The frustrated TPP and new challenges for the Global Governance of Trade and Investment

Osvaldo Rosales[1]

1. Introduction

The Trans-Pacific Partnership (TPP) was the first of a new generation of trade negotiations of a vast scope, known as megaregional agreements. TPP would have created the largest free trade area in the world, measured by its members' joint Gross Domestic Product (GDP), and the second largest, after the European Union (EU), by total trade among its members. The members of the TPP were Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. These countries cover around 38 percent of world GDP, 24 percent of global trade, and a market of 800 million of people.

TPP was expected to eliminate the vast majority of tariffs on the goods trade among its members, but also access to services markets, investment, and government procurement. It also set rules on matters that World Trade Organization (WTO) agreements have regulated to a limited extent—such as Intellectual Property Rights (IPR)—or not at all, such as e-commerce, State-owned enterprises, regulatory coherence, several labor and environmental matters, and some commitments to supporting small and medium enterprises.

The strategic and explicit aim of the United States in the TPP was to write the new rules for global trade and investment over the coming decades, not only in the trans-Pacific area, but potentially at the global level, particularly trying to counterbalance China`s influence in Asia Pacific, the most dynamic economic area in the world now and probably over the next decades.

Following the formal withdrawal of the United States from this agreement, the other 11 governments expressed their willingness to remain in the agreement, and are therefore assessing the adjustments that will have to be made, once the main partner has retired.

A widespread conclusion of many critics is that the TPP reduces the policy space for the management of capital flows, affecting macroeconomic stability and the possibility of using countercyclical policies. They also underscore the fact that it poses a certain threat to different levels of social and environmental regulations and imposes significant restrictions on access to new drugs and biological drugs, as well as to affordable seeds and agricultural chemicals needed to raise agricultural productivity. They also claim that these agreements limit tax autonomy, particularly to further progressive taxation and to combat "tax havens."

However, the novelty of the TPP is that in these areas, it offers more flexibility to governments than the previous U.S. Free Trade Agreements (FTAs), resulting in greater control of external capital flows, investment, and intellectual property. The policy space is, therefore, higher than those allowed in the previous U.S.'s FTAs.

[1] I appreciate the effective collaboration of Tania García-Millán in the preparation of this text.

The reasons for such flexibility were both internal to the U.S., and related to a dynamic negotiation process with more complex interactions between the U.S and 11 partners, including big economies like Australia, Canada, and Japan. The domestic reasons were the desire of President Obama to conclude negotiations during his tenure, forcing increased flexibility by the U.S. to close the deal in the shortest time possible, and the need to incorporate explicit flexibilities in the chapters on IPRs and Investor-State Dispute Settlements (ISDS), according to precise mandates delivered by the Congress and particularly by legislators from the Democratic Party (U.S. Congress, 2015). Several experiences of foreign investors' lawsuits against the U.S. led the Democrats to introduce several amendments that reduced the space for foreign investors to sue States in defense of their investment or IPRs.[2] In turn, the fact that the TPP was a multinational negotiation opened the space to alliances with variable geometry between two or more partners in specific subjects, thus reducing the bargaining power of the largest economy when compared with bilateral negotiations.

FTAs today have little support in the United States. The effect of the financial crisis of 2008 has placed inequality and job creation at the heart of the debate. In this context, typically, trade liberalization is seen as a major cause of job losses, lower wages, and reductions in the welfare of the working and middle class. This reduces the support for these agreements, or promotes provisions demanding the protection of labor or environmental rights.[3]

On the other hand, the pharmaceutical industry, the financial industry, internet companies, and Hollywood businesses have managed to lobby for clauses in FTAs that protect their interests, beyond regulations that facilitate free trade. One of these excesses has been the establishment of the ISDS agreements that skew the playing field in favor of the external investor and against the ability of the state to regulate important aspects of public policies, such as environment and health. Using bilateral investment treaties (BITs) or the investment chapter of FTAs, U.S. corporations and individuals have filed 117 cases in the International Centre for Settlement of Investment Disputes (ICSID). There are also five cases of foreign corporations against the U.S, all of them Canadian firms. These lawsuits against the U.S. in the North American Free Trade Agreement (NAFTA) context have induced a marked reaction in environmental groups[4] and in legislators from the Democratic Party who resent the reduced policy autonomy generated by such investment agreements. From therein, after the older authorizations for negotiating trade agreements (such as the "fast track" negotiating authority vested to the U.S. President from 1975-1994 and the Trade Promotion Authority (TPA) vested to the U.S. President in 2002), Democratic lawmakers managed to introduce clauses seeking to preserve the government's authority to regulate public welfare issues.

The great influence of financial deregulation in the subprime crisis in the U.S. also has generated a significant current of opinion in academia, international organizations such as the International

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[2] Previously, the Democratic Party had pressure the U.S. Trade Representative (USTR) to reformulate several points already negotiated in the FTA with Colombia, giving more flexibility to Colombia in the field of intellectual property that protects the pharmaceutical industry.

[3] This explains the remarkable support for anti-establishment presidential candidates in the 2016 U.S. election, as well as the fact that the two major candidates opposed TPP and, once in power, President Trump announced that the U.S. would not sign the agreement.

[4] The vast majority of the demands of the U.S. against other states correspond to mining or energy companies claiming breach of bilateral investment agreements.

Monetary Fund (IMF) and the World Bank, and Congress, aimed at correcting the excesses of financial deregulation. This was also reflected in the negotiations of financial issues in the TPP with regard to previous FTAs. In fact, the respective TPP chapter offers more flexibility to governments to control financial flows than previous U.S.'s FTAs.

A negotiation between several actors also introduces more restrictions to the principal negotiator, if he is interested in remaining active in a negotiation with a large number of participants. In this sense, as one of the purposes of TPP was to isolate China, it was essential for the U.S. to be receptive to Japanese demands. This also implied that the agreement aimed at reducing the growing trade and economic dependence that Australia had been developing with China. This was perceived by the Australian negotiators, who particularly used that as leverage in the negotiations of biological medicines, a position that Chile and Peru also supported. Finally, those countries that already had FTAs with the U.S. (Australia, Canada, Chile, Mexico, Peru, and Singapore) already knew the dynamics of negotiating with the country, the relations between negotiators and U.S. Congress, and the difficulties that each of them had faced in their own parliaments at the time of legislative approval. This experience was fundamental for the TPP to exclude additional requirements in complex issues already addressed in their respective FTAs.

In short, the evolution of the U.S.'s negotiations shows a double trend. On the one hand, there was strong pressure from the U.S. business lobbies seeking financial deregulation, high protection to the intellectual property rights in pharmaceuticals, software, internet, and digital issues, and strong investor rights and an ISDS mechanism. On the other hand, negotiating instructions from Congress sought to defend the regulatory space of public policies in areas such as health and the environment, thus limiting the ability of multinational corporations to demand States for policies or decisions in these areas that adversely affected their investments. The net effect of such conflicting pressures and criteria was an important dose of ambiguity in the final texts. This was also useful for those governments that negotiated with the U.S. because they could reach agreements using exactly this ambiguity, which prevented them from assuming commitments that restricted their policy space to a much lesser extent than in past negotiations.

Also, in contrast to patents and public health issues, on issues related to the internet, the U.S. was more successful in imposing binding positions, given the absence of a multilateral agreement. Thus, in technological measures, the liability of internet service providers and legal protection of program-carrying signals transmitted by satellite, the flexibility for the contracting parties is scarce.

2. Differences between the TPP and previous FTAs

The novelty of the TPP is that it deals with new issues, not yet included in the WTO agenda. Table 9.1 shows a synthesis of these novelties. The first column shows the classic issues of a trade agreement covered by WTO. The second shows issues covered by WTO, but only in a very partial way and with few of its members. The third column indicates the subjects that are not present in the WTO agenda.

Table 9.1: Thematic coverage of megaregional negotiations, 2014*

Traditional topics	"Second generation" topics	Topics that are not regulated by WTO
Tariffs	Trade in services	Regulatory convergence
Quotas	Intellectual property	E-commerce and digital trade
Customs valuation	Government procurement	State-owned enterprises
Antidumping duties		Investment
Safeguards		Competition policies
Technical norms		Temporary entry of business persons
Sanitary and phytosanitary Norms		Cross-border data flows
Dispute settlement		Copyright and the internet
		Export taxes
		Energy trading
		Labor standards
		Conservation of forests, fisheries and protected species
		Trade and climate change

* Transatlantic Trade and Investment Partnership, Trans-Pacific Partnership and Regional Comprehensive Economic Partnership

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

In the case of trade of goods, the negotiation goals defined by the U.S. Congress for the trade agreements, including TPP, in the Trade Promotion Authority (TPA) established that the main new objective was the connection between Global Value Chains (GVC) and trade liberalization. The liberalization of trade in services is linked also with the GVC, highlighting the role of services in the efficiency of the GVC, on the one hand, and the linkage between this liberalization and the plurilateral Trade in Services Agreement (TiSA), on the other.

In turn, the TPA opened the door for the digital trade of goods and services and cross-border data flow. On this issue, the goal was, "to ensure that governments refrain for implementing trade related measures that impede digital trade in goods and services, restrict cross-border data flow, or require local storage or processing of data" (reference to localization requirements).

Another new issue with the TPP was the introduction of "regulatory practices," trying to stimulate the regulatory convergence between the members of the TPP. Here, the principal objectives proposed by the U.S. Congress were to increase transparency in rules, legislation, and law; eliminate redundancies in testing and certification; and stimulate convergence and regulatory compatibility through harmonization, equivalence, or mutual recognition of different regulations, and the use of international standards.

State-owned and state-controlled enterprises (SOEs) were novelties of the TPP. In this case, the negotiations' goals were to eliminate and prevent trade distortions and unfair competition that favored SOEs, ensuring engagement based solely on commercial considerations.

Another new issue was the “localization barriers,” where the goal was to prevent and eliminate localization practices and prohibit indigenous innovation wherein a country seeks to develop local technology by the enforced use the of domestic standards or local content.

On labor, the TPA stipulated that, “Each party must adhere to and put in practice the core international labor standards, such as freedom of association, collective bargaining, elimination of forced labor and child labor, elimination of discrimination.” On environment, the instruction was to, “ensure that enforceable labor & environmental standards are subject to the same dispute settlements mechanism as other enforceable provisions of the agreement and withdrawal of trade concessions until dispute is resolved.”

Finally, on currency issues, the negotiation objective was to, “avoid manipulation of the exchange rate in order to prevent the effective balance of payments adjustment or to gain unfair competitive advantage over other parties.”

In summary, the merits of the TPP lie in its significant economic weight, particularly after Canada, Mexico, and Japan’s accessions. The TPP also addressed multiple issues linked to GVCs, such as the regionalization of exchanges; connectivity, logistics; complexity of cross-border flows; increasing links between trade of goods, services, and investment; disciplines related to property rights of tangible and intangible assets; legal certainty for multinational companies to move GVC segments to developing countries; and digital trade and regulatory convergence. Thus, it was much closer to the demands of emerging value chains than the provisions of the stalled multilateral trade system. And herein lies the particular importance of regulatory convergence.

The controversies around TPP lie in the many and relevant issues unrelated to trade. Between them, the most relevant are excessive IPR protections, with strong patent term extension, data exclusivity, and patent linkage; more protection of business interests (such as those of the pharmaceutical industry) than free trade; an investment chapter with an abusive system of ISDS, with a bias in favor of foreign investors that means a huge imbalance of rights and obligations between investors and state. Another relevant issue concerning U.S.’s FTAs is the treatment of capital controls and the balance of payments exceptions in previous FTAs, where the U.S. did not recognize certain interventions on the capital account, even those that were allowed by the General Agreement on Trade in Services (GATS) and IMF`s Articles of Agreement. Finally, disciplines to regulate SOEs may be too stringent for countries with a high presence of enterprises, particularly in Asia.

The U.S.’s main goals in the TPP was to create rules to govern the increasingly complex interaction of production activities, trade, and investment within GVCs. But, of course, there are also geopolitical objectives, such as recovering lost competitiveness of U.S. firms from the Chinese and other Asian competitors; limiting the expansion of Chinese firms in East Asia through binding and demanding rules (IPRs, SOEs, Labor & Environment); neutralizing the China-Japan-Korea FTA and Regional Comprehensive Economic Partnership (RCEP) by incorporating Japan and potentially Korea into the TPP and later on; seeking to export TPP commitments into the multilateral framework. But, in my opinion, the main mistake of the design of the TPP was leaving out China and conceiving the TPP as a game of “all against China.” For the world economy and for the best governance of global trade and investment, the best scenario would have been a less ambitious agreement on critical issues, with the ability to engage China in it, forcing a reasonable upgrade of China's trade and investment policies. An agreement of this kind could be easily projected to the multilateral space, providing significant stimulus to the ailing world economy.

3. Intellectual Property Rights (IPR)

a) TRIPS and IPR chapters in the U.S.'s FTAs[5]

The main criticisms of the developing countries to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) are: i) less flexibility to develop public policies in health in general, and in particular, in the case of medicines, given the higher costs of them, when patents on these medicines are introduced; ii) expansion in the coverage of copyright protection; iii) limited protection of living matter, genetic resources, and traditional knowledge; and iv) strong mechanisms of enforcement and dispute settlements. However, TRIPS allowed different timelines for its implementation depending on countries' levels of development.

These flexibilities were much more limited in FTAs, particularly in those promoted by the United States. At this level, it is criticized that FTAs limited the flexibilities of the TRIPS agreement in several areas: i) limitation on the use of compulsory licenses; ii) restrictions on the freedom to implement systems of exhaustion of rights and, consequently, resorting to parallel imports;[6] iii) extension of protection to second uses; iv) the expansion of the protection of test data on safety and efficacy of products, which is transformed into a prohibition of use this information at least five years since the adoption of the pharmaceutical product and ten years since the adoption of agrochemicals; and vi) the possibility to prohibit the marketing of products to third parties before the expiry of the patent protection, except with the consent of the owner.

According to Abbot (2007), the major controversy surrounding the Internet Protocol (IP) Chapters in U.S.-negotiated FTAs has focused on pharmaceutical-related provisions, including patents and marketing exclusivity requirements. Though country-to-country results vary, the U.S. template has included: i) extending the scope of patent protection to cover new uses of known compounds, and plants (and, on occasion) animals; ii) providing patent term extensions to offset regulatory delay; iii) limiting the scope of permissible exceptions to patent rights; iv) providing fixed periods of marketing exclusivity for a broad class of previously unapproved products, based on submission of regulatory data, or reliance on foreign marketing approval or foreign submission of regulatory data; v) prohibiting the effective granting of marketing approval by the health regulatory authority during the patent term without the consent or acquiescence of patent holders ("linkage"); vi) authorizing non violation nullification or impairment dispute settlement claims, and; vii) prohibiting parallel importation (in some cases) (Abbot 2007).[7]

[5] This section borrows from Rosales and Sáez (2010).
[6] Parallel imports are goods brought into a country without the authorization of the patent, trademark, or copyright holder after these goods have been put in circulation elsewhere. The TRIPS agreement recognizes the right of each country to have its own regulations on parallel imports.
[7] Of course there are differences between different FTAs negotiated by the U.S. For example, FTAs with Latin American countries have not limited the use of compulsory licenses as did those with Morocco and Singapore. The same is in the case of parallel imports, as opposed to the undersigned by the U.S. with Australia and Morocco. In the

The conclusion of FTAs negotiated by the U.S. is usually followed by intensive intervention by the USTR (and the U.S. private sector) in the national implementation process as a pre-condition to bringing the FTA into force. In some cases, the implementation phase has proved to be even more difficult than the treaty negotiation because the USTR's demands may exceed those explicitly enumerated in the respective FTA, and because these implementation negotiations tend to be "non-transparent" (Abbot 2007). These provisions strengthen the position of originator-patent holder pharmaceutical enterprises on national markets, and may impose substantial obstacles to the introduction of generic pharmaceutical products.

The Democratic Party majority in the U.S. Congress in 2007 obtained modification of pharmaceutical-related provisions in the FTAs with the Executive Branch (USTR 2007), and also required changes to signed but not yet ratified agreements with Colombia, Panama, and Peru. The proposed changes included limiting the granting of marketing exclusivity in some cases to a period contemporaneous with that obtained in the United States; eliminating provision for patent term extension based on approval delay; eliminating the express linkage between patents and marketing approval; and incorporating express provision for use of compulsory licensing notwithstanding existing marketing exclusivity. These changes are a clear improvement, and have been extremely important in the evolution of the next negotiations, including the TPP. However, it must be noted that additional TRIP-plus obligations have been proposed to reduce the magnitude of the changes.[8]

b) <u>TPP`s IPR chapter: hard provisions but an important level of ambiguity</u>

The relevance of the IPR issue in the TPP may be exemplified by citing the extent and breadth of the treatment given to this subject in the text of the TPP agreement: the respective chapter covers 74 pages, 83 provisions, 159 footnotes, and 6 annexes. But one of the most important conclusions of this paper is its high level of ambiguity. In effect, along with drastic provisions aimed at protecting the rights of producers and innovators, there are other equally precise paragraphs with respect to the need to preserve the space for public policy.

Such a mixture of hard-binding provisions and precise references to respect the main international agreements in matters of public health, and dissemination of technologies and similar issues, only can generate a final product with a high degree of ambiguity and many loopholes. Probably the reasons for this ambiguity are the result of contradictory pressures: i) within U.S, between big business and some Democrat lawmakers; and ii) in the negotiation, between U.S. and its counterparts.

For example, there is a trend in the USTR to read the TRIPS agreement more closely to the interests of big business and to try to go further in each agreement in order to create precedents

case of "second applications," the FTA with Chile specifies that marketing permissions relate to "new chemical entities," which was not collected in the CAFTA-DR.

[8] Patents and marketing exclusivity are to be expressly de-linked, but signatories will be obligated to provide transparent and expeditious mechanisms for initiating patent infringement litigation. Direct patent term extension will be eliminated, but obligations will be added to ensure expeditious processing of applications for patents and marketing approval. While marketing exclusivity obligations may be limited, in some cases to periods contemporaneous with those running in the United States, the basic requirement of marketing exclusivity remains a substantial TRIPS-plus obligation (Abbot 2007).

for the next agreement. However, at the same time, the TPA approved by the Congress in 2003 expressed the need to ensure the full implementation of the TRIPS agreement. Moreover, in revising the FTA with Colombia, Congress forced the USTR to unilaterally change its negotiating stance, indicating that intellectual property rights obligations should not preclude or prevent a party must take the necessary measures to protect the public health.[9] Moreover, for the first time, Congress explicitly stated that if the TRIPS is modified, the parties shall make the relevant consultations to introduce corresponding changes in the respective FTAs. This tension between TRIPS and the pressures of the powerful pharmaceutical industry, or "big pharma," gives some flexibility for the exclusions in the agreement and the implementation process. In fact, despite the hardness of the provisions, the U.S. has never used the dispute settlement chapter of its FTAs to invoke patent infringement in their different FTAs.

i. <u>IPR chapter in the TPP: An Introduction strongly committed to international agreements.</u>

An interesting novelty of the TPP's IPR chapter is located in the introductory chapter, where appears the objectives (18.2), principles (18.3) and agreements with respect to this chapter (18.4). To make explicit at the beginning of the chapter the objectives and principles of the chapter is very important because it provides the context for implementing the agreement, and therefore should provide the guide to discuss any future controversy on this issue.

The hard provisions protecting the rights of inventors or content producers is included in the agreement, alongside calls to abide to international standards and commitments that protect the rights of persons and governments against corporate interests. Examples can be detected in several articles where the protection and enforcement of IPRs should contribute to, or be compatible with, the promotion of technological innovation and to the transfer and dissemination of technology (Article 18.2: Objectives); protecting public health and nutrition; preventing the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology (Article 18.3: Principles); promoting innovation and creativity; facilitating the diffusion of information, knowledge, technology, culture, and the arts; and fostering competition and open and efficient markets (Article 18.4: Understandings in Respect of this Chapter). Of course, in all cases, these measures should be consistent with the provisions of the chapter.

In other words, the IPR protection can only occur in the context described, which certainly gives a wide range of freedom to governments that may be eventually subject to dispute by the application of IPR`s chapter. As this controversy is also a state-to-state controversy, the probability of its occurrence is smaller.

[9] The Complete reference is: "The obligations of this Chapter do not and should not prevent a Party from taking measures to protect public health. Accordingly, while reiterating their commitment to this Chapter, the Parties affirm that this Chapter can and should be interpreted and implemented in a manner supportive of each Party's right to protect public health and, in particular, to promote access to medicines for all. Each Party has the right to determine what constitutes a national emergency or other circumstances of extreme urgency, it being understood that public health crises, including those relating to HIV/AIDS, tuberculosis, malaria and other epidemics, can represent a national emergency or other circumstances of extreme urgency." (TPP Chapter 18, Article 18.6).

The inclusion of these provisions in the introduction of the IPR chapter of the TPP is a joint achievement of the pressure exerted by the U.S. Congress, on the one hand, and the countries that negotiated with the U.S., on the other. According to negotiators from several of the participating countries of the TPP, the resulting treaty is a robust defense in any future demands on this issue.

This commitment to international agreements is reinforced regarding public health, as Article 18.6 shows (Commitment to the Declaration on TRIPS and Public Health; protecting public health; promoting access to medicines for all and allowing the necessary space to deal with a national emergency or other circumstances of extreme urgency).

The pressure of Democrats was consistent on this issue. For example, on May 25th, 2016, a group of 15 House Democrats sent a letter to USTR Michael Froman urging the Administration to clarify its position on compulsory licensing for generic medicines in Colombia. The letter said:

> As you know, the issuance of compulsory licenses is permissible under U.S. trade agreements and the WTO Agreement…We therefore find it deeply troubling that U.S. officials may not be respecting the Doha Declaration… There are growing concerns about the very high and increasing costs of pharmaceuticals in the United States and in other nations. And the annual price of this medicine in Colombia is almost twice as much as the average annual income per person in Colombia. As policymakers struggle to address this issue, we should not seek to limit the existing, agreed upon flexibilities public health authorities have to address these concerns. We ask that you clarify the position the Administration has taken in meetings with Colombian officials on this important issue as soon as possible.[10]

ii. TPP's IPR chapter: An assessment

As a preliminary conclusion, the IPR chapter in the TPP has standards of protection more demanding than that in the TRIPS areas such as: i) expanding the scope for patentability of an invention; ii) expanding patent terms; iii) data exclusivity; iv) patent linkage; and v) expanding the scope for trademark (i.e., sound and smell).

However, comparing the end of negotiations with the initial aspirations of the USTR in terms of strengthening IPR, it is also clear that there were important goals that were not achieved.[11] As

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[10] The letter was led by Ways and Means Committee Ranking Member Sander Levin (D-MI), and also signed by Reps. Jim McGovern (D-MA), Jim McDermott (D-WA), Jan Schakowsky (D-IL), Eddie Bernice Johnson (D-TX), Peter Welch (D-VT), Rosa DeLauro (D-CT), John Lewis (DGA), Barbara Lee (D-CA), Chris Van Hollen (D-MD), Peter DeFazio (D-OR), Lloyd Doggett (D-TX), David E. Price (D-NC), Carolyn B. Maloney (D-NY), and Sam Farr (D-CA). See Inside US Trade`s. World Trade Online (https://insidetrade.com/), Thursday, May 26, 2016.

[11] Some of the most relevant objectives of the USTR which were not enshrined in the final agreement were: i) rresponsibility of ISP: replicate the American system of notification of copyright infringement and automatic drop of the content; ii) Technological Protection Measures: sanction the infringement to TPM, independent of whether or not linked to an infringement of a copyright; iii) patenting surgical procedures; patenting animals (genetic sequences or similar), and patenting plants; iv) treble damages in patents (fines than three times the damage); v) more precise patentability criteria (novelty, inventive step and industrial application) (more ambiguity: more flexibility in the implementation); vi) payment of reasonable royalties for patent infringement; vii) "linkage": the health authority does not grant sanitary permits to generic pharmaceutical products until the expiration of the patent; viii) protection of undisclosed information for biological pharmaceutical products (12 years); ix) definition of biological

already noted, the demanding provisions just mentioned coexist with precise references to multilateral commitments that expand the policy space to states. This coexistence can actually impose additional restrictions on governments, as every time the bearers of rights push to impose more restrictive clauses that eventually pave the way to controversies, which may in fact limit government actions due to the high political and economic cost of such disputes. Additionally, bringing those controversies to the multilateral space would help to develop precedents in the WTO that can apply to members of the WTO with which U.S. does not have bilateral agreements, and would help to put the treatment of such issues on the agenda of an upcoming multilateral round of trade negotiations.

Finally, as Abbot (2006, 20) synthesizes,

> U.S. law reflects a balance between the interests of IPRs holders and consumers. Most U.S. IPRs' rules are formulated in terms of general principles and exceptions to them. The FTAs negotiated by the United States largely reflect the general rules of application, though not in all cases. What the FTAs do not adequately reflect is the interplay between rule and exception that establishes the balance. This is of special importance in areas such as public health regulation where incomplete familiarity with the flexibility inherent in the U.S. system may lead its trading partners to conclude that restrictive implementation of the FTAs is required.

If so, the message is clear: i.) during the negotiating process, developing countries should carefully consider whether the capacity of their domestic legal and regulatory system will permit them to balance interests as does the United States legal system, avoiding accepting commitments that would strain domestic capacity and which could lead to the application of rules in a more restrictive manner than the agreements require; ii.) the implementation process is another important tool because if commitments are accepted, developing countries should pay careful attention to implementing the agreements in a way which properly reflects the domestic public interest; and last, but not least, iii.) appeal to TRIPS standards and to the successive pronouncements of the U.S. Congress on this topic can be very useful.

4. Global Governance of Investments and FTAs

The measures of liberalization, promotion, and facilitation of investment are a crucial issue for developing countries, improving their position in international value chains, balancing the rights of investors with the legitimate space for public policies, and framing the policy of domestic and foreign investment in a sustainable development approach (UNCTAD 2015). This undeniable fact, however, is still not taken seriously by developing countries, many of which continue to refuse them to be treated urgently in international forums. In the absence of these forums, the agenda of the governance of international investment tends to be filled by the messy explosion of bilateral investment agreements or free trade agreements, which include as one of their provisions the criticized ISDS mechanisms.

pharmaceutical products (including proteins, vaccines, and blood derivatives). (Information provided by Chilean negotiators of the TPP).

It seems necessary that the widespread criticism to the International Investment Agreement (IIA) and in particular the ISDS scheme, come from that criticism to a proposal reform mobilized by developing countries themselves. Moreover, the difficulties that ISDS has been generating in the negotiation of the Transatlantic Trade and Investment Partnership (TTIP) between the U.S. and the E.U. shows the possibility of a partnership between developing countries and the E.U. to create an International Tribunal on Investments that can correct the many failures that the ISDS mechanisms have.

a) Investments in Trade Agreements

Gradually, some WTO agreements have been incorporating matters relating to investments, as a reflection of the growing complementarity between trade in goods and services and investment. Indeed, the phenomenon of value chains has reinforced this link, given the increasing relevance of the services in the competitiveness, innovation, and transmission of technological change in the value chains.

However, we should recognize that the multilateral framework has lagged significantly in this area, leaving the field open to bilateral agreements. In fact, these bilateral agreements not only grant legal protection to investments, but incorporate rules detailing how to treat these investments. These bilateral agreements of investment disciplines have begun to join FTAs, where the opening of investment schemes has become a key objective of the negotiations (Rosales and Sáez 2010). In this way, the protection of investments in the FTAs consolidated existing provisions in previous investment agreements, and added new topics such as the prohibition of anti-competitive practices, intellectual property protection, the liberalization of investment approval procedures, and the liberalization of trade in services. Disciplines on investment incentives and tax normally are not included (Sauvé 2006).

This type of agreement seeks to reduce the use of instruments that limit the entry of foreign investment, such as a performance requirement and discrimination in favor of national investment. The aspect that here has generated the most controversy is the establishment of the ISDS mechanism, which is skewed in favor of the external investor and who does not give the possibility that the state can bring those investors to trial. The claim is also that this mechanism reduces the regulatory public policy space, maintaining high levels of ambiguity in the definitions and procedures that could lead to that state should face costly lawsuits by virtue of their attempts to regulate various aspects of public policies.

Given this widespread debate regarding the pro-investor bias of these agreements, promoted mainly by the United States, the FTAs of this country have been collecting part of these criticisms. An important focus is the concept of "indirect expropriation." In the North American Free Trade Agreement (NAFTA), Chapter 11 (investment) prohibited—with certain exceptions—both direct and indirect expropriation, but did not provide a precise definition of this concept. This gave rise to a series of demands covered in this ambiguity, including frivolous claims. In the U.S.-Chile FTA, indirect expropriation was defined as, “an act or series of acts of a party which have an effect equivalent to a direct expropriation without formal transfer of title or the right of domain” (Chile-U.S. 2003, Annex 10-D, Expropriation, point 4b). The same text clarifies that:

> Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

Governments of developing countries who enter this type of negotiation are aware of the threats and, as Sauvé (2006) points out, value the exceptions and reservations that these agreements provide, both with respect to existing or future measures, as well as the periods of transition with regard to key disciplines. This means that, if these exceptions and reservations are well handled, states can maintain a greater degree of freedom in public policy areas that seem necessary. In any case, it remains true that some of these exceptions are limited with respect to those that a multilateral investment regime could provide (possibly as part of the multilateral trading system). The challenge remains in developing the negotiating skills that allow an adequate handling of exceptions, reservations, and deadlines for implementation, in line with medium- and long-term public sector objectives.

However, given the lag in providing multilateral governance to international investments, the advance of the FTAs has been covering investment topics, including an ISDS system that is still skewed and a potential threat to the deployment of public policies. I think that developing countries made a mistake in refusing to discuss a multilateral scheme of investment regimes. The TPP represents progress towards greater balance and more space to public regulation. However, the playing field remains unbalanced and is increasingly necessary to address that multilateral governance of the international investment regime.

b) TPP: The Investment Chapter

The Investment chapter of the TPP in comparison with previous FTAs with the U.S expands the regulatory space reserved to states, both in environment, public welfare and health (TPP, Investment Chapter, paragraph 9.16), as well as in financial regulation (29.3; Annex 9-G), where temporary financial safeguards in "exceptional circumstances" are allowed (29.3).

For example, Article 9.16 on investment and objectives of environmental, health, and other regulatory objectives express that, "none of the provisions of this chapter can be interpreted as a limitation to a state from adopting, maintaining, or enforcing any measure that it considers appropriate to ensure that investment in its territory is conducted in a manner that is sensitive to the environment, health or other regulatory objectives." It is a reaffirmation of the consecration of the right to regulate that preserve the states, to the extent that they are non-discriminatory regulations.

In the next lines, several cases are presented where investment provisions in the TPP are more flexible than previous FTAs signed by the U.S.

Investor´s expectations.

The TPP text talks about "reasonable and unambiguous expectations." The fact that expectations must be clear and unequivocal sets a much more demanding yardstick for any investor seeking to claim that its expectations have been "interfered with" by the government. In addition, the TPP Treaty explains what should be understood by "clear and reasonable" (footnote 36), putting all the burden of proof on the investor and strengthening the position of the government applying the measure. Even more, “public interference” only happens when something generates a violation of any provision of the Treaty and causes a pecuniary loss to the investor. In other words, it is not “any” public interference. That is to say that public interference in itself is not enough to trigger a “sanction.” On the contrary, the sanction can only result from an arbitration procedure which establishes the existence of a “violation” of the Treaty, accompanied by “property damage” to the investor–i.e., the single “claim” does not imply the imposition of a “penalty.”

In the context of an arbitration procedure, in addition to the “interference” caused by the measure, arbitrators should consider other factors such as “the economic impact of the same” and the “character” of government action. In other words, the mere fact that a measure to “interfere” the "reasonable and unambiguous expectations," is not sufficient to establish a violation of the Treaty or to initiate arbitral proceedings. This is a clear advance with respect to the previous formulations in the FTAs.

Minimum Standard of Treatment (Article 9.6)

In this area, we also have more accurate and balanced precepts. For example, the article 9.6.4. says: “For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.” And footnote 36 says:

> For greater certainty, whether an investor’s investment-backed expectations are reasonable depends, to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector.

Finally, the article 9.22.7 delivers a clear statement that, in alleging a violation of the Minimum Standard Treatment (MST), the investors bear the burden of proof on all elements.

Article 9.8 and annex 9-B relating to expropriation and compensation

Article 9.8 and annex 9-B establish that acts non-discriminatory regulatory of a party that are designed and applied to protect legitimate objectives of public welfare, such as public health, safety, and the environment, do not constitute indirect expropriation. They clarify, in addition, that protection of public health includes, among others, measures regarding regulation, price, and supply, as well as the reimbursement of pharmaceutical products (including biologics, diagnostics, vaccines, medical devices, therapies and genetic technologies, supports and apparatus related to health and blood, or blood-related products). This standard is very relevant in light of the claims that, in the context of other international investment agreements, investors have submitted, claiming that certain regulations have constituted an indirect expropriation.

Article 9.23 (6) and (7) on the implementation of the arbitration

Article 9.23 (6) and (7) establish that the tribunal must consider whether the plaintiff's claim or the objection of the respondent was frivolous, and granted the parties disputing reasonable opportunity to present their comments. Also, if an investor of a party submits a claim, the investor has the burden of proof of all elements of their claims, in a manner consistent with the general principles of international law applicable to the arbitration. This provision seeks to prevent the use of the dispute resolution mechanism without information with respect to the breach of an obligation of the chapter. In short, the outcome is a proper balance between protection of foreign investments and the sovereign right of states to regulate.

In the recent literature, there remains different points of view with respect to the TPP's investment chapter. For example, Hogson (2015) argues that it widened the regulatory space reserved to states, as exemplified with the greater flexibilities in environment, health, and public welfare, as well as with flexibilities in financial regulation and the tobacco exception. In broader terms, in his view, because "the long controversial coverage of investment agreements and authorizations have been restricted, both in substance and with respect to ISDS."

But there are other points of view. According to Johnson and Sachs (2015), changes to investment rules were marginal, contained ambiguous language, and did not address the fundamental concerns about ISDS–for example, the right to regulate; the burden of proof; investor´s expectations; dismissal of frivolous claims; arbitrator ethics; and clarifying rules of non-discrimination. Even more, some "improvements" were expressly or implicitly included in previous agreements.

On investment, the TPP is a step forward in comparison with previous FTAs. The bias in favor of external investors is minor with respect to previous FTAs with the U.S., but the bias persists. This bias is compensated for by the inclusion of several relevant provisions oriented to widen the regulatory space assigned to governments. There persists, in any case, the need to reform the international system of investment governance, recognizing the need for a neutral, independent, and efficient dispute-settlement mechanism (DSM) on this area. In the new global context (GVC, Climate Change, Sustainable Development), there is a need for international investment law to enable host governments and investors to maintain a fruitful relationship in the long term.

c) <u>Reforming the international system of investment governance</u>

The great paradox with the IIAs and with the FTA's investment chapters is that partners may confront demands in ISDS, seeking to influence the "undisciplined countries"–those not seeking to enter the FTAs. On the other hand, it must be recognized that countries with IIAs, including ISDS mechanisms, are not necessarily those who receive more Foreign Direct Investment (FDI).

The listing of criticism by academics and non-governmental organizations (NGOs) against the ISDS is sufficiently large and well-known. A relevant list of them can be consulted in Schill (2015) and Johnson, Sachs, and Sachs (2015). According to these criticisms, the core objectives to reform the ISDS system should be: i) congruent with principles of constitutional law, democracy, and the rule of law; ii) congruent with human rights; iii) compatible with sustainable development; iv) neutral, transparent, predictable, independent, and efficient DSM; v) leave sufficient policy space for host states to regulate in the public interest (updating the regulation, based on scientific evidence available); and vi) accessibility of small and medium-sized investors to the DSM (Schill 2015).

For developing countries, the challenge is to build an attractive package for foreign investors that includes reforming ISDS to address the legitimacy crisis of the current system but also to promote and facilitate investment by effectively expanding this dimension in IIAs, ensuring responsible investment to maximize the positive impact of foreign investment according sustainable development criteria (UNCTAD 2015). While this process advances, it is important to support developing countries' governments with a minimum-institutional infrastructure oriented to identify, track, and manage investment conflicts. This task is part of the state modernization challenge, taking into account the critical need for coordination between domestic agencies linked to investment, international trade, capital movement and financial issues, different regulation offices, and different geographical levels of government.

The investment issue is of growing importance for developing countries. The current challenge is not only to define the best policies for bringing FDI into their economies, but also to accompany the international expansion of their own firms, including legal stability for Multinational Enterprises (MNEs) from developing countries, such as the "translatinas."

d) TPP and Taxation Measures

It's quite common to find in the literature that deeper free trade agreements, in the style of the FTAs signed by United States, affect the capacity of governments to act with autonomy in their tax policies. It is argued that these agreements would prevent modifying the tax burden or impose new taxes, which would limit progressive tax reforms or the establishment of royalty to the exploitation of natural resources. Strictly speaking, that is not correct. Normally tax issues are exempted from the application of the regulations of the FTAs and that is recorded in the so-called exceptions to the agreement. The only restriction is that any tax changes must be non-discriminatory in nature, which could mean, for example, that it meets the criteria of National Treatment (NT) and Most Favored Nation (MFN).

TPP does not display innovations in this area. Chapter 29 of Exceptions in paragraph 29.4 (Taxation Measures) specifies precisely the exclusion of the tax regulations from the TPP (29.4.2); it also validates the countries belonging to various international tax conventions, specifying the primacy of these conventions on the provisions of the TPP (29.4.3)–though reminding the validity of NT and MFN commitments on tax policy. Additionally, 29.4 paragraphs (e), (f), and (g) indicate the validity of non-conforming tax measures, for example, those that are explicitly left outside the disciplines of the agreement.

The provision 29.4(h) in turn, allows the adoption of new measures or tax reforms aimed at raising taxes or improving its progressive structure, subject always to the NT and MFN nature of these measures. Finally, article 29.4.8 (Expropriation and Compensation) designates the obstacles that foreign investors face to plead expropriation in those case in which tax measures are non-discriminatory.

5. Balance of Payments and Regulations to Capital Flows

Negotiations on trade in financial services in the TPP include: (i) measures adopted relating to financial institutions; (ii) investments in financial institutions; (iii) cross-border trade in financial services; and (iv) the rights of financial regulators to take action to ensure stability of financial markets.

The fourth category—the rights of financial regulators to take action to ensure stability of financial markets—centers mostly on capital controls. Initially, the United States was seeking to use the language of the U.S.-Korea FTA (KORUS) as a template for the TPP. A reading of the plain language of the Financial Services Chapter (in conjunction with the Investment Chapter) of the KORUS seemed to indicate that capital controls would not allowed. Although there does exist a "prudential exception" to this limitation, it is rather narrow and appears to apply to financial institutions and not to macroeconomic policies applied by governments to address system-wide risks.

This has thus raised concerns in Congress, which, in a May 2012 letter addressed to Secretary of the Treasury Timothy Geithner and signed by Representatives Barney and Levin, requested an official written statement from the Obama Administration clarifying the U.S. policy in FTAs and BITs regarding capital controls (both past and present).[12] In that letter, they sought assurance from the Administration that parties to an FTA will have the ability to deploy capital controls on the inflow and/or outflow of capital without being challenged by private investors. The rationale is that this policy space must be preserved in order to manage volatility and long-term controls in order to avoid a financial crisis like that of 2008-2009, a position which is firmly supported by the IMF and reflects the emerging challenges of trade in financial services.

Until very recently, the USTR and the U.S. Treasury were dominated by the neoliberal framework to address the link between opening capital account and economic growth. In the opinion of both entities, this openness facilitated access to new sources of savings, improved resource allocation, and favored economic growth. In their view, more financialization was always and in all places good for growth and development. Thus, they refused financial regulation, stressing that the best financial regulation was self-regulation of the sector. The subprime mortgage crisis sent these policy options to the dustbin, even inducing policy changes in the approach of entities like IMF and World Bank.

a) <u>Capital flows: new academic perspectives and in trade agreements</u>

Recent works of the IMF speak of the need to differentiate between capital flows of a short term character, part of which are of a speculative nature, and FDI flows, which can also facilitate technology transfer. Long-term capital seems to stimulate economic growth while the impact of short-term flows is more dubious, as they increase volatility and the frequency of crises (Ostry et al. 2016, 581). According to Ghosh et al. (2016),

> Since 1980, there have been about 150 episodes of surges in capital-inflows in more than 50 emerging market economies and about 20 percent of the time, these episodes end in a financial crisis, and many of these crises are associated with large output declines.

[12] This is a novel approach given that traditionally treaty law allows parties to make interpretations of language through letters exchanged contemporaneously with the negotiations with the intent that they are binding.

It should be noted that TPP members have addressed capital controls in a variety of ways in agreements between each other, as shown in Table 9.2. For example, Chile, Peru, and Singapore tried obtaining greater flexibility to impose capital controls in their FTAs with the U.S. but were only able to get a special dispute settlement procedure that includes an additional six-month cooling off period before investors can file a case and obtain limits on damages. On the contrary, the Australia-Singapore FTA and Malaysia-New Zealand FTA allow either party to adopt restrictions on transfer of payments related to investment in the event of serious balance of payments and external financial difficulties or threat thereof.

Table 9.2: Treatment of capital controls in different FTAs and BITs

Treatment of Capital Controls	**Coverage in Existing Agreements**
Capital controls are prohibited but there are special procedures for disputes related to certain types of controls. These include an extended cooling off period before investors can file claims and have limits on damages	U.S.-Singapore FTA U.S.-Chile FTA U.S.-Peru FTA
Capital controls are prohibited but there is a safeguard that, with some special restrictions, allows the use of capital controls in the event of serious balance of payments and external financial difficulties or threat thereof	Australia-Chile FTA Australia-Malaysia FTA Australia-New Zealand FTA Australia-Singapore FTA New Zealand-Singapore FTA
Capital controls are prohibited, no ISDS	Australia-Malaysia FTA Australia-New Zealand FTA
Capital account liberalization is encouraged but agreements defers to national law	Malaysia-Chile BIT Malaysia-Peru BIT Malaysia-Viet Nam BIT Singapore-Peru BIT Singapore-Viet Nam BIT Chile-New Zealand BIT Chile-Peru BIT Chile-Viet Nam BIT Australia-Chile FTA Australia-Viet Nam BIT

Source: Boston University Pardee Center Task Force Report, March 2013

b) Balance of Payments, capital movements: evolution in U.S. approaches[13]

In the FTAs negotiated by the E.U. with Latin American countries, the respective chapter applies to "all current payments and capital movements between the Parties," forcing them to allow payments and transfers in freely convertible currency and in concordance with the IMF's Articles of Agreement. The chapter also includes an article that allows exceptions and safeguards

[13] In the NAFTA model of negotiation, capital movements appear in the Investment chapter (through ISDS); in the Services chapter (Article 10.12: Payments and Transfers) or in the Exceptions chapter, like the TPP. See Sáez (2010).

under exceptional circumstances.[14]. In such a case, it is possible to apply measures that are not respecting the obligations of the chapter. Those measures may last one year but can be extended, if the exceptional circumstances continue. These provisions are very similar to those contained in articles 59 and 60 of the Maastricht Treaty.

In contrast, in the FTAs negotiated by the U.S. with Latin American countries, the U.S. refused to accept measures of capital controls and the balance-of-payments (BoP) exceptions (Sáez 2010). The negotiating mandate given by Congress to the USTR did not allow for the application of these measures, which are accepted by GATS and the IMF Articles of Agreements. In the FTA with Chile, the first with this approach, this issue was finally resolved at the highest political level through an annex applicable to measures adopted by Chile that could be subject to dispute settlement by U.S. investors. According to this annex, a U.S. firm may claim damages if it believes that Chile is breaching an obligation when applying a restriction on payments and transfers.[15] The claim can be submitted only one year after the measure is adopted, and can refer only to the reduction in the value of transfers, not subsequent effects on profits, showing a distinction between volatile and non-volatile capital flows. This reflects Chile's use in the past of unremunerated reserve requirements on capital to address the volatility of short-term inflows in the 1990s and its willingness to keep open the possibility of re-using this policy instrument in the future.[16]

In the case of BoP, the TPP shows a significant change with respect to previous U.S.'s FTAs by enshrining in Annex 29.3 (Exceptions of Balance of Payments) collecting both balance of payments provisions of GATT 1994 and IMF rules. In the previous FTAs, the U.S. had refused to pick up these provisions, accentuating the emphasis of financial deregulation. The respective provisions in the TPP allow governments to restrict payments and transfers both current and capital, "in the event of serious balance of payments and external financial difficulties or threats thereof." These measures "shall not exceed 18 months in duration"; "however, in exceptional circumstances, a Party may extend such measure for additional periods of one year." By the way, these measures are subject to requirements of NT, MFN, and expropriation and compensation provisions and they must be consistent with the IMF agreement and Article XII of GATT 1994 and the Understanding on the Balance of Payments Provisions of the GATT 1994.

[14] Under the heading "exceptional circumstances, payments and capital movements between the Parties cause or threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy of either Party".
[15] "A claimant may submit any such claim only after one year has elapsed since the events giving rise to the claim" (Annex 10-C, Special Dispute Settlement Provisions, 1a); "the claimant may, on behalf of the enterprise, only seek damages with respect to the shares of the enterprise for which the claimant has a beneficial interest" (Annex 10-C, Special Dispute Settlement Provisions, 1b), and "Loss or damages arising from restrictive measures on capital inflows shall be limited to the reduction in value of the transfers and shall exclude loss of profits or business and any similar consequential or incidental damages" (Annex 10-C, Special Dispute Settlement Provisions, 1c).
[16] In the same spirit, claims can be immediately submitted when restrictions affect i) transfers related to FDI and ii) payments pursuant to a loan or bond issued in a foreign market, provided that such payments are made in accordance with the maturity date agreed on in loan or bond agreement.

6. Final reflections: FTA and development

a) Reasons to negotiate

The best scenario for trade negotiations for developing countries is the multilateral stage. For example, an updated WTO, with trade agreements of comprehensive coverage and depth would be the best-case scenario, a scenario that could deal with the challenges of technological change, value chains, the growing link between trade in goods, services and investments, e-commerce and the challenges of intellectual property in this new context. Unfortunately, the WTO, for now, is far from able to address these issues.

With the weakening of the WTO, regional integration emerges as second best, of which the E.U. is the best example. This experience, however, requires leadership and political consensus that are not always available in developing countries, as shown by the failed experiences of integration in Latin America. From that point of view, for small and open economies of this region, the weakness of multilateral and regional options has influenced several economies of the region, particularly Chile, Colombia, Mexico, and Peru, to engage in bilateral trade agreements with extra-regional economies, particularly with major trading partners, such as the U.S., E.U., and China.

There is an important "domino effect" in these negotiations. Indeed, when the U.S. or the E.U. negotiates a FTA with any developing country, those countries that compete in those markets with major products and do not have those trade agreements may experience a competitive disadvantage, which they then seek to overcome by entering a trade negotiation with these partners.

FTAs by themselves do not assure either dynamism or export diversification; nor do they guarantee greater FDI flows. It is indeed a naïve view that a free trade agreement is enough to trigger automatically an important increase in exports. In an extreme case, this could happen if country "A," which has a great competitive potential, negotiates a FTA with a country "B," which has high tariffs and non-tariff barriers to products for which "A" is very competitive. If those countries are geographically close, and therefore with reduced transportation costs and if the FTA addressed effectively the trade barriers, including the Non-Trade Barriers (NTB), the FTA will quickly favor exports from country "A" in the direction of country "B." In real life, however, the results are more complex.

This is so because now there is a very extensive network of trade agreements and therefore, there are many competitors who have trade agreements with the major economies; because tariffs have fallen in a systematic way; because non-trade barriers can be as or more important than tariffs and NTB are not always well covered in trade agreements; because the link goods-services-investment is increasingly important and that link is well treated only in a very small number of trade agreements; because, to be made effective, the benefits derived from trade agreements must be accompanied by domestic advances in infrastructure, logistics, and transport, and this does not always happen.

I have pointed out previously that FTAs by themselves do not assure either dynamism or export diversification, nor do they guarantee greater FDI flows. Then why do developing countries seek to negotiate FTAs with the U.S. or the E.U.? They negotiate because there are trade and non-trade benefits.

Among the various reasons given to justify these North-South free trade negotiations are as follows: (i) attracting investment with high standards; (ii) accessing new technologies; (iii) facilitating participation in value chains linked to main trading partners; (iv) through these processes, enhancing business modernization; and (v) facilitating additional higher-standard FTAs with other trade partners.

The market access advantages that are available in the FTAs do not lie only in the reduction or elimination of tariffs. In the case of FTAs with the United States, for example, these additional benefits help to: (i) consolidate GPS access; (ii) compensate tariff advantages of competitors; (iii) eliminate tariff peaks; (iv) eliminate tariff escalation that blocks export diversification; and (v) avoid trade barriers based on sanitary and phytosanitary measures or technical barriers.

In the experience of countries in the region, far from the U.S., and with a relevant network of FTAs, like Chile or Peru, other benefits of the agreements have been improving competitiveness through raising the quality and timeliness requirements of national companies; opening opportunities for business and technological alliances with partners of the industrialized world; and encouraging an entrepreneurial culture oriented to seize opportunities in the global economy.

There are other arguments that arise to justify these agreements. They would be: (i) Stimulate the presence of small and medium enterprises (SMEs) in trade; (ii) Stimulate productivity and innovation; and (iii) export diversification (Gervin 2015). However, these objectives are not achieved automatically. To make good use of these agreements, it is necessary to understand that the FTAs are only part of the necessary equation. These FTAs can afford to take advantage of commercial opportunities to the extent that the investments in infrastructure, logistics, and transport are made, as well as to strengthen the skills of workers. But with or without FTAs, the key tool is active industrial policies that foster innovation and productivity, and strengthen linkages between exports and the rest of the economy.

To stimulate productivity, innovation, and export diversification is, therefore, a challenge that is not related to the FTAs, but is defined in the domestic adoption of appropriate policies. From this point of view, countries with FTAs that lack industrial policies can hardly achieve these objectives, whereas countries with active industrial policies but without FTAs can move forward on these important challenges. The mistake of several countries in the region has been to think of FTAs as a substitute for such policies, thinking that these FTAs would be enough along with market signals to diversify the productive structure. In turn, without robust policies that support the SMEs in the use of the FTAs, it is possible that its benefits would be limited, possibly generating advantages only for traditional exporters. If this is the outcome, FTAs will not help to reduce inequalities.

b) <u>How to deal with the costs of the negotiations?</u>

Depending on the institutional framework and the quality of the negotiation, there may be significant costs. Of course, each country must make its own cost-benefit analysis to make the appropriate decision. This must be framed in a strategy of long-term development which adequately balances the internal and external challenges and, in this context, define precise areas to improve the quality of the international insertion. It is possible that in this context it may be convenient to negotiate FTAs with some of these economic giants. These negotiations can affect important areas of economic policy. It is, therefore, essential to develop negotiating strategies to realize medium-term objectives and to detect issues that may affect the strength of the long-term development strategy. In those cases, the negotiating strategy has a variety of possible instruments.

The first of these is to define areas (sectors, themes, or activities) which will be out of the agreement and, therefore, will not form part of the negotiation. This is referred in negotiating jargon as exclusions or non-conforming measures (NCMs). For example, there are the NCMs of annex I in the TPP (Present Measures) and Annex II (Futures Measures), where the State parties of the agreement reserves the right of not respecting NT, MFN clauses, or others in sectors which are defined specifically.[17]

A second tool is to exploit the internal differences of the other party, if they exist. We have already seen the important differences of opinion that exist in American society in the way of trying several of the most conflicting issues of these agreements. For this reason, a key aspect of the negotiation is to know how to manage this relationship with the various actors of the negotiating counterpart (Congress, Administration, business, academics), collecting legal precedents, academic and legislative arguments that help to better outline the negotiating strategy.

Learning from the American practice, it is necessary to maintain close contact with national members of your Congress, so that they place limits to excessive concessions or emphasize the offensive objectives in the negotiation. The idea is to use your Congress as an esquire protection as U.S. negotiators permanently do, explaining the limits that Congress places, avoiding to go further in certain subjects. Finally, the ambiguity in final texts is extremely useful when there is not an auspicious field for precise agreements.

c) <u>Policy space and complementary policies</u>

In economics, there is a certain consensus for the favorable impact of trade on economic growth, technology diffusion, and best business practices. However, it is also clear that not everyone benefits equally, since the increase in trade and open markets may require difficult adjustments, particularly for firms with lower productivity levels and workers with lower-skills. Hence the importance of accompanying trade agreements with explicit policies oriented to support such firms and workers with financial assistance and policies of re-training and training workers who will eventually be displaced due to the higher level of imports.

Despite FTAs, there remains ample room for industrial policy. Of course, WTO and FTAs have limited some instruments like export subsidies or FDI performance requirements. However, there

[17] For example, in the TPP, Chile's Annex I has 38 pages and the Annex II has 24 pages. They cover issues as varied as health care and child care; education; social services, social security; environmental services; construction services; mining; energy; hunting; domestic and international transportation; communications; arts and cultural industries; entertainment, audio-visual and broadcasting services; and the rights or preferences to socially or economically disadvantaged minorities, indigenous peoples.

remains an important policy space in several critical areas such as: (i) support for innovation and research and development policies; (ii) preferences for SMEs in public procurement; (iii) support for "green" goods and services; (iv) selective attraction of FDI; (v) possible use of production clusters and other policies for local development; (vi) support the development of specialized suppliers; (vii) specialized human capital programs and training programs for workers; and (viii) certification of competencies and quality certification.

Normally, the problem with these policies lies not in conflict with the FTAs but in limited resources for them, which reduces the impact on the productive and export structure. A further limitation is that the hallmark of modern industrial policy that inspires some public agencies is not necessarily shared by other areas of the government, resulting in lack of coordination that affects the overall effectiveness of this policy.

Therefore, the so called "policy space" is not limited by FTAs, except if you believe that the only way to carry out industrial policies is through SOEs benefiting from discriminatory policies. But modern open economy industrial policies that stimulate innovation, productivity, and entrepreneurship are not limited by the FTAs. The limitations of "policy space" may lie elsewhere: in the shortage of resources, poor design of policies, lack of coordination between the various public agencies, or in short life programs that change with each government.

In any case, the TPP contains rules which can effectively reduce the space of policies for developing countries compared with WTO regulations of the WTO. This is true in all the issues considered here: IPR, investment, balance of payments, financial services, and capital flows.

What is new, however, is that the TPP breaks with the USTR's tradition of a permanent increase in the intensity of the requirements of each FTA compared to the previous ones. The reasons for this has already been explained in the text: (i) the novelty of negotiating with the other 11 countries, including two members of the G7 (Canada and Japan) and four members of the G20 (Australia, Canada, Japan, and Mexico), and (ii) internal differences in the U.S. Congress with regard to the FTAs and, in particular, on issues such as labor, environment, ISDS, and IPR.

d) <u>Prospects of the TPP</u>

President Trump finally excluded the U.S. from TPP and a new era seems to have taken off. In any case, the support of some major business associations to the TPP was not strong. According them, three key objections should have been addressed and corrected before the deal could be approved: (i) the provisions on biologic drugs, where the pharmaceutical sector is claiming a similar level of protection that they have in the U.S. market (12 years); (ii) two specific provisions on financial services (lack of application to financial services of language prohibiting governments from requiring data to be stored on local servers,[18] and a provision that allows Malaysia to maintain a screening mechanism under which it can block foreign investment in financial services if it deems them not in the best interest of the country); and (iii) language in the TPP allowing government to block investor-state challenges of their anti-tobacco policies USTR has pointed out that these objections can be addressed through side-letters or through the implementation plans of the agreement. The question that arises is if this unilateral pressure of

[18] 63 House bipartisan lawmakers are urging the USTR to ban local server requirement for the financial sector in the TPP and in future FTAS.

the U.S. is breaking the plurilateral nature of the TPP, breaking the delicate balance between the 12 members.

As the U.S. (61.4 percent) and Japan (17.2 percent) added 78 percent of the total GDP of the TPP, without the endorsement of U.S. and Japan, the agreement will not enter into force.[19]

A relevant moment in the area of trade negotiations is open. The TPP should be reinvented without the U.S. The TTP is locked for several years. In the meantime, the Free Trade Area of the Asia-Pacific (FTAAP), the idea of a free trade agreement in the Asia-Pacific Economic Cooperation (APEC) forum, driven by China, will continue its slow but persistent advance. The RCEP, promoted by China in Asia and the "One Belt, One Road" (OBOR) initiative are other relevant issues that have to be followed carefully.

The anti-globalization climate today is stronger in the U.S. and the E.U. than in developing countries. There is, nonetheless, growing support in these countries for measures to increase regulation of financial flows and to reduce the investors' space to sue states. It is, therefore, an opportune moment so that developing countries adopt a more pro-active stance on reforming the governance of trade and global investments rules.

Latin America, for example, should seek partnerships with the E.U. and China to promote the establishment of an International Tribunal of Investments, correcting the bias of the current ISDS system. It could also promote new international arrangements to update and deepen the TRIPS Agreement, preserving developing economies interests, and could also support the E.U. in its attempts to get larger regulatory space for financial flows. It could also reinforce the link with academics and American legislators committed to these issues.

Questioning the mega-trade agreements without considering alternatives has not shown to be a good road for developing countries, as the vacuum tends to be filled in by the FTAs promoted by U.S. or E.U. Taking advantage of the new political scenario in the developed countries, with greater resistance to the impacts of globalization, developing countries could begin to design new forms of globalization. This requires, nonetheless, the adoption of new policy schemes: open economies, counter-cyclical macroeconomic policies, control of short-term capital inflows, macro-prudential regulations, modern industrial policies with emphasis on innovation, and meeting the demands of climate change. Overcoming the marked inequalities of the twentieth century will not be possible without conforming to these requirements—and that being the objective, developing countries should not be content with secondary roles in the design of the new global scenario.

[19] In fact, the TPP will enter into force once approved in their parliaments by all the members, within a period of up to two years of signing the agreement, which took place in February 2016. If at that date not all the members it passed legislatively, the TPP shall enter into force 60 days after the expiry of this period if at least six of the original signatories, which together account for at least 85 per cent of the combined gross domestic product of the original signatories in 2013 have approved it.

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