Investment is a key component in economic development and has become one of the main objectives of countries in pursuing regional economic integration. The logic is that larger markets and greater competition following trade liberalization and improved policy credibility will increase the incentives for investment. This in turn will raise incomes both directly by increasing the capital intensity of production and by encouraging technical progress. These arguments apply to investment from all sources, but they are applied particularly frequently to regionalism as a means of attracting foreign direct investment (FDI). In the North American Free Trade Agreement (NAFTA), for example, stimulating FDI flows was an explicit objective.

Negotiators have also turned their attention to investment-related policies, including those affecting trade in services. The latter is heavily dependent on the ability to establish a presence in a market (invest). Reaching agreements on investment issues at the multilateral level has proven elusive, with the exception of selected investment in services where commercial presence is covered as one of the four modes of supply. This may help explain why investment provisions are now becoming common in bilateral and regional preferential trade agreements. Even before the most recent wave of preferential trade agreements (PTAs), bilateral investment treaties (BITs) designed to spur investment flows by providing recourse to international dispute resolution in event of conflict with governments had become commonplace.\(^2\)

However, in the past five years, the number of PTAs covering investment policies has surged. North–South agreements, notably the PTAs involving the United States and of the EU, have been important drivers. Examples involving the United States are recent bilateral agreements with Australia, Chile, Central America, Jordan and Morocco. The EU engagement in PTAs is even more intensive, with more than 100 PTAs as of 2003, and investment is increasingly on the agenda. Thus, for example, investment policies are being discussed as part of the Economic Partnership Agreement negotiations with ACP countries and the recent agreements with Southern Mediterranean countries. Often investment policies are addressed through parallel investment treaties.

---

1 Bernard Hoekman is with World Bank, Groupe d’Economie Mondiale, Sciences Po, Paris and CEPR, London. Richard Newfarmer is with World Bank. The views expressed in this article are personal and should not be attributed to the World Bank. Parts of this article draw on World Bank (2004).

2 Indeed, BITs have been the primary vehicle for international cooperation in this area. Although some PTAs explicitly do not include investment policy disciplines because of pre-existing BITs—e.g., the 2001 Canada–Costa Rica PTA (Gestrin, 2002)—most recent US bilateral and plurilateral trade agreements have more ample rights and coverage, and generally subsume prior BITs.
From a development perspective, the extension of PTAs to investment can be beneficial. BITs can also support development prospects. However, clearly much depends on the content of the rules that are agreed. In theory, international cooperation in this area can help countries that need to improve the credibility of an open investment regime. It may also reduce risk premia and help attract investment by lowering perceived probabilities of being confronted with adverse policy changes, “regulatory takings” or expropriation. Cooperation could in theory also enhance overall welfare of signatories by coordinating policies so as to reduce negative spillovers from national policies. The latter can arise due to tax or incentive competition to attract FDI, often a beggar-thy-neighbour policy that ultimately primarily benefits multinationals.

But the rules may not be beneficial to all signatories. In broad terms, the US strategy, for example, can be characterized as offering partial access to its large markets for goods in exchange for acceptance of rules that may or may not be first best for developing country partners. Recent agreements that include language on investment may do little if anything to increase the flow of investment to developing country partners. Indeed, in the case of investor protection and dispute settlement provisions, the disciplines that are contained in some agreements may be detrimental.

Determining the payoffs of inclusion of investment disciplines in PTAs has become more important given the failure to include investment in the Doha round negotiations. While there were good reasons for the position taken by many developing countries that opposed the launching of investment negotiations, the fact that such disciplines are included in the PTAs being negotiated by both the United States and the EU with developing country partners suggests a need to understand what is driving this. Such agreements may be of limited benefit to signatories or they may be beneficial but come at the cost of non-signatories (i.e., generate “investment diversion”). Whatever the case may be, these PTAs may have important lessons for the potential extension of the WTO to cover investment in the future.

This article begins with a brief review of the potential impacts of PTAs on investment, both directly—through specific rules governing investment related policies—and indirectly, through the liberalization of trade flows. We then turn to a synoptic comparison of recent agreements, with a focus on provisions in bilateral US and EU agreements. This is followed by a brief discussion of some of the evidence to date on the investment effects of PTAs. We end with some concluding comments.

I. Potential Impact of PTAs and Investment-related Rules on Investment

A. Creating Larger Markets

Perhaps the most frequently mentioned channels through which PTAs may have a positive effect on investment are through the associated increase in the size of regional markets due to trade liberalization and accompanying disciplines on trade policies, new
investment rules that relax restrictions on market entry (e.g., for services), through new (stronger) investor protections, and the added credibility of government policies generally.

New trade rules that create a larger internal market create an incentive to invest for members and for third countries. Eliminating barriers to trade within a region (without increasing initial levels of external tariffs) creates an incentive for more investment from within the region and, provided there are no barriers to foreign investment, from outside the region. This occurs because the PTA can create a larger market of potential buyers. Inward investment to reach the local market may well also include tapping lower cost production sites within the new PTA to serve the higher-cost parts. The larger market can also raise productivity. A larger market allows for economies of scale and scope, for increasing competition among a greater number of suppliers, and for taking advantage of differing regional factor prices to drive productivity increases and hence more rapid growth—with the prospect of the latter providing a dynamic attraction to intra-bloc and extra bloc investment (see Frischtak, 2004; Markusen, 2004; Schiff and Winters, 2003).

PTAs may also permit new market access. A decision to lift an administrative barrier impeding manufacturing investment or an investment in natural resources can create an opportunity for new investment. As most remaining restrictions today—equity ownership limitations, bans on foreign investment in particular activities—are not on manufacturing, but rather on services investment (e.g., broadcasting, telephony and airlines in the United States) and natural resources (e.g., oil in Mexico), insofar as PTAs generate such effects this is mostly going to depend on the services provisions of the agreement.

Granting new investment protections might also attract additional investment. In general, the strongest investor protections entail nondiscrimination among all investors, provisions against expropriation, and dispute settlement with eligibility for investor-state suits and independent arbitration. The legal power granted to investors to sue governments under the terms of bilateral or regional agreements is arguably the strongest new protection provided by those trade agreements that incorporate such provisions. The relevant provisions, while differing in detail, closely mirror those found in many BITs, even though they are anchored within the trade agreement, with the implicit larger commitment of that treaty behind them.

As argued in World Bank (2000) and Schiff and Winters (2003), North–South PTAs could in theory enhance a southern country’s credibility, but typically only if the PTA is likely to enhance economic performance in its own right and if the large northern partner is willing to enforce investment-encouraging “club rules”. The latter is more likely to be true if the policies on which a developing country wants to gain credibility are specified explicitly in the agreement. In general, sound macroeconomic policies, well-defined property rights, and efficient financial and banking sectors—in interaction with structural conditions (e.g., market size) and economic performance (e.g., growth rates)—are likely to be far more important in influencing investment and
FDI than merely joining a PTA. Regional integration will foster investment only if it is accompanied by good policy overall.

B. Disciplines on Policy Spillovers

Investment-related policies may rationally attempt to shift rents (profits) from source to host countries through measures that effectively tax investors. The opportunity for this is created by the fact that FDI usually occurs in imperfectly competitive markets. Such policies can therefore give rise to spillovers. The same is true for policies that encourage FDI, which may be motivated by various factors, e.g., asymmetric information or a perceived need to offset institutional weaknesses. From an individual country’s perspective, incentives to attract FDI may be justified if FDI generates positive externalities. Clearly, both types of policies can provide a basis for international cooperation to reduce the negative spillovers. What follows focuses primarily on incentive policies, as these are most obviously potentially detrimental to developing countries and have also tended not to be covered in PTAs.

If governments use tax and other incentives to attract inward FDI, countries may find themselves in a bidding war. This can be to the detriment of the parties involved if it leads to excessive payment to the investor. International cooperation to ban or discipline the use of fiscal incentives could then be beneficial by eliminating these negative policy externalities. A key issue here is whether fiscal incentives are effective. If not—and the evidence suggests they are not—while they will not distort the global allocation of FDI, the funds expended will simply end up as transfers to multinationals. It is precisely when such incentives fail to attract FDI that developing countries have the most to gain from committing to not using them. In practice, locational competition is rarely driven by tax considerations because in most countries tax rate differences are far smaller and a far smaller share of total costs than other factors, e.g., electricity, material inputs, labour, financing and transportation costs. Moreover, crediting of corporate income and other taxes assessed in developing countries against home country taxes mutes the effects of incentives associated with income tax holidays (Morisset and Pirmia, 2000).

A more common problem is design. It is virtually impossible for governments to target tax incentives that at the margin would attract investments that would not have occurred in their absence. Most investment, attracted by natural resource endowments, efficiency concerns, or market-extension objectives, would occur without the incentives. However, governments usually have to pay tax holidays to all new investors to attract the investor that at the margin would not have invested in the absence of incentives. In most cases, this substantially lowers the rate of return to the incentives.3

3 This design was originally proposed as part of the Caribbean Basin Initiative when it was announced in 1984, and subsequent analysis and criticism contributed to the Congressional decision to drop it from the final legislation. See Feinberg and Newfarmer (1982).
Beyond this, locational decisions are in general often influenced more by political economy forces than pure efficiency rationales. This is the case in particular for efforts by high-income countries to retain or attract FDI that would be more efficiently employed in developing countries. Labour unions and local communities may oppose plant closures and efforts by firms to transplant facilities. Locational incentives used by industrialized nations are particularly likely to be inefficient by attracting or retaining industries that otherwise would locate in developing countries.4

Developing countries therefore have an incentive to push for international disciplines on incentive policies. PTAs represent one potential vehicle for doing so. In practice however there are very few examples of PTAs being used to do so. The EU is the only example where subsidy disciplines have some teeth, and even there, central governments have only limited influence and ability to constrain the use of incentives by sub-central governments, especially in federal States, and the European Commission is continuously challenged in applying the rules to Member State governments.

Another example of negative policy spillovers is trade-related investment measures (TRIMs). These performance requirements commonly mandate that foreign investors use local materials (defined as a domestic value-added requirement), employ host country nationals, or export in some proportion to imports (see Moran, 1998). TRIMs can constitute beggar-thy-neighbour negative policy externalities when they distort investment patterns among countries along with trade patterns. The United States, Canada, and Japan, among others, have used bilateral investment treaties to circumscribe governments' usage of these policies, beyond what is contained in the WTO agreement on TRIMs. Canadian BITs commonly preclude domestic content rules, mandatory technology transfers, and value added requirements; Japanese BITs prohibit restrictions on foreign management of subsidiaries, requirements for R&D investment in host countries, and requirements for headquarters or regional offices (see Peterson, 2004c: 34). Recent US BITs also proscribe mandatory local content requirements, export requirements, and requirements to transfer technology, among other things (see below). It should be noted that many of these policies may not per se impinge upon investment decisions that affect other countries, save arguably the trade performance requirements. However, in cases where investors have a choice among competing locations to supply regional markets, many of these policies may have extra-national effects as they can tip locational choices among competing locales. This is likely to be the case in industries with high scale barriers to entry—such as autos, petrochemicals and chemicals.

4 There is surprisingly little information on the magnitude and incidence of investment incentives. See Subrahmanyan (2004) for a review of existing policies.
II. INVESTMENT-RELATED PROVISIONS IN PTAS

Governments have generally approached international cooperation on investment policies in two ways. The first revolves around bilateral investment treaties; the second is to include investment (and services) provisions in PTAs.

A. BILATERAL INVESTMENT TREATIES

Bilateral investment treaties are the primary vehicle for international cooperation on the regulation of investment flows. There are now well over 2000 BITs between countries. They customarily provide a definition of investment coverage, include rules of origin to determine the nationality of investors, and specify the treatment of inward investment and investors, either once established and/or pre-establishment. Most BITs do not deal with market access restrictions _per se_—i.e., sectoral entry prohibitions, equity limitations, etc., although some do impose disciplines on performance requirements and similar TRIMs. They generally guarantee MFN and national treatment. Often the treatment that is guaranteed foreign investors is better than that accorded to domestic investors, e.g., in terms of access to foreign exchange or ability to transfer capital outside of the country, or in terms of investor protection/rights.

A major function of BITs is to provide investor protections such as against expropriation, stipulating that there be due process, transparency and compensation for any expropriation of foreign investments. They also provide for a dispute resolution mechanism to enforce these provisions. Dispute settlement provisions vary, but usually include arbitration procedures, often based in recent BITs on international standards, such as those of the World Bank Group’s International Centre for Settlement of Investment Disputes (ICSID) or the UN Commission on International Trade Law (UNCITRAL). BITs involving the United States generally allow private investors to bring cases against host country governments, thereby removing any foreign-policy-driven uncertainty regarding the willingness of their home country governments to defend their rights.

B. INVESTMENT PROVISIONS IN PTAS

Insofar as investment is covered in PTAs, some agreements have subsumed aspects of investment into negotiating protocols, but in most cases little additional liberalization has actually been achieved. In the case of the China–ASEAN FTA launched in 2002 and the earlier South Asian Preferential Trade Agreement in 1993, for example, the negotiations on details for intra-regional investment liberalization have languished without result (see Inama, 2005). In other cases, the coverage of investment in PTAs is simply an extension of the BIT model. Examples are free-standing investment agreements such as the Agreement on Investment and Free Movement of Arab Capital among Arab Countries (1970), and the Colonia Protocol on the Promotion and
Reciprocal Protection of Investment within Mercosur (1994) (Schiff and Winters, 2003; Nofal, 2004). This approach has continued to be pursued, with “side-BITs” accompanying PTAs (Gestrin, 2002). However, an increasing number of PTAs, most notably virtually all of those involving the United States, include investment provisions, often in the form of free-standing chapters. Indeed, nearly every recent agreement involving OECD countries has some coverage of investment, often through the inclusion of services-related provisions as well as directly addressing investment policy.

The most far-reaching are those applying within the EU to Member States, reflecting the objective of creating a common market with a single market for capital and investment. This extends to integration of capital markets and a common competition policy that disciplines government use of investment incentives and subsidies for firms (State aids).

The NAFTA and the US bilateral agreements (except Australia) provide the most far-reaching example of investment provisions in PTAs that do not aim at the type of deep integration that drives the EU. The NAFTA provides for national treatment and MFN and bans TRIMs. It also guarantees capital transfers. Sectoral coverage of the investment provisions is on the basis of a negative list, with exceptions listed in an annex. NAFTA also has a ban on expropriations that are not motivated on clear public policy grounds and calls for full compensation in cases of expropriation. There are extensive dispute settlement provisions, including investor-state dispute resolution.

C. US Bilateral Agreements

In the broadest terms, a major incentive driving recent PTAs between the United States and developing countries is the desire for assured access to US goods markets. The *quid pro quo* is offering better access to their services markets and providing guarantees to the United States in many non-trade areas. Key facets of recent PTAs include:

- Opening services markets to competition from foreign suppliers—or locking in prior autonomous liberalization—except in those sectors excluded (through a negative list). This therefore may expand on the coverage of commitments in the GATS, where a positive list is used, and greatly enhances the transparency of prevailing policies. Since most of the countries with which the United States has concluded bilateral PTAs are already open in most sectors, as a general statement the agreements lock in prevailing openness and effect changes in only a few still-restricted activities. Common provisions range from inclusion of insurance, financial advisory services, and selected telecommunications services to arguably relatively inconsequential changes to already open regimes, such as the commitment of Singapore to cease cross subsidies in express mail delivery or the commitment of Chile in insurance services and a few other sectors. Moreover, notable for their absence is the
exclusion of labour services, except provisional visas for professionals associated with investing firms.

- Investment rights, with provisions for national treatment, non-discrimination, pre-establishment provisions for companies based in each others’ markets, bans on TRIMs, and investor–State arbitration of disputes, limited only by a negative list of exclusions.

**Investment Access and Protections**

The PTAs have subsumed pre-existing BITs and provided new measures covering investment (see Table 1). Agreements, especially post–NAFTA ones, include broad definitions of investment, including not only FDI, but also portfolio flows, private debt and even sovereign debt issues as well as intellectual property (see Mann and Cosby, 2004; Vivas-Eugui, 2003). The inclusion of short-term debt, together with pre-establishment rights, led the US Treasury to demand that Chile modify its controls on capital inflows that were designed to curtail destabilizing hot money inflows. Such broad definitions of investment policies can expose countries to dispute settlement across a wide range of assets.

The inclusion of intellectual property rights in the definition of assets covered by the investment provisions creates a potential liability for signatory governments. Not only are the intellectual property rights far more extensive under the recent PTAs than under the WTO (TRIPs) (see Abbott, 2004; Fink and Reichenmiller, 2005), the dispute settlement provisions are more powerful. For example, if a government decides to issue a compulsory licence to control drug prices and the patent owner disputes this action under the terms of the US PTA, the patent holder can take the claim to commercial arbitration under the PTA’s investment provisions. This instrument is considerably more powerful for IPR enforcement than the State-to-State provisions under the TRIPs Agreement (see World Bank, 2004; Fink and Reichenmiller, 2005).

All PTAs provide for treatment of foreign investors on the same footing as domestic investors (national treatment) and have provisions banning discrimination among investors from signatory countries (MFN treatment). For many of the initial PTA countries, these had long been included in national legislations and/or have been incorporated into bilateral investment treaties on a post-establishment basis.

The PTAs go beyond GATS through broad extension of the pre-establishment right to invest in businesses and activities in all sectors. In contrast to the positive list approach for services in the GATS, US PTAs extend pre-establishment rights across the board except where expressly prohibited through a negative list. These pre-establishment rights lock in the right of Mexican and Canadian investors under NAFTA to invest in all but excluded 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 imply 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 that will in turn translate into increased investment inflows (the evidence for this is discussed in the next section).

Another area of disciplines on government that is more expansive than under the WTO concerns TRIMs—government policies that require foreign companies to export in a certain portion of its sales or balance trade, use local inputs to achieve value-added objectives. All of the bilateral US PTAs ban TRIMs. The US bilateral agreements have in effect established a “WTO TRIMs Plus” set of obligations that include outright bans on certain performance requirements, including management restrictions and export, minimum domestic content, domestic sourcing, trade balancing and technology transfer requirements. In general, government procurement, environmental standards, and requirements for local R&D are not covered (te Velde and Fahnnbulleh, 2003).

Finally, with the exception of the Australian PTA, all the US agreements contain 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 they are also contained in the other bilateral agreements.

D. EU BILATERAL TRADE AGREEMENTS

In addition to market access in merchandise, the EU has also focused on services in its recent bilateral PTAs. The earliest (and least comprehensive) are the Euro-Mediterranean Partnership agreements (starting in 1995) and the South African Agreement (1999). These contain only the promise of potential liberalization after discussions to transpire some five years after the entry into force of the agreement. In the EU–Mexico PTA, several general provisions were included, many ratifying GATS arrangements, as well as specific liberalization commitments in the financial sector. The EU–Chile agreement goes further by additionally locking in some liberalization of telecommunications and maritime services (Ullrich, 2004).

The EU agreements with Mexico and Chile differ in important respects from the US agreements. The trade provisions are phrased on the basis of a positive list, and implicitly exclude new products. 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, without specifying particular sectors or setting a timeline for liberalization. The language in the EU–Chile agreement is even

---

5 The WTO disciplines on TRIMs essentially specify that the WTO disciplines of national treatment and the ban on quantitative restrictions apply to TRIMs (see Hoekman and Saggi, 2000).

6 Of course, for the EU itself (the Single Market), free movement of services is one of the core disciplines.
<table>
<thead>
<tr>
<th>Agreements</th>
<th>National MFN/Treatment Market Access&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Rule of Origin (Nonrestrictive)&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Pre-establishment &amp; Limitations Market Access</th>
<th>Right to Provide Services w/o establishment&lt;sup&gt;c&lt;/sup&gt;</th>
<th>Ratchet Mechanism&lt;sup&gt;d&lt;/sup&gt;</th>
<th>National Treatment/MFN Post-establishment</th>
<th>Ownership Limitations&lt;sup&gt;e&lt;/sup&gt;</th>
<th>Pre-establishment Limitations</th>
<th>Ban on Performance Requirement</th>
<th>Investor-State Dispute Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-Jordan</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-Chile</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-Singapore</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-Australia</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-CAFTA</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S.-Morocco</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>NAFTA</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>EU</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&gt;i&lt;/sup&gt;</td>
</tr>
<tr>
<td>EU-South Africa</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&gt;i&lt;/sup&gt;</td>
</tr>
<tr>
<td>EU-Mexico</td>
<td>Yes</td>
<td>Yes</td>
<td>Standard&lt;sup&gt;k&lt;/sup&gt;</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&gt;i&lt;/sup&gt;</td>
</tr>
<tr>
<td>EU-Chile</td>
<td>No</td>
<td>Yes</td>
<td>Positive-list</td>
<td>Yes</td>
<td>No</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&gt;i&lt;/sup&gt;</td>
</tr>
<tr>
<td>South-South</td>
<td>MERCOSUR</td>
<td>Yes</td>
<td>Negative-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Negative-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>Andean</td>
<td>No</td>
<td>Yes</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Positive-list</td>
<td>TRIMs&lt;sup&gt;f&lt;/sup&gt;</td>
<td>No</td>
</tr>
<tr>
<td>CARICOM</td>
<td>Not specified</td>
<td>Yes</td>
<td>Negative-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Positive-list</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Asean</td>
<td>Yes</td>
<td>Yes</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>SADC</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>None</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>COMESA</td>
<td>Yes</td>
<td>No</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&lt;l&lt;/sup&gt;</td>
</tr>
<tr>
<td>Other</td>
<td>Japan-Singapore</td>
<td>No</td>
<td>Yes</td>
<td>Positive-list</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Canada-Chile</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Chile-Mexico</td>
<td>Yes</td>
<td>Yes</td>
<td>Negative-list</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<sup>a</sup> Includes fair and equitable treatment.

<sup>b</sup> Denial benefits only to juridical person that do not conduct "substantial business" in one of the member countries.

<sup>c</sup> Provides for future negotiation of commitments à la GATS.
Table 1 (contd)

<table>
<thead>
<tr>
<th>Note</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>Right of non-establishment; that is no establishment required to supply a service.</td>
</tr>
<tr>
<td>b</td>
<td>Autonomous liberalization is automatically incorporated into agreement.</td>
</tr>
<tr>
<td>c</td>
<td>Limits on equity shareholdings for companies in sectors other than those excluded from pre-establishment limitations.</td>
</tr>
<tr>
<td>d</td>
<td>COMESA does grant fair and equitable treatment to members, but not to non-members.</td>
</tr>
<tr>
<td>e</td>
<td>Requires only adherence to international conventions.</td>
</tr>
<tr>
<td>f</td>
<td>The MERCOSUR agreement does not include IP, but provides for interparliamentary committees to begin work on harmonization of IP laws.</td>
</tr>
<tr>
<td>g</td>
<td>Andean community regulates all patents.</td>
</tr>
<tr>
<td>h</td>
<td>ASEAN has a framework agreement.</td>
</tr>
<tr>
<td>i</td>
<td>Act 128(e) calls for adoption of new patent laws.</td>
</tr>
<tr>
<td>j</td>
<td>EU treaties provide for investor-State dispute resolution through BITs rather than FTAs, though the latter commonly contain State-to-State provisions.</td>
</tr>
</tbody>
</table>

Source: Legal treaties; Matteo and Sauve, 2003; te Velde and Fahmbulleh, 2003; Mann and Cosby, 2004; Szepesi, 2004a, 2004b; Abbott, 2004; Geestrin, 2002; information provided by governments.
more general, calling for "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 use of safeguards in the event of monetary or exchange rate difficulties, and, although the time limit is set at six months for Mexico and 12 months for Chile, allow for continuation of the safeguard after the time limit through its formal reintroduction.

The treatment of dispute settlement is similar across 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 (see Szepesi, 2004a, 2004b). 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 and Mediterranean countries) within 30 days of a party's request. If this step of "dispute avoidance" proves unsuccessful, in the case of Chile, 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.

E. OTHER AGREEMENTS

Virtually all other recent major PTAs contain references to services liberalism. Most agreements allow for national treatment, post-establishment nondiscriminatory provisions (see Table 1). All have a relatively nonrestrictive definition of preferential access; by allowing firms to invest that have substantial business in member countries and can invest through those subsidiaries, the number of potential competitors 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; establish a stronger floor for liberalization by locking in the status quo; and are more transparent, potentially supporting a more productive internal dialogue with sectoral private interests (Mattoo and Sauvé, 2003). Ratchet mechanisms that allow new autonomous liberalization to be incorporated automatically into treaties can only occur through negative lists. However, most of the South–South agreements have not liberalized many sectors and some, like MERCOSUR, have not fully implemented accords.

Investment provisions have differed as well. South–South PTAs generally have been less ambitious with respect to investor protections. Few provide for the right to provide services without establishing local affiliates, and most rely on State-to-State dispute settlement. For the most part, only the US FTAs and the EU, through their BITs, have established sophisticated mechanisms to deal with disputes on investment. Some South–South agreements provide for investor–State dispute resolution, although these protections are less strong than in the North–South agreements.
Finally, most PTAs do virtually nothing to discipline the use of investment incentives. The exception is the EU itself.

III. **Do PTAs Attract More Investment?**

There are few empirical studies of the impact of PTAs on investment. Available evidence suggests mild positive effects on overall investment. The strongest evidence relates to FDI inflows, as investors from non-member countries confront greater incentives to locate plants within a new PTA. As noted by Schiff and Winters (2003), the impact on intra-bloc investment flows is in principle ambiguous. Firms originally located in a member country receive access to the whole market without relocation and so have less incentive to invest in other members. Firms located in third countries, on the other hand, will have greater incentives to locate new production facilities in a member country and service the other members of the bloc through intra-PTA (preferential) exports—so-called platform investment. This is particularly likely if there are increasing returns to scale in production, making for “lumpy” investments that are only viable above a certain size. The integrated regional market may become large enough to bear the fixed costs for the establishment of new foreign affiliates.

Moreover, insofar as the PTA is between a developing and a developed country, a firm located in the developing country can take advantage of cheap local inputs (labour) while obtaining free access to the large developed economy. This can be a powerful stimulus to investment, as illustrated by the experience of NAFTA. Although Mexico has long been used as an export platform to the United States, NAFTA had a profound impact on FDI into Mexico after 1994 from countries outside NAFTA, as it became a way to guarantee market access into its northern neighbours. About 80 percent of the vehicles and parts produced by US auto manufacturers in Mexico in 1997 were for export, compared with 48 percent in 1994 (USITC, 1997). Following the creation of NAFTA, Japan redirected part of its FDI from the United States and Canada toward Mexico. While Japanese investments in the United States are geared primarily for the local market (mainly directed towards manufacturing, commerce, and banking and finance), those in Mexico particularly in the automobile industry are intended more for the NAFTA continental market. FDI to Mexico doubled as a share of GDP after NAFTA; FDI net of privatizations rose from 1.2 percent of GDP in 1985–1993 to 2.9 percent in 1994–2001, though it should be noted that it rose only slightly less in other non-NAFTA Latin American countries as well. Lederman et al. (2004, p. 130) calculate that “Mexico’s entry into NAFTA led to an increase in annual FDI by around 40 percent”. Waldkirch’s (2001), with less complete annual data, also found that NAFTA increased FDI substantially, mostly from the United States and from Canada.

It has been widely documented that European integration has made member countries more attractive to US, Japanese and other third country firms. The creation of the single market in the EU in 1992 had a significant impact on Japanese, Korean and Taiwanese company decisions to establish operations in the union (Motta and Norman,
Total inflows of FDI into the member countries expanded from ECU10 billion in 1984 to ECU63 billion in 1989. The European Commission (1998) finds that the EU share of worldwide inward FDI flows increased from 28 to 33 percent during 1982–1993.

For other PTAs similar evidence exists. In the case of MERCOSUR: following the signature of the Asuncion Treaty, FDI into MERCOSUR member countries increased from $3.5 billion in 1991 to $18 billion in 1996 and $38 billion in 1998. With nearly $11 billion, Brazil surpassed Mexico as the largest FDI recipient in Latin America in 1996 (compared with $1.1 billion in 1991). To be sure, it is probable, however, that the formation of MERCOSUR per se was less important in boosting FDI during this period than improved macroeconomic and sectoral policies; the end of high inflation in both Argentina and Brazil, together with large-scale privatization were more or less contemporaneous in both Argentina and Brazil.

All of these examples entailed anticipation of the PTA followed by something of a decline. This strongly suggests that PTAs change the firms’ views of the optimal stock of investment in the PTA; thus we observe a big step up during the adjustment period, but only a small permanent increase in the flow commensurate with maintaining the higher stock, a pattern also noted in Lederman et al. (2004) for Mexico. There is no evidence to date that steady-state flows of FDI increase (Schiff and Winters, 2003).

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 (designed to produce for the local market). Hence, they conclude FDI probably contributed to growth less than it otherwise would have.

Levy Yayati, Stein and Daude (2004) use a gravity model to analyse, among other things, the effects of PTAs on FDI inflows in 13 major agreements, and then apply this to a simulation for the FTAA. They found that PTAs have a strong positive impact on inflows, and that if these average magnitudes would 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-PTA market size, low inflation rates, strong domestic institutions, and greater trade are likely to be the biggest beneficiaries.

To investigate further whether PTA formation can affect FDI flows in a consistent fashion, World Bank (2004) examines the effects of PTA membership and other variables on FDI inflows for a panel of 152 countries during 1980–2002. The analysis is not without problems, but does produce rather robust results. The dependent variable

---

7 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 of FDI data that allow the effects of PTAs on differing types of investment—vertical or horizontal—to be distinguished limits the analysis. Nonetheless, the regressions are robust to variations in specifications.
is FDI inflow by country measured in current US dollars, and the independent variables include host country GDP and per capita income, the trade-to-GDP ratio (openness), GDP growth, annual rate of inflation (CPI), world FDI, world growth, the combined GDP of the country’s PTA partners, and year and country fixed effects. The sample takes into account 238 PTAs (both regional and bilateral), many of which overlap and that encompass the vast majority of sample countries. The model was estimated in natural logarithms for FDI, GDP, GNI per capita, world FDI, world growth, and PTA GDP, and in levels for the other variables. In general, countries that are more open (measured as the sum of exports and imports over GDP), grow more rapidly, and are more stable (captured by less volatile inflation rates) attract greater quantities of FDI, controlling for growth rates of FDI to all countries and the world growth rate.8

The PTAs that result in larger markets do attract greater FDI. The interaction of signing a PTA and expanded 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 a PTA produces an increase in FDI of 5 percent.9 This has important policy implementations: if a country seeks to use a PTA to attract investment, it should seek to amalgamate with the largest possible markets; PTAs among small market countries have little effect.

Two important caveats to this conclusion are worth underscoring: First, a PTA cannot substitute for an inadequate investment climate. Stein and Daud (2001) show that institutional variables that make up the whole of a country’s investment climate—including political stability, government effectiveness, the 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

---

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

| Variable | Coef. | Std. Err. | t (P>|t|) |
|----------|-------|-----------|--------|
| fdi | 0.39404982 | 0.2655772 | 4.55 0.000 |
| lgdp | -0.12284653 | 0.2008249 | -0.61 0.541 |
| lnopen | 0.0051226 | 0.0011387 | 4.50 0.000 |
| lnopen | 0.0198651 | 0.0040816 | 4.87 0.000 |
| lnopen | 0.0196485 | 0.0060906 | -3.23 0.001 |
| lnopen | 0.442645 | 0.0710985 | 6.22 0.000 |
| lnopen | 0.0615766 | 0.0432152 | 1.42 0.157 |
| lnopen | 0.0515623 | 0.0173279 | 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 = 0.000 |

9 Test that all u_i = 0: F(43, 2003) = 12.79 Prob > F = 0.000

9 As mentioned earlier, this variable contains the sum of the host country’s PTA partners’ GDP, excluding the host country itself. Thus, if we consider Brazil as the host country and MERCOSUR as the relevant PTA, the variable lgtargdp would be the sum 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 a PTA 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 PTA membership would be counterproductive in the presence of this variable, since it will capture the “threshold effect” of signing a PTA). 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 a PTA 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.
effects of PTAs. If the economy suffers from poor macroeconomic management, high levels of corruption, and poor infrastructure, a PTA by itself will not offset these disadvantages. To be sure it may have helped governments through their collective action to improve the investment climate, but a PTA cannot substitute for an adequate investment climate. Second, creation of a PTA will not have much effect on investment inflows from outside the region if restrictions on market access are severe and remain unchanged.

What about investor protections? Here theory would suggest that sound property rights are a foundation of any country’s investment climate, and, other things 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 protections contained in BITs is that these additional rights have no significant effects on inflows of FDI (see Box 1). While a PTA with new investor protections may enhance the credibility of a reform programme, evidence that these have observable consequences is scarce.

Box 1 Lessons from bilateral investment treaties: isolating the effects of investor protections

Does increasing investor protections produce the benefit of higher investment? One test of this proposition was performed by Hallward-Dreimeier (2003). She studies the enhanced investor protections through BITs on flows of FDI among signatory countries. Analysing 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. Put differently, countries signing a BIT were no more likely to receive additional FDI than countries without such a pact. Even comparing flows in the three years after a BIT was signed to the three years prior, there was no significant increase in FDI. This supports the findings of uncorrelated with the amount of FDI it received. Similarly, in a more recent empirical study of PTAs, Dee and Gali (2004) find that whether investment treaties are signed or enacted between countries has no statistically significant effect on outward investment flows.

Gallagher and Birch (2004) undertake a further literature review and use 1980-2001 data and find no evidence that BITs with the US lead to additional FDI, but rather size of the economy, trade integration in exports, and stable macroeconomic policy are the most important determinants.
While the benefits of BIT-type protections in the form of new FDI inflows are open to question, the costs of stronger protection in the form of investor suits can be nontrivial. This is a growing phenomenon. The number of cases brought under the various bilateral investment treaties and PTAs has risen dramatically. Although the absence of reporting data from all the dispute tribunals prevents full analysis, the International Centre for Settlement of Investment Disputes (ICSID) reports a steady and indeed geometric increase in the number of cases from an annual average of 1.5 cases in 1972–1995 to 29 in 2003–2004 (see Figure 1).

In NAFTA, as of July 2004, there were 31 cases brought under chapter 11 (including 14 against Mexico, nine against Canada, and eight against the United States). Six cases have been decided in favour of the investor, but the amount awarded has been small compared to initial—undoubtedly inflated—claims. Tribunal awards have totalled $35 million compared to claims of $1.0 billion. Cases have arisen out of the Argentine devaluation, changes in tax policy perceived as adverse by investors, expropriations following conflict or coups, irregularities in bidding processes and others (Peterson, 2004a).

Awards are rising in amounts. In February 2005, the Slovak Republic agreed to comply with an ICSID arbitral award of $830 million to CSOB, a Czech bank (Invest—
**Figure 1**

Number of cases filed before ICSID

Source: ICSID lists of pending and concluded cases (ICSID website, accessed 2 April 2005).

*SD Investment Law and Policy News Bulletin*, 22 February 2005). This award surpassed that of a tribunal in Stockholm, which required the government of the Czech Republic to pay one company, Central European Media (CME), $350 million for violation of a BIT that deprived CME from a stake in an English language television station in Prague. This amount was ten times higher than previously known awards under arbitration cases, and about equal to the entire public sector deficit of the Czech Republic (Peterson 2004b). But the biggest case has been filed against the Russian Federation, involving a claim for US$ 28 billion for the alleged expropriation of Group Menatep’s majority shareholding in the Yukos oil firm under the 1994 Energy Charter Treaty (as yet ungratified); a Swedish group is also reported to be considering a claim under the Russia–Sweden bilateral investment treaty (Peterson, 2005).

The legal and macroeconomic consequences of broad investment rights are largely unknown. They have not been thoroughly analysed, tested in arbitration cases, and are without precedent. One could certainly speculate about adverse outcomes. For example, new rules in the US–Chile PTA limiting the ability of the Chilean government to impose restrictions on short-term capital inflows that could complicate future macroeconomic management. The IMF staff informally raised questions to the US government about these restrictions. 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 in ways that may ultimately be unenforceable because a country cannot pay. For example, Argentina’s default has led investors to file some 40 arbitration cases, with collective claims amounting to US$ 16–20 billion.
IV. Harnessing the Potential Benefits—Mostly a Services Agenda

As argued above, benefits of addressing investment-related policies in PTAs would be greatest if the agenda were to be extended to include (fiscal) incentives for investment, in particular FDI. In addition, given that the great bulk of remaining investment restrictions are in services, this is probably the area where PTA based liberalization can have the largest direct beneficial impact on investment flows. Services investment is mostly market seeking, i.e., comprises horizontal investments. The services concerned require the commercial presence of affiliates, branches, or franchises to deliver the service. To be sure, some countries like India have experienced substantial foreign exchange flows associated with services provided by call centres, software development and data processing. However, new investment also accompanies this type of cross-border supply.

Barriers to entry into services markets usually take the form of regulatory restrictions on entry, foreign workers, foreign equity ownership limitations, quotas on outputs and requirements or restrictions on the legal form of establishment. None of these generate revenue for the government, and so, unlike reducing tariffs, removing these restrictions produces no fiscal losses, although they may erode rents accruing to domestic firms. Preferential access, if granted, could lead to a higher cost foreign firm gaining competitive advantage relative to investors from outside the region, and because of first mover advantages, and barriers to entry make it difficult for lower cost suppliers from third countries to enter the market. The extent to which such discriminatory policies are applied to services in the PTA context is unknown. In many situations the types of regulatory reforms that are needed should and often will be applied on an MFN basis. As discussed below, the rules of origin that are included in PTAs for services (and other) investors will identify the extent to which intentions are discriminatory or not.

Rules of origin for service suppliers, as with merchandise trade, play a significant role in determining the degree to which PTAs may discriminate against non-members. For example, if one participant has a fully liberalized market, the adoption of a liberal rule of origin by the other PTA participants can be likened to MFN liberalization. This is because service suppliers can enter through the liberal jurisdiction and then extend services in the other partner countries. Some governments take liberal rules of origin one step further and subsequently extend regional preferences on an MFN basis under the GATS. This widens the number of competitors in the market and offers greater opportunities of securing access to the most efficient suppliers, particularly of infrastructure services that are likely to exert significant effects on economy-wide performance. The extent to which this is done is not well documented, however.

Restrictive rules of origin can limit the potential benefits of 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, in particular, of regionally dominant but non-globally
competitive service providers towards 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 limit benefits to juridical persons that are owned and controlled by natural persons of a member country. The experience of the Mexican banking market in the decade following the NAFTA suggests that the adoption of a liberal rule of origin played an important role in mitigating any strong preferences that US and Canadian owned banks received from Mexico under NAFTA.

Unfortunately, to date the actual additional liberalization has not matched the promise. In an early assessment of PTAs, Hoekman and Sauve (1994) argued that with the exception of the EU, most PTAs did not go much beyond the GATS. Hoekman and Messerlin (2000) speculate that this may reflect the nature of the political economy that prevails in services, in that the incentives to pursue unilateral reform is greater than for goods, and it is more difficult to construct an effective reciprocal, discriminatory bargain. Pink and Mattoo (2002) note that in the case of telecommunications and financial services, the GATS has achieved a higher level of bound liberalization than that on offer in most PTAs. United States bilateral PTAs have achieved some additional liberalization in Central America (CAFTA), Bahrain, and Morocco, but most of the post-2002 agreements were with countries that had already open services (e.g., Chile, Singapore, and Australia), and new opening was confined to a few selected subsectors (World Bank, 2004).

Aside from new liberalization, countries may experience some advantages from locking in liberalization. Investors may find this increases certainty and offers a more attractive investment climate, increasing investment. As of this writing, we lack studies that would demonstrate any quantifiable effects.

Of course, multilateral, explicit MFN-based 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 gives consumers maximum choice. It also leads to a less complex policy regime than a preferential arrangement, implying lower administration costs for the government and lower transactions costs for the private sector. It remains to be seen whether the ongoing round of WTO talks will deliver significantly more services commitments by WTO Members or whether governments will instead put greater emphasis on using PTAs.

V. CONCLUDING REMARKS

PTAs differ markedly in their coverage and implementation of investment-related provisions. Results have ranged from mixed to missed opportunities. In general, the US PTAs have prompted some additional services market opening in Morocco, CAFTA and Bahrain, some changes in Singapore, but few changes in Chile and Australia. To be sure, investors may place value on enhanced credibility through lock-in effects in the latter cases, but evidence of this does not exist. In the South, agreements that have
seriously improved services access have been limited—and those that have included such measures often have the most limiting rules of origin for determining investor nationality. More common is the lack of progress.

At the same time, the bilateral PTAs have strengthened investment policy rules, with unclear development benefits for developing country partners. While additional market access to formerly restricted industries is important, the new investor protections provide uncertain benefits in terms of new investment flows. Not only is the promise of greater investment flows or more technology as a development vehicle potentially hollow, but 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 the case law of arbitration panels, whose judgments at times conflict (Ewing-Chow, 2004). Governments may find themselves hauled before arbitration panels and compelled to pay large amounts of compensation for enacting regulations they had considered within their sovereign domain. Thus, care needs to be taken not to create incentives to make the legal departments of multinationals a profit centre. Ensuring that foreign investors do not get inappropriate “preferred” treatment relative to domestic investors is also important in order to ensure continued political support for using international agreements as a mechanism to support further integration into the world economy. This is almost by definition the case because, for a range of regulatory takings, domestic firms in many countries do not have access to a commercial arbitration system.

The empirical evidence on the effect of BITs/PTAs on investment flows clearly reveals there are effects for some agreements, especially North–North and North–South PTAs. However, these effects do not appear to be a function of investment protections embedded in the agreements. Instead, they are driven by a mix of market access/size and complementary policy actions relating to the investment climate more generally. Often these will be implemented in conjunction with the PTA.

Another way of assessing the likely impact of PTAs is to ask to what extent they go beyond the GATS in elimination of discrimination in service markets. Given that most remaining restrictions are in services, this is an appropriate test to impose. While a number of recent PTAs have gone beyond the GATS by using a negative list approach, most PTAs do little to effectively open up access to service markets across all modes of supply. Moreover, almost none constrain the ability of governments to provide incentives for FDI—the EU being the exception. In conjunction with the empirical findings that the marginal effects of BIT-type commitments are negligible, and considering the potential downsides in terms of the “ownership” cum political acceptability of agreements that include investor–State dispute settlement mechanisms that generate ever higher and frequent awards against governments, it would appear that there is only limited positive value added associated with the large-scale administrative investments that have been and are being made to negotiate investment disciplines in or in parallel to PTAs.
The best way forward would appear to revolve around focusing on the specific areas where there are still significant restrictions on investment, i.e., services, and in getting more serious about dealing with the investment-distorting implications of incentive competition. To date neither appears to have been given great attention by most PTAs. Both issues can be better addressed through the WTO.

References


Inama, Stefano (2005), *The ASEAN–China Free Trade Area: Negotiating beyond eternity with little trade liberalization?*, mimeo (Geneva: UNCTAD).


Te Velde, Dirk, and Miatta Fahnbulleh (2003), Investment-Related Provisions in Regional Trade Arrangements (London, Department for International Development).


USTR (United States Trade Representative) (2004), USA–Chile Free Trade Agreement. Vivas-Eugui, David (2003), Regional and Bilateral Agreements and a TRIPS-plus World: The Free Trade Area of the Americas (Geneva: QU NO).

