminatory

| Discriminatory | |
|--|---|
| Cuts in applied tariffs in FTAs (resulting in new market access and/or increased predictability) | Cannot benefit TC, assuming strict RoO |
| Tariff elimination within TRQs | Cannot benefit TC, assuming strict RoO (which is the case as these are only used for agricultural products) |
| Strict RoO (wholly obtained products for agriculture) | Cannot benefit TC |
| Not using global safeguard against FTA partner | Not legal in WTO, but exists anyway |
| Authorised Economic Operators (AEOs) and other “control-reducing schemes” | Will not benefit TC, if scheme is limited to firms registered in contracting parties |
| Border cooperation schemes | Cannot benefit TC, based on trust between FTA partners. |
| Pre-listing of food-processing facilities | Cannot benefit TC |
| MRA for goods, services and worker qualifications (called <i>equivalence for SPS</i>) | May theoretically benefit TC, but most likely will not (based on trust) |
| Administrative cooperation regarding qualifications and regulations | Based on trust and administrative capacity, only for FTA partners |
| “Closed transparency” | Information published or shared in a non-open way, provides FTA firms with an information advantage |
| Reducing policy space for mode 4 | Always directed at partner country |

Provisions with uncertain effects

* due to political choices or

* due to capacity

| Provisions with uncertain effects | |
|--|--|
| Reducing policy space for services and establishment (binding water) | Political choice, mainly benefiting TC |
| Elimination of market access restrictions for services/ establishment | Political choice, mainly benefiting TC |
| Granting national treatment for services/establishment | Political choice, mainly benefiting TC |
| Simplification of visa procedures | Political choice, simplification of procedures might spill over to TC |
| Reform of performance requirements for establishment | Political choice, mainly benefiting TC |
| Reducing price preferences in procurement policy | May benefit TC, political choice |
| Relaxing local content requirements in procurement and for establishment | May benefit TC, political choice |
| Covering more procuring entities | May benefit TC, political choice |
| SOE reform in FTA partner country | May benefit TC, a political choice |
| SOE reform in home country | May benefit TC, a political choice |
| Breaking up of state monopolies | May benefit TC. Depends on establishment provisions, often benefiting TC |
| Investment protection | Cannot benefit TC (unless TC firms use another agreement as their "basis for a dispute") |
| Impact assessments | May benefit TC, a political choice on how to design them |
| Stakeholder consultations | Consultations may be open to everyone. If not, the outcome may still serve to pre-empt trade barriers in general |
| Intra-FTA notifications | Notifications provide FTA partners with opportunities to comment on regulations that third countries do not receive, but may serve to pre-empt trade barriers in general |
| Special technical requirements (RoO) | Reforms may benefit TC, depending on the form of the rule |
| Limits/bans on antidumping and countervailing measures | Seen in isolation, discriminatory to TC. But uncertain in conjunction with competition provisions |
| Regulatory dialogue | May benefit TC, depends on outcome of dialogue in each case |
| Harmonisation (in a broad sense) | May benefit TC, depends on country, sector |
| "Reaffirm TRIPS" provisions | Must "benefit" all TC equally under the law, but some TC will, in reality, not benefit. In some cases, TC may benefit more |
| TRIPS plus provisions – stricter IPR legislation and/or application | Some of them must "benefit" all TC equally under the law, but some TC will, in reality, not benefit. In some cases, TC may benefit more |
| Introduction of Geographical Indicators (GIs) | May make third-country firms with no GI less competitive but also makes it possible for them to register their own GIs |
| Sustainable development provisions | Effect on TC unclear, depends on firm's business strategy |
| Anti-corruption provisions | Effect on TC unclear, depends on firm's business strategy |

A vibrant landscape featuring a lush green field in the foreground, a single large green tree on a small hill in the middle ground, and a bright blue sky filled with scattered white clouds. The scene is captured from a low angle, emphasizing the vastness of the sky and the horizon.

Horizontal factors mitigating discrimination

Horizontal factors mitigating discrimination

- Dynamic effects
 - FTA-committees working out new solutions
 - Spillovers into the WTO and/or FTAs
 - Spillovers into national legislation
- Global value chain-perspective
 - As a supplier third country firms can almost always benefit

Summary

- FTAs provide third countries with more absolute market access
 - but often at a price of lower *relative* competitiveness
- How mitigate?
 - Focus on pro-competitive reforms and public sector efficiency
 - Where there is a political choice, choose non-discriminatory options
 - Introduce liberal rules of origin
 - Finally and hardest: open up cooperation schemes for third countries



Extras



**Trade
defence**

Trade defence

- Most FTAs do not have provisions on trade defence measures
- Theoretical effect for third countries negative (AD and CVD)
 - but cannot be seen in isolation from competition provisions
- Abolition of global safeguards negative for third countries
- But introduction of intra FTA-safeguards is positive

**International
Departures**
TERMINAL 3



**Temporary
movement of
natural persons**

Temporary movement of natural persons

- Unlike capital, this is very sensitive to the origin of the labour
- Most FTAs not very ambitious in this area – rarely any new market access
 - hence, little discrimination
- VISA-requirements, qualifications etc are based on trust between the parties and may require active cooperation between the parties



Protecting investments

Protecting investments

- ISDS – Investor state dispute settlement and similar schemes
- Only protects firms based in the FTA-parties
 - however, a firm may set up a mailbox company to receive the protection

Sustainable development



Sustainable development

- Sustainable development provisions not aimed at market access
- Aim: ratify multilateral agreements and/or “not lower standards”
- Method: incentive based model or model based on sanctions
- The effects not dependant on membership of the FTA
 - third country firms may benefit from avoiding SD-provisions in the short run
 - in the long run they may benefit from adopting higher standards

Corruption



Corruption

- Corruption provisions a “public good” – if they are enforced
 - aim to cut trade costs
- Effects not dependant on FTA-membership
 - Some third country firms will benefit from a less corrupt market
 - Others may lose from the same reforms

Trade creation and trade diversion

- Evidence inconclusive, even signs of “reverse trade diversion”
 - but associated with tariffs and insufficient and even misleading today
- For more recent agreements, deep FTAs, evidence also inconclusive
- Major difficulties in modelling the effects

Stumbling stones or building blocks?

The negative side:

- Distortions
- Complexity (RoO etc)
- Weak countries at risk

The positive side:

- Quicker
- Go further (WTO plus and WTO beyond)
- Spillovers