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Institutional and policy adjustments to implement Free Trade Agreements with the European Union: A developing country perspective

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WIDER Working Paper 2015/127

**Institutional and policy adjustments to
implement Free Trade Agreements with the
European Union**

A developing country perspective

Kenneth Baltzer*

December 2015

Abstract: Free Trade Agreements (FTAs) between the European Union (EU) and trade partners go far beyond mere elimination of tariffs to include such diverse issues as non-tariff barriers, competition legislation, investment protection, and more. Implementing such provisions requires deep institutional and policy adjustments. This report reviews the international experiences with institutional and policy adjustments needed to implement FTAs with the EU, as seen from a developing country perspective. It focuses on three issues: investment, competitiveness, and competition, including state-owned enterprise reform. The report concludes that the FTAs represent significant challenges for developing countries, but also potential opportunities for a more efficient trading system.

Keywords: developing countries, European Union, Free Trade Agreement, institutional development, policy adjustment

JEL classification: F13, K33, O17

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1 Introduction

The proliferation of Free Trade Agreements (FTAs) is by now a widely recognized trend in the international trading system (see e.g. WTO 2011). According to the World Trade Organization (WTO), as of 7 April 2015, 449 regional trade agreements¹ had been signed, of which 262 are currently in force. The rapid expansion in the number of FTAs since 1990 has been ascribed to the slow progress in multilateral negotiations—not least since the launch of the Doha round in 2001—as well as a desire to liberalize further and deeper than is politically feasible in multilateral agreements. Also, the spread of FTAs sometimes appears to have a momentum of its own—indeed, some scholars suggest that major trade powers, such as the European Union (EU) and the United States (US), are engaged in a form of competition for FTAs with smaller partners (van Loon 2013; Woolcock 2007), illustrated by the fact that the two trade powers tend to negotiate FTAs with the same partners, for example, Mexico, Morocco, and Chile (Horn et al. 2009).

The EU is a relative latecomer to the race for negotiating FTAs with countries outside its own neighbourhood, owing to a *de facto* moratorium on negotiating trade agreements on a preferential basis in favour of a focus on the multilateral track (Woolcock 2007). By 2006, the EU had only signed trade agreements with three countries, Mexico, South Africa, and Chile, in addition to neighbouring countries in Europe, the Middle East, and North Africa (Horn et al. 2009). However, since a policy shift in 2006 towards a more active pursuit of preferential trade agreements, the EU's negotiations with trade partners around the world have picked up pace, and the EU has so far entered bilateral agreements with South Korea, Columbia, Peru, and six Central American countries, as well as Economic Partnership Agreements (EPAs) with CARIFORUM (15 Caribbean states), the ESA (Eastern and Southern Africa—Zimbabwe, Mauritius, Madagascar, and the Seychelles), and the Pacific (currently just Papua New Guinea). Agreements have been signed, but not yet implemented, with Canada, Singapore, and several Eastern European and African countries, and the EU is currently negotiating with the US, Japan, India, Malaysia, Thailand, Vietnam, and additional regions in Africa (European Commission 2013a).

In addition to the geographical spreading of FTAs, another trend is the gradual deepening of the agreements by including more behind-the-border issues in the agreements, and by disciplining those areas further. The EU seems to be particularly diligent in this respect. While, for example, the US tends to base its FTAs on the North Atlantic Free Trade Agreement (NAFTA) model, the EU has no model FTA to form the basis of negotiations with all parties (Woolcock 2007). And while the US FTAs mostly concentrate on regulating areas already covered by existing WTO agreements, adding a few other areas such as environmental and labour regulations, the EU's FTAs seem to develop further with every FTA signed, adding more and more areas, such as stipulations on human rights, competition policy, regional co-operation, and social matters (Horn et al. 2009).

The bulk of the economic research on the impacts of FTAs involves numerical trade policy simulations, attempting to quantify the economic effects of the tariff liberalizations stipulated in the FTAs. Examples include Jean et al. (2014) on the EU-Chile FTA, François et al. (2007) on

¹ The WTO uses the term 'Regional Trade Agreement' to denote reciprocal trade agreements between two or more parties, including FTAs and customs unions. In this report, I will use the term 'Free Trade Agreement' to distinguish such agreements from customs unions, and to underline that they do not necessarily involve agreements within or between particular regions.

the EU-South Korea FTA, and European Commission (2013b) on the EU-Singapore FTA. While such studies provide useful indications of the economic potential of the agreements, they do not account for the institutional challenges that FTA partners need to overcome in order to reach that potential. For instance, firms may not be prepared to take advantage of the improvements in export market access provided by the FTAs or it may be too costly for them to do so, and governments may lack the capacity to properly implement the many detailed provisions in such varied areas as investment protection, competition regulation, or intellectual property rights. Better understanding of such institutional challenges is vital for trade partners, not least developing countries, to get the most out of the FTAs in which they participate.

The purpose of this report is to review the international experiences with institutional and policy adjustments needed to implement FTAs with the EU, primarily from a developing country perspective. The report will focus on the following issues:

- (a) the challenges and opportunities in developing countries for institutional and policy changes in order to implement FTAs with the EU;
- (b) institutional and policy adjustments in some selected countries, for example the Republic of Korea (signed in 2010), Mexico (signed in 2000), and Peru/Colombia (signed in 2013).

The report will focus on three aspects of institutional and policy changes:

- (1) institutional and policy changes in order to comply with the commitment of ‘Most Favoured Nations’ (MFN) in investment as well as the improvement of investment to facilitate investors, particularly foreign investors;
- (2) institutional and policy changes for improving the competitiveness of the country, sectors, and enterprises; and
- (3) State-Owned Enterprise (SOE) reforms and eliminating market dominance, ensuring fair competition.

The study will be based on two types of literature: (i) literature discussing the various elements of the EU’s FTAs more generally, including the implications of some of the finer details of the stipulations, and the institutional considerations countries need to undertake to implement the agreements; and (ii) actual experiences from the implementation of specific FTAs with developing countries, including (but not limited to) the ones with South Korea, Mexico, and Peru/Colombia. The former literature is more plentiful than the latter, so the main focus of the study will be an institutional review of the relevant provisions of the FTA, which is then supported by actual evidence from FTA implementation as available.

The second section following this introduction will provide a short overview of EU FTAs with developing countries, discussing the overall EU FTA strategy and the scope of the FTAs. It will also briefly summarize the institutional and policy changes needed to properly implement the FTAs without going into too much detail. The rest of the report will focus on the three main topics of the review: investment, competitiveness, and competition. Section 3 presents the EU’s approach to investment agreements in its FTAs, including provisions on MFN commitments, investment promotion, investment protection, market access, and post-admission provisions. It also discusses the challenges that particularly developing countries face when implementing the provisions. Section 4 addresses competitiveness issues. While competitiveness is not a specific focus area in the EU’s FTAs, certain provisions, such as labour and environmental standards, are often accused of adversely affecting the competitiveness of developing countries’ firms. Furthermore, developing countries, sectors, and individual firms will only benefit from the

agreements if they can strengthen their capacities to meet requirements detailed in the FTAs, in the form of Rules of Origin (RoO), Technical Barriers to Trade (TBTs) and Sanitary and Phytosanitary (SPS) standards. Section 5 reviews how competition policy and state aid, including in the form of the special status of SOEs, is disciplined through the EU's FTAs. Finally, section 6 concludes.

2 The EU's FTAs with developing countries

2.1 The EU's FTA policy

By the turn of the millennium, the EU had effectively put a moratorium on new FTA negotiations (Woolcock 2007). This was not a formal policy adopted by the EU, but there was a consensus among member states and the European Commission to halt new FTA negotiations in order to signal commitment to the multilateral track and to focus all efforts on achieving a new multilateral agreement through the WTO. Even after the disappointment at the Cancún Ministerial Conference in 2003, where the EU had to accept dropping the three so-called 'Singapore issues', investment, competition, and transparency in government procurement, from the Doha negotiations, the EU stayed committed to the multilateral track.

A shift in trade policy towards a more aggressive pursuit of FTAs came in 2006. The multilateral negotiations under the Doha round had effectively ground to a halt, the EU witnessed the US taking a more active role in negotiating FTAs with countries around the globe ranging from Central America to South Korea, and it became increasingly obvious that much of the economic growth in the world was centred in emerging markets in Latin America and especially Asia. Given this background, the new trade commissioner, Peter Mandelson, was more willing to consider FTAs than his predecessor, Pascal Lamy.

Very recently (in October 2015), EU trade commissioner Cecilia Malmström announced the new trade policy of the EU, 'Trade for all', which emphasizes the deepening and widening of trade agreements to address new challenges such as digital market liberalization and data protection issues, facilitating the spread of global supply chains and securing access to energy and raw materials. This new trade policy sees trade agreements as much more than just liberalization of trade to the benefit of EU citizens—it is meant to be an integrated part of the EU's foreign policy, recognizing the geopolitical repercussions of trade policy and the sustainable development potential of trade as an engine of growth (European Commission 2015).

Woolcock (2007) sees three overall motivations shaping the EU's FTA policies: political and commercial motivations, and a desire to promote regional integration.

The EU has always had a political interest in promoting security, political stability, and economic prosperity in neighbouring countries in Central and Eastern Europe, the Middle East and North Africa, exemplified by Association Agreements with most neighbouring countries. Most of these Association Agreements contain FTAs as a core component (e.g. Israel, Jordan, Egypt), and in some cases they have developed into actual membership of the EU (Eastern and South-eastern European countries), Deep and Comprehensive Free Trade Agreements (e.g. Morocco, Moldova, Armenia, and Georgia), and customs unions (Andorra, San Marino, and Turkey) (EU Commission 2013b). The trade preferences extended to African, Caribbean, and Pacific (ACP) developing countries, which are in the process of being replaced by EPAs, have very little commercial interest for the EU and are motivated more by development objectives.

FTAs with more distant trade partners are mostly motivated by commercial interest, although some of these interests appear to have more defensive overtones. The EU has negotiated FTAs

with most Latin American countries, even the ones with relatively weak trade ties to the EU, with a view to neutralizing the trade-distorting effects of those countries' trade agreements with the US. For instance, the EU-Mexico FTA was the EU's first trade agreement with a country in the Americas and it followed close after the implementation of NAFTA. Similarly, FTAs with Chile, Peru/Colombia, the Central American region, and South Korea all enter ground first broken by the US. However, the EU also pursues more offensive interests, for example in negotiations launched with India, Japan, and countries in the Association of Southeast Asian Nations (ASEAN).

A third motivation identified by Woolcock (2007) is a clear desire to promote the regional integration of the EU's trading partners. This is most obviously seen in the EPAs with the ACP countries, which specifically encourages countries to establish regional customs unions, such as the CARIFORUM in the Caribbean, the ESA, and the Economic Community of West African States (ECOWAS). But it is not limited to the EPAs. There is a tendency for the EU to first seek trade agreements with regional communities and only to launch talks on a bilateral basis if the regional negotiations fail. For instance, the agreement with the Andean Community (CAN) was reduced to a Peru/Colombia FTA when Ecuador and Bolivia decided to leave the talks in favour of closer co-operation with Venezuela (Stevens et al. 2012). When negotiations with ASEAN stalled in 2009 over disagreements with the EU's concern over human rights issues in Myanmar, the EU concluded an agreement with Singapore in 2012 and resumed bilateral talks with Malaysia, Thailand, and Vietnam. Stalled negotiations with Mercosur and the Gulf Cooperation Council represent other attempts at pursuing the regional approach.

These different motivations are important for understanding the EU's FTA policies and they are, to a large extent, reflected in the contents of the agreements. Agreements concluded by the EU tend to include a wide range of issues, which are not purely commercial in nature, such as respect for human rights, regional co-operation, cultural co-operation, and political dialogue. This is in contrast to agreements, to which, for example, the US is party, which tend to focus more on issues with economic implications (Horn et al. 2009). The wide scope of EU FTAs has implications for the institutional adjustments needed to implement the agreements.

2.2 Institutional and policy changes needed to implement the FTAs

Implementing trade agreements, whether on a multilateral or preferential basis, is not just a matter of adjusting tariff schedules to comply with the provisions of the agreement, and then moving on. WTO agreements cover areas beyond traditional trade policy measures, such as TBTs, SPS regulation, and trade in services (through the General Agreement on Trade in Services, GATS). Such provisions have lasting institutional and policy implications for the parties to the agreement.

Most of the countries, with which the EU has concluded or is negotiating trade agreements, are also members of the WTO (exceptions include Algeria, Lebanon, Ethiopia, and Equatorial Guinea). Thus, FTAs should only elicit institutional changes to the extent that their provisions go substantially beyond the WTO commitments or venture into new areas. In a comparative study on EU and US FTAs, Horn et al. (2009) count no less than 52 areas disciplined in 14 EU and 14 US agreements notified to the WTO as of October 2008. More agreements have been signed since then, potentially adding even more areas, and the EU's new trade policy suggests that the widening of the scope of trade agreements is likely to continue (European Commission 2015). Of the 52 areas identified by Horn et al. (2009), all but three appear in at least one EU FTA, whereas the US agreements tend to be much more parsimonious. The authors divide the areas into 14 issues already covered by WTO treaties and 38 areas, which go beyond the multilateral agreements. They point out that it is primarily in the latter group of issues that EU

and US FTAs differ, with EU FTAs containing provisions on 37 of the 38 areas, whereas the US FTAs only deal with 9 of those areas. This suggests that the EU's FTAs in particular could have substantial institutional and policy implications for the parties to the agreement, as the FTAs tend to include several areas not already disciplined under the WTO.

A detailed discussion of all the areas found in the EU's FTAs is beyond the scope of this report. But the following will briefly discuss and provide a few examples of possible implications for particularly developing trade partners under four headlines: the institutional framework of the agreements, the institutional capacity needed to implement the agreements, implications for policy changes, and potential legal implications. More detailed discussions of impacts related to investment, competitiveness and competition regulation is presented in sections 3-5.

Institutional framework of the agreements

FTAs are complicated international agreements, which require a large institutional capacity to negotiate in terms of diplomatic talent, analytical power, and political capital (Chasek and Rajamani 2001). The negotiations are often protracted affairs, drawn out over many years, which is not necessarily to the disadvantage of developing countries, as it allows the countries to gradually strengthen their institutional capacity over time (Borrman and Busse 2007). However, it also means that the negotiations draw on institutional resources for a long time, and often continue to do so even after they are concluded. The FTAs require a permanent institutional set-up in the form of bodies to facilitate the further discussions of and co-operation on trade issues, continued negotiation on areas slated for review, monitoring of compliance with the provisions of the agreements, and for settlement of disputes.

The EU-Mexico FTA is an example of an elaborate institutional framework. A Joint Council supervises the implementation of the FTA, assisted by a Joint Committee and several sub-committees on specific areas, such as customs co-operation and RoO, standards and technical regulation, and government procurement. Unlike most other FTAs, this framework was not just responsible for administering the agreement but also for negotiating most of the stipulations (Ecorys 2015). The FTA (named the 'Global Agreement'), which entered into force in 2000, contained a number of review clauses committing the parties to engage in future talks on further tariff liberalization and other trade-related issues. However, very little progress has been made since then, despite frequent meetings and repeated mutual assurances of continued commitment to the negotiation process.

Although the EU-Mexico FTA may be an extreme example, there is a clear tendency that broader and more complicated trade agreements require more elaborate institutional frameworks, and review clauses seem to be a common way to postpone agreement on contentious issues. For instance, in the EU-Peru/Colombia FTA, a specific Sub-committee on Trade and Sustainable Development is charged with monitoring the implementation of provisions on labour and environmental standards, and the Trade Committee not only has the responsibility to evaluate the results of the agreement in general but also to monitor that the broad provisions on human rights and democracy issues are respected (Stevens et al. 2012). Also, in several FTAs, for example, Euro-Med agreements with the EU's Mediterranean neighbours, and the Trade, Development and Cooperation Agreement (TDCA) with South Africa, the parties pledge to continue negotiations of deeper liberalization of trade in services in the future (Ullrich 2004). In all these examples, the FTAs require a long-term commitment of resources in the form of skilled negotiators, academically trained professionals to analyse the impacts of the complex issues, and political will.

Institutional capacity

In addition to the purely administrative requirements, developing countries will not benefit fully from the FTAs if they do not have or cannot develop the institutional capacity to take advantage of the provisions of the agreement.

Central to any preferential trade agreement are the RoO, which are meant to prevent third countries from using one trade partner as ‘gateway’ to gain preferential access to the other partner’s market. The rules stipulate that, in order for firms to be able to export to the FTA partner country on concessional terms, the firms must demonstrate that the exported product was produced substantially within the country’s borders. The specific criteria for when a product can be said to have been produced within the country can be very complex and can vary on a product-by-product basis (Stevens et al. 2012). This complexity can result in under-utilization of trade agreements, as firms have little knowledge about how to comply with the RoO or find it too costly to do so. A business survey following the conclusion of the EU’s FTA with South Korea found that many South Korean firms failed to take advantage of the improved market access to the EU due to lack of knowledge about the changes in market conditions and the costs of complying with the RoO relative to the value of the tariff preferences gained (Cheong 2014). The paper identified a need for the creation of government services to aid businesses in utilizing the trade agreement.

Many other elements of the EU’s FTAs require the development of key institutional infrastructure to facilitate their implementation. For instance, co-operation in the areas of TBTs and SPS regulation require the establishment of ‘quality’ infrastructure in the form of conformity assessment procedures (e.g. testing, inspection, and certification) and the strengthening of the capacity to engage in the development of international standards.

Policy changes

FTA provisions may directly or indirectly have implications for the public policies conducted in the partner countries. One of the most important examples (to be discussed in more detail in section 3) is the much debated investment agreements, designed to protect foreign investors against the threat of expropriation and discrimination. The scope of the investment agreements is often very wide and, unlike other provisions in the FTAs, they usually allow individual investors to request international dispute settlement with a country’s government. This implies that if a certain government policy harms a foreign investor, the investor can demand binding arbitration from an international tribunal against the government, potentially resulting in injunctions against the policy and/or substantial compensation. Critics argue that the investment agreements can severely hinder the legitimate conduct of public policy for fear of being liable to compensate foreign investors for the harm done (Mann 2013).

Other examples of areas which are closely integrated with public policy are provisions on services and public procurement. Some service sectors are regarded as sectors of high strategic or systemic importance for governments, including telecommunications and the financial sector, and liberalization of trade in such sectors may influence governments’ ability to regulate these sectors. Similarly, some forms of services trade require the physical relocation of people, potentially affecting public policies on visa requirements and temporary migration.

Public procurement is carved out of the multilateral agreements under the WTO as an exemption to free trade in goods and services. Instead, the area is disciplined through a plurilateral Agreement on Government Procurement (GPA) and the FTAs on a bilateral basis. Government procurement is occasionally used as a public policy instrument, for example to

favour ethnic and indigenous minorities or for strategic defence purposes. Provisions on public procurement generally mandate national treatment of foreign contractors, potentially opening up a market, which represents a substantial share of economies, to foreign competition, and restricting the use of public procurement for public policy purposes. However, the EU's FTAs tend to include a wide range of exceptions to the general provisions. The EU-Peru/Colombia FTA exempts development aid, agricultural support, social programmes, and sensitive defence equipment, and sets a lower threshold value, below which foreign competition can be excluded (Stevens et al. 2012). Also, the EU's official trade policy specifically states that:

EU trade agreements do not and will not prevent governments, at any level, from providing, supporting or regulating services in areas such as water, education, health, and social services, nor will they prevent policy changes regarding the financing or organisation of these services (European Commission 2015: 11).

Still, liberalization of public procurement is likely to influence public policies conducted through such measures.

Legal implications

Finally, the EU's FTAs with developing countries may in some way be in conflict with fundamental laws or otherwise require substantial legislative adjustments. Many developing countries enshrine in their constitutions not just respect for universal human rights, but also wider economic, social, and cultural rights (Rodriguez et al. 2014). Critics have claimed that FTAs may be in conflict with such rights, for example that provisions on intellectual property rights restrict the production of generic pharmaceutical products and infringe on the population's right to health; that liberalization of agricultural trade worsens conflicts over land rights; and that allowing for foreign investments in mining operations may create greater competition for land and water, degrade the environment, and lead to the displacement of indigenous peoples (Stevens et al. 2012). While many such claims have been dismissed, the potential for conflict persists and may continue to grow as the scope of the FTAs spreads into more and more areas (Rodriguez et al. 2014).

As noted above, the EU's FTAs tend to involve a wide range of issues beyond those already disciplined at the multilateral level under the WTO. However, Horn et al. (2009) note that most of the extra-WTO issues in EU FTAs are stipulated in language which makes them virtually unenforceable, such as 'The parties shall cooperate ...', 'Dialogue shall be established ...', 'Special attention shall be paid to ...', etc. In potential disputes between the FTA parties, it will be very difficult to ascertain that a party has not cooperated, maintained dialogue or paid special attention in relation to a particular issue.

Such unenforceable provisions would presumably have very few real legal implications beyond the mutual expressions of intent of co-operation. However, in the words of Horn et al. (2009: 18):

More problematic is the presumption that vagueness in the legal text works to the benefit of the respondent in a dispute. It could reasonably be argued that a vague

text provides opportunities for the legally astute party to shape the interpretation of the agreement. Most probably, this would work to the advantage of the two hubs [the EU and the US], which almost invariably have access to more legal competence than their partners.

Similarly, to the extent that provisions are not legally enforceable, disputes in such areas are more likely to be resolved through political rather than legal means, and again it may be argued that the EU and the US would be able to wield more political clout than their trade partners. Unenforceable provisions are not necessarily to the benefit of developing countries.

3 Institutional and policy changes to facilitate investment

3.1 Investment provisions in the EU's FTAs

In virtually all the EU's FTAs until now, including the comprehensive FTA with South Korea, provisions on investment have been relatively weak and mostly focused on broad statements on continued co-operation on and promotion of investment between the parties. The reason is that, until the adoption of the Lisbon Treaty in 2009, the authority on committing to binding investment agreements was still retained by individual EU member countries. As a result, most investment obligations of the EU are captured by bilateral investment treaties between each EU member and the EU's trade partners.

After the Lisbon Treaty, investment became part of the EU's common commercial policy. The current almost 1,200 bilateral investment treaties between individual members and external partners will continue to be in force (and can be further amended and renegotiated) until they are replaced by common EU treaties. The recently concluded EU-Canada trade and investment agreement is the first EU FTA containing extensive provisions on investment protection, and investment will be part of future trade agreements (European Commission 2015).

Szepesi (2004a) identifies four broad categories of investment provisions:

- (1) Investment promotion: commitments to co-operate to increase investment flows between the parties.
- (2) Investment protection: including the liberalization of capital flows, the guaranteeing of foreign investors' property rights, and dispute settlement provisions.
- (3) Market access for foreign investors (also known as pre-admission provisions): defining the rights of foreign investors to place investments and establish businesses.
- (4) Post-admission provisions: application of the National Treatment principle, stating that foreign investors must not be discriminated against.

Almost all the EU's FTAs contain wording on co-operating to promote investments. The provisions on market access and national treatment of foreign investment are particularly detailed within the area of liberalization of trade in services, which under mode 3 (commercial presence) requires foreign investment to deliver the services. Investment protection is, for the most part, under the purview of the bilateral investment treaties of the member countries, although most FTAs do contain stipulations on the liberalization of cross-border capital mobility. The following will discuss the FTA's provisions on investment under these four headings, including their implications for policy and institutional adjustment and the potential consequences of the application of the MFN principle.

3.2 Investment promotion

The provisions on investment promotion in the EU's FTAs propose a range of areas, on which the parties commit to greater co-operation. These areas include the establishment of information mechanisms on legislation and investment opportunities, harmonization and simplification of procedures, facilitating the creation of joint ventures and co-investment, and providing technical assistance (Szepesi 2004a).

The wording of the provisions related to investment promotion tends to be very broad and they are unlikely to be enforceable in a legal sense. Still, the commitments reflect a mutual recognition that both parties may benefit from a more open culture with respect to investment, in which barriers to investment are progressively reduced. To the extent that these commitments are honoured, they could have substantial institutional and policy implications. For instance, simplifying the procedures needed to establish a presence in the partner country would require a more general deregulation of the business environment. Reducing the paperwork required for establishing a new enterprise, whether domestic or foreign-owned, and simplifying burdensome tax procedures would benefit domestic businesses as well as promote foreign investment (Borrmann and Busse 2007). Similarly, the establishment of information mechanisms to facilitate foreign investment and the creation of joint ventures requires the devotion of resources to create and maintain such infrastructure.

3.4 Investment protection

Liberalization of capital flows

The obligation to liberalize movement of capital across borders is a fundamental part of investment protection in virtually any investment agreement. Free capital flows ensure investors' rights to move capital into the country to establish, expand, and maintain investments, as well as to withdraw capital again, in the form of wages, investment returns, payments to creditors, and the repatriation of the investment (Bernasconi-Osterwalder et al. 2012).

Capital liberalization is the only form of investment protection included in pre-Lisbon Treaty FTAs. In some of the earlier FTAs, the wording of the provisions is fairly loose. For instance, in the TDCA with South Africa the parties 'shall consult each other with a view to facilitating and eventually achieving full liberalisation of the movement of capital ...' and in the Association Agreements with Tunisia and Morocco full liberalization should be completed 'when the time is right ...' (both quotes are from Szepesi 2004a: 2). The later FTAs tend to contain stronger commitments. The EU-Mexico FTA obliges both parties to sign up to the Organisation for Economic Co-operation and Development (OECD) Codes of Liberalization of Financial Movements and of Current Invisible Operations, which are binding rules stipulating free capital movements and the right to carry out transactions in the services sector (Serrano et al. 2015). The EU-South Korea FTA liberalizes the movement of capital for Foreign Direct Investment (FDI), other transactions related to Trade in Services, Establishment and Electronic Commerce, as well as the repatriation of such investments (EU-South Korea FTA, Article 8.2). The EU-Peru/Colombia FTA goes even further than this and includes any payments and transfers on the current account as well (Stichele 2012).

While free capital movements across borders are often taken for granted in the EU, they may have substantial policy implications for its developing trade partners as the commitments restrict the countries' ability to pursue independent monetary and/or exchange rate policies. A fundamental proposition of international macroeconomics, often referred to as the Trilemma, states that it is economically impossible to have free capital movements, fixed exchange rates,

and pursue independent monetary policy at the same time (see e.g. Feenstra and Taylor 2014 on standard international macroeconomics). For instance, if a country pegs its currency to the euro and attempts to follow a tighter monetary policy than the European Central Bank, capital controls may be necessary to prevent the inflow of foreign exchange, which would push up the value of the currency relative to the euro. For developing countries, the liberalization of capital flows could make it harder to stabilize the national currencies and economies, and increase the risk of financial crises as ‘hot money’ flees emerging markets at the first sign of trouble.

Because of this, the EU’s FTAs stipulate exceptions, allowing for the temporary suspension of free capital mobility in response to macroeconomic problems. The EU-South Korea FTA permits ‘safeguard measures with regard to capital movements that are strictly necessary ...’ in ‘exceptional circumstances ...’ where ‘payments and capital movements between the Parties cause or threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy’ (EU-South Korea FTA Article 8.4). Similar wording is found in FTAs with Peru/Colombia (Stichele 2012) and Mexico (Szepesi 2004a), but the Chilean FTA contains wider exceptions, allowing Chile’s Central Bank to ‘maintain or adopt measures [...] in order to ensure currency stability and the normal operation of domestic and foreign payments’ (Szepesi 2004a: 5). However, these safeguard measures are generally short term in nature (except in the case of Chile), usually no more than six months, so they cannot permit the parties to the trade agreements to pursuing both independent monetary and exchange rate policies in the long run.

Although the FTAs include other exceptions, allowing countries to restrict capital transfers to ‘Protect safety and public order’, ‘Protect human health’, or ‘Prevent deceptive and fraudulent practices’, critics argue that the free capital movement provisions make it much harder to combat money laundering, tax evasion, and other illicit financial transactions (Stichele 2012: 10). Not least in regions plagued by drug-related organized crime, such as Colombia and Central America, this is seen as a potentially serious public policy limitation.

Guarantees of investors’ property rights

One of the main purposes of investment treaties is to protect investors from unfair treatment by the host country government in the form of arbitrary regulation or outright expropriation without proper compensation. Investors’ property rights are guaranteed through provisions on expropriation and a catch-all stipulation mandating ‘fair and equitable treatment’ of foreign investors (Bernasconi-Osterwalder et al. 2012).

Expropriation of property by the government is a legitimate practice and often necessary for the development of infrastructure and the production of public goods, such as improved health and environmental protection. Expropriation is not banned by investment treaties, but the agreements stipulate that investors should be properly compensated. The main source of dispute involves delineating exactly what constitutes expropriation which must be compensated, and what is merely a government’s legitimate conduct of public policy. There is little doubt in cases of direct expropriation, where a host government assumes possession of the property of an investor, for example in the case of a piece of land expropriated for infrastructure development purposes. But there is a large grey area of indirect expropriation, where a government takes partial or complete control of a property without taking actual possession of it. For example, environmental regulation may stipulate that an investor’s piece of land may not be used for specific (polluting) activities, potentially reducing the value of the investor’s property.

More generally, in most investment treaties, investors are protected against arbitrary regulation by the catch-all provision of Fair and Equitable Treatment (FET). The FET clause is usually very loosely worded and it is therefore up to the individual tribunal to decide whether specific

government actions constitute a breach of the FET principle. Examples of rulings against governments include cases where governments had failed to act in a transparent manner, where state agencies had acted inconsistently, or where public policies had caused severe harm to foreign investors. Generally, it has become the custom to interpret the FET provision as a protection of investors' 'legitimate expectations' (Bernasconi-Osterwalder et al. 2012). This interpretation is clearly not without problems, as it raises a number of difficult questions, such as what can investors legitimately expect from host governments when making the investment? Are the expectations generated by the investors themselves, or were investors led to have certain expectations by the host government? Is it legitimate to expect that the business environment will remain static for all time, with no change in public policies?

Issues related to the protection of investors' property rights are highly contentious as they effectively determine the distribution of risks and costs of public policy between host country and foreign investor. If the investor protection is very weak, foreign investors face a great risk of uncompensated expropriation and arbitrary regulation, and may demand higher rates of return on investment as compensation. If the provisions of the investment treaties are more strongly in favour of investors, the costs and risks of pursuing public policy for improving health, protecting the environment, or developing the economy may increase.

Critics argue that investor protection clauses may be particularly onerous for developing countries (Bernasconi-Osterwalder et al. 2012). The high standards of transparency, consistency, and co-ordination between state agencies needed to comply with a very strict interpretation of the FET principle requires a highly developed bureaucracy, which is not always present. Developing countries are in the process of political, institutional, and legislative development (as well as economic development), which often involves some regulatory experimenting to determine what is appropriate in the specific context. Such developmental approaches may be contested by investors under the investment treaties, and this may induce governments to refrain from establishing needed regulation or retract policies if threatened with investor claims.

In response to such criticism, investment treaties have started to include more precise wording to distinguish what constitutes indirect expropriation and how to interpret FET. In particular, treaties may contain carve-outs, specifically excluding regulation applied for pursuing legitimate public policy goals such as health, safety, and the environment from the definition of indirect expropriation. The EU's new trade policy states that: 'The Commission will in a first step, include modern provisions in bilateral agreements, putting stronger emphasis on the right of the states to regulate, something which was not sufficiently highlighted in the past' (European Commission 2015: 21).

Dispute settlement

The Investor-State Dispute Settlement (ISDS) system is a unique feature of investment treaties. Whereas international arbitration under the WTO or individual FTAs takes place between states, the ISDS allows individual investors to raise a claim for binding arbitration before an international tribunal, such as the World Bank's International Centre for Settlement of Investment Disputes (ICSID) or United Nations Commission on Trade Law (UNCITRAL). This means that investors can take action directly without having to convince their own government to make the claim on their behalf.

Some critics have raised concerns about the impartiality and independence of the system (Bernasconi-Osterwalder et al. 2012). The three arbitrators on a tribunal are typically appointed by the parties to the dispute, one from each side and a third by agreement of both sides. Since there are relatively few professionals available with the required specialized expertise in

international investment law, arbitrators in one dispute tend to be lawyers working for one side or the other in other disputes. This dual-role of experts may influence the way they interpret the provisions of the investment treaties, for instance the dividing line between legitimate conduct of public policy and infringement of FET. Finally, since the tribunals are in principle temporary institutions independent from one another, they are not bound by previous precedents and there is greater risk of inconsistent rulings.

To address such concerns, the EU has publicly stated that it seeks to establish a permanent international investment court. Specifically:

EU bilateral agreements will begin the transformation of the old investor-state dispute settlement into a public Investment Court System composed of a Tribunal of first instance and an Appeal Tribunal operating like traditional courts. There will be a clear code of conduct to avoid conflicts of interest, independent judges with high technical and legal qualifications comparable to those required for the members of permanent international courts ... (European Commission 2015: 21).

3.4 Market access for foreign investors

Provisions on market access for foreign investors govern how countries may or may not impose limitations or requirements for foreign investment and establishment of business. Such limitations may be in the form of pre-establishment restrictions, such as rules restricting foreign ownership of companies in specific sectors, and performance requirements, which define a set of conditions that foreign firms must observe before gaining access. Examples of performance requirements are mandates to export a certain percentage of total sales or total production, requirements to transfer technology, local sourcing requirements, etc. (Bernasconi-Osterwalder et al. 2012).

Most countries, as well as the EU, already observe commitments under the GATS to provide free access to foreign investors in their services sectors, and the WTO agreement on Trade-Related Investment Measures (TRIMs agreement) outlaws the use of certain types of trade-related performance requirements (such as domestic sourcing of inputs). Thus many stipulations on market access in the EU's FTAs merely confirm the countries' commitments under other agreements. This is the case in the EU's FTA with Mexico and, while a review clause commits the parties to negotiate further liberalization within three years, no progress has been made since the agreement's inception (Ecorys 2015). The EU-Chile FTA contains broad prohibitions on pre-establishment limitations and performance requirements, but the provisions are watered down by substantial exceptions in key strategic sectors, such as privatized utilities and the defence industry (Szepesi 2004a). In the Peru/Colombia FTA, the two Latin American countries preserve the right to restrict the establishment of foreign companies to allow for the preferential treatment of socially or economically disadvantaged minorities or ethnic groups (Stevens et al. 2012).

Pre-establishment limitations and performance requirements are often viewed by developing countries as important tools in the public policy tool box, and liberalizing market access to foreign investors can therefore potentially reduce developing countries' policy space. Limiting access for foreign investors to strategically important sectors may keep control of firms in those sectors in national hands. Considering the often rather expansive rights of foreign investors under the investor protection clauses, developing countries may wish to retain domestic control over sensitive sectors to limit the costs of regulating those sectors. Similarly, developing countries have often used performance requirements to improve the terms of the relationship with foreign investors in the host country's favour, for instance to facilitate transfer of

technology, to improve the balance of payments, and to create employment opportunities for the country's nationals (Bernasconi-Osterwalder et al. 2012). Restricting the use of such policies may serve to shift the balance of power further in favour of foreign investors.

3.5 Post-admission provisions

Once foreign investors are established in the host countries' markets, virtually all FTAs and investment treaties require that foreign investors shall be treated no less favourably than domestic investors. This national treatment principle is also a cornerstone of the GATS. While simple in principle, the national treatment provision may be contentious in practice. To adjudicate claims of violation of national treatment, the tribunal has to compare the treatment of foreign investors with domestic investors 'in like circumstances' (Bernasconi-Osterwalder et al. 2012). This is not always a trivial exercise. For instance, certain sectors, such as mining, oil, or telecommunications, may be completely dominated by foreign firms and no domestic firms exist for comparison. Also, a non-discriminating public policy may nevertheless put differential burdens on foreign and domestic businesses, due to differences in production processes, ownership structures, etc.

The national treatment principle disciplines how public policies are designed and implemented. National governments may have reasons to differentiate between domestic and foreign firms, for instance if it is less costly for foreign investors to abate pollution than their domestic competitors due to superior technology. Even if not intending to treat foreign and domestic investors differently, the outcome of regulation may be differentiated, for instance if based on national rather than international standards. The scope for international arbitration tribunals to interpret the national treatment principle narrowly or broadly introduces another source of uncertainty in the regulatory process which could restrict legitimate public policy-making.

3.6 Most Favoured Nation commitments

MFN obligations with respect to market access and national treatment

Like the multilateral agreement on the trade in goods, the GATS under WTO is based on the Most Favoured Nation principle. If a bilateral agreement between the EU and a trade partner grants improved access and national treatment to foreign investors in the services sector beyond the commitments made under the GATS, this should automatically apply to foreign investors from third countries as well. GATS Article V allows for an exception to the MFN principle (similar to GATT Article XXIV on trade in goods) when WTO members engage in a preferential trade agreement liberalizing trade in services, providing that the agreement has 'substantial sector coverage' and 'provides for the absence or elimination of substantially all discrimination' between the parties.²

Thus, to avoid extending the services trade liberalization to all WTO members under the MFN clause, FTAs must either merely confirm the parties' GATS commitments or make the move to almost complete liberalization. Most of the EU's earlier FTAs, including the Euro-Med agreements with the EU's Mediterranean neighbours, the TDCA with South Africa, and the FTA with Mexico chose the former approach (Ullrich 2004). As noted above, the Mexican FTA contains language committing the parties to review the FTA provisions to pursue further liberalization of trade sectors, but no progress has yet been registered (Ecorys 2015). Later

² The legal text of the GATS is available on the WTO website, https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm.

agreements tend to take the latter approach. The FTA with Peru and Colombia makes extensive services trade liberalization across the board, excepting a few sensitive sectors, such as mining or manufacture of nuclear materials, production or trade in arms, audio-visual services, waterway cabotage transport, processing, disposal of toxic waste, and national and international air transport services (Stevens et al. 2012). It is not clear exactly what constitutes ‘substantial sector coverage’ and ‘substantially all discrimination’, but so far the EU’s approach to preferential liberalization of services trade has not been challenged on the grounds of breach of the MFN principle.

MFN obligations with respect to investor protection

Most investment treaties specifically contain MFN commitments with respect to investor protection. In a sense, the MFN provisions are the counterpart to the national treatment clauses. While the latter is intended to level the playing field between foreign and domestic investors, the former ensures that an individual foreign investor is not treated less favourably than other foreign investors. Although investment treaties tend to contain more or less the same provisions, there can be large differences in the specific wording, the level of detail and exceptions applied to each agreement. Thus, the MFN commitments in principle allow foreign investors to cherry-pick provisions from an array of different treaties to better suit their claim. In effect, the MFN provisions can be used to bypass exceptions and cautious wording in individual agreements (Bernasconi-Osterwalder et al. 2012).

Seen from a developing trade partner’s perspective, the MFN provisions can be a potential source of regulatory uncertainty. Investment treaties differ in their details, partly because they develop over time as provisions of earlier agreements are tested by arbitration, partly due to differing interests across trade partners, and partly because the stipulations to some extent reflect the relative negotiating strengths of the parties to the agreements. Investment agreements may also emphasize different elements. A treaty may contain fairly broad wording on expropriation provisions, but restrict access to international arbitration by requiring investors to seek local remediation first. By invoking the MFN clause, foreign investors may be able to claim breach of the broad expropriation provisions and use a different investment treaty to bypass the restrictions on international arbitration (Bernasconi-Osterwalder et al. 2012).

4 Institutional and policy changes to improve competitiveness

4.1 Competitiveness and FTAs

Reciprocal trade liberalization entails reducing or eliminating protective trade barriers on both sides of the agreement. Seen from the perspective of the individual country, the FTA grants improved market access to the trade partner’s markets, but at the same time exposes domestic industries to increased import competition. If domestic firms are not able to improve their competitiveness on the domestic market and take advantage of the greater openness on the foreign market, the positive welfare effects of the FTA will be greatly diminished or may even disappear altogether.

In several respects, institutional and policy changes are needed to facilitate the improvement of domestic firms’ competitiveness. The EU’s FTAs contain provisions which may affect firms’ ability to compete directly. In recent FTAs, requirements to observe minimum labour and environmental standards are written under the common headline of sustainable development. The preferential nature of the FTAs necessitates the establishment of RoO, which may be rather complex and costly to comply with. And potentially severe trade restrictions remain in the form of TBTs and SPS regulations. These issues will be discussed in more detail below.

In addition to responding to these specific elements of the FTAs, developing governments often face huge challenges in improving the regulatory environment, strengthening the country's capacity for international trade, and preparing domestic businesses for the greater competition following trade liberalization. Large investments may be needed in the form of physical infrastructure, such as roads, harbours, power generation and distribution, etc., in development of financial, logistical, and other supporting services, and in the production of public goods, such as education and health, to improve the productivity of the workforce.

Institutional reform is vital to make the business environment run more smoothly. For instance, according to a few examples presented by Borrmann and Busse (2007), 'Entrepreneurs in Guinea-Bissau have to pay 261% of (national) income per capita to start a business' and 'they have to comply with 17 bureaucratic procedures that take on average 233 days', or, in another example, 'The judicial practice for the enforcement of a contract in Burkina Faso involves 41 procedures, takes 446 days, and costs some 95% of the disputed amount' (2007: 410). While the authors themselves admit that these examples are rather extreme, the practical implications are still generally valid: cumbersome bureaucratic procedures make it costly to do business and represent a significant drag on competitiveness. Similar arguments relate to the establishment of clear and enforceable property rights, simplification of tax procedures, reform of financial market regulation, and eradication of corruption.

Not all businesses and sectors can or should be 'saved' from foreign competition by improving competitiveness. A significant share of the welfare benefits from trade liberalization is produced when less competitive industries and firms contract or disappear and the resources, in the form of scarce capital, skilled and unskilled workers, are reallocated to more productive businesses and industries (see e.g. Feenstra and Taylor 2014, on standard international trade theory). Rather than preventing such structural transformation, public policies should facilitate it and ease the inevitable pain of adjustment, for example by creating transparent bankruptcy legislation and liberalizing capital markets, by retraining workers, and by providing temporary support for parties adversely affected by increased trade competition. An example of the latter is South Korea's Trade Adjustment Assistance (TAA) programme introduced in 2007. Modelled on the US TAA system, the South Korean version works somewhat differently, in that it primarily focuses on supporting small and medium-sized firms facing structural adjustment rather than displaced workers, bringing the support scheme into potential conflict with WTO regulation (Ahn 2010).

4.2 Sustainable development provisions

Whereas labour and environmental standards have long been a part of US FTAs, it is only recently that these issues have begun to appear in the EU's FTAs, including the CARIFORUM EPA and the FTAs with Peru/Colombia and with South Korea, under the general heading of sustainable development. In early FTAs, such as the agreements with Mexico, Chile, South Africa, and the Euro-Med countries, the language on environmental standards is so vague that the stipulations are virtually unenforceable, and provisions on labour standards are excluded altogether (Horn et al. 2009). By now, labour and environmental standards have become a core part of the EU's FTAs and, in the new trade strategy, sustainable development is included as part of a comprehensive development agenda, along with promotion of respect for human rights and good governance (European Commission 2015).

Labour and environmental standards are defined by a set of international conventions established by the International Labour Organization (ILO) and various international environmental agreements. Individual countries may choose sign up to those conventions, but no dispute settlement body exists to enforce the agreements. The multilateral trade agreements

under the WTO do not permit countries to restrict trade due to violation of labour standards, with the sole exception of products made by prison labour. They do, however, allow countries to impose environmental regulation, even if such regulation is trade distorting, providing that the regulation is 'necessary to protect human, animal or plant health' or 'relating to the conservation of exhaustible natural resources' and as long as 'such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction of international trade' (GATT, Article XX, cited in Cuyvers 2013: 12-13).

Promoting higher labour and environmental standards through FTAs tends to be high on the political agenda of high-income countries like the EU member states and the US. Whether or not this is a good idea is a hotly debated topic. Proponents argue that it is an important instrument for improving labour conditions in developing countries and that the poor environmental regulation in most developing countries needs to be upgraded to be able to cope with increasing pressures from economic growth and growing populations. Also, if trade was liberalized without placing higher demands on labour and environmental standards, rich countries would merely 'export' pollution and labour exploitation to developing countries. Conversely, critics argue that labour and environmental standards are merely hidden forms of protectionism to replace traditional trade policy instruments liberalized by the agreement and that the standards prevent developing countries from utilizing their competitive advantage in low-wage production (Bourgeois et al. 2007). Irrespective of the merits of these arguments, inducing higher labour and environmental standards through FTAs is potentially costly for businesses in developing countries and may affect their competitiveness.

Labour standards

The provisions on labour standards in the EU's FTAs focus on what has become to be considered as the 'core' labour standards defined by ILO conventions. From the wording of the EU-Peru/Colombia FTA (cited in Stevens et al. 2012: 50):

Each party commits to the promotion and effective implementation in its laws and practice and in its whole territory of internationally recognized core labour standards as contained in the fundamental Conventions of the International Labour Organization (hereinafter referred to as ILO):

- a) the freedom of association and the effective recognition of the right to collective bargaining [ILO conventions no. 87 (1948) and no. 98 (1949)]
- b) the elimination of all forms of forced or compulsory labour [ILO conventions no. 29 (1930) and no. 105 (1957)]
- c) the effective abolition of child labour [ILO conventions no. 138 (1973) and no. 182 (1999)]
- d) the elimination of discrimination in respect of employment and occupation [ILO conventions no. 100 (1951) and no. 111 (1958)].

In addition to these specific commitments, the agreement pledges co-operation on a wide range of related issues.

It is not a coincidence that the wording of the agreement goes beyond the adoption of ILO conventions and focus on the ‘effective implementation in its laws and practice’ (Stevens 2012: 50). Most developing countries in Africa and Latin America, including Colombia and Peru, have already signed up to most or all of ILO’s core conventions or enacted laws with comparable standards. However, records have shown that some developing countries fail to enforce the regulations due to capacity constraint or lack of political will. This has prompted the US to place more emphasis on capacity building and technical assistance in its agreements, and less on adoption of specific standards (Bourgeois et al. 2007).

The record in Asia and the Middle East is a bit more mixed. According to the ILO,³ South Korea has not ratified the ILO conventions on forced labour (C29 and C105) or freedom of association (C87 and C98), and Singapore has opted out of C87 (freedom of association), C105 (forced labour), and C111 (discrimination).⁴ The FTAs with South Korea and Singapore do not specifically obligate the countries to adopt the agreement, but they are committed to ‘respecting, promoting and realising, in their laws and practices, the principles concerning the fundamental rights’, and to effectively implement in their laws the conventions that they have signed up to (EU-South Korea FTA, Article 13.4(3)). In addition, ‘The Parties will make continued and sustained efforts towards ratifying the fundamental ILO Conventions as well as the other Conventions that are classified as “up-to-date” by the ILO’ (EU-South Korea FTA, Article 13.4(3)). While that latter provision merely refers to a less enforceable commitment to make ‘efforts towards ratifying’, it potentially goes beyond the fundamental ILO conventions and touches upon the higher standards involving the ‘decent work’ agenda (Cuyvers 2013).

Environmental standards

Provisions on environmental standards are very similar in principle to those on labour standards. There are a number of multilateral conventions on environmental issues which have implications for international trade, including the Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES), the Montreal Protocol on Substances that Deplete the Ozone Layer, the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal, and the Stockholm Convention on Persistent Organic Pollutants (Cuyvers 2013).

The EU-South Korea FTA contains language on environmental standards which is similar to the wording on labour standards—emphasizing the effective implementation of multilateral environmental agreements to which the countries are party, but not specifying explicitly what these agreements are and without mandating the adoption of any particular convention. With respect to multilateral agreements on climate, the parties ‘reaffirm their commitment to reaching the ultimate objective of the United Nations Framework Convention on Climate Change and its Kyoto Protocol’ (EU-South Korea FTA, Article 13.5), but there are no binding obligations. There are, however, signs that the EU will seek to strengthen the language in future FTAs. The recently concluded FTA with Singapore was branded as the first ‘green’ FTA and the agreement with Malaysia currently under negotiation may touch upon more contentious issues such as the environmental sustainability of Malaysia’s palm-oil based biofuel production (Cuyvers 2013).

³ The list of ratifications of core international labour standards is available on the ILO’s website, http://www.ilo.org/dyn/normlex/en/?p=NORMLEXPUB:10011:0::NO::P10011_DISPLAY_BY,P10011_CONVENTION_TYPE_CODE:1,F

⁴ In all fairness, it should be noted that the US has only signed up to two out of the eight core conventions, so lack of adoption does not necessarily imply sub-standard labour conditions. Also, both South Korea and Singapore have ratified several other ILO conventions beyond the fundamental standards.

The institutional and policy implications of the FTAs' labour standard provisions are likely mixed. Research suggests that the fears of lost competitiveness due to raising labour conditions up to the most basic standards are overblown. Martin and Maskus (2001) expect that fundamental labour standards are more likely to raise labour productivity than reduce competitiveness and Basu (1999) shows how child labour may be the result of a market failure and that abolishing the practice could improve welfare in the short term and further increase labour productivity in the long term as children spend more time in school. Some environmental conventions, like CITES, are not likely to have much impact on developing country competitiveness. However, if the EU seeks to incorporate more detailed and enforceable obligations, for example on sustainable criteria for specific sectors, in future FTAs, the implications could be considerable.

The primary challenges related to the labour and environmental standards provisions seem to involve the effective implementation of ratified labour conventions. Monitoring and enforcement of compliance with labour and environmental protection laws are likely to require substantial upgrades in developing FTA partners' institutional capacity. In a study on Nike's efforts to improve labour conditions among its suppliers, Locke et al. (2007) found that even considerable resources devoted to monitoring labour conditions had very mixed and limited effects. To help address these issues, the EU is determined to enlist civil society organizations and the public at large (Cuyvers 2013). For instance, the EU-Peru/Colombia FTA mentions the establishment of national committees and bi-regional annual dialogue with involvement of civil society (Stevens et al. 2012).

4.3 Rules of Origin

FTAs do not automatically grant firms preferential access to trade partner's markets when the agreement enters into force. To enjoy the benefits of lower tariffs, exporters have to obtain a 'proof of origin' for the exported products, certifying that the products originate within the FTA member country. The importer on the other side of the border presents the proof of origin for preferential treatment at the importing country's customs clearance. The RoO stipulate how such proof of origin is issued and what the requirements are.

In 2010, the EU revised its policy towards RoO in its preferential trade agreements in an effort to simplify the procedures and update the rules to facilitate the globalization of supply chains. One should therefore distinguish between the RoO in the early FTAs, such as the Euro-Med agreements with the EU's Mediterranean neighbours, the TDCA with South Africa, and FTAs with Chile and Mexico, and the new generation of FTAs exemplified by the agreement with South Korea. For the most part, the reform involved a simplification of the origin criteria, but there were also potentially important changes in how the proof of origin is issued (de Anda del Corte 2011).

At the conceptual level, the RoO are fairly similar across FTAs. The specific origin criteria are product or sector dependent. They may follow a minimum value added rule (a certain percentage of value must be added in the country), a change of tariff heading rule (imported materials must be subject to sufficient processing to warrant a change in tariff heading), a specific process rule (imported materials must be processed in a specific way) or a mix of the three (Naumann 2006). The RoO allow for cumulation, which implies that materials or processing taking place within the free trade area count as originating within the country for the purpose of proving origin. A unique feature of the EU's FTAs is that cumulation can be diagonal, meaning that cumulation can take place across other FTAs to which the EU is a party. For instance, materials imported

from Chile by a firm in Peru counts as originating in Peru, since both Chile and Peru have signed FTAs with the EU (Stevens et al. 2012).

Apart from the simplification of the origin criteria, the 2010 reform of the RoO introduced two significant changes (de Anda del Corte 2011). First, the RoO now allow for duty drawback on imported materials used in the production of goods exported to the EU (assuming of course that the exported product still complies with the origin criteria). This reduction in costs of imported materials is potentially important for many developing countries, which base their industrialization strategy on their integration into global supply chains.

The second major change is to the ways that exporters obtain their proof of origin. In earlier trade agreements, exporters could either apply for a certificate of origin with the exporting country's customs officials by proving compliance with the origin criteria, or they could become registered as an approved exporter, in which case the exporting firm effectively issues the proof of origin itself. The 2010 reform abolished the certificate of origin, and only the approved exporter channel remains (European Commission 2010). The motivation for the change in proof of origin procedures is, according to the European Commission website, that '[t]his will allow the authorities of the exporting country to re-focus their resources on better control against fraud and abuse, while reducing red-tape for businesses'.⁵ The decision has been criticized: by abolishing one of the two certification channels, the proof of origin may become harder to obtain, particularly for small businesses and infrequent exporters, which may require the assistance of customs authorities to meet the requirements (de Anda del Corte).

RoO are often criticized for being too complex for many exporters and even trained customs officials to understand and comply with (Cheong 2014). Effectively, they present a non-tariff barrier, which replaces the tariffs eliminated by the trade agreements, and many businesses fail to obtain proof of origin due to lack of knowledge or because the procedures are more costly than the tariffs saved. The EU's 2010 reform eases the burdens on exporting countries' customs officials by shifting the responsibility for proof of origin certification onto the businesses themselves, but exporters, particularly small and medium-sized firms with little or infrequent contact with foreign markets, may not necessarily be better equipped than customs officials to handle the complex regulations.

The South Korean experience illustrates the need for public institutions to facilitate compliance with the RoO, thereby strengthening the competitiveness of domestic firms on foreign markets (Cheong 2014). Early business surveys in South Korea showed that only around 20 per cent of firms utilized the preferential access provided by FTAs, largely due to the complexity of the RoO. But after the introduction of a comprehensive policy package for supporting FTA utilization in the form of web-portals and call centres to disseminate detailed information on the FTAs, the preferential tariff rates, the RoO, and the procedures for obtaining proof of origin, the FTA utilization rates increased substantially to around 80 per cent for the EU-South Korea FTA.

4.4 TBT and SPS regulations

The FTAs eliminate the explicit trade barriers posed by import barriers, but the implicit restrictions generated by TBTs and SPS regulations remain. TBTs and SPS regulations are already disciplined by multilateral agreements under the purview of the WTO, applying the principles of MFN and national treatment, and requiring that the regulations are designed and

⁵ Cited from:

http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_777_en.htm

implemented in the least trade-restrictive way. The FTAs do not go beyond the multilateral commitments in terms of reducing or eliminating regulation (Rudloff and Simons 2004). Instead, they tend to focus on co-operation between the parties to facilitate compliance with the regulation.

A number of instruments are available for easing the burden of regulation. Both the multilateral agreements and the FTAs tend to recommend that regulations follow or be based on international standards to avoid having to comply with several different standards on the same issue. In cases where international standards do not exist or are deemed to provide an insufficient level of protection of health, safety, or environmental quality, FTAs recommend that national standards and conformity assessment procedures are harmonized to facilitate cross-border trade. An alternative approach to harmonization is the signing of Equivalence- or Mutual Recognition Agreements (MRAs), under which regulation and/or conformity assessment may be different across countries but states recognize that the different standards provide the same level of protection. Many FTAs, particularly the ones between a developed and one or more developing partners, also include provisions on technical assistance, improved transparency, and deepened co-operation on the design and implementation of regulation.

As with many other areas, the provisions on co-operation with respect to TBTs and SPS regulation in the EU's FTAs have developed over time. In the early FTAs, such as the Euro-Med agreements with the EU's Mediterranean neighbours and the TDCA with South Africa, the language is very shallow and does not move much beyond reaffirming WTO commitments. Starting with the FTA with Mexico, a specific committee is established to administer and facilitate the co-operation between the parties on TBT and SPS issues, and the FTA with Chile in 2002 is the first agreement to provide more detail on the nature of co-operation, such as the process of equivalence determination, guidelines for conducting verification and certification, and exchange of information (Rudloff and Simons 2004). The FTA with Peru/Colombia largely follows the Chilean FTA in this area, and the South Korean FTA moves even further with more detailed sector-specific arrangements (Stevens et al. 2012). The FTAs with the nearer neighbours, that is, the Euro-Med agreements and to some extent the EPAs with the ACP countries, tend to focus on harmonization of standards and conformity assessment procedures—which often implies adoption of EU standards (Prévost 2010; Stoler 2009). FTAs with more distant partners, such as Mexico, Chile, Peru/Colombia, and South Korea, contain more detailed provisions on equivalence assessment and mutual recognition.

Institutional and policy changes needed with respect to TBTs and SPS regulations

Improving product quality and safety to meet EU standards, and proving compliance with the regulation is very costly for most developing countries. But the compliance costs are there, whether or not countries engage in trade agreements with the EU. Arguably, the FTAs with the EU may reduce the costs of compliance through the deepened co-operation between the parties coupled with the provision of technical assistance from the EU resulting in greater harmonization or equivalence of standards between the parties.

Reducing those trade barriers requires substantial investment in public or private quality infrastructure in the form of testing and certification facilities, accreditation of such facilities, inspections by authorities and dissemination of information regarding quality and safety standards. Improving product quality and safety in the developing country as a whole (as opposed for just the products exported to the EU) by adopting international or EU standards may reduce trade barriers and allow businesses to exploit economies of scale, but it may also force countries to introduce regulation which is inappropriate to the country's local context and level of development. Alternatively, obtaining recognition of equivalence of national standards

offers a great deal more flexibility in tailoring domestic regulation to local challenges, but it is also likely to require substantial improvements in institutional capacity and public policies to achieve the level of credibility required by the EU.

5 SOE reform and competition regulation

5.1 Competition regulation in the EU's FTAs

In a sense, ensuring free competition between businesses is the foundation of international co-operation on trade. Traditional trade policies, in the form of import tariffs and quotas, and protectionist technical trade barriers, such as discriminating product regulation, can be seen as government policies designed to enable national firms to achieve a dominant position on the domestic market. International trade policy co-operation through the WTO progressively prohibits such anti-competitive behaviour by governments, and the next natural step is to begin co-operating on policies to prevent anti-competitive behaviour by firms.

Anti-competitive behaviour by firms can affect international trade in a number of ways. For instance, domestic firms can collude to keep foreign competitors out of the domestic market. Alternatively, firms in different countries may agree to stay out of each other's markets, thus reducing international competition and allowing everyone to maintain their dominant position on their home markets (Szepesi 2004b).

The EU has long pursued the incorporation of competition policies into international co-operation at all levels. Competition regulation, monitoring and enforcement are among the European Commission's core responsibilities, and the EU was one of the main proponents for keeping competition policy on the agenda during the Doha round of multilateral trade negotiation. It is also part of all the EU's FTAs. The EU's trade agreements usually do not have separate chapters on SOEs, but a few provisions are often included under the general heading of competition regulation. Similarly, the EU tends to lump competition together with state aid, reflecting that state aid is part of competition law in the Treaty on the Functioning of the EU (Sung 2013). The following will discuss the provisions on competition policy and state aid under the three headlines of competition policy, state aid, and SOEs and designated monopolies.

5.2 Competition

There is no specific agreement or article of an agreement under the WTO that deals exclusively with competition policy. Originally, it was on the agenda for negotiation under the Doha round but, in the face of strong opposition, particularly from developing countries, competition policy was taken off the table after the Cancún Ministerial Conference in 2003, along with two other areas, collectively known as the Singapore issues. Provisions in the FTAs on competition policy therefore typically go beyond already existing multilateral obligations.

Provisions related to competition policy generally involve commitments to (i) adopt or maintain competition laws; (ii) competition enforcement principles; and (iii) co-operation and co-ordination mechanisms (Lapr  vote et al. 2015).

The specific provisions on the *adoption and maintenance of competition legislation* largely reflect whether or not the EU's trade partners had effective competition legislation to begin with and how closely associated the trade partners are to the EU. Generally, FTAs recognize the sovereignty of the parties to develop and enforce their own competition laws—mutual recognition of national competition legislation is explicitly stated in the agreements with Mexico, Chile, and Peru/Colombia, and the TDCA with South Africa. But in a few instances, notably the Euro-Med agreements with Jordan, Morocco, the Palestinian Authority, and Tunisia, the

commitments largely involve the adoption of EU competition rules within five years after the agreement enters into force (Szepesi 2004b; Stevens et al. 2012). Potential accession candidates, such as Albania, Ukraine, and Serbia, are obligated to ensure that their competition regulation is compatible with EU legislation (Laprévôte et al. 2015).

Whatever the source of the competition legislation, the FTAs detail that the regulation should cover ‘concerted practices’ (prohibition of anti-competition agreements between firms), abuse of a dominant position (monopoly per se is not illegal, but abuse of monopoly power is), and in some cases anti-competitive mergers and acquisition (Szepesi 2004b). The provisions are generally horizontal in nature (general for all sectors), but in several FTAs the parties have found it necessary to include sector-specific details, such as in the postal and courier sector (FTAs with Ukraine, Moldova, Central America, and Peru/Colombia), tourism (CARIFORUM), dry and liquid bulk trade (Jordan) and international maritime transport (Montenegro) (Laprévôte et al. 2015).

Some FTAs set out a few principles for the *enforcement of competition legislation*. These principles are very general in nature and largely reiterate the general obligations of non-discrimination, transparency and procedural fairness which apply to all trade-related matters in the FTAs (Laprévôte et al. 2015). As an example, Article 11.3(2) of the EU-South Korean FTA reads: ‘The Parties recognize the importance of applying their respective competition laws in a transparent, timely and nondiscriminatory manner, respecting the principles of procedural fairness and rights of defence of the parties concerned.’ A few of the FTAs with potential accession countries (Serbia, Montenegro, and Albania) go a step further and oblige the parties to ‘entrust competition enforcement to an operationally independent authority’ (quoted in Laprévôte et al. 2015: 10).

All the EU’s FTAs emphasize *co-operation and co-ordination* between the parties’ competition authorities on competition regulation enforcement. The co-ordination commitments may involve exchange of non-confidential and/or public information between the parties and obligations to notify the competition authorities of the trade partner of enforcement activities which may be relevant for the other authority (Laprévôte et al. 2015). The EU-South Korea FTA specifically requires representatives from the two competition authorities to meet at least once per year to exchange information, to discuss general policy issues of mutual interest, and to build up a relationship of mutual trust and respect (Sung 2013).

In some cases, the procedures for how co-operation between the parties should take place are very detailed. For instance, the EU-Mexico FTA emphasizes avoidance of conflict over competition regulation and specifically stipulates that ‘each Party shall [...] take into consideration the important interests of the other Party in the course of its enforcement activities’ and ‘if adverse effects for one Party result [...] the competition authorities shall seek a mutually acceptable solution’ (quoted in Szepesi 2004b: 5). The agreement moves on to list a number of detailed issues that may be considered. The EU-South Korea FTA has similar stipulations, that the parties should ‘give careful consideration to the important interests of the other party throughout all phases of its enforcement activities’ (quoted in Sung 2013: 93). The provisions on competition specifically rule out the use of the FTA’s dispute settlement procedure for arbitrating any conflicts over competition co-operation. Instead, a separate side agreement on ‘Cooperation on Anti-competitive Activities’, signed by the EU and South Korea in 2009, provides a co-operative mechanism, which provides a dispute settlement forum where the parties can negotiate a settlement through consultations (Sung 2013).

Several of the EU’s FTAs (including the TDCA with South Africa and the FTAs with Peru/Colombia and South Korea) also mandate co-operation in cases where one party’s

competition authority requests the assistance of the other party's authority in dealing with anti-competitive behaviour. This could involve the exchange of information to allow the competition authority to compile a case, or the authority of one country could request the other authority to initiate an enforcement action against a firm, where the firm's anti-competitive behaviour in the latter country has a harmful effect on the former (Stevens et al. 2012; Sung 2013; Szepesi 2004b). Other forms of co-operation could involve mutual technical assistance, especially in the form of support from the EU to the partner country in cases where the competition legislation and enforcement mechanisms are not yet fully developed.

5.3 State aid

State aid and subsidies are prohibited by the multilateral agreements under the WTO to the extent that they adversely affect international competition. The WTO distinguishes between two types of subsidies. *Prohibited subsidies*, which are specifically designed to distort international trade, can be challenged directly at the WTO dispute settlement body. Examples include subsidies tied to export targets or the use of domestic inputs. *Actionable subsidies* are not tied directly to international trade. They are only illegal under WTO regulation if a complainant can demonstrate that it is adversely affected by the subsidies, either on the subsidizing country's own market, on the complainant's markets, or on third markets. In either case, if the dispute settlement panel rules in favour of the complainant, the defendant must remove the subsidies immediately—if not, the damaged parties may impose countervailing duties to mitigate the effects of the subsidies. If subsidies and state aid are not trade distorting, they are allowed under WTO rules.

Whereas the WTO regulates subsidies from an international trade perspective, the EU sees subsidies and state aid as an integrated part of competition regulation. This view is also reflected in the EU's FTAs, where provisions on state aid are usually included in chapters on competition regulation. The extent to which state aid is included in the EU's FTAs differs substantially across trade partners. FTAs with the EU's close neighbours, such as the Mediterranean countries and non-EU European nations, generally contain broad provisions prohibiting 'any public aid which distorts or threatens to distort competition by favouring certain undertakings or products' (quoted in Laprévotte et al. 2015: 8). Such provisions potentially go beyond WTO commitments, since it is not necessary to prove that businesses have been hurt by the subsidies of the other party. State aid is outlawed even if it just 'threatens to distort competition'. Additionally, FTAs usually contain obligations on transparency, mandating submission of yearly reports on state aid to the trade partner (Szepesi 2004b).

FTAs with more distant partners tend to contain somewhat looser language, with few commitments beyond those defined through the multilateral agreements. The FTA with Mexico completely excludes provisions on state aid, while the agreement with Chile contains commitments to exchange information on state aid (on an annual basis) (Szepesi 2004b). The FTA with Peru and Colombia specifically removes subsidies and state aid from the purview of the agreement and refers remediation and dispute settlement on these issues to the multilateral channels under the WTO (Stevens et al. 2012).

The South Korean FTA is more elaborate on state aid than most of the previous FTAs. In addition to staking out a general principle committing the parties to 'use their best endeavours to remedy or remove [...] distortions of competition caused by subsidies in so far as they affect international trade and to prevent the occurrence of such situations' (EU-South Korean FTA, Article 11.9), the agreement also specifically prohibits the use of trade-distorting subsidies to cover 'debts or liabilities of certain enterprises [...] without any limitation', as well as subsidies 'to insolvent or ailing enterprises, without a credible restructuring plan' (EU-South Korean FTA, Article 11.11). The subsidies described in Article 11.11 of the EU-South Korean FTA are not

specifically designed to be trade distorting, so they fall under the actionable category of subsidies under the WTO agreements, requiring proof of harm done to national firms before raising a case before a WTO dispute settlement panel. The Article therefore provides an alternative channel for remediation under the EU-South Korea dispute settlement procedures with possibly lower burdens of proof (Sung 2013).

Most of the FTAs also designate exceptions to the general rules on state aid. The Euro-Med agreements with the Mediterranean neighbours, as well as the TDCA with South Africa allow for state aid for development purposes (Szepesi 2004b), as well as more specifically subsidies to agriculture and fisheries (Laprévôt et al. 2015), and the South Korean FTA specifically excludes the coal sector and compensation for carrying out public service obligations (EU-South Korean FTA, Article 11.11).

5.4 State-Owned Enterprises

SOEs are not subject to specific obligations under the WTO agreements except in the form of State Trading Enterprises (STEs) managing the imports and exports of certain commodities. STEs are not prohibited (or even discouraged), but they are required to operate in accordance with the general principle of non-discrimination and their actions must be guided by commercial considerations alone.

In the EU's FTAs, SOEs are typically only mentioned briefly and together with public and private enterprises entrusted with special or exclusive rights. The provisions state that such enterprises are subject to the same rules and obligations as other private enterprises in terms of competition regulation and state aid (Laprévôt et al. 2015). Thus, nothing prevents the parties from establishing or maintaining SOEs, or even from granting them exclusive rights or monopoly status, as long as they are regulated by the national competition authorities alongside other private enterprises, they do not abuse their dominant position, and they do not collude with other enterprises in conducting anti-competitive practices.

The SOEs are also bound by the countries' commitments on state aid as discussed above, which for instance in the case of the EU-South Korean FTA implies that the state may not grant explicit or implicit subsidies to SOEs to cover losses without limit and without a 'credible restructuring plan'. An important exception to these stipulations is the compensation offered for public service obligations, included in several of the EU's latest FTAs, including the ones with South Korea and Singapore (the latter is concluded but not yet ratified). It is not specifically detailed which activities can be designated as public service.

5.5 Institutional and policy implications of competition regulation

In the material studied for this report, very little is written on the experiences of EU's FTA partners with implementing the provisions on competition regulation. However, based on the brief review of the different FTAs summarized above, it is possible to identify a potential need for policy changes as well as both institutional and legislative development, depending on the institutional starting point of the trade partners.

If the trade partner does not already have a fully developed set of competition laws enacted to regulate anti-competitive behaviour in the form of collusion, abuse of dominant market position, and anti-competitive mergers and acquisitions, such legislation must be developed—usually within a given time frame upon the entering into force of the FTA. In a few cases, the FTAs have effectively required the adoption of EU-style competition legislation, but more generally the trade partners are free to develop their own laws provided they effectively regulate competition.

In addition to suitable competition laws, the trade partner should develop institutional arrangements for the effective implementation of the competition laws if it does not already have them in place. This will involve a central competition authority with a mandate and capacity to investigate anti-competitive behaviour and with the power to enforce the competition laws. A few FTAs have specifically stated that such competition authorities should be politically independent, but this is not a general provision. The competition authority should also have the mandate and capacity to co-operate with the European Commission (the EU competition authority) on exchange of information and collaboration on specific cases.

Finally, the FTAs may have implications for policy changes on state aid, subsidies and the operation of SOEs. For the most part, the EU's FTAs do not move substantially beyond WTO commitments on subsidies—if subsidies are legal under the WTO, chances are that they are also legal under the FTAs. In some cases, however, there may be differences in terms of enforcement of the provisions on subsidies and state aid. Forcing governments to remove actionable subsidies under the WTO requires a claimant country to bear a significant burden of proof of harm done to its firms. Some FTAs, such as the agreement with South Korea, offer an alternative channel for raising a claim, with a potentially lower burden of proof.

The FTAs do not necessarily require significant reforms of SOEs, such as privatization or the removal of special rights, as SOEs are accepted under the EU's agreements. They may, however, require changes in the way they are operated. The FTAs view SOEs exactly like any private enterprise subject to the same laws on competition and state aid. Therefore, SOEs which are closely integrated within the state and operating according to political mandates may need to reform. SOEs should be run at arm's length, according to commercial principles. It may be possible, however, to negotiate exceptions to the general provisions on state aid, for instance to allow for subsidies for development purposes or in the form of compensation for the provision of public services.

6 Conclusion

The purpose of this report was to review the international experiences with the institutional and policy adjustments needed to implement FTAs between developing countries and the EU. Three areas have received particular attention: investment, competitiveness, and competition. To conclude the analysis, the following discussion will briefly review the *challenges* and the *opportunities* associated with the institutional and policy implications of the FTAs, seen from a developing country perspective. The main focus will be within the areas of investment, competitiveness, and competition.

Challenges

The main challenges associated with FTAs are related to the need for substantial investment in infrastructure and institutional capacity and the implications of reduced policy space.

Proper implementation of the FTAs requires potentially costly *investments in infrastructure and institutional capacity*. Upgrade of physical infrastructure is needed to further reduce trade costs and improve competitiveness, and so are improvements of public or private services, such as product quality testing and certification, and dissemination of information regarding standards, RoO, and trade opportunities. Trade agreements can be greatly disruptive to less competitive industries, and public institutions may be needed to facilitate structural transformation and to mitigate the adjustment costs. Several provisions in the FTAs oblige countries to develop or adopt specific laws and regulations, such as competition laws and labour laws, and to establish institutions for the monitoring and enforcement of the new legislation.

Commitments in trade agreements typically *reduce the policy space* of the signatories of the agreement by restricting what policies governments may pursue, by making certain policies costly or risky, or by mandating specific policies or regulation. The provisions on investment protection can potentially be very restrictive to public policies. Requirements to allow for free capital movements make it harder to pursue independent monetary and exchange rate policies, and foreign investors' rights to FET and protection against expropriation may be so broad that they could hinder public policy-making. Similarly, obligations on state aid and the operation of SOEs restrict the way governments can use these instruments for public policy purposes.

Opportunities

While the challenges for developing countries may be substantial, the FTAs also present certain opportunities, in addition to greater market access. Such opportunities arise from the greater co-operation with the EU on important topics and the opportunity to make credible commitments to more appropriate legislation, institutions, and policies.

FTAs are not just collections of obligations that the parties must observe, they also delineate a range of topics on which the parties engage in *closer co-operation*, and they often describe in some detail procedures to facilitate this co-operation. Examples include investment promotion provisions, closer co-operation on meeting standards related to TBTs and SPS regulation, and collaboration and exchange of information in relation to the enforcement of competition laws. In certain areas, the EU combines such co-operation with technical assistance and other support. While the wording on such provisions is often somewhat vague and unenforceable, they do offer the opportunity to reduce the trade barriers and transaction costs related to these issues.

Binding international agreements may also offer the opportunity of *credible commitment to more appropriate legislation, institutions, and policies*. Some of the policy restrictions mandated by the FTAs may actually be in the best interest of the developing countries, but their governments may be unable to credibly commit to such policies by themselves. Investment protection obligations prevent governments from pursuing public policies tantamount to expropriation without compensating the investors, and such commitments may attract more foreign investment and/or induce them to accept lower rates of return. Adoption of minimum labour and environmental standards may send the signal to investors and western consumers that the country takes such matters seriously. And while provisions on competition regulation may require reform of state aid and the way SOEs are operated, such reforms may pay off in the long run by improving market efficiency.

While it is not possible to assess whether the opportunities generally outweigh the challenges based on this brief review, the continued proliferation, deepening, and widening of FTAs between more and more countries suggests that, at the very least, the parties involved think that the balance tends to be favourable.

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