Free Trade Agreements: Key Negotiating Issues, Substantive Provisions and Major Considerations

James L. Kenworthy
1998, Revised 2004

1.0 Introduction

This memorandum addresses technical aspects of the content and structure of a free trade area agreement, including the major negotiating issues and substantive provisions that result therefrom.

The overall goals of a regional free trade area (FTA) arrangement are (1) to stimulate domestic economic growth through (a) enhancing the market access of a nation's exports to other countries; (b) attracting increased foreign direct investment (and the modern technology that comes with it); (c) stimulating increased productivity and competitiveness in domestic as well as foreign markets; and (2) to aggregate regional economic "clout" and leverage - and thereby regional competitiveness - and to avoid marginalization in a world rapidly being divided up into global economic alliances such as the European Union (EU), the North American Free Trade Area (NAFTA), and the Asean Free Trade Area. These goals are intended to be implemented by, and, thus, are reflected in, the substantive provisions of regional economic integration agreements as they are eventually negotiated.

2.0 Key Negotiating Issues and Provisions of an FTA Agreement

FTAs have become increasingly more detailed and complicated since they began to be negotiated in the late 1950s (in the "modern" era of such agreements, although the conclusion of free trade areas goes back to the early 19th Century). Generally speaking, however, the modern FTA will be structured with and contain the following basic substantive provisions:

(1) **Market Access**, involving issues related to:
- (a) preferential removal/reduction of tariffs for imports from member countries;
- (b) reduction of non-tariff barriers thereto;
- (c) development/harmonization of facilitating customs structures and formalities; and
- (d) guarantees of Most-Favored-Nation (MFN) or National treatment for the imported goods of member countries;

(2) **Sectoral Exclusions** from the preferential tariffs conceded by member countries under the FTA agreement (frequently, government procurement, agriculture, energy, textiles/apparel, etc.)

(3) **Trade Rules**, including:
(a) rules of origin;
(b) standards (sometimes referred to as "technical barriers to trade"); and
(c) domestic trade remedies including safeguards, antidumping, and countervailing duties;

(4) **Special Sectoral Regimes** involving "differential treatment" of certain sectoral areas such as services, agriculture, telecommunications, etc.;

(5) **Trade-Related Substantive Provisions,** usually the special rules affecting foreign direct investment plus certain other substantive areas such as intellectual property rights;

(6) **Governance/Administration**, the so-called "housekeeping" matters such as
(a) consultation/decision making;
(b) harmonization of laws/procedures;
(c) surveillance and enforcement;
(d) accession of new members; and, most importantly,
(e) dispute resolution; and

(7) **Other Matters** such as special provisions for labor and/or environmental issues or third country compensation for market access rights under other agreements that may be impaired under the FTA.

3.0 Market Access Issues/Provisions

The purpose of an FTA is to confer tariff preferences in a given country's domestic market on the goods of another member country in exchange for roughly similar tariff preferences in other member country markets for the goods of that given country (as opposed to the non-reciprocal, "concessionary" preferences granted certain countries under programs such as the GSP, Lome IV, CBI, etc.). The key to the arrangement is the "give/get" concept of "reciprocity," so that the overall economic "value" of the tariff reductions and other concessions made by one member country to the goods (and, sometimes, services) of other member countries is roughly equal to the value they realize out of the arrangement. So, the central or threshold issue of any FTA is that of the extent and quality of "market access" to be realized by the signatory countries. "Market access" has been defined as "the availability of a national market to exporting countries, i.e., reflecting a government's willingness to permit imports to compete relatively unimpeded with similar domestically-produced goods."

3.1"Reciprocity"- while an underlying principle of FTA arrangements, is necessarily only a relative concept. Generally, "reciprocity" in trade agreements means "the lowering of customs duties on imports in return for tariff concessions from other countries; the negotiated reduction of a country's import duties or other trade restraints in return for similar concessions from another country." Absolute reciprocity is unlikely of achievement, since all countries have differing endowments of resources and factors of production. While the economic theory of comparative advantage posits the differing competitiveness of countries based on comparative advantage in selling similar products to each other and this aspect of trade is always a part of an FTA, the incremental trade creation that is the object of such agreements is usually sought through maximizing "complementarities" among member countries, e.g., trade in differing products (or services). This means that tariff concessions granted among and FTA's member countries may be different based on their overall realizable "reciprocity", and not absolute reciprocity. Thus, as indicated above, the purpose of market access preferences through tariff reductions is the giving and getting of roughly equal economic value as determined by each of the member countries of an FTA.

3.2 Tariff Removal/Reduction - The giving of "market access" means the immediate (or often phased) removal or reduction of a nation's tariffs on defined exports of an FTA partner nation. The removal or reduction is usually implemented through agreement among the member nations on commitment to tariff removal/reduction on "schedules" of goods identified on an item-by-item basis with reference to the tariff schedules of member countries, for example, in the case of Egypt, on the eight digit enumeration of items contained in its Tariff Law based on the Harmonized System of Tariffs which it implemented in 1993 (or other tariff tables such as the former Brussels Tariff Nomenclature or United Nations' Standard International Trade Classification). It is the number of specific items enumerated in the tariff removal/reduction commitments of member countries that define the scope and significance of an FTA.

3.3 Removal of Non-Tariff Barriers - Now, however, nearly equal in importance to tariff removal and/or reduction is the removal of so-called nontariff barriers (NTBs) or nontariff measures (NTMs).These have proliferated in the last 25 years as a direct result of the success of the global trading community in various GATT-sponsored multilateral trade negotiations (MTNs) in achieving broad multilateral reductions "across-the-board" in import tariffs. Having given commitments to tariff reductions, many countries then innovated new, non-tariff , impediments to imports or utilized existing regulatory systems for the purpose of avoiding the results of their tariff liberalization commitments. These impediments are referred to collectively as NTBs or NTMs. NTBs can take nearly any regulatory form other than a tariff, e.g., they include: import quotas; import licenses; import "exclusions"; customs surcharges or other additional import taxes or fees; unnecessary or drastic import labeling requirements; tariff rate discrimination based on ultimate use (e.g., as inputs in assembly/processing operations for export); implementation of certain so-called "voluntary restraint agreements" (like agreements entered into bilaterally under the Multifibre Agreement); market price controls or discrimination on imports; unnecessary or extraordinary technical standards or quality controls; and local content requirements. Whilst some of

these measures reflect valid domestic concerns or policies - such as the need for sanitary standards related to health and safety to protect consumers - many have either been innovated or abused with the direct intention of restricting international trade. The UNCTAD has developed an index of over 150 separate NTBs aggregated into 10 broad NTB categories. The removal of NTBs cited by member countries is often one of the most contentious and prolonged areas of FTA negotiation and usually results in the most explicit substantive requirements for their removal or remediation ("tariffication") in an FTA agreement. "Tariffication" is an effort to compute "tariff equivalents" (in terms of their overall impact on export costs) of NTBs, with the goal of thereafter eventually removing or reducing such constructed tariffs.

3.4 Customs Structures and Formalities - It is essential to implementation of FTAs and facilitation of trade thereunder that there be developed some degree of harmonization and "fit" among FTA member countries of their customs systems, including, in particular, the operations of classification and valuation through which their tariff removal/reduction commitments can be realized. Foremost in importance is the customs classification system. "**Classification**" refers to the coding system and description of goods that enter into international trade used by customs officials as their guide in applying tariff rates to a particular item. Efforts to implement FTA commitments through differing customs classification systems is often much more difficult than the proverbial comparison of "apples" and "oranges." Without common customs classification guidelines, it becomes nearly impossible to relate tariff commitments to specific items offered for importation since such items may be described differently in differing classification systems. The basic customs classification systems utilized in modern times have been the 1955 Brussels Tariff Nomenclature (BTN) (utilized until recently by the EU and Japan and many other developed and developing countries), the Tariff Schedules of the United States (TSUS), and the United Nations-inspired Standard International Trade Classification (SITC), while the former Soviet bloc and Eastern European nations operated under a Russian-inspired classification system. In the early 1970s, an effort was undertaken to combine the BTN and SITC into a single, harmonized, global classification system, now known as the Harmonized System of Tariffs, which is gradually being implemented by most of the developed and developing nations and which was implemented by Egypt in 1993.

The term "**Valuation**" is used to describe the process of determining the value of imported goods on the basis of which duties are assessed, according to the tariff schedule of the particular country. As a result of the Tokyo Round MTN, many countries are shifting to a method of valuation prescribed by the Tokyo Round Customs Valuation Code, under which most items' value is determined on so-called "transaction value," e.g., the price actually paid or payable for the imported good, with additions for costs, charges, and expenses incurred with respect to imported goods which are not separately reflected in the price.

Similarly, differing Customs substantive requirements and **procedural formalities** at ports of entry can complicate trade among FTA member countries, resulting in unnecessary delays and undue costs that undermine the goals of an FTA.

These may involve unnecessary documentation or inspection requirements, duplicative or inconsistent entry procedures, unnecessary records requirements, certificates of origin or country of origin marking requirements, bonds, etc. (many of which are among the usual suspects in identifying NTBs). So, it becomes important, in the negotiation of an FTA arrangement for the negotiating countries carefully to examine and compare their customs requirements and procedures with a view toward harmonizing them as much as possible. Many of the issues in this area can be referred for technical assistance to the Customs Cooperation Council in Brussels, which substantially developed the Harmonized System.

3.5 The "Quality" of Treatment Under an FTA - MFN and National Treatment - The most important aspect of an FTA arrangement, after the tariff commitments granted, is the **quality of treatment** guaranteed to member countries of an FTA for their goods in the markets of other member countries. This relates both to the passage of their goods through other member countries' customs (in particular, the assessment of duties) and the subsequent treatment such goods receive once they have arrived in the other member countries. Over 125 countries are currently members of the World Trade Organization (WTO) and, as a result of their membership, are required to adhere to the general rules of the WTO embodied in the post-Uruguay Round MTN agreement known as the "GATT '95" (with some provision for "differential" treatment for certain developing countries).

The GATT '95, like its predecessor GATT Treaty (for "General Agreement on Tariffs and Trade") incorporates two specific rules that govern international trade relating directly to the quality of treatment of the goods of WTO signatory countries (or "contracting parties") which are often adopted for use in FTAs as guarantees relating to the quality of treatment of their goods in other member markets. These are (a) "Most-Favored-Nation" treatment and (b) "National" treatment. "MFN" describes a commitment that a country will extend to another country the lowest tariff rates it applies to any third country (in the case of an FTA, to any third country, whether or not a member of the FTA). Under Article I of GATT '95, all WTO contracting parties undertake to apply such treatment to one another. Normally, a country is under no obligation to extend MFN treatment to another country unless both are contracting parties of the WTO or of an FTA or other economic integration arrangement that incorporates and applies this principle among its members. The MFN principle has been incorporated directly or by reference in most recent trade agreements. The second major "quality" of treatment is that of "National Treatment." Taken from Article III of the GATT '95, it requires the treatment of imported goods, once they have cleared customs and border procedures, to be no worse than that extended to domestically-produced goods in the importing country's market. Or, as more positively formulated, it means that a party must give goods from another country the same treatment it gives goods originating in its own market - but not necessarily better treatment. Most recent economic integration agreements now incorporate both of these treatment principles and will often guarantee FTA member countries the better of the two treatments if both are at issue in a given country. It is these two measures of the quality of treatment of member country goods in

the markets of other member countries that - together with the extent of the tariff preferences provided - determine the real economic "value" of FTAs to their members.

4.0 Sectoral Exclusions/Special Regimes

Many prospective members of proposed regional integration want to enhance foreign market access for their exports but do not feel they are ready totally to liberalize trade in certain sectors of their economy that are considered "import sensitive" in terms of the foreseeable negative impacts on the competitive positions of domestic producers in their home markets. Negotiators face two basic choices regarding such "import sensitive" sectors, either (a) total exclusion of the sector from the preferential benefits of the arrangement, or (b) conclusion of so-called "special regimes" for such sectors that provide some market access under certain conditions but also impose carefully-crafted restrictions thereon intended to limit the scope of access, or so-called "safeguard" provisions or "escape clauses" specific to individual sectors designed to limit any detrimental impacts that may occur as a result of any liberalization. Sectors that frequently have been excluded in their entirety from FTAs or shielded through "special regimes" include Agriculture, Textiles/Apparel, Services, and, more recently, Telecommunications. The NAFTA agreement, for example, provides special regimes for Agriculture, Energy and Basic Petrochemicals, Government Procurement; and Services, with special regimes for cross-border trade in Telecommunications and Financial Services.

Provisions of sectoral special regimes tend to parallel the substance and structure of the overall FTA agreement, with specific rules within each such regime - different from those of the overall FTA governing: scope and coverage, tariff rates and import restrictions, export subsidies, standards, customs procedures, and dispute resolution. They often incorporate provisions reflecting the specialized, technical issues and jargon of the particular sector - as in the Tendering Rules for Government Procurement (The NAFTA agreement provisions for Government Procurement comprise 25 separate articles and 11 annexes).

The problem with sectoral exclusions or sector-specific regimes is that, once introduced into FTA negotiations, they tend to draw out a whole range of protectionist tendencies in sectors throughout a nation's economy that can eventually undermine either the negotiations themselves or any agreement ultimately concluded. Sometimes, negotiators will attempt a middle path by excluding particular sectors from the FTA eventually entered into, but with a promise by the member countries to enter into further negotiations for eventual incorporation of such sectors into some kind of coverage under the agreement. Failure of member countries to resolve difficult issues of sectoral coverage have frequently undermined negotiations or led to the basic ineffectiveness of agreements that are reached, as in the case of FTAs attempted in Africa and Latin America, some of which now are essentially dormant.

5.0 Trade Rules

FTAs, like all economic agreements among sovereign nations, involve an exchange of promises relating to State behavior in exchange for tangible economic benefits. The behavior affected relates to how conscientiously and accurately such nations will meet their FTA commitments in terms of tariff removal/reduction or treatment extended to imports from FTA partner nations. Because national commitments do not necessarily effect the actions promised, economic integration arrangements provide for certain rules structuring implementation of such agreements among member nations and providing remedies in the event of default on such promises or to resolve problems occasioned by the unforeseen consequences of commitments that have been given under the agreement. Among the most significant such rules are those relating to "rules of origin," "standards," and certain trade remedies involving "safeguards," "anti-dumping," and "countervail."

5.1 Rules of Origin - The customs laws of most countries require identification of the country of origin for imported goods. Apart from its statistical utility in identifying and recording trade patterns, such rules are used to implement the sometimes differing customs treatment of such goods based on their country of origin, usually reflecting, in turn, outstanding commitments of the importing country to exporting countries related to various preferential global or regional arrangements affecting international trade. Egypt, for example, is a member both of the GATT/WTO and of certain regional trade arrangements which, at least, purport to involve trade preferences. As a member of the GATT, it is obliged to guarantee MFN treatment to the goods imported into Egypt from other GATT signatory nations. As a member of one or more FTA arrangements, it presumably has outstanding commitments regarding the tariff treatment of imports from member countries thereof. Thus it could well occur that, upon the importation of a given product into the country, Egypt might apply any one of several tariff rates: (a) an MFN rate if the product has been exported to Egypt from a GATT signatory country; (b) a different rate if the product is imported from a partner nation in an FTA arrangement; or (c) even a third rate if the product comes from a country that is neither a GATT signatory nor an FTA partner country. Rules of origin are used to determine exactly which country an imported product has come from, in order, in turn, to apply the appropriate tariff rate.

Moreover, in the case of implementing an FTA (or nearly any other variant of economic integration arrangements), rules of origin are necessary to avoid the so-called "free rider" or "transshipment" problem. Under such a scenario, a non-FTA country may export goods - say to Egypt - in order to avail itself of the FTA preferences extended to Egypt by a third, FTA member, country - by transshipping the product through Egypt to the latter country. Transshipment becomes economically desirable in situations in which, in the example just described, FTA member Egypt has lower tariffs applicable to products from non-FTA member countries than does the other FTA member country to which the products are ultimately transshipped. Transshipment through FTA members countries to other FTA member markets is often attempted by "free rider" countries attempting to obtain the preferential benefits of FTAs without adhering to their requirements or undertaking their obligations.

So, nearly all economic integration arrangements contain detailed, often very complex, rules of origin. They are used to determine the "real" source of products so as to qualify or exclude such products from FTA preferences to which they are not entitled. Rules of origin often employ one of two basic tests to determine the "real" origin of products: (a) "substantial transformation" or (b) "value-added." Under the substantial transformation test, the origin of a product is attributed to its most recent exporting country only if the product underwent a "substantial transformation" within that country that differentiates it from its nature when it left its original exporting country. Substantial transformation is usually determined by whether or not it was or would be classified under a different item heading or description in the tariff schedules of the intervening country than it was upon its exportation from the original exporting country.
The second test - "value added" - examines the percentage of resulting total value of the product that can be attributed to its original country and the intervening country from which it was most recently exported. Under this test, goods are attributed to the final exporting country only if a given percentage of the pro-duct's resulting total value was added or originated in that country. For example, under the U.S. Generalized System of Preferences (GSP), for an import to be determined eligible for GSP tariff-free treatment, it must have originated in a GSP-eligible country. Under the U.S. GSP program, in order for the imported product to be GSP-eligible, no less than 35 percent of its total value (in material or processing) must have been added in a GSP beneficiary country. Rules of origin also come into play in administering a country's import country-of-origin marking requirements.

5.2 Standards/Quality Controls - A "standard" is a technical specification intended to set forth minimum acceptable characteristics of a product in terms of quality, performance, dimensions, safety, or uniformity, with the object of ensuring that the product conforms to such a standard as a requirement for admission into a country's market. Standards and so-called "quality controls" are a form of administrative regulation affecting international trade presumably for the purpose of ensuring product quality and protecting consumers. While most of the trading world acknowledges the sovereign right of nations to protect their consumers from health and safety risks and their animal and plant stocks from disease and pests, experience demonstrates that industrial standards and sanitary and phytosanitary standards have often been abused for protectionist purposes, particularly to avoid the consequences of tariff removal/reduction commitments - and, when they are, they qualify as NTBs. Standards that are unduly restrictive when applied to imports, or which are applied in an arbitrary and prejudicial manner against imports but not against competitive domestically-produced goods, discriminate against imports in a way that nullifies the commitments given in an FTA and undermine its goals. This becomes especially apparent when such standards are not established in an open, transparent manner and/or do not reflect basic international standards formulated under international agreements by global standards organizations.

There currently are two international standards agreements developed under auspices of the GATT/WTO: (a) the Agreement on Technical Barriers to Trade, negotiated during the Tokyo MTN round and updated in the Uruguay Round (Standards Agreement) and (b) the Agreement on Application of Sanitary and Phytosanitary

Measures (SPM Agreement), negotiated in the Uruguay Round. These two agreements, as a result of the conclusion of the GATT'95 establishing the WTO, are now binding upon all WTO signatory nations. The Standards Agreement provides disciplines relating to: (a) adoption of standards in WTO countries; (b) conformity assessment, testing, and certification; and (c) rules to ensure transparency of administration and notice to trading partners. The SPM agreement provides rules relating to (a) adoption of SPM within a country; (b) inspection, controls, production, and quarantine; (c) food additive and pesticide tolerance approvals; (d) risk assessment procedures; and (e) membership in international sanitary/phytosanitary organizations and systems and multilateral and bilateral agreements.

Prior to the adoption of the two above-described agreements and their becoming binding on all WTO members, detailed standards provisions were negotiated in many multilateral trade agreements. For example, The NAFTA agreement (see **Attachment B**) includes 15 articles relating to "Standards-Related Measures" and 24 articles relating to "Sanitary and Phytosanitary Measures." However, with nearly universal coverage of the WTO agreements, it is increasingly likely that future FTAs will simply include provisions incorporating-by-reference the disciplines of the WTO agreements as binding on FTA member countries, although they may still provide more specific provisions for sanctioning failure to abide by the requirements of such agreements tailored to the specific commitments of the given FTA and the relationships created thereby among the FTA member countries. In particular, such agreements may place even greater emphasis on requirements for the harmonization of standards - their formulation, interpretation, application, and enforcement - among FTA partners.

5.3 Domestic Trade Remedies - These remedies relate to a nation's right to (and method of) response to and remedy of problems created for its domestic economy as a result of either "fair" or "unfair" trade practices. The three most common such remedies are: "Safeguards" for so-called "fair" practices, and either (a) Antidumping or (b) Countervailing duties for "unfair" trade practices. All of these remedies are authorized to WTO signatory countries, under very detailed preconditions, by certain constituent agreements of the GATT '95 and the purpose of their inclusion in FTAs is to apply them more directly and, in some cases, more or less stringently, among the member countries of an FTA arrangement.

"**Safeguards**" - Once an FTA (like the overall GATT agreements) has been negotiated, signed, and entered into effect, member countries sometimes may confront the reality of unintended consequences thereof relating to overall balance of payments considerations or unforeseen specific sectoral impacts that must be resolved for their economies, either within the framework of the FTA, the GATT '95, or otherwise. Since remedial action outside the provisions of the FTA would expose such countries to assertions of nullification or impairment of their commitments for tariff removal/ reduction or MFN/National treatment against exports of FTA member countries and, thus, to retaliation against their own exports, efforts are usually made in the negotiation of FTAs to develop an acceptable but limited form of "escape clause" that permits a country to act to protect its economy or producers, while escaping retaliation, usually by

offering compensatory concessions in the form of broader tariff reductions or expansion of market access in less negatively-impacted sectors. Indeed, safeguard provisions are sometimes used as a way to gain political and sectoral support for entry into an FTA arrangement. A typical FTA safeguards provision would allow a member country to initiate safeguard measures (suspension of tariff preferences in one or more sectors or import surcharges or quotas) only if the imports from the contracting party occur in such increased quantities or under such conditions as to cause or threaten to cause disruption to the domestic market or to the production of the importing country (sometimes referred to as "injury" to the involved sector(s)). Nearly all FTA safeguard provisions, however, also require extensive prior consultation among member countries before imposition of safeguards by any member country, and usually provide for some form of compensation in the form of increased or other tariff reductions or market access concessions in other sectors.

"**Dumping**" is considered to be the sale of a commodity in a foreign market at "less than fair value," with "fair value" usually defined to be the price at which the same product is sold in the exporting country or by the exporting country to third countries. Dumping may also include sale of the commodity in a foreign market at less than the cost of production in its exporting country. Dumping can be predatory in nature as, for example, when it is intended to drive a given domestic producer in the importing market out of business. Dumping has been used as a form of market offense - to create or increase market share in the importing country. Sometimes dumping is resorted to eliminate overhanging inventory of goods in the exporting country at "sacrifice" prices. In these contexts, dumping can disrupt markets in the importing country and injure domestic producers of competitive products and put their employees out of work. These forms of dumping are nearly universally viewed as "unfair" trade practices. Moreover, dumping has often been alleged by domestic producers in an importing country solely as a tactic for protection of their sector.

Article VI of the GATT Agreement, as supplemented by the Uruguay Round's International Antidumping Code, authorizes the imposition of special "antidumping duties" equal to the difference ("margin") between the export sales price of a product in the importing country and the "fair" value thereof (as determined by that country's Antidumping authorities), provided that, it can be demonstrated that such dumping is causing or threatens to cause "material injury" to competing domestic producers. Under the Antidumping Code, the imposition of antidumping duties is also subject to detailed rules as to (1) the facts needed to substantiate "dumping" and the calculation of "fair value"; (2) the process for determination of injury or threat of injury; and (3) the procedures under which these determinations may be made and duties imposed, review of such determinations, and the period during which such duties may be imposed. As with unnecessary quality standards, dumping is an activity that is inconsistent with the goals of an FTA arrangement, as is the remedy that may be used to sanction it if actual dumping or injury has not been proven or it is being used simply as a protectionist device to scare foreign producers away from attempting to sell in a member country's markets. Prior to the conclusion and entry into effect of the GATT '95 agreements on dumping,

negotiators of FTA agreements concentrated on strengthening antidumping disciplines and procedures among their member countries. For example, the NAFTA accord (**Attachment B)** eleven articles and six different annexes dealing with "Review and Dispute Settlement in Antidumping and Countervailing Duty Matters." Subsequent to the new GATT/WTO Antidumping Code, it is more likely that such agreements will in most cases incorporate the provisions of the Code by reference.

Countervailing Duties - Countervailing duties are additional tariffs levied on imports by an importing country to offset government export subsidies to producers in an exporting country. Export subsidies are direct government payments or other benefits given by the government of an exporting country to producers therein of goods destined for export. The purpose of direct export subsidies is to give the exporting country's producers a competitive edge over the sales of products of domestic producers in an importing country and, as such, is considered an "unfair" trade practice. The difference between the Anti-dumping and Countervailing Duty remedies is that the former is directed to practices of private sector producers in an exporting country, while the latter is directed at actions of the government or public sector of that exporting country. In the latter case, the additional duties assessed are supposed to equal the subsidy "bounty" (similar to the Antidumping "margin") provided by the State above and beyond the producer's standards costs of production and exportation.

Article XVI of the GATT '95 provides that " . . . contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of a product other than a primary product which results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market", and that ". . .contracting parties should seek to avoid the use of subsidies on the export of primary products." Article XVI of the GATT, however, does not define the term "subsidy." Thus, "violations" of Article XVI are a matter of GATT/WTO member-to-member consultations and, under certain circumstances, retaliation. The basic remedy for direct export subsidies as an unfair trade practice is found in the Uruguay Round Subsidies/Countervailing Duties (CVD) Agreement. That agreement also prohibits subsidies based on export performance (except in Agriculture, which are subject to a specific agreement). Moreover, upon a finding of the fact of such subsidies and a determination of the "bounty" thereof and injury to a domestic industry resulting therefrom, it authorizes the imposition of Countervailing Duties. The CVD Agreement itself also does not define "subsidies" but does include as an annex an "Illustrative List of Export Subsidies" that enumerates 12 categories thereof. The procedures of a Subsidies/Countervailing Duty case are essentially similar to those for the imposition of Antidumping Duties. And, as with the GATT/WTO Antidumping Code, it is now likely that provisions for countervailing duties are less likely to be included in FTA agreements since such agreements can now invoke the provisions and remedies of that Code.

6.0 Trade-Related Substantive Provisions

6.1 Foreign Direct Investment - Until recently, international trade arrangements did not include provisions relating to foreign investment. Historically, international agreements addressed one or the other but not both. Trade was addressed in trade-specific agreements and investment in investment-specific agreements, like Bilateral Investment Agreements (or BITs). Only more recently has the focus of such agreements turned to other areas than just trade in goods - to areas such as Services, Foreign Direct Investment, and Protection of Intellectual Property Rights. This patterns the development of the GATT itself, which did not address these issues until the most recent MTN, the Uruguay Round, but which produced agreements that are now part of GATT '95. This seems to be a final acceptance by international trade negotiators of the old international commercial maxim that "investment follows trade and trade follows investment," which recognizes that the basic goals for foreign direct investment are related toward either creating or increasing or defending market share in foreign countries and that Foreign Direct Investment (FDI) is actually just the final phase of a scenario in market penetration that begins with direct export sales from a country, leads on to indirect exports through agents/distributors, and finally results in the emplacement of warehousing, repair and spare parts facilities and, ultimately, vertically-integrated manufacturing installations. FDI is now addressed in the Uruguay Round Agreement on Trade-Related Investment Measures (TRIMS), while intellectual property rights are addressed in that Round's Agreement on Trade-Related Intellectual Property Rights (TRIPS). What is notable about this development is that some of the provisions of each of these two agreements were innovated in recent FTA agreements, notably the Canada-U.S. FTA and the NAFTA.

FDI is generally defined as an investment made to acquire and manage a continuing interest in a target entity and is measured by the IMF and OECD as comprising ownership of at least ten percent of the shares or voting power of an incorporated entity or the holding of a right to ten percent or more of the profits of an unincorporated entity. Basic issues related to FDI include: (1) Admission/Establishment, e.g., the legal regime and the regulatory/administrative procedures through which FDI is recognized and legitimized within a nation's sovereignty; (2) Treatment, which relates to the manner in which FDI and foreign investors will be treated in that foreign country; (3) Expropriations and the recourses therefor; and (4) Dispute Resolution, which relates to how investment-related disputes between foreign investors and the host governments will be resolved.

While the GATT '95 addresses FDI in its TRIMS Agreement, the coverage of FDI issues therein is not extensive. It does require national treatment for FDI and prohibits so-called "performance requirements" (such as export quotas, domestic content requirements, "trade balancing" provisions, etc.), but it does not address some of the more contentious issues described above - Establishment, Expropriation, and Dispute Resolution. Thus, FTA negotiators in the future are more likely to confront demands for explicit FDI-related provisions and guarantees in the development of FTA agreements. The most important issues likely to be confronted are Admission/Establishment and the demands for guarantees of National Treatment, MFN, or the better of both. Provisions

ensuring against Expropriation without guarantees of judicial due process, adequate and effective compensation, and access to international adjudication of investment disputes are also likely to become standard negotiating areas.

6.2 Intellectual Property Rights - As a general concept, "Intellectual Property Rights" (IPR) refers to an author's or inventor's right to the exclusive ownership, use, or control of an original product of human thought or imagination. It includes rights relating to literary, artistic, and scientific works; performances of performing artists, phonograms, and broadcasts; inventions of all kinds; scientific discoveries; patents; trademarks, service marks, and commercial names and designations. Intellectual Property "Rights" refers to the right of the owner to receive effective protection for his exclusive use or control of intellectual property for a given period of time specified in law. Intellectual property is divided into two major subdivisions: (a) industrial property - which relates to inventions, marks, trade names, indications of source or origin, and repression of unfair competition from violations of his IPR - it is generally understood as applying not only to industry and commerce, but to agriculture and extractive industries as well and to all manufactured products; and (b) Copyright - which relates to the protection of rights of authors and artists and protects original creations such as books, music, original paintings, sculpture, sound recordings, motion pictures, and computer programs.

Many industrial and other producers have complained of violation of their IPR around the world usually because countries: (a) fail to accord and enforce any protection at all against violations of such rights and tolerate patent infringement, counterfeiting, and piracy; and/or (b) impose conditions upon such protection that are unacceptable to holders of IPRs such as compulsory licensing of patents. Until very recently, international rules governing national IPR protection regimes were confined to a number of global agreements such as the Paris Convention from the Protection of Industrial Property, the Patent Cooperation Treaty, and the Berne Copyright Convention. But the protections afforded owners of IPRs in any country under these agreements depended on whether that country was a signatory to the appropriate treaty or convention and had the technical competency and bureaucratic capacity to enforce compliance with its disciplines. It wasn't until the 1980s that IPR concerns became conceptualized as "trade" issues, when an effort to confront trade in counterfeit goods was introduced into the Tokyo MTN Round. However, IPR came to front focus during the Uruguay Round and conclusion of the Agreement on Trade-Related Intellectual Property (TRIPS) Agreement established minimum standards of IPR protection binding upon all WTO members, obliging them to take positive action to provide IPR protections, while leaving it up to them to determine how such obligations will are implemented. The TRIPS agreement also established a binding enforcement mechanism for the various international IPR-related treaties and conventions that preceded it. It requires application of MFN and National Treatment to IPR protection, establishes minimum periods of protection for trademarks, copyright and other types of intellectual property. It also deals with the competition law facets of IPR protection and with enforcement and dispute resolution procedures.

Nevertheless, although the TRIPS agreement goes well beyond the protections of prior IPR-related treaties and conventions, there are a number of controversial issues of coverage, term of protection, and enforcement that remain. These are likely to become subjects for negotiation in FTA agreements as part of the "quid-pro-quo" for tariff and other commitments implicit in such arrangements.

7.0 Governance and Administration

7.1 Consultation and Decisionmaking - Like any institution that depends on the interaction of "rights" and "obligations," FTA arrangements require some form of communication between and oversight by members and subsidiary structures for management of the FTA as it is implemented in terms of consultation among members regarding new (and often, unforeseen) or unresolved issues, oversight of operations, enforcement of commitments, and procedures for dispute resolution. There is a need for an institutional forum for consultation to interpret and apply provisions of the underlying agreement and to manage their implementation into transactional reality, while assuring that operations under the FTA represent the consensus understanding of members of their commitments and obligations on a practical, item-by-item basis at the level of the border Customs station. Most FTAs have provisions for regularly scheduled meetings of member countries on an annual or semi-annual basis with provision for "emergency" meetings upon the call of one or more members. The more countries involved in an FTA, the more detailed its provisions, and the broader the scope of sectors incorporated within it, the more likely the members will establish a secretariat to provide support to the governing body, which may itself establish committees or subcommittees to address certain specific substantive areas or administrative facets of its operation. Thus, important governance and administrative issues that will have to be con-fronted early on by the negotiators will include the nature, powers, and levels of participation in its governing body, the size and staffing of the secretariat, the location thereof, voting rights, etc.

7.2 Accommodating Developmental Differences - A major issue can arise when there are significant differences in the sizes or nature of economies of prospective members of an FTA or in their levels of economic development, or the progress of macroeconomic reforms among them. When such differences are present, issues will arise as to their capability to support commitments and performance obligations other members may be in a position to undertake in participating in an FTA arrangement. In some instances, countries that are considered less well developed than the majority of prospective members may be afforded special consideration in the form of reduced commitment obligations or the phasing in over a longer period of time of such obligations. Some countries may be granted scaled-down obligations or afforded less stringent enforcement of the same, while in other cases they may be required only to accept certain "core" requirements of membership with allowance for eventual phased implementation of the remaining obligations.

7.3 Harmonization of Laws/Procedures - Essential to the optimum working out of an FTA arrangement is that the legal and juridical systems of the member countries

allow for a degree of "meshing" or "fit" that accommodates efforts to standardize policies and procedures among the countries so as to best synergize their interaction in support of the goals of the arrangement. What is necessary is that, at some point in time, their trade and investment laws and regulations, bureaucratic procedures and practices, reach a level that accommodates implementation and enforcement of the commitments and obligations undertaken by member countries and facilitate, rather than complicate, the basic transactional activities upon which the success of the arrangement depends. For instance, it would be difficult to "facilitate" import and export transactions between member countries that operate on the basis of differing tariff regimes, such as the Brussels Tariff Nomenclature in one country and the new Harmonized System in another. Cooperation is essential at the basic level of the cross-border transaction which involves customs classification and valuation, inspection requirements, documentation, enforcement, with a view toward simplifying all of these operations, thereby the easier to harmonize them. Another important requirement is cooperation in harmonizing and standardizing among the member countries of accurate trade data and the sharing of it among them on a timely, useful basis. All of these facets of FTA administration will have to be negotiated successfully for the optimum development of an FTA.

7.4 <u>Accession of New Members</u> - Like any "club," an FTA arrangement will need rules for the screening and admission of candidates for membership. Conclusion of an FTA cannot help but make neighboring countries or traditional trade partners feel threatened as to the possibilities of trade and investment diversion and marginalization in both regional and global trade. By and large, the larger the membership of an FTA, the greater the economic benefits realizable and the more powerful will be its voice in the formulation of international trade and investment rules. An important issue that has affected the EU and both the Andean Pact and MERCOSUR in Latin America has been that of "broadening" (accepting more members into an essentially unchanged agreement) or "deepening" (that is, increasing the economic ties and interrelationships of existing members - such as evolving from an FTA arrangement into a customs union or common market). A successful FTA will give its members more leverage in imposing more stringent membership requirements in terms of commitments demanded of them while "grandfathering" current members to avoid the same.

7.5 <u>Dispute Resolution</u> - Differences of opinion among member countries of an FTA regarding the extent and meaning of commitments to tariff removal/reduction and quality of treatment, procedures and formalities, and eventually even the "fairness" of how the FTA works out over time for a given country are inevitable. Particular issues areas likely to cause disputes are the safeguards and trade remedy provisions. This will necessitate negotiation of effective institutional and procedural provisions for the consultation, negotiation, and resolution of disputes. Such a system should consider precedents for trade dispute resolution in the GATT and other successful economic integration agreements and should take into account, as well, the differing legal and administrative systems of its member countries. It should require consultation as a precondition to the exercise of any recourse within or without the agreement and provide a forum for negotiation among the member countries themselves and then, only if

unavailing of resolution, referral of the matter to arbitral panels of disinterested experts in the issue areas confronted.

8.0 Other Issues

In the last four or so years, matters not heretofore conceptualized as "trade" issues have been advanced to trade negotiating agendas in the NAFTA and the GATT/WTO and other for a. Principal among these are issues related to protection of the environment, respect for so-called "internationally-recognized worker rights," and most recently, corruption. These issues have been advanced by the developed countries, principally the United States and other OECD nations. Most developing nations reject such efforts principally upon the suspicion that they really reflect efforts to create issues allowing for retaliation for protectionist purposes.

Another issue area that must be confronted by FTA negotiators, especially if they represent countries that have preexisting trade agreement relationships with other countries not a part of an FTA negotiation, is the issue of "compensation." For example, Egypt is a member of the so-called Arab Common Market and the Arab-Maghreb Union, a would-be common market. Members of these organizations that might not be invited to enter into an FTA arrangement with Egypt and other countries could have justified concerns regarding trade and investment diversion and see the new FTA relationship as causing, in effect, nullification and impairment of their trading "rights" under their prior trade agreements. Thus, for example, Mexico - now a member of the NAFTA - is currently the focus of compensation demands from a number of South American countries, members of ALADI agreement of thirty years ago, who assert that they are losing valuable trade and investment opportunities as Mexico refuses to apply NAFTA preferential tariffs to their bilateral trade with Mexico.

9.0 Basic Economic Considerations to be Taken into Account

A major economic consideration in determining whether to enter into FTA negotiations has to do with the economic impacts for a country resulting from its membership in an FTA. The FTA is a "give/get" transaction that provides both certain benefits but also imposes certain costs. Among the areas that must be addressed and evaluated on a "cost/benefit" analysis basis are (a) the impacts of FTA membership on the country as a whole (its impact on that country's trade with other nations - as discussed above) and on the likelihood of actually realizing net incremental trade possibilities versus other trade and investment development opportunities that may present themselves; and (b) sectoral impacts on the nation's industrial sectors in terms of their competitiveness and concerns for their workers, and, in particular, on so-called "infant industries" such as higher value-added technologically-intensive industries a country may be trying to nurture. The question presented is essentially "do the benefits of the trade agreement (in terms of increased market access/decreased tariffs) exceed the costs of dislocation to the domestic economy and its industrial sectors caused by tariff concessions and resulting increased foreign competition in those markets - as well as

impacts on industry and worker adjustment and the effective rate of protection impact on allocation of capital within the economy among sectors.

# # # # # # # # # #