Part III Global Trade and Regional Development

Chapter 11

Regional Integration: The Next Wave

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Introduction

The nature and extent of trade has changed over time as transport technologies, production technologies and the rules of trade have evolved. As briefly discussed by Goldstein and van Lieshout in Chapter 7 of this Handbook, the multilateral trade rules currently governing world trade are a relatively recent phenomenon from a historical perspective. The General Agreement on Tariffs and Trade (GATT) celebrated its 70th anniversary in 2017. Before the existence of the GATT, international trade was largely governed by bilateral treaties among a limited numbers of players and by power relationships resulting from colonialism. The shift in global power relationships in the aftermath of World War II opened the door for a new set of rules for trade that ended up being multilateral in nature. Following the 70th anniversary of the GATT, international trade relationships may undergo another set of changes, as they are exposed to three types of pressures concurrently:

- the rise of China as a major global player;
- the appearance of a new "industrial revolution", due to the fast development of the digital economy; and,
- the increased complexity of trade rules as further liberalisation increasingly implies the need to move "behind the border".

In this chapter, regional integration is discussed within the context of these three phenomena. The second section gives a short and broad-brush historical overview of regional integration with a focus on the past century and the interplay between multilateral and regional trade rules. Then, section three examines the surge of so-called mega-regionalism in the light of the relationships between three major trade "blocks":

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Northern America, the European Union (EU) and China. The interaction between different "domestic" policy areas and international trade is the subject of the following section, which also discusses the advent of the digital economy and its impact on trade rules. Finally, section five ventures into the future by asking what the next wave of regional integration may look like.

Regional Integration within a Multilateral Framework

Early Trade Policy

Throughout history trade has mostly occurred within relatively small geographic regions, and for good reason. The main constraints faced by early traders were primitive transportation and communication technologies, combined with poorly maintained or entirely absent infrastructure. One of the earliest recorded direct inter-regional trading relationships was between the Sumerians in Mesopotamia and the Harappan civilisation of the Indus Valley in around 3000 BCE (Possehl, 2002).

Perhaps the first example of regional trade on a scale modern observers would find familiar was during the height of the Roman Empire, between 26 and 180 AD (the dates chosen here are the generally accepted span for the so-called Pax Romana, a period of relative peace and prosperity experienced by the Roman Empire). During this period, vast amounts of grain, olive oil and wine were produced and shipped across the Empire. Even so, trade was heavily controlled by the state, with tariffs applied to goods moving between provinces and strong regulations on ship-owner associations which executed much of this trade. Indeed, it would be misleading to characterise trade in this period as efficiency maximising; for the Romans, trade was about maintaining control and power rather than promoting commercial links, increasing productivity or stimulating investment (Bang, 2007). This would be the lens through which trade policy would be viewed until the European Enlightenment.

In the 18th and 19th centuries, the contributions of both Adam Smith and David Riccardo to economics challenged prevailing mercantilist theories. Adam Smith was the first to articulate the principles of absolute advantage in the context of international trade in his seminal 1776 publication *An Enquiry into the Nature and Causes of the Wealth of Nations*. Around 40 years later, David Ricardo would refashion these ideas into what is now referred to as the law of comparative advantage. As also discussed by Höppner in Chapter 2 of this Handbook, comparative advantage, which focuses on the opportunity costs of producing goods instead of absolute costs, is the basis for the free trade consensus among economists today.

These arguments helped precipitate the so-called first wave of regionalism in the second half of the 19th century (Mansfield and Milner, 1999). Under Britain's lead, a broad network of bilateral trade agreements were signed, starting with the Anglo-French free trade agreement of 1860 (although commonly referred to as the "Anglo-French treaty", the proper name is the Cobden–Chevalier Treaty, after its originators). However, when these bilateral free trade agreements came up for renewal in the 1890s, many European nations decided against prolonging previous agreements. Despite being near the peak of her power and prestige, Britain could do little to stop this drift away from free trade ideals, partly because she had already abolished most of her tariffs and consequently was left with little bargaining power.

The United States and Latin America remained relatively protectionist in this period, while Asian, African and other countries were being forced into trade agreements *via* so-called gun-boat diplomacy (World Trade Organization, 2007). In the early 20th century, Britain herself became split on the issue of free trade when the conservative party argued in favour of reintroducing tariffs. Economic fragmentation in Europe increased at the turn of the century, and combined with strained foreign relations between major European powers, set the conditions for World War I, and the economic turmoil that followed.

Trade policy in the inter-war years

World War I was fought on an industrial scale. It led to a severing of trading relationships between enemies, and a shift of production to war materials damaging lower priority trading relationships (Horowitz, 2004). In the aftermath of the World War I, the resulting structural changes shifted the economic balance towards industries in favour of continued protection. A lack of leadership prevented a reciprocal dismantling of wartime trade restrictions. As a result, European nations looked to their colonial holdings as markets for their products rather than to each other. In the British Commonwealth, for example, by 1925 preferential *ad valorem* tariffs had grown by 9% since the end of World War I. In some senses, the Imperial Preference system developed by Britain in the 1930s can be considered the first expression of regionalism on a truly global scale.

What little trust existed in the international trading system evaporated with the passage of the US Smoot–Hawley Tariff Act in 1930. The protectionist measures introduced by the world's biggest creditor with the largest trade surplus stoked retaliatory action. Agricultural prices plunged and a long depression set in similar to that experienced in the 1870s. Europe suffered greatly, being still heavily dependent on agriculture.

The United States attempted to correct course with the adoption of the Reciprocal Trade Agreements Act of 1934. However, undoing the damage of the Smoot–Hawley Tariff Act proved slow and difficult (Irwin, 2017). In the end, it came too late to help stem rising disillusionment in Europe, and the world was set on course for war once again.

The Failure of the ITO and the Establishment of GATT

In the aftermath of World War II, the victorious powers were determined not to return to beggar-thy-neighbour trade policies. Indeed, as soon as the war began to turn against the axis powers, conferences discussing the architecture of post-war international cooperation were held. At the United Nations Monetary and Financial Conference, better known as the Bretton Woods Conference, the Monetary Fund and the International Reconstruction Development Bank were formalised (United States, Department of State, 1944). However, even though the elimination of tariffs and restrictions on trade was seen as important, it was not viewed as an immediate priority (Irwin, 1993). Therefore, it was not until 1946 that an international conference was held to discuss the creation of a multilateral trade body, known as the International Trade Organization (ITO).

The ITO was designed to have the power to create rules over a wide variety of aspects of economic policy, including employment, business practices and international investment. However, business groups in the United States refused to support an organisation with weak protections on foreign investment and provisions for commodity price stabilisation (Narlikar *et al.*, 2012). At the same time, the United States and Britain clashed over the elimination of the Commonwealth's Imperial Preferences (World Trade Organization, 2007).

The United States was in favour of non-discrimination without exception, and while Britain did not disagree with American goals, they disagreed on the timing of US plans, fearing their beleaguered economy would suffer greatly if tariffs fell before Britain could secure itself on a firmer economic footing (Zeiler, 1997). Although the United States eventually backed down, the ITO was effectively killed off when in 1950 US President Truman announced his administration would not put the charter to Congress.

Regionalism under GATT

GATT Article XXIV

The GATT was originally intended to serve as an interim agreement until the ratification of the ITO. When it became clear that the ITO would not be ratified, the GATT became the primary vehicle through which liberalisation efforts would be coordinated. The GATT was signed by 23 countries in 1947, and came into force on 1 January 1948. The overall objective of the GATT was to reduce tariffs and the use of quotas. A cornerstone of the GATT system was the principle of non-discrimination or the most-favoured-nation (MFN) rule. However, exceptions to the MFN rule were written into the GATT from an early stage (World Trade Organization, 2007). Interestingly, although scholars have traditionally attributed these exceptions to a desire on the part of the United States to facilitate European integration and keep the British from abandoning the talks, this is not the full story. At the time, US officials had secretly entered into trade negotiations with Canada, which they wanted GATT rules to accommodate (Chase, 2006). Ironically, no such treaty was ever signed or ratified, leaving behind only the ambiguous terminology of Article XXIV. However, within these exemptions the genesis of regionalism as we understand it today would form.

GATT Article XXIV gives exceptions from the obligation of the MFN principle to customs unions and free trade areas as long as they meet certain criteria. The main criteria are transparency, that a "substantial part of trade" between territories is covered in the liberalisation effort, and neutrality vis-à-vis third parties.

Regionalism in the 1960s and 1970s

The first major regional trade agreement (RTA) to be reviewed under Article XXIV was Part IV of the 1957 Treaty of Rome, which established a preferential treatment between European Economic Community (ECC) members and their overseas countries and territories (the Treaty of Rome was signed in March 1957. The founding ECC members were Belgium, France, Italy, Luxembourg, the Netherlands and West Germany). The working group charged with reviewing the agreement quickly stalled on a fundamental issue: what constituted a customs territory or free trade area? Here it is instructive to quote Article XXIV:8(b) from the GATT.

> A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce [...] are eliminated on substantially all the trade between the constituent territories in products originating in such territories. (World Trade Organization, 1947)

But what constitutes *substantially all the trade* or *other restrictive regulations of commerce*? The working group was not able to reach clear conclusions, which may have partly been due to political considerations, but also because GATT Article XXIV was designed to be intentionally vague on these issues. Both these concerns would preoccupy subsequent RTA examinations and demonstrated the weakness of GATT rules on regional arrangements. In the end, the GATT sanctioned Part IV of the Treaty of Rome by granting a waiver to GATT rules, as the politics of the day trumped legal considerations. Interestingly, there was some enthusiasm to follow the ECC's example and set up free trade areas centred on the United States. Japan probed the possibility of a free trade agreement with the United States in 1960, but the United States remained indifferent to such ideas (Bhagwati, 1992).

In the following years, developing countries, encouraged by the example of European countries, sought to create free trade areas of their own to stimulate industrialisation. However, given strong state control of many of the sectors under discussion, the talks came to nothing as negotiations centred on industry-trade allocations rather than liberalisation (Bhagwati, 1992).

Regionalism builds up steam

Regionalism in the post-World War II era thus remained confined to European countries for a few decades. That changed when the United States, then a key defender of multilateralism, entered talks first with Israel and then, more significantly, with Canada, in the 1980s. Negotiations conducted in the following years concluded with the signing of the United States' first major post-war free trade agreement, the 1988 Canada–United States Free Trade Agreement (CUSFTA). Soon after, Mexico approached the United States on signing a bilateral agreement. Canada, fearing it would lose its recently won preferences, asked to join the talks. The three parties first sat down in 1990, and on 1 January 1994 the North American Free Trade Agreement (NAFTA) came into force. NAFTA eliminated tariffs on over 97% of the parties' tariff lines, representing more than 99% of intra-trade by volume (World Trade Organization, 2000). NAFTA set the stage for an explosion of RTAs and preferential trade agreements (PTAs) starting in the mid-1990s.

A Surge in Preferential Trade Agreements

The establishment of the World Trade Organization (WTO) ushered in a new era of multilateral trade cooperation. This development was accompanied, however, by a new wave of regionalism in the form of a surge of bilateral investment treaties (BITs) and regional trade agreements (Mansfield and Milner, 1999). The terminology can be confusing. For instance, in some cases "PTAs" refer to preferential trade agreements while in others to preferential trade arrangements (preferential trade arrangements are unilateral trade preferences as well as other non-reciprocal preferential schemes granted a waiver by the General Council). In this section, we use the more generic term PTA (preferential trade agreements) as we discuss reciprocal bilateral, plurilateral and regional agreements.

By 2016, almost 650 PTAs had been signed (Figure 11.1; Dür *et al.*, 2014). A large share of PTAs are between countries in the Americas and Europe. Agreements between countries in Asia and countries in Europe, the Americas and Africa also account

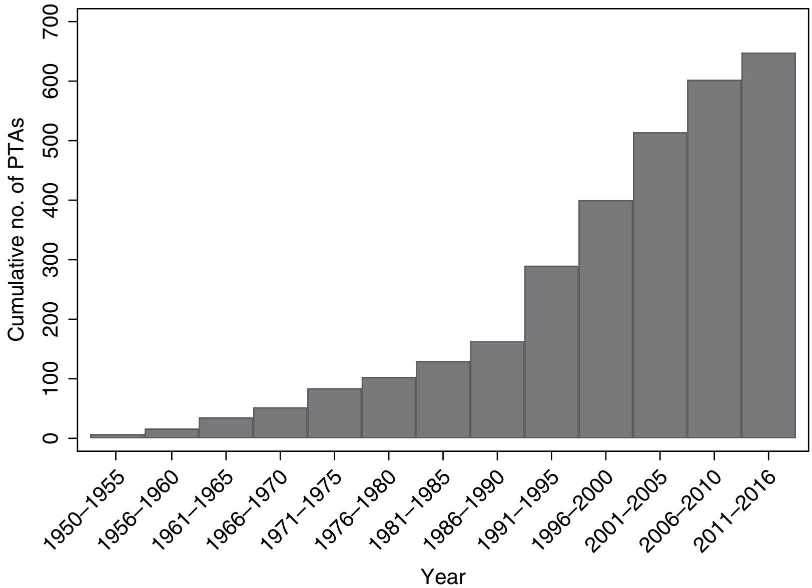

Figure 11.1 Evolution of preferential trade agreements, 1950–2016.
Source: Authors' illustration based on the Design of Trade Agreements (DESTA) database (Dür *et al.*, 2014).

for a substantial share of PTAs. The number of PTAs signed among Asian countries has increased over the past ten years. However, the growth rate of intra-African PTAs has been somewhat stagnant since the early 2000s.

Why do countries sign PTAs?

There is a rich body of research that assesses the economic and political reasons of why countries enter into bilateral, plurilateral and regional PTAs. On the domestic side, governments might join PTAs to accommodate interest groups in the exporting as well as importing industries. Beyond the important role played by these key industries and other interest groups, states' domestic institutions and the type of electoral system have been found to affect a country's interest in joining PTAs (Mansfield and Milner, 2015).

From an international economic perspective, PTA ratification is thought to be motivated by strategic interaction and the competition for market access. As exporters face trade diversion from the exclusion from a PTA concluded by other countries, they push their governments into signing an agreement with the country in which their exports are threatened. This contagion effect accelerates the spread of PTAs known in the literature as the Domino Theory of Regionalism (Baldwin and Jaimovich, 2012; Baldwin, 1993).

Another body of literature suggests that the proliferation of PTAs is related to "slow multilateralism", i.e. the stagnation of the Doha Round, and other shortcomings of the WTO system (Bhagwati, 1993, 2008; Krugman, 1993, 1991). On the one hand, member countries of the WTO may have little incentive to join PTAs because they already benefit from multilateral openness and liberalisation. On the other hand, WTO members might be especially interested in joining PTAs as this may increase their (block) bargaining power at the WTO. A PTA may also allow them to achieve negotiation outcomes that are unlikely to be feasible when being negotiated with a large number of countries with different interests. In fact, a PTA may also serve as a means to discriminate against certain WTO members while being compliant with WTO law. A forth reason, that may gain relevance in these turbulent times, is that countries sign PTAs as an insurance against a faltering WTO system (Mansfield and Milner, 2015; Mansfield and Reinhardt, 2003).

EU and United States at the centre of the spaghetti bowl

The rapid growth of PTAs has resulted in a dense network of partly overlapping (double) PTAs – the so-called spaghetti bowl of trade agreements (Pauwelyn and Alschner, 2014; Figure 11.2). The EU is the leading signatory of PTAs and plays a central role in the global PTA network. Figure 11.2 also illustrates the variability of

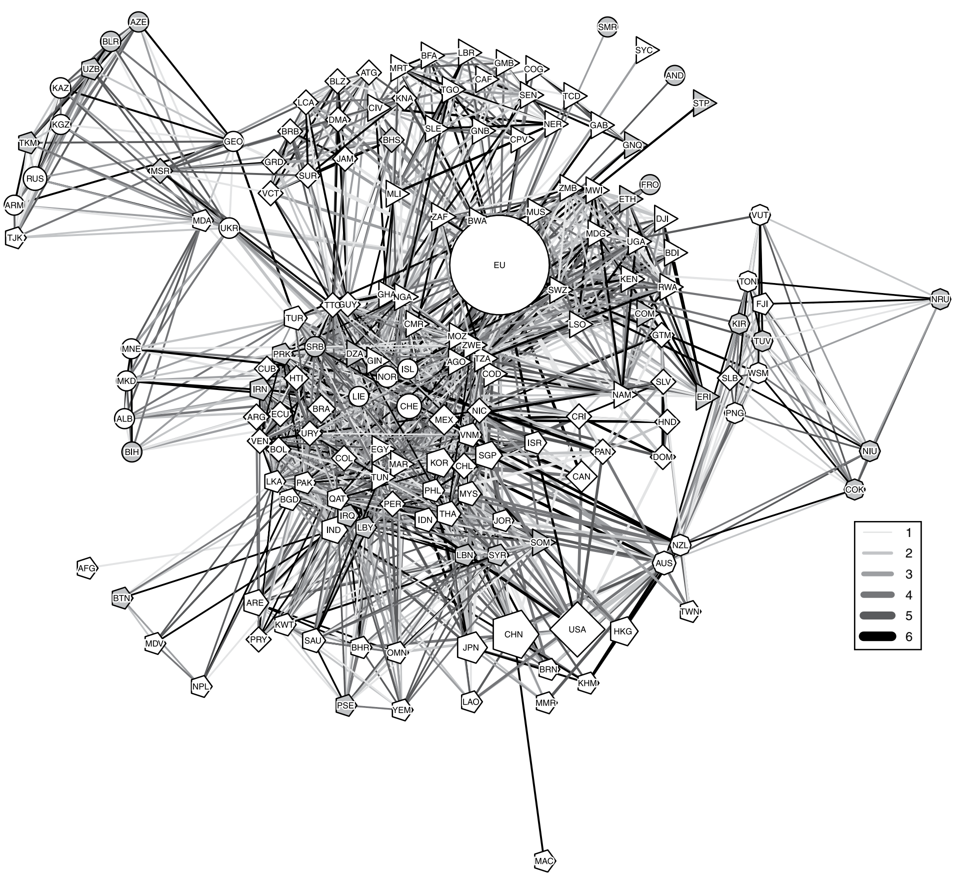

Figure 11.2 Spaghetti bowl of preferential trade agreements, 1950–2016.
Source: Authors' illustration based on the Design of Trade Agreements (DESTA) database (Dür *et al*., 2014) and the World Bank Development Indicators (World Bank, 2018).
Note: The size of each marker is proportional to the country's exports of goods and services (current US$) in 2016. The marker's shape indicates a country's region (Africa – triangle, Americas – square, Asia – pentagon, Europe – circle, Oceania – octagon). The marker's colour indicates a country's WTO membership status (White – WTO member, grey – not WTO member). Thin and grey ties present shallow PTAs, dark and thick ties present deep PTAs.

PTA design in terms of scope and depth. A depth indicator developed by Dür *et al.* (2014) captures the degree of tariff reductions as well as substantive cooperation in areas such as services trade, investments, standards, public procurement, competition and intellectual property rights (IPRs). The result of this work showed that the EU's PTAs have the highest average depth (Hofmann *et al.*, 2017).

The large majority of deep agreements were signed after 1995. Prior to this, less than a quarter of PTAs included substantive provisions on services, investment, IPRs, public procurement, competition, technical barriers to trade (TBT) or sanitary and phytosanitary (SPS) measures. Over the years, this has changed. Now, more than three in four PTAs include substantive provisions on these policy areas. However, regional differences remain. The largest share of PTAs that contain substantive provisions on services and investment is found in the Americas, as reflected in Table 11.1. European agreements lead the way in the other policy areas, including IPR, public procurement, TBT and SPS. Overall, countries seem to put a particular emphasis on these policy areas when signing intercontinental agreements.

PTAs become deeper and more flexible

These regional differences in PTA design are the focus of a growing body of literature. In a recent contribution, Rohini (2016) collects a number of subject-specific studies on: market access provisions (Crawford, 2012), rules of origin (Abreu, 2016), anti-dumping rules (Rey, 2016), safeguard provisions (Crawford *et al.*, 2016), SPS (Jackson and Vitikala, 2016), TBT (Molina and Khoroshavina, 2015), services (Pierre, 2016), IPRs (Valdes and McCann, 2016) and dispute settlement (Chase *et al.*, 2013). It is interesting to note that not only the depth of PTAs has changed over time. As PTAs have become more ambitious, countries have also started to include more flexible measures and op-out clauses which allow them to react to changing domestic conditions or international challenges without leading to a *de jure* breach of an agreement (Baccini, Dür *et al.*, 2015).

In the short run, such flexibility measures mainly include tariff transition periods. Long-term flexibility measures include escape clauses as well as anti-dumping and anti-subsidies provisions. Figure 11.3 illustrates the co-evolution of depth and

Table 11.1 Preferential trade agreements with substantive provisions on different policy areas, by region, 1950–2016

	No. of total PTAs	*Services (%)*	*Investment (%)*	*IPR (%)*	*Procurement (%)*	*Competition (%)*	*TBT (%)*	*SPS (%)*	*Dispute (%)*
Africa	38	21	32	8	0	8	37	32	76
Americas	161	51	60	26	29	17	48	47	80
Asia	82	46	44	28	22	16	45	44	79
Europe	163	48	52	63	64	16	60	75	91
Oceania	7	43	29	0	29	0	29	14	100
Inter-continental	197	63	65	49	52	34	63	68	89

Source: Authors' calculations based on the Design of Trade Agreements (DESTA) database (Dür et al., 2014).

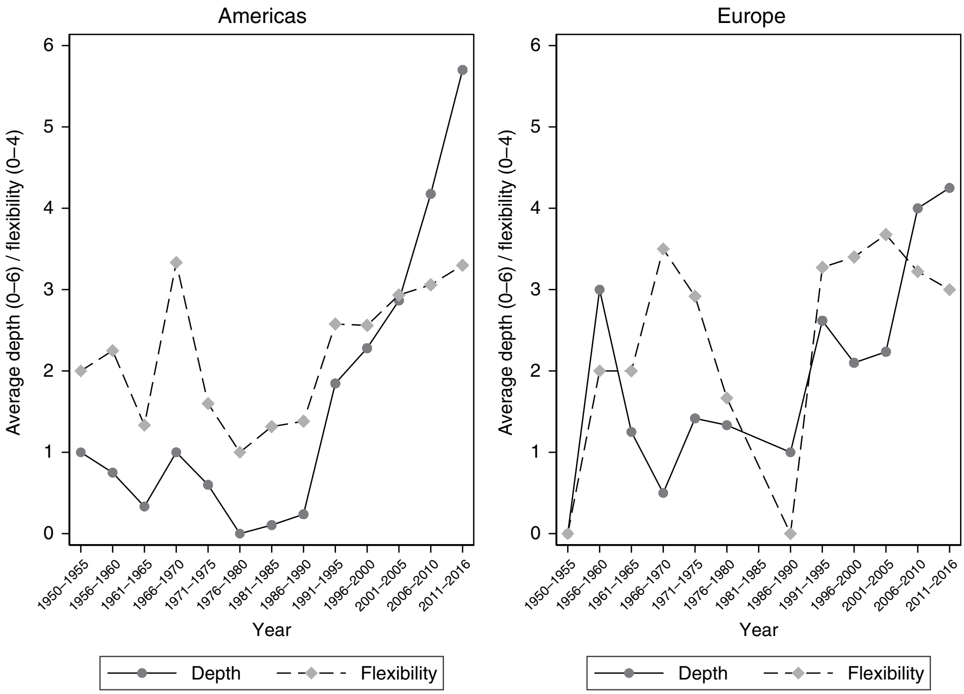

Figure 11.3 Depth and flexibility of preferential trade agreements in the Americas and Europe, 1950–2016.
Source: Authors' illustration based on the Design of Trade Agreements (DESTA) database (Dür *et al.*, 2014).
Note: The depth index ranges between 0 and 6, the flexibility index between 0 and 4.

flexibility in the PTAs signed since 1950, for the Americas and Europe. Both indices have experienced a significant increase since the early 1990s. This is the case across the different regions, albeit the increase is most substantial in PTAs signed among countries in the Americas and Asia as well as across continents.

PTA provisions strongly influenced by WTO legal language

There is a longstanding debate as to whether the proliferation of PTAs is a stepping stone or a stumbling block to multilateralism and the WTO. Some studies regard rising regionalism as a threat to the multilateral trading system (Bhagwati, 2008, 1993; Krugman, 1993, 1991; Winters, 2015). While there continue to be sceptics, much of the more recent literature finds that the relationship between the WTO and PTAs is complementary and dialectical (Lejárraga, 2014; Cottier *et al.*, 2015; Allee *et al.*, 2017a).

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), for instance, grew out of two PTAs: the Paris Convention on the Protection of Industrial Property and the Berne Convention on the Protection of Literary and Artistic Works. The WTO General Agreement on Trade in Services (GATS), in contrast, has not been influenced by previous PTAs but rather had considerable influence on the design and structure of subsequent PTAs (Cottier *et al.*, 2015).

In a comprehensive study of 292 recent PTAs, Allee *et al.* (2017a) examine the WTO–PTA relationship systematically. The authors find that around 90% of PTAs

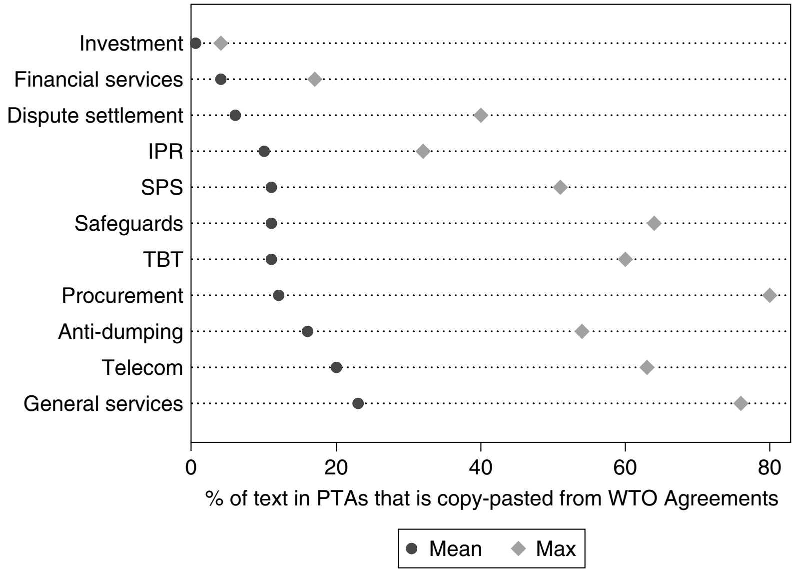

Figure 11.4 Preferential trade agreements and the WTO Agreements.
Source: Authors' illustration based on Allee *et al.* (2017a).

engage the WTO with explicit references and do so across the majority of chapters. A sizeable majority of PTAs that do not explicitly refer to the WTO are PTAs where at least one signatory is not a WTO member. The authors further find that PTAs do not only refer to the WTO – they copy-paste sizeable parts in verbatim. As illustrated in Figure 11.4, this methodology is particularly dominant in PTAs' services chapters. On average, 23% of text is copy-pasted from the GATS. In some instance, more than three quarters of text is adopted.

The Surge of Mega-Regionalism

The WTO and its rules have been influential to the design of PTAs around the globe. Two other initiatives that have significantly shaped the landscape of (mega-) regionalism are the EU and NAFTA. The competitive interdependence of the big trading communities on either side of the Atlantic has characterised trade policies, and trade politics, since the 1950s. The end of the 20th century witnessed the rise of China as a major trading partner, with a market that has the potential to outgrow both the EU and the United States. With the rise of China, the Pacific became the centre of interest for trade flows and deals.

Europe: The European Union

The first steps towards a "European Federation" were made on 18 April 1951 when Belgium, France, Germany, Italy, Luxembourg and the Netherlands signed the Treaty of Paris to establish the European Coal and Steel Community (ECSC). The relevance of steel in the forging of the EU is worth noting, given the current pressures on China to reduce its volume of steel production.

The ECSC came into force on 23 July 1952 with the primary objective to support the modernisation and conversion of the coal and steel sectors. Beyond increasing efficiencies, accelerating the reconstruction process and eliminating discrimination in intra-regional coal trade, the choice of the coal and steel sectors was highly symbolic as the pooling of French and German resources was intended to mark the end of the rivalry between the two nations. The ECSC created a set of institutions including a High Authority, Council, Parliamentary Assembly and Court of Justice, which would ultimately be copied to a significant degree in the later European Communities.

On 25 March 1957, the same six countries signed the Treaty of Rome to set up the European Economic Community (EEC) and the European Atomic Energy Community (EAEC). When the EEC entered into force on 1 January 1958, the European integration project was extended to include general economic cooperation including the elimination of customs duties between member states; the establishment of an external common customs tariff; the introduction of common agricultural (CAP), transport and commercial policies; the creation of a European Social Fund; the establishment of the European Investment Bank and the development of closer relations between the member states.

Ten years after the signing of the Treaty of Rome, the Brussels Treaty (1957) entered into force with the objective to streamline the European institutions. The Treaty created a single Commission and a single Council to serve the then three European Communities of the ECSC, EEC and EAEC.

After the entry into force of the Single European Act in 1987, the Maastricht Treaty (formally the Treaty on the European Union, TEU) of 1993 marked another milestone, as it prepared for the European Monetary Union and introduced elements of a political union in the form of three pillars: common economic, social and environmental policies; common foreign and security policies; and justice and internal affairs. The EEC became the European Community to reflect the fact that the community no longer dealt with economic matters only.

The TEU marked a significant step towards European integration. The Treaty of Amsterdam, which entered into force on 1 May 1999, made further substantial amendments to the TEU. The member states agreed to devolve certain powers from their national governments to the European Parliament, existing EU institutions were reformed in preparation for the arrival of future member countries and a High Representative for EU Foreign Affairs and Security Policy was introduced. The Treaty of Nice (2003) and the Treaty of Lisbon (2009) further reformed the European institutions to enable them to efficiently accommodate the new member states.

Since the Treaty of Rome, the European Communities (and since 1993 the European Union) has expanded both its member states and its external trade and partnership relations. Denmark, Ireland and the United Kingdom joined in 1973, followed by Greece (1981) and Portugal and Spain (1986), as well as Austria, Finland and Sweden (1995). In 2004, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia joined, followed in 2007 by Bulgaria and Romania. With many of the now-member states, the EU had signed PTAs prior to their accession. Since its early days, the EU has also followed an active, and increasingly deeper, PTA policy with other partners around the world (Figure 11.5).

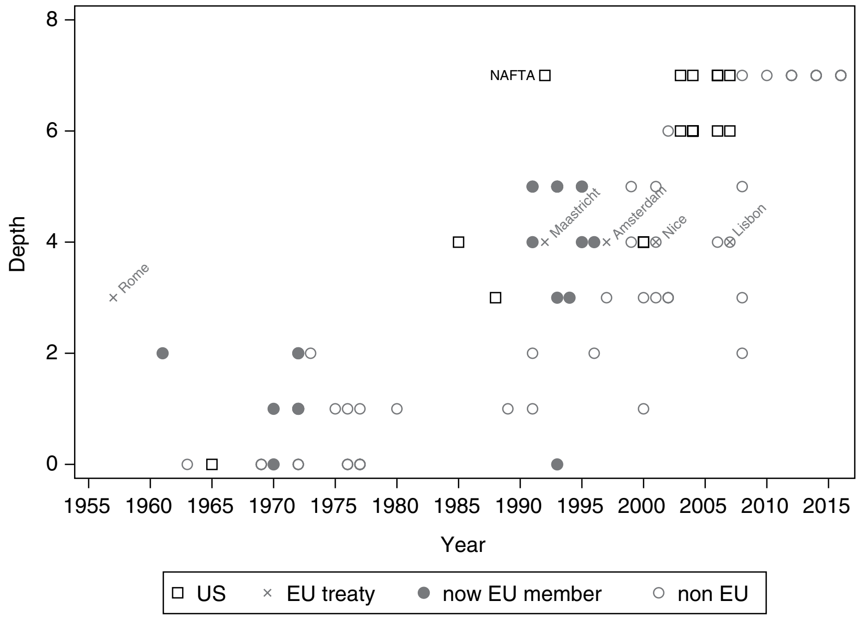

Figure 11.5 Evolution and depth of EU and US preferential trade agreements, 1950–2016.
Source: Authors' illustration based on the Design of Trade Agreements (DESTA) database (Dür *et al.*, 2014).
Note: Filled circles show EU accession treaties. Empty circles show PTAs between the EU and non-EU countries.

The United States was a firm supporter of a tightly integrated post-war Europe. However, the progressing integration and the expansive drive for PTAs with countries all around the world also caused some concern on the other side of the pond.

North America: North American Free Trade Agreement

During the 1960s and early 1970s, three events/policies were particularly relevant to the formulation of US trade policy: the accession of the United Kingdom, Denmark and Ireland to the European Communities; the pursuit of PTAs with the remaining countries of the European Free Trade Association (EFTA); and the PTAs with the Mediterranean countries. The enlargement of the European Community entailed the expansion of the CAP which, in turn, was feared to increase the level of trade barriers to the fifth-largest market for US agricultural products – the United Kingdom. US agriculture exporters were equally concerned about the European Community's PTAs with Israel in 1964 and Spain in 1970 as these agreements were likely to divert trade at the expense of US agriculture exporters. As a reaction to European trade policies, the United States even demanded a "standstill agreement" that would stop the "proliferation" of PTAs beyond Europe as well as the consultations with the EFTA countries (Dür, 2010).

Another major concern of the US administration was the European push towards standardisation, harmonisation and mutual recognition of technical regulations with limited concerns for third-country considerations. The United States hoped to use the WTO Tokyo Round (1973–1979) to achieve an agreement that would allow it to monitor standard-setting in the European Community. The Community, in contrast, attempted to convince the United States to accept international standards. While the parties found some compromise in the Tokyo Agreement of Technical Barriers ("Standards Code"), the different regulatory systems and approaches towards standard-setting continue to be a hot-button issue until this day.

The European Community continued to push for the completion of the internal market. In 1985, it published a white paper that contained some three hundred proposals for the elimination of physical (border formalities, quotas), technical (standards, public procurement rules) and fiscal (taxation) barriers within the Community. Starting in 1987, and gathering speed in 1988 and 1989, the aim was to implement the single market programme (SMP) by 1992.

This big push for further integration did not go unnoticed on the other side of the Atlantic. In fact, the US administration's reaction to the SMP even entailed the setting up of an interagency task force focusing on the external effects of a deeper integrated Europe in 1988. As a response to the US trade deficit with European and other countries, the US Congress also pivoted away from free trade towards fair and strategic trade (Nollen and Quinn, 1987) – terminology that is popular with the current US administration.

On 1 January 1989, CUSTFA entered into force. Influenced by the 1965 Auto Pact, CUSFTA was a comprehensive agreement that provided national treatment; the elimination of tariffs, duty drawbacks and most quantitative restrictions, export taxes and other export measures. It also afforded reciprocal access to government procurement and services, relaxed most foreign investment restrictions and facilitated temporary immigrations entry for business purposes. CUSFTA was an important model for NAFTA, which entered into force on 1 January 1994.

While there are many economic, political and social considerations that led to the decisions of the three countries to sign a North America-wide FTA, it is hard to argue that the accelerating integration of the EU did not play a part. As pointed out by Schott (2004), NAFTA was also a way for the United States to convince its recalcitrant GATT partners, and in particular the EU, to resurrect the then stalled WTO Uruguay Round by demonstrating that the United States was prepared to achieve freer trade through regional agreements if it proved impossible to do so multilaterally in Geneva.

With its 22 chapters and economic size, NAFTA is often regarded as the first comprehensive mega-regional PTA. Of course, the regional integration efforts in North America did not go unnoticed in the EU either. In the years immediately after NAFTA's entry into force in 1994, EU trade with Mexico declined significantly, from 10.6% of Mexico's total trade in 1991 to 6.5% in 1999 (Gantz, 2009). The EU's response to NAFTA was clear-cut. Pierre Defraigne, then Deputy Director-General in the Commission's Directorate-General for Trade, stated the dynamic clearly:

> In order not to be evicted from the NAFTA market, the EU immediately started a FTA negotiation with Mexico. (Defraigne, 2002)

As illustrated in Figure 11.5, in the subsequent years the EU and the United States engaged in a race for increasingly deep PTAs, partly in a tit-for-tat manner. For instance, the EU signed a PTA with Mexico six years after NAFTA while the United States signed a PTA with Jordan, only three years after the EU did. The United States and the EU were also simultaneously negotiating with Chile, resulting in an EU–Chile PTA in 2002 and a US–Chile PTA in 2003. After the United States signed PTAs with Colombia and Peru in 2006, the EU signed a PTA with the two countries in 2012. Similarly, the EU signed a PTA with the Republic of Korea in 2010, only three years after the United States did.

The EU and NAFTA: Templates for (Mega-) Regionalism

Signing PTAs with countries and regions all over the world is driven by economic, social and political considerations. No doubt, preferential market access plays an important role. However, for trade heavyweights such as the United States and the EU, signing PTAs is also a way of strategically diffusing their regulatory systems and shaping the design of future regional integration initiatives.

Both the European model and the NAFTA model have become templates for subsequent PTAs (in many of which the EU or United States were not signatories) and therefore directly and indirectly shaped the evolution of regionalism over the years (Baccini, Haftel *et al.*, 2015). The EU presents an institutions-based integration model in which powerful bodies and institutions are created to reinforce the integration process. These agreements tend to cover non-trade issues, but the legal language is kept relatively vague and leaves it to the created institutions to enforce the commitments. The NAFTA model, by contrast, promotes rules-based integration. Trade and non-trade commitments as well as their enforcement are more precisely formulated, which limits the need to create further institutions.

Based on a cluster analysis on almost 600 PTAs and their provisions on services, investment, IPRs, public procurement, competition, TBT, SPS measures and dispute settlement, Baccini, Haftel *et al.* (2015) identified a clear pattern. Whether a PTA is closer to the EU or the NAFTA model is found to be influenced by the PTA signatories' political relationship with the EU and the United States, respectively. Furthermore, the choice between the templates depends on the nature and objective of the PTA to be signed. Plurilateral agreements that aim to integrate a number of markets, such as for instance the Central American Common Market (CACM), the Caribbean Community (CARICOM), the Andean Community and the Economic and Monetary Community of Central Africa, are closer to the EU than to the NAFTA model. Many of the bilateral agreements, in particular those signed by the United States, Chile, Japan and Mexico, show significant parallels to NAFTA.

Despite its impact on the world of bilateral, plurilateral and regional PTAs, NAFTA has become the focus of criticism – including within the US administration. On 18 May 2017, the United States began renegotiating NAFTA with the primary objective to eliminate the country's trade deficit with its northern and southern neighbours. On 30 November 2018, the NAFTA parties signed the United States–Mexico–Canada Agreement (USMCA), sometimes referred to as NAFTA 2.0.

Transpacific: Trans-Pacific Partnership (TPP)

The 1990s were an eventful time for trade policy – the WTO Uruguay Round was concluded and NAFTA established. At the same time, the leaders of the Asia-Pacific Economic Cooperation (APEC) signed the Bogor Declaration (1994) calling for free trade in the Pacific region by 2020. China became a WTO member in 2001. At the time, it was the world's fourth-largest merchandise exporter. A few years later it had risen to number two, behind the EU and ahead of Japan and the United States.

In October 2015, 12 Pacific-Rim countries signed the Trans-Pacific Partnership (TPP). The TPP originally evolved out of the Trans-Pacific Strategic Economic Partnership Agreement by New Zealand, Singapore, Chile and Brunei in 2005. The United States, Australia, Peru and Vietnam joined the talks in 2008, followed by Malaysia in 2010 and Canada and Mexico in 2012. Japan was the last country to join the TPP negotiations, in 2013.

Given its geographic and economic scope, the TPP presented a mega-regional PTA that could have become a new standard for future trade negotiations at the plurilateral or even multilateral level. Therefore, the country or the countries that had the greatest hand in writing the TPP could see their influence magnified if the contents of the TPP become the standard legal text and spread into future agreements. The United States clearly saw the TPP through this lens, as its then President Barack Obama stated in the 2 May 2017 issue of the *Washington Post*:

> The world has changed. The rules are changing with it. The United States, not countries like China, should write them. (McGlone, 2017)

Allee and Lugg (2016) look at the 74 previous PTAs that TPP members have signed and calculate the share of text copied into the final TPP draft. NAFTA plays a surprisingly small role. This is not to say that the United States did not rely on previous PTAs though. In fact, Allee and Lugg (2016) find that the language of previous US PTAs is disproportionally prominent in the TPP compared to other TPP drafters' past PTAs. Ten of the PTAs that match the TPP most closely are previous US PTAs. Some bilateral PTAs, such as, for instance, those with Bahrain, Oman and South Korea, have almost half of their contents copied into the TPP.

This becomes even more evident when zooming into the different issue areas (see Figure 11.6). For instance, on average 80% of the investment chapter is copied from previous PTAs, and 88% of the investment chapter corresponds to the investment chapter of the US–Oman PTA. Figure 11.6 illustrates that the TPP relies strongly on previous PTAs among the member states and that the treaty is to a large extent "Made in America", as proclaimed by US authorities in 2016.

Despite the influential role of the United States in shaping the TPP and potentially future regional trade initiatives, the Trump administration decided to withdraw from the agreement on 23 January 2017. The 11 remaining members reached a partial agreement on 11 November 2017 for a Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

Transatlantic: CETA and TTIP

With the United States' trade negotiation activity turning towards the Pacific, the EU made further efforts to intensify its ties across the Atlantic. Negotiations with Canada on a Comprehensive Economic and Trade Agreement (CETA) started in 2009 and CETA was signed in 2016. The idea of a free trade agreement between the United States and the EU had been discussed since the 1990s but formal

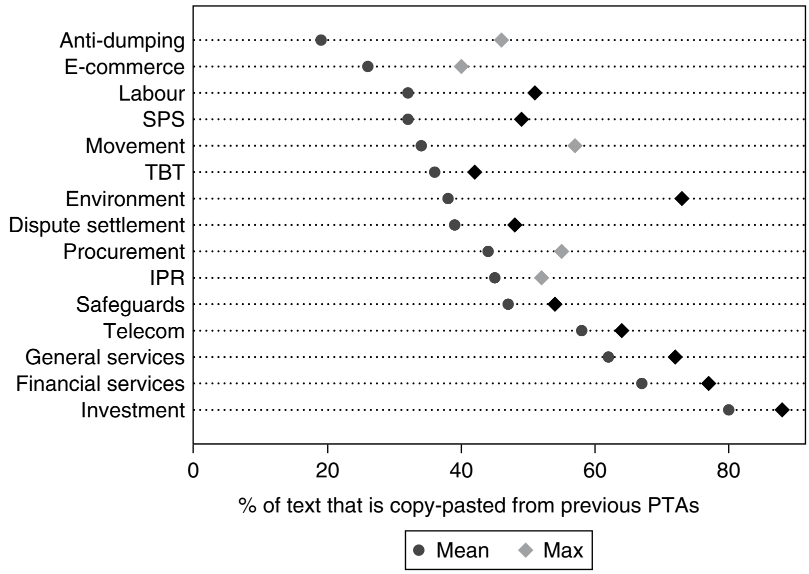

Figure 11.6 Trans-Pacific Partnership and previous preferential trade agreements.
Source: Authors' illustration based on Allee and Lugg (2016). The marker is black if this maximum amount of text was copied from a previous US PTA and grey if it was copied from a previous PTA of another TPP member.

negotiations on the so-called Transatlantic Trade and Investment Partnership (TTIP) between the United States and the EU only started in 2013. They were put on halt again in 2016.

Both the CETA and the TTIP agreements had the ambition to be innovative models for future trade deals. Only the future will tell whether this will be the case. What is clear already, however, is that neither agreement was drafted in a void and both do rely, to varying degrees, on legal text from previous agreements. In the case of CETA, Allee *et al.* (2017b) find that the agreement is indeed more forward-looking than backward-looking, and that relatively little of its treaty text is recycled from past trade agreements – certainly when compared to the TPP. As illustrated in Figure 11.7, this varies by issue area, and there are exceptions. In the case of the procurement chapter, for instance, 79% of the text was adopted from the EU–Singapore agreement.

Similar to CETA, TTIP was envisaged to become a template for future trade agreements and therefore a shaping factor for the future of regionalism. A comprehensive study on TTIP does not exist as the negotiations were stalled before a common draft was reached. However, Elsig and Klotz (2019) rely on the US and EU draft proposals to assess the extent to which the two parties rely on previous agreements when designing their TBT and SPS chapters. For both issue areas, the authors find that the US negotiators rely, on average, more on their previous PTAs than the EU negotiators. Interestingly, the TPP plays a fairly limited role in the US draft proposal for TTIP, even though it is an agreement largely written by the United States. In contrast, the European draft proposals for the TBT and SPS chapters of TTIP rely heavily on CETA text (Figure 11.8 and Figure 11.9).

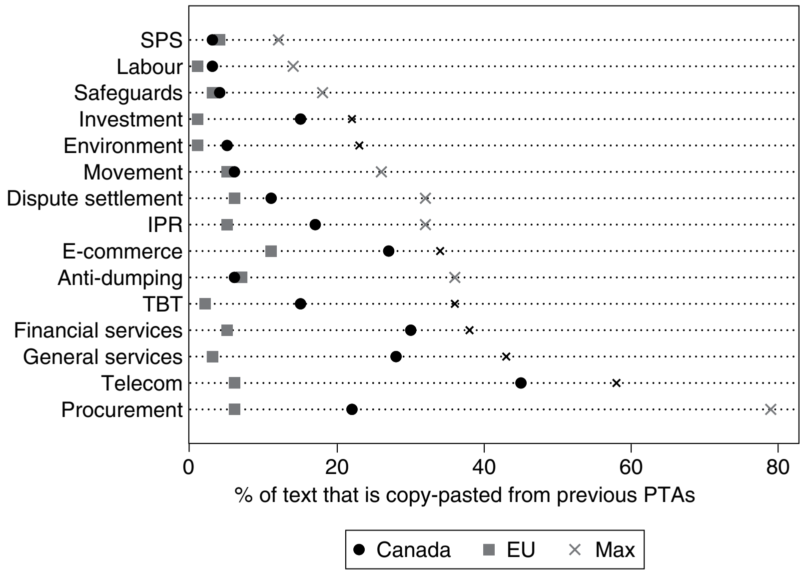

Figure 11.7 Comprehensive Economic and Trade Agreement and previous EU and Canadian preferential trade agreements.
Source: Authors' illustration based on Allee *et al.* (2017b).
Note: Max shows the maximum amount of text copied from a previous PTA. The marker is black if this maximum amount of text was copied from a previous Canadian PTA and grey if it was copied from a previous EU PTA.

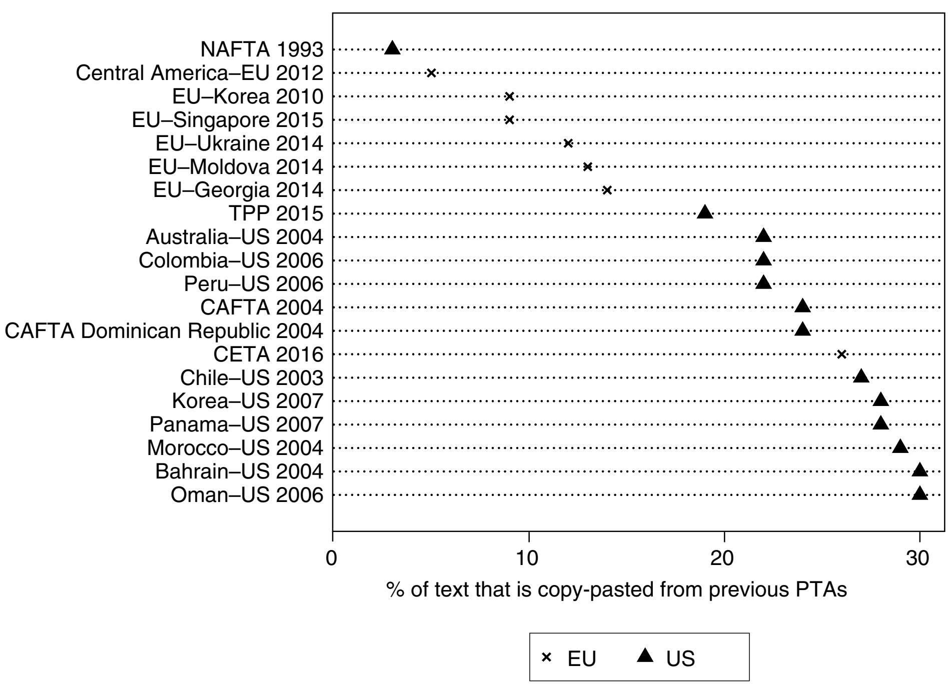

Figure 11.8 TBT in EU and US draft proposals for the Transatlantic Trade and Investment Partnership (TTIP).
Source: Authors' illustration based on Elsig and Klotz (2019).

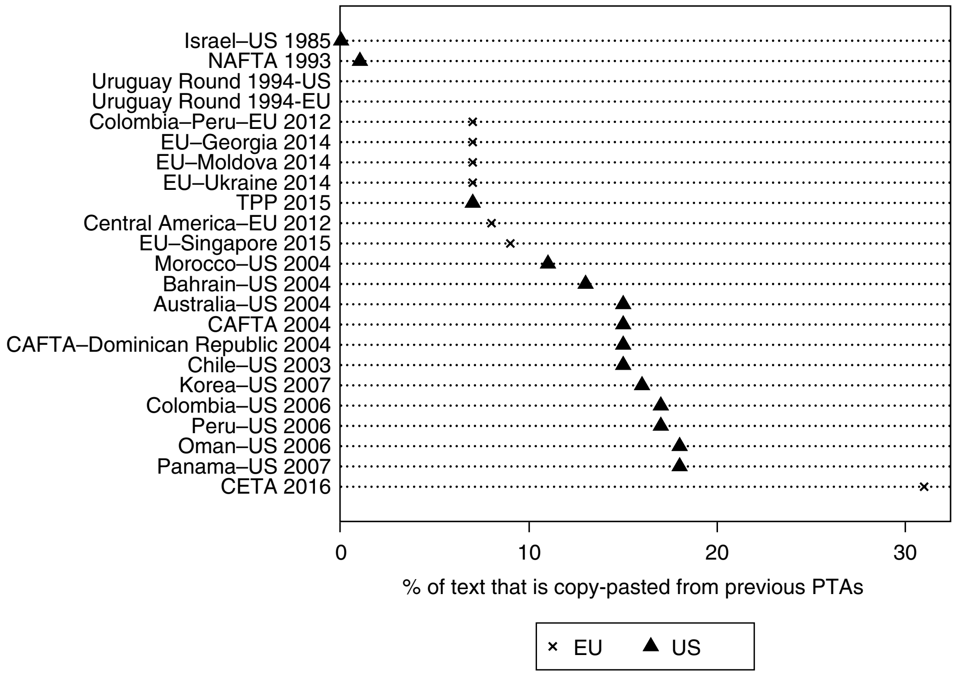

Figure 11.9 SPS in EU and US draft proposals for the Transatlantic Trade and Investment Partnership.
Source: Authors' illustration based on Elsig and Klotz (2019).

Asia and beyond: Belt and Road Initiative

The previous section illustrates that recent years have experienced the rise of mega-regionals on either side of the Atlantic as well as the Pacific. Beyond this, new forms of mega-regionalism are evolving – the most prominent one is the Belt and Road Initiative that has been undertaken on the initiative of China.

Like the EU and the United States, China has been actively negotiating PTAs, and several have been ratified since China's entry in the WTO. A preliminary textual analysis confirms that earlier EU and US PTAs are also influential to the design of Chinese PTAs (Figure 11.10). US PTAs had a stronger influence on China's PTAs with Anglo-Saxon countries like Australia and New Zealand and its PTAs with Latin American countries like Chile and Costa Rica. The influence of EU PTAs, instead, is stronger in China's PTAs with the EFTA countries Iceland and Switzerland, but also with the Eastern European country Georgia and with the Asian country Korea. China borrowed significantly from the EU PTA with Korea (2010) when it designed its own agreement with Korea in 2015. While not shown in Figure 11.10, the textual analysis of Chinese PTAs also indicates that the Europeans adopted considerable parts of Chinese PTAs when designing their agreements with Vietnam (2016) and Singapore (2018).

One of the most striking aspects of regional integration as pursued by China is, however, that the focus may not be on designing joint rule books. China's best known and by far most ambitious initiative, the Belt and Road Initiative (BRI), is an ambitious plan for greater regional integration without predefined rules. Representing a political vision to foster cooperation and connectivity between China and BRI

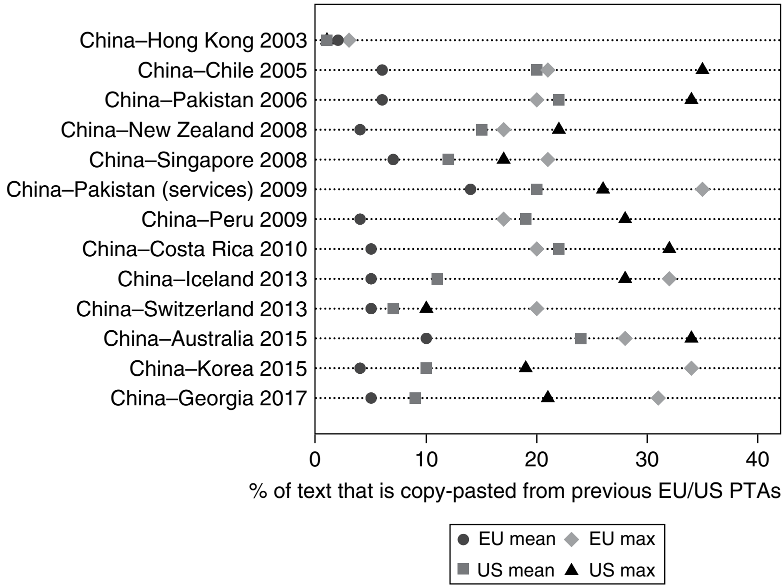

Figure 11.10 Chinese and previous EU and US preferential trade agreements.
Source: Authors' calculation and illustration based on PTAs identified in the Design of Trade Agreements (DESTA) database (Dür *et al.*, 2014).

members, the initiative is different from conventional trade agreements or regional cooperation mechanisms (International Trade Centre [ITC], 2017). The emphasis is on strengthening physical infrastructure (railways, ports, energy pipelines and special trade zones) as well as soft infrastructure (such as institutional foundations for trade and investment flows, i.e. easing customs processes). While the BRI is not a free trade agreement, the expansion of infrastructure, finance and information technology (IT) links across countries is likely to facilitate trade further, provided that soft (regulatory) infrastructure is upgraded simultaneously with hard (physical) infrastructure.

Invoking historical imagery of ancient China's naval expeditions and trading routes, the BRI aims to establish two new routes. The land-based "Silk Road Economic Belt" links: China and Europe *via* Central Asia and Russia, and China and the Middle East *via* Central Asia. The sea-based "Maritime Silk Road" connects China with Southeast Asia, the Middle East, Europe and Africa (Figure 11.11).

China's President Xi Jinping unveiled the initiative in 2013 during his visits to Central Asia and the Association of Southeast Asian Nations (ASEAN), and in 2015, China's National Development and Reform Commission (NDRC), Ministry of Foreign Affairs and Ministry of Commerce jointly issued the Vision and Actions Plan on the BRI.

The BRI can potentially enhance interconnectivity in a geographical area accounting for roughly 70% of the world's population, 55% of world's gross domestic product (GDP) and 75% of known energy reserves. However, the geographic composition of BRI has not been clearly defined. Any country with an interest in the initiative can potentially join it. This contrasts sharply with existing treaty-based integration efforts, where the geographical scope, partner countries, strategy, principles and rules were clearly defined at the outset.

Figure 11.11 Routes of the Belt and Road Initiative.
Source: *The Economist* (2017).

The BRI calls for a massive infrastructure push to enhance the connectivity among the countries on the proposed Belt and Road routes. It aims to deliver greater energy and power interconnections as well as a more secure and efficient network of land, sea and air passages across the key routes. Its influence is already evident in China's overseas investment flows, with investment related to the BRI rising twice as fast as total outward foreign direct investment (FDI) in 2015.

According to the China Development Bank, some 900 projects at an estimated cost of US$890 billion are currently under way or planned. For instance, in January 2017, the first direct train from China to the United Kingdom arrived in London carrying 44 containers of clothes and consumer goods. It took 15 days to travel 12,000 km across ten countries, half the time it would have taken by sea.

China and its neighbouring countries have an urgent need for basic infrastructure. Data from the Asian Development Bank (ADB) show that Developing Asia will need to invest US$26 trillion from 2016 to 2030, or US$1.7 trillion per year, to maintain its rapid growth and respond to climate change. Of the total investment needs over the period, US$14.7 trillion will be for power, US$8.4 trillion for transport, US$2.3 trillion for telecommunications and US$800 billion for water and sanitation. The Asia-Pacific region's infrastructure investment gap is estimated to equal 2.4% of projected GDP in 2016–2020, with the gap at 5% of projected GDP if China is excluded.

A number of government and multilateral funds were created recently to reduce this funding gap and finance Silk Road projects, although some of these are not exclusively directed towards the BRI. They include: the Asian Infrastructure

Investment Bank (AIIB) with a capital stock of US$100 billion; the US$100 billion BRICS New Development Bank and the US$40 billion Silk Road Infrastructure Fund (SRF); China Development Bank, with a capital stock of US$16.3 billion; ASEAN Infrastructure Connectivity Fund, with a capital stock of US$20 billion; and Maritime Silk Road Bank with a capital stock of US$810 million. The Export-Import Bank of China is also expected to make major contributions – it lent more than US$80 billion in 2015.

But even taken together, these official and multilateral financing channels will not be able to meet the funding needs of BRI projects and, more broadly, bridge the investment gap in the Asia-Pacific region. Hence, it is critical to facilitate participation of the private sector and institutional investors, such as international pension funds, insurers and sovereign wealth funds, to complement public funds. Challenges for investors in the BRI will be as diverse as the BRI countries covered by the initiative, which range from Singapore to Syria.

According to its vision document, the BRI initiative goes beyond infrastructure to include closer coordination of economic development policies, harmonising technical standards, removing investment and trade barriers, establishing free trade areas and deepening financial integration. Although it remains to be seen how the BRI will evolve, it is already clear that it represents a new approach towards regional trade integration as it appears to prioritise the reduction of transport costs over the reduction of transactional costs like those related to tariffs.

New Players, Shifting Priorities?

The second half of the 20th century has been characterised by a high level of activity in designing multilateral and preferential trade rules, driven by the WTO and also by the two major trading powers of the period: the EU and the United States. One important difference between the EU and US approaches to integration is the way in which their agreements deal with behind-the-border measures. The EU approach puts a stronger emphasis on harmonisation and mutual recognition of standards and regulations than the US approach. The creation of joint bodies or institutions also plays an important role in the EU approach towards integration. In their respective PTAs, the EU and the United States have sought (and often succeeded) to transmit their preferred approaches to integration.

The rise of China has significantly, if not entirely, upset this race for influence and market access between the EU and the United States, a race that was still ongoing but taking place in a rather friendly manner and following a well-understood script. China has upset this race in at least two ways: by representing a third global power that is seeking influence and market access through PTAs, and by giving an entirely new importance to infrastructure investments thus upsetting the script that the EU and the United States were used to.

New Themes: Preferential Trade Agreements in the Driver Seat

The 11th Ministerial Conference of the WTO in Buenos Aires took place 16 years after the start of the Doha Round of negotiations. No significant progress has been made to conclude that round. Yet the world of trade continues to evolve, and policymakers need to find ways to deal with these changes. Two changes are of particular importance in this context: the rapid development of the digital economy, and the recognition that trade, investment and other financial flows are much more intertwined than originally expected.

The rise of the digital economy confronts trade policymakers with fundamental and often new questions regarding the borders between merchandise and services trade, the nature of data flows and the technologies, regulations required to protect individual consumers and also the security of nations. The dazzling speed at which the digital economy evolves stands in stark contrast with the slowness of multilateral trade negotiations.

The gradual opening of markets for trade flows after World War II was accompanied, at the end of the 20th century, by a rapid opening of markets for capital flows. One of the results was the increased role of value chain trade that for many industrialised countries now represents two thirds of all trade. With trade liberalisation at the multilateral level, investment through a myriad of BITs and taxation still being a matter of purely national rules, governments ended up losing the ability to tax large chunks of capital. This became painfully clear in the aftermath of the Global Financial Crisis when state funding was needed to intervene in a recessionary economic environment. Governments needed to act rapidly in the context of a slow-moving multilateral trading system that has no clear mandate for either investment or taxation.

The 11th Ministerial Conference of the WTO witnessed the introduction of the themes "e-commerce" and "investment facilitation" in the WTO agenda, but in an ambiguous and explicitly plurilateral way. Rule setting has in the meantime progressed but in different forums. New legal language for e-commerce and digital trade is emerging in bilateral and regional agreements, supported by active and innovative unilateral rule-making in this area. The investment theme has been brought into numerous integration agreements as a separate chapter, and international collaboration on tax rules has progressed rapidly through G20 (Group of Twenty) initiatives and at the Organisation for Economic Co-operation and Development (OECD) level.

Investment

Trade and investment are the drivers of the global economy. The share of trade in GDP has steadily increased from 13% in 1970 to 29% in 2016. The growth of net investment outflows as a share of GDP is much more volatile (see Figure 11.12). While foreign investment accounts for a smaller share of GDP, it has been growing six times as fast as income and two times as fast as trade (van Marrewijk, 2017). The increase in global investment flows has been accompanied by a rise in regulatory initiatives to protect foreign investors.

The bumpy multilateral road

Although the 1948 Havana Charter already recognised the relationship between trade and investment and encouraged work on multilateral rules for FDI, it took the multilateral system until 1994 to agree on an international set of rules. The 1994 Uruguay Round Agreement contains two legal texts dealing explicitly with investment: the Agreement on Trade Related Investment Measures (TRIMS) and the

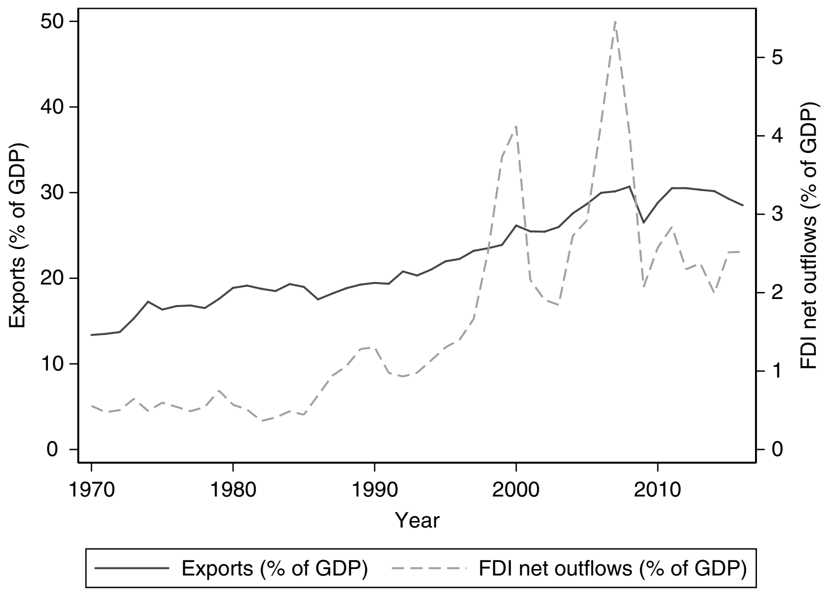

Figure 11.12 Evolution of exports and outward foreign direct investment, 1970–2016. Source: Authors' illustration based on the World Bank Indicators database (World Bank, 2018).

GATS. The latter, however, only concerns investment in the field of services as it falls under the GATS concept of "mode 3 services trade" (services trade through commercial presence). Furthermore, TRIPS is of relevance for investment.

It appeared clear from the outset that this set of rules may not be sufficient, and 1995 witnessed the start of negotiations on a Multilateral Agreement on Investment (MAI) under the auspices of the OECD. The MAI draft text, however, became subject to widespread criticism, in particular from civil society, and negotiations were stopped in 1998. In 2017, investment found its way back on the WTO agenda. At the 11th Ministerial Conference in Buenos Aires, 70 WTO members, recognising the links between investment, trade and development, announced plans to pursue structured discussions with the aim of developing a multilateral framework on investment facilitation.

International rules for investment: going bilateral

BITs began to mushroom in the early 1990s. For developing countries, BITs were a way to attract investment. Investors from developed countries used BITs to seek protection for their investments in foreign countries. More recently, developing countries also regard BITs as a way to protect their regulatory policy space from international arbitration excesses (Forere, 2017). The historical nature and purpose of BITs also explains why the vast majority of BITs are signed between countries from different continents. Over the past three decades, more than 6000 BITs have been signed and resulted in a dense, intricate network in which Germany, China, Switzerland, the United Kingdom and France play central roles (see Figure 11.13 and Figure 11.14).

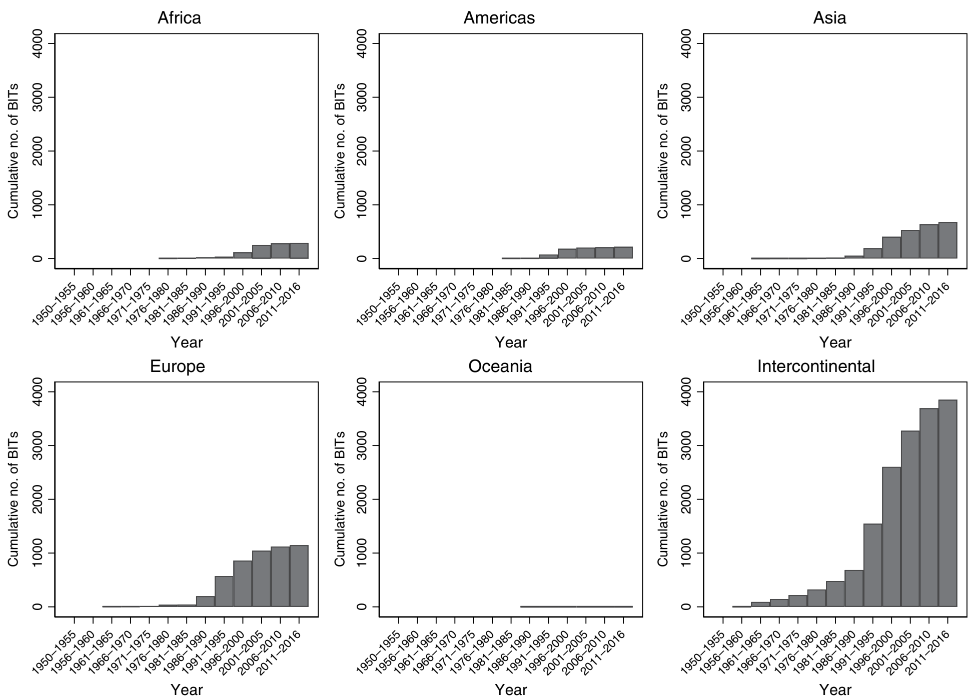

Figure 11.13 Evolution of bilateral investment treaties by region, 1950–2016.
Source: Authors' illustration based on the UNCTAD International Investment Agreement database (UNCTAD, n.d.).

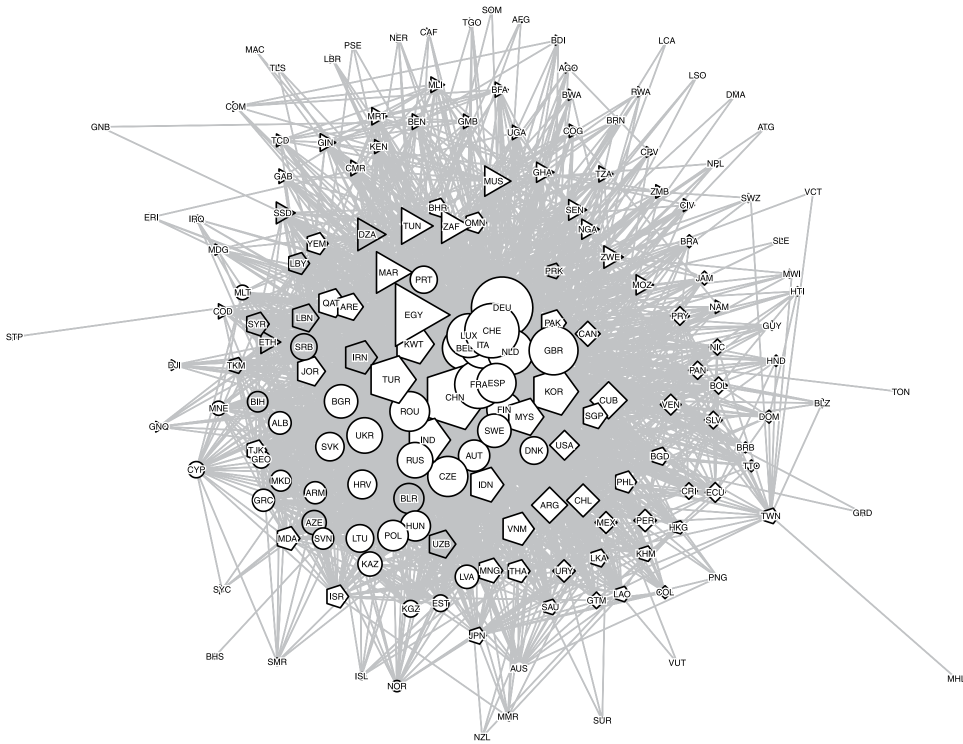

Figure 11.14 Network of bilateral investment treaties, 1950–2016.
Source: Authors' illustration based on the UNCTAD International Investment Agreement database (UNCTAD, n.d.).
Note: The size of each marker represents the total number of a country's bilateral investment treaties. The marker's shape indicates a country's region (Africa – triangle, Americas – square, Asia – pentagon, Europe – circle, Oceania – octagon). The marker's colour indicates a country's WTO membership status (White – WTO member, grey – not WTO member).

Investment chapters in preferential trade agreements

More and more, however, bilateral investment is also governed in PTAs. As illustrated in Figure 11.15, investment chapters that go beyond the governance of services have increasingly been included in trade agreements since the early 2000. In recent years, almost 75% of trade agreements have included an investment chapter that goes beyond services. Only a minority of agreements are explicitly based on existing BITs. Evidence suggests that the inclusion of investment and trade provisions under one legal umbrella is beneficial for the country receiving FDI inflows as it supports domestic value addition to trade within international value chains (ITC, 2017).

The large majority (more than 70%) of these agreements grants MFN and national treatment (NT) for foreign investments. Around half of recent agreements still include explicit restrictions on the temporary movement of businesses and natural people. Similarly, most of the PTAs that include investment chapters also include an investor–state, and increasingly state–state, dispute settlement mechanism. Maybe surprisingly, only a low share of less than 10% of recent PTAs includes an explicit reference to TRIMs.

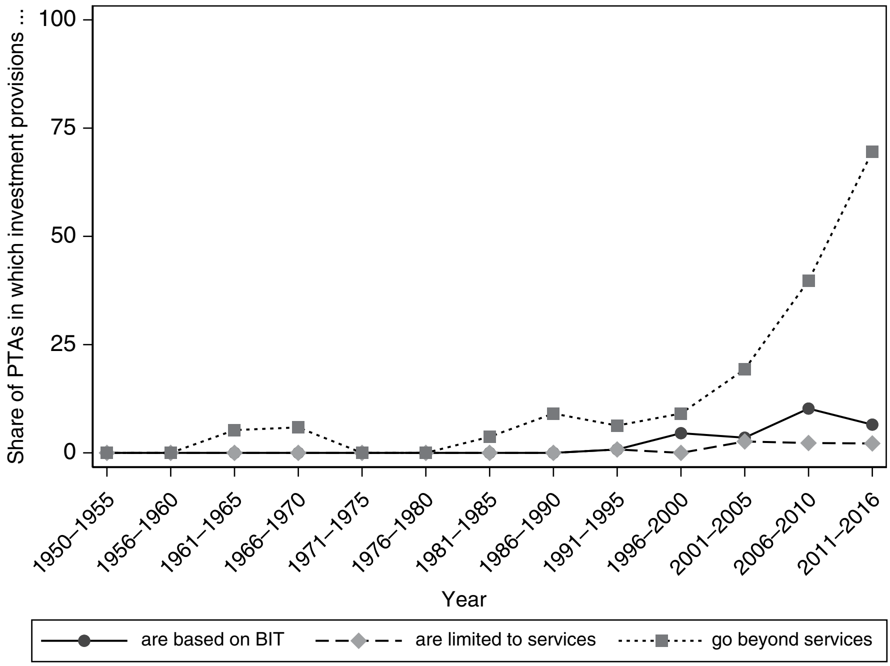

Figure 11.15 Investment provisions in preferential trade agreements, 1950–2016.
Source: Authors' illustration based on the Design of Trade Agreements (DESTA) database (Dür et al., 2014).

Taxation

Taxation of business: bilateral agreements

Double taxation treaties (DTTs), which prevent excessive or double taxation of multinational companies, also affect trade flows. DTTs have emerged as international legal instruments concluded between two or more countries primarily to relieve juridical double taxation, considered one of the most visible obstacles to FDI (Egger *et al.*, 2006).

Double taxation is when two or more countries levy tax on the same declared income. In such cases, a multinational company pays tax on the same corporate income twice, in two different countries – once to the tax authorities of the foreign country which is host to the economic activity, and once to the tax authorities of the home country, where the parent company is headquartered.

Bilateral DTTs, now totalling more than 3000 worldwide, have remained outside of the network of PTAs and mega-regional trade pacts (Hufbauer and Moran, 2015). Only half of DTT relationships are also covered by a BIT (UNCTAD, 2015). Mirroring the spread of BITs around the world (Neumayer and Spess, 2005), DTTs first grew quickly between developed countries and then expanded in the 1980s and 1990s to accords between developing and developed countries. By 2008, these accounted for more than 50% of DTTs signed (UNCTAD, 2009).

Most bilateral DTTs are based on either United Nations or OECD Model Tax Conventions, thus the WTO plays no substantial role in this area. In practice, DTTs can mitigate legal and fiscal uncertainty for foreign investors about how overseas profits from their investments will be taxed (Neumayer, 2007). Yet, the evidence on whether DTTs actually affect FDI turns out to be mixed (IMF, 2014). There are growing fears, however, that DTTs will lead to major tax revenue losses, especially for developing countries. Moreover, the complex network of DTTs at a global level may offer the opportunity for multinational companies to avoid taxes.

Moving towards multilateral solutions

One aspect that opens doors to tax evasion is related to the fact that tax authorities do not necessarily know which assets tax payers hold in different jurisdictions. Concerns about this lack of transparency led to the creation of the Global Forum on Transparency and Exchange of Information for Tax Purposes in 2000. The Global Forum has a self-standing dedicated Secretariat, based in the OECD Centre for Tax Policy and Administration. The Global Forum has notably supported the creation of the Common Reporting Standard (CRS), developed in response to the G20 request and approved by the OECD Council in 2014. The CRS calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis.

Even in the case of full transparency, tax differences across countries provide multinationals with an arbitrage opportunity allowing them to minimise tax payments. While there are many ways in which firms can shift profits to low-tax locations, the use of internal, or transfer, prices is seen as one of the most significant (OECD, 2012). This is

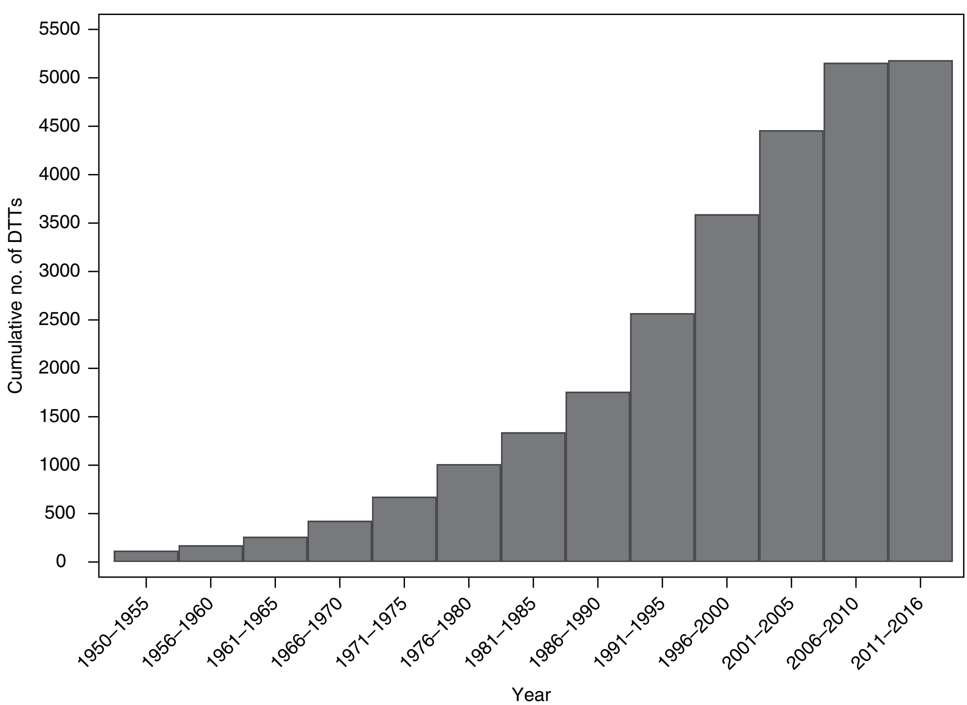

Figure 11.16 Evolution of double taxation treaties, 1950–2016.
Source: Authors' illustration based on the UNCTAD Investment Policy Hub database (UNCTAD, n.d.).

achieved by having an affiliate in a low-tax location charge high transfer prices for what it sells to an affiliate in a high-tax jurisdiction – in essence, inflating revenues where taxes are low and costs where taxes are high (Davies *et al.*, 2018). Such behaviour need not be illegal, yet the result is that profits are artificially shifted towards low-tax locations.

A multilateral legal platform for the taxation of transnational corporations' income is currently being explored by the OECD's Base Erosion and Profit Sharing (BEPS) Project and upon initiative of the G20 (OECD, 2013). In June 2017, over 70 countries signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. The so-called Multilateral Instrument (MLI) includes signatories from all continents and all levels of development. The MLI offers concrete solutions for governments to close the gaps in existing international tax rules by applying the results from the OECD/G20 BEPS Project into bilateral tax treaties worldwide. The MLI modifies the application of thousands of bilateral tax treaties concluded to eliminate double taxation.

Digital Trade

As discussed by Gröning, de la Rubia and Straubhaar in Chapter 3 of this Handbook, the digital economy is an increasingly important part of world trade. As early as 1998, the WTO adopted a first definition of the related term, "electronic commerce", understood as the "production, distribution, marketing, sale or delivery of goods and services by electronic means" (World Trade Organization, 1998). Twenty years on, there is consensus that digital trade encompasses digitally enabled transactions in trade in goods and services which can be either digitally or physically delivered, and which involve consumers, firms or governments (González and Jouanjean, 2017).

The liberalisation of digital trade presents similar challenges for policymakers who want to increase the benefits from trade whilst maintaining the possibility to pursue "other legitimate policy objectives". One particularity of digital trade is that the national and international rule books have to be designed from scratch. Whilst regulations in areas such as food safety have sometimes existed for over 500 years, rules to guarantee public security, enforcement of national law, national security, privacy, consumer protection and freedom of speech in the context of free data flows have often been designed from scratch. The risk of designing regulations that act as protectionist barriers is therefore real. At the same time, serious gaps in national and individual protection (at commercial, physical health and private levels) can arise, if regulation is absent or too weak.

Multilateral initiatives: early start, slow progress

As the key policy player in modern global trade, the WTO has established a system of agreements regulating international trade. To differing degrees, these treaties also extend to digital trade. The GATT, the GATS and its Annex on telecommunications services, TRIPS and the Information Technology Agreement (ITA) as well as its subsequent extension at the Nairobi Ministerial Conference (ITA-II) are the major treaties that are relevant to the governance of digital trade.

The WTO Work Programme on Electronic Commerce, established in 1998, sets out responsibilities for WTO bodies in e-commerce-related areas. While the latest initiative of the WTO, the Trade Facilitation Agreement (TFA) promotes electronic procedures to facilitate trade, it does not include e-commerce as an explicit part of the WTO negotiations on trade facilitation.

There are a number of challenges the WTO faces with regards to the governance of digital trade, including challenges regarding definitions (e.g. Fleuter, 2016) and challenges regarding classifications (e.g. Wu, 2017). In addition to this, a myriad of challenges need to be addressed in order to define the interface between trade liberalisation and relevant regulatory frameworks and in order to operationalise desired market opening. In preparation for the 11th Ministerial Conference of the WTO in Buenos Aires in December 2017, members submitted papers and proposals to reflect their interests with regards to these issue areas. The EU *et al.* paper (World Trade Organization, 2017) provides an interesting structure for thinking about digital commerce in the context of the multilateral trading system (the here-called EU *et al.* paper was circulated at the request of the delegations of Canada, Chile, Colombia, Côte d'Ivoire, the EU, the Republic of Korea, Mexico, Montenegro, Paraguay, Singapore and Turkey). In particular, it distinguishes between disciplines related to regulatory frameworks and disciplines guaranteeing open markets.

In the first category, the paper distinguishes between regulatory frameworks to address transparency, consumer confidence and trade facilitation. The explicit reference to consumer confidence is interesting in itself as it is not a theme that past trade negotiations have tended to give such a prominent role. The paper mentions consumer protection, cybersecurity, privacy protection and unsolicited communications as specific concerns. The trade facilitation header features a number of topics that are of quite technical nature, like the recognition of e-signatures, addressing e-payment and the role of technical standards.

Regarding the opening of markets, the paper makes the distinction between explicit commitments to liberalise trade in relevant services (e.g. telecom, professional services) and goods on the one hand and measures to ensure openness on the other hand. Disciplines regarding the cross-border flow of data, access to source code and localisation requirements fall under the second category according to the EU *et al.* paper.

Fundamental differences exist among WTO members on many of the topics mentioned in the previous paragraphs. In some cases, members are not even certain whether they are willing to negotiate the items. At the 2017 Ministerial Conference, members therefore merely agreed to continue to work under the Work Programme on Electronic Commerce, and no substantial progress was made in negotiations at the multilateral level. An important subgroup of 71 members, however, said they would initiate exploratory work towards future WTO negotiations on trade-related aspects of electronic commerce, with participation open to all WTO members. The group accounts for around 77% of global trade but excludes one of the most important players: China.

Rule-making in regional integration initiatives: progress with hurdles

In parallel with discussions at the multilateral level, a number of mega-regional initiatives, such as the Trade in Services Agreement (TISA), TTIP, CETA, the Regional Comprehensive Economic Partnership (RCEP) and TPP, have made significant progress in developing definitions (e.g. "digital product", "electronic transmission", and "personal information") and agreeing on provisions regarding market-opening commitments and relevant regulatory framework. To varying degrees, these agreements also include provisions on the intermediary liability of internet platforms, the use of cryptographic technologies or algorithms, the disclosure of source code of digital products, data localisation and geo-blocking, network neutrality and cyber espionage (e.g. Wu, 2017).

Progress on rule-making has therefore been more rapid at the regional rather than at the multilateral level, with the caveat that most of these regional initiatives represent ongoing negotiations or negotiations that have been put on hold. The only agreement that is currently operational is CETA, the agreement between Canada and the EU. This agreement contains a separate chapter on electronic commerce. Interestingly, out of the seven articles in this chapter, one deals with "trust and confidence in electronic commerce", stipulating that each party "should adopt or maintain laws, regulations or administrative measures for the protection of personal information of users engaged in electronic commerce and, when doing so, shall take into due consideration international standards of data protection of relevant international organisations of which both Parties are a member". The importance of the protection of personal information is thus explicitly recognised in the legal text.

Design of regulatory frameworks: catching up rapidly

As mentioned before, given the novelty of relevant technologies, regulatory frameworks for areas like cybersecurity and protection of private information were virtually non-existent at the national level until very recently. Regulators are, however, rapidly catching up, at least in the three main trading economies discussed in this chapter: China, the EU and the United States. Whilst the United States – home to some of the most important players in the digital world – maintains its traditional "hands off" stance when it comes to regulating markets, the level of regulatory activity has been high in the EU.

The EU has been one of the major promoters of privacy and data protection, affecting the global digital policy landscape in particular through the EU General Data Protection Regulation (GDPR) and the Privacy Shield between the United States and the EU. The EU adopted the GDPR in 2016 and it came into force in May 2018. The EU regulation affects the way private companies and organisations handle EU citizens' data. The GDPR is intended to harmonise data protection laws in EU member states. It also gives EU citizens much more control over their data, for example, by allowing users to move data (portability), or to demand the erasure of their data (right to be forgotten). At the same time, it imposes strict and onerous obligations, requiring companies, regardless of where they are based, to adhere to compliance requirements and standards of security.

China's cybersecurity law came into force in June 2017 and also contains explicit provisions regarding the protection of private information. Interestingly, the law contains a separate provision regarding restrictions on the transfer of "sensitive" personal information and business data overseas.

The EU also has an instrument dealing with the overseas sharing of data. The so-called Privacy Shield was adopted in 2016 and addresses the sharing of data across the Atlantic Ocean – the major data highway in the world – between the EU and the United States. The Privacy Shield is an attempt to reconcile differences in how the EU and the United States regulate data protection in cases in which data of

EU citizens are hosted in the United States. The Shield imposes stronger obligations on US companies and the US government to protect EU citizens' personal data and requires the US government to more robustly enforce the new provisions and monitor their implementation.

New Themes, New Partners?

At the writing of this chapter, discussions and negotiations on investment, taxation and digital trade are ongoing at the bilateral, regional and plurilateral level. As a matter of fact, positions on these matters are in many cases not yet clearly defined at the national level. It is therefore hard to predict where ongoing discussions and negotiations will lead. It is, however, interesting to note that entirely new spaces for synergies, compromise but also disagreements appear to be opening up.

The theme of investment is actively pursued at the WTO, albeit at the plurilateral level. It is the subject of new legal proposals, like the one for a Multilateral Investment Court by the EU. It is also the object of negotiations between two of the three main global players, as the EU and China are negotiating a Comprehensive Agreement on Investment.

Digital trade is a top theme on most countries' national policy agenda and is actively discussed and negotiated in different international forums. One of the main challenges in this field is how to define the interface between domestic regulation and international flow of digital products and data. As has been the case in the context of goods trade (e.g. relevant for TBT and SPS provisions), the US and EU positions are not entirely aligned in this matter, the United States rather taking a "hands-off" approach whilst regulatory activity at the EU level is high. China finds itself at the other extreme of the spectrum, being considered to maintain a "digital wall". In this context, it is interesting to note that the EU and Japan agreed in July 2018 to recognise each other's data protection systems as "equivalent", thus creating the world's largest area of safe data flows.

Last but not least, the theme of taxation has also entered the sphere of international negotiations after the financial crisis of 2007–2009, with the most prominent initiative, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, being supported by the OECD.

From Mega-Regionalism to Mega-Multilateralism?

Whilst the second half of the 20th century has been marked by impressive progress on the multilateral trade agenda, the first two decades of the 21st century have taken a distinctive regional or plurilateral character. Since the creation of the multilateral trading system after World War II, regional integration has progressed in parallel with global integration. Indeed, multilateral trade rules have from the outset left space for preferential integration within their framework. Regional economic spaces like the EU and NAFTA could therefore be created and develop in full compliance with the WTO system.

As argued in this chapter, the interplay between the EU and the United States has played a fundamental role in shaping the dynamics and nature of the development of PTAs. This interplay also fundamentally shaped discussions and negotiations at the WTO. Agreements like the TBT Agreement and the SPS Agreement have very much arisen out of transatlantic differences in attitudes towards food safety.

With the success of early multilateral trade negotiation rounds to bring down tariffs, attention of discussions, negotiations and increasingly also disputes has shifted towards questions of how to deal with non-tariff measures. The Uruguay Round put issues like (trade-related) investment measures and (trade-related) IPRs on the negotiating table. Themes like labour, environment and competition policy entered and exited the discussions in different ways.

As this chapter shows, all these themes have been taken up in PTAs over the years. It can be argued that this is increasingly the case and that PTAs have significantly deepened the trade agenda. It is nevertheless the case that WTO discussions tended to be the stage setter for legal responses to new challenges in the realm of international trade. GATT rules also fundamentally influenced legal design in PTAs.

The beginning of the 21st century has arguably been marked by the recognition that the interaction of rule setting in trade with other domestic policy areas is even more complex than acknowledged so far. Two important construction sites on "trade and" matters have been added to the list for policymakers. The first one concerns the relationship between trade and finance. The Global Financial Crisis has brought the relationship between markets for goods and services on the one hand and financial markets on the other hand to the forefront of public attention. Matters of trade and matters of finance and taxation have traditionally been dealt with by different ministries and within different international frameworks yet are fundamentally interconnected. The second one concerns the development of new technologies and the need to create new rules for phenomena like e-commerce and data flows at the national and international level. The speed of technological development requires a speedy response.

Under pressure to deliver responses to complex challenges, changes in the membership of the WTO have at the same time made it more difficult to agree on common rules. If, in the second half of the 20th century, it was impossible to come to a deal at the WTO without an agreement between the two main players, the United States and the EU, the system now has a third player that cannot be avoided: China. China is, however, at a different level of development than the United States and the EU. In addition, though cultural differences between the United States and the EU exist and are significant, the differences between the old couple and the new player are probably starker. Those differences matter when it comes to questions regarding the balance between risk and technological progress, regarding the relationship between finance and trade and more generally regarding the need to balance trade prerogatives against other "legitimate policy objectives".

The jury is out as to where these new challenges will bring the multilateral trading system in the medium to long term. At the time of writing, the following three phenomena are worth highlighting:

- Regional agreements have traditionally relied on WTO legal text, but rule-making in new areas – like digital trade – is now increasingly being driven by legal innovation in preferential treaties. Preferential treaties now set the stage, rather than multilateral ones, which may create a real incentive for large players to influence regional rule setting with their views.

- Two players have been particularly active when it comes to "innovative" rule setting: the EU and China. The EU stands out because of its initiatives in the areas of trade and standards/regulation and because of the headway it has made in the area of digital trade. China has turned the post-World War II approach towards trade liberalisation upside down by putting a significantly stronger emphasis on infrastructure than on trade rules in its Belt and Road Initiative.
- The Global Financial Crisis has triggered unprecedented international interest in taxation rules for multinationals and, through the G20, put the OECD at the forefront of international actors in this field. The organisation that failed to bring the MAI negotiations to an end is now successfully handling the BEPS aspect.

Together, these three phenomena suggest that innovation in rule-making for trade has shifted to the regional level and that multilateral collaboration efforts on international economic law have shifted away from the WTO towards forums like the OECD. What does this imply for the role of the WTO as a rule setter for global trade?

The past two decades of the 20th century witnessed an unprecedented increase in trade and investment flows, largely driven by China's integration in the global economy. This integration was strongly facilitated by China's entry into the WTO. Future jumps in global trade and investment activity will not be the consequence of enlargements of the WTO family as most nations of the globe are already members.

Any new impulses will either come from the WTO deepening existing agreements or expanding into new areas, or from a deepening of regional integration. The latter is already happening, implying that regional integration initiatives increasingly incorporate new fields of international economic law like digital trade and investment. Innovation in international trade law is therefore more likely to come from the side of regional initiatives in the coming decades rather than from the side of the WTO.

In the meantime, multilateral activity in the field of international economic law is not dead but has shifted towards other fields of economic law, most notably taxation. This is a field that is highly "trade-related" and indeed has come to the forefront of policymakers' attention because of the tax avoidance strategies of multinational enterprises. The relevance of tax policies for trade is also recognised in the GATT. Like other national policies (e.g. labour market policies), tax policies have nevertheless never been dealt with directly under the WTO framework.

It remains to be seen whether the multilateral trading system manages to absorb these new regional initiatives and connect to "trade-related" multilateral initiatives. For the time being, the initiation of a number of plurilateral initiatives on small and medium-sized enterprises, investment facilitation and e-commerce within the WTO framework may put the multilateral system in a good position to get back in the driver's seat once major global trade players feel that it is time to return to the multilateral negotiating table.

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