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LSE Enterprise

Preferential services and investment liberalization in Asia: Implications for Switzerland

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Final Report

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This study is dedicated to the memory of Edward M. Graham, a colleague and co-author whose courage, intelligence and quiet determination were constant sources of inspiration to all those graced by his friendship.

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Production networks are extensive in Asia – in particular in manufacturing and electronics – due in no small measure to the progressive lowering of service links costs among different production blocks. The fragmentation of production patterns throughout the region has a substantial impact on regional trade and investment flows. This does not mean, however, that Asian countries are becoming less dependent on western markets, as much intra-Asian production sharing is dependent on demand outside the region and western MNEs – including Swiss companies - are deeply integrated into these networks.

The literature on trade and FDI linkages suggests that exports typically increase as a result of FDI; i.e. trade and FDI tend to display a strongly complementary relationship. This is most prevalent for intermediate inputs and in particular trade within firms. Complementarity between FDI and trade is highest in the early stages of internationalisation, whereas substitution of local sales over exports – for instance to third countries - seems to be more likely as operations in host countries become competitive over time. Finally, high tariffs can lead to a substitution of market-seeking FDI over exports for big multinationals.

Such a complimentary relationship is borne out in studies on trade-FDI linkages in Asia. This is particularly the case for intermediate inputs and intra-firm trade. Similarly, increased trade among Asian countries leads to increased intra-Asia FDI-flows. The growth of FDI among Asian countries thus contributes to the regionalisation of Asian trade; and vice versa, increased trade among Asian countries contributes to the regionalisation of Asian investment flows.

It is important to recall, however, that even though Asian economic integration is increasing, this is not necessarily bad news for non-Asian countries or their MNEs. First of all, much of Asian production sharing is dependent on market demand outside the region and therefore does not entail a de-linking of Asia from the global marketplace – quite the contrary. Secondly, non-Asian MNEs plugged into Asian production networks are able to benefit from increased economic opportunities in the region and much Asian trade is thus carried out between foreign affiliates of MNEs. Swiss' and other multinationals are already inside players in this process, both promoting (albeit indirectly) more integrated markets as well as enjoying the benefits deriving from such closer integration.

Trade and FDI policies – such as export processing zones – directed towards the establishment of production networks have played an important role in promoting the trade-FDI nexus. Also, whereas tariff-jumping is most likely not important for intra-Asian FDI flows, exports of multinationals in Asia do respond to protectionist measures, as has been observed in Thailand and Indonesia. Lowering preferential tariffs through Asian regional and bilateral agreements could thus stimulate Swiss multinationals' economic activities in the region even further. This, in turn, raises the important issue of whether increased opportunities for intra-Asian trade due to preferential agreements divert economic activities away from parent countries.

Preferential Services Liberalisation in Asia

ASEAN member states are increasingly active in liberalisation and integration of trade in services within the region as well as with key third country partners, both within and outside Asia. Such partners include China, India, Japan, Korea, Australia, New Zealand and the

United States. Such liberalization processes have taken the form of regional trade agreements, as in the case of the ASEAN Framework Agreement on Services (AFAS), as well as bilateral free trade agreements. The region features 25 agreements governing services trade already in force, with an estimated 40 more negotiations currently underway. While some of these PTAs do not go significantly beyond the rules and the depth commitment achieved within the multilateral trading system (based on Uruguay Round commitments under the WTO's General Agreement on Trade in Services and offers made to date under the Doha Development Agenda), others extend well beyond WTO bindings (or proposed new commitments) and rules. The latter developments raise important questions regarding their potential effects, both positive and negative, on third countries.

The ASEAN Framework Agreement on Services (AFAS)

The AFAS provides a framework for the progressive liberalisation of services within ASEAN member states, based on a set of GATS-like rules and the periodic negotiation of liberalisation packages that lock-in the collective sets of individual ASEAN countries' liberalisation commitments in specific sectors. While intra-ASEAN liberalisation efforts have been prioritised in the sectors of air transport, business services, construction, financial services, maritime services, telecommunications, tourism, and professional services (via mutual recognition agreements in engineering and nursing to date), AFAS commitments also extend to a range of other service sectors in individual member's schedules. This paper's assessment of AFAS achievements yields the following results:

- ***Rules** – Little advances has been achieved under AFAS on services rule-making, with the notable exception of two areas. First, ASEAN members have reached agreement on mutual recognition of licensing and professional practice regimes in nursing and engineering services, with a third ASEAN MRA on architecture being close to completion. Such agreements establish principles, provisions and institutions to facilitate the movement of persons across borders. Second, the rule of origin for Mode 3 in services extends the benefits of intra-ASEAN liberalisation to juridical persons with substantial business operations in the territories of AFAS members. On the other hand, AFAS rules fall short from the GATS in many respects, with generally weak disciplines on regulatory transparency and non-discriminatory domestic regulation (i.e. the Article VI:4 work programme under GATS). It is notable that no progress can be reported within AFAS on the outstanding rule-making challenge of emergency safeguard measures for services trade, an issue on which ASEAN countries have maintained a demandeur posture in WTO/GATS discussions.*

- ***Depth and scope of liberalisation** – The five packages of progressive liberalization negotiated to date under AFAS extend the scope of ASEAN members' sub-sectoral commitments by an estimated 50% over existing GATS commitments. However, the depth of such of such commitments remains low and often only marginally improves commitments undertaken or offered in GATS. Within ASEAN, Thailand, Indonesia and the Philippines have significantly improved their level of bound liberalization over and above their GATS bindings, although this tends to reflect the paucity of these countries' existing WTO commitments or DDA offers rather than the actual depth of their AFAS commitments.*

- ***Effects on Switzerland** – This paper's analysis suggests that the trade diversion effects resulting from AFAS liberalization may be expected to be small, due to the relatively small margin of preference embedded in ASEAN members' AFAS commitments and the liberal stance adopted with regard to the treatment of third country investors. It cannot be excluded however that AFAS liberalisation, if deepened, may not generate negative effects on third country suppliers, particularly in Modes 1, 2 and 4, such that Switzerland*

should be targeting recent AFAS commitments, particularly under Modes 1 and 4, in its WTO dealings with key ASEAN partners. Furthermore, since some of the priority areas in the AFAS include areas of interest to Switzerland, such as air transport services, logistics, financial services and business services, Switzerland must guard against the possibility that future AFAS liberalisation yield greater trade diversion or hamper the possibility for Swiss service providers to penetrate ASEAN's rapidly growing service markets. The recent launch of formal negotiations between the EU and ASEAN Member countries (and India), combined with the protracted state of the WTO Doha Round and the modest prospects for significant new market openings under the GATS, suggest that Swiss authorities and the country's private sector may need to ponder the scope for securing preferential access on par (be it AFAS or EU-ASEAN parity) with that of its key trading partners and chief competitors.

Asian PTAs with third countries

- ***Rules*** *– The growing network of PTAs covering services that ASEAN countries have entered into with non-ASEAN partners in recent years can be characterized as AFAS+ and GATS+ in character in regard to both rule-making (though less systematically so) and market opening (almost systematically so, particularly in agreements concluded with the United States). Such advances include new and improved rules governing trade and investment in financial services, regulatory transparency, telecommunications (including pro-competitive regulatory disciplines in the sector that go beyond the rules contained in the GATS' Reference Paper on basic telecommunications). A number of PTAs also develop standards, principles and disciplines for the movement of natural persons in certain professional fields and promote regulatory and other forms of cooperation well as cooperation in various areas of services policy, such as small and medium enterprises or research and development. Fully 40% of all PTAs concluded between ASEAN member countries and third countries (though not with EFTA) operate on the basis of a negative list approach to market opening, although the gains in transparency and added liberalization vary depending on the sectoral scope and breadth of appended reservations.*

- ***Depth and scope of liberalisation*** *– The depth of liberalisation varies considerably across the sample of third country PTAs reviewed in this paper. While some agreements marginally deepen liberalisation beyond that scheduled under the GATS or AFAS, others significantly improve liberalisation commitments in terms of sectoral coverage and the quality of bindings. Status quo bindings locking in existing levels of market access are noticeably more prevalent under PTAs than under ASEAN countries' current GATS commitments or their DDA offers. In modal terms, substantial GATS+ improvements have been achieved with regard to commercial presence (mode 3). Progress is also notable in some agreements in regard to the movement of natural persons (mode 4), though not in the case of recent US agreements. However, in terms of quality and depth of commitments, commitments in both areas remain subject to numerous restrictions, such that full liberalisation remains more prevalent (as under the GATS) as regards cross border supply (mode 1) and consumption abroad (mode 2). The experience in Asia suggests that liberalisation through negative listing does not necessarily lead to better results than liberalisation through positive listing, though overall levels of commitments do appear greater overall under negative list agreements. Negative list agreements, however, can bring significant gains in regulatory transparency and more easily lock in the regulatory status quo.*

- ***Effects on Switzerland*** *– The possible trade diversion effects on Switzerland, or the negative results stemming from the non-extension of preferential access to sectors of interest to Switzerland, are likely more significant in the case of Asian PTAs entered into with third countries relative to AFAS. Such effects differ across sectors and modes of*

supply as well as between individual ASEAN members based on their importance as trading and investment partners for Switzerland. Potential trade diversion effects worthy of closer negotiating scrutiny on the part of Switzerland include the following: Brunei - architectural and engineering services, computer-related services, modes 1 and 2; Laos – all sectors in modes 1, 2 and 3, professional services, financial services, and distribution services; Philippines - engineering services, financial services, environmental services and air transport services; Singapore – modes 1 and 2 as well as financial services; Thailand – distribution services, architectural and engineering services, air transport services, environmental services, and financial services. The tendency for most PTAs entered into between individual ASEAN members and third countries to adopt a liberal rule of origin for investment in services (a denial of benefits clause operating via a substantial business operations test) implies a generally limited potential for investment diversion detrimental to established Swiss operators or to those willing to entering these markets via a commercial presence. It should however be noted that the remaining high degree of protection of ASEAN service markets in several sectors of interest to Swiss industry suggests that individual bilateral agreements or a deepened EFTA agreement with ASEAN as a whole could yield positive gains in all key sectors and modes of supply in which Switzerland maintains offensive interests in services trade.

Preferential investment liberalisation in Asia

The study focuses attention on the key investment provisions found in a sample of 19 Asian preferential trade and investment agreements (PTAs) and assesses their implications for third country – including Swiss - investors. As investors in services are often treated separately, interactions between investment and service chapters are also discussed. The main findings – some of which are based on secondary literature – are as follows.

Most PTAs in the region – including the two EFTA-agreements, with Korea and Singapore - use a broad and 'asset-based' definition of investments in the investment chapter, whereas a narrower 'enterprise-based' definition of service investments is used in service chapters. Most definitions of commercial presence require ownership or control by natural or legal persons covered under the agreement as defined under agreements' rules of origin/denial of benefits clauses (see below).

The services chapters of EFTA agreements solely govern national- and most-favoured-nation treatment for commercial presence. This stands in contrast to US agreements with EFTA partners – Korea and Singapore – which cover both service and non-service investors in investment chapters. The US approach reduces the risk over conflicting obligations and increases transparency. It furthermore gives service investors access to investor-to-state dispute arbitration in more cases (see below). The Commission's recent mandate to negotiate an EU-ASEAN agreement applies an enterprise-based definition of investors, but is highly transparent as one single chapter governs all investors.

In general, rules of origin as applied for services and investment are fairly liberal. The most restrictive origin-criterion for juridical persons – ownership and control – is only applied in two of the PTAs reviewed. Swiss juridical persons constituted or otherwise organised under the laws of a party with substantial business operations there – or in some cases in any party – therefore enjoy preferential treatment in most agreements. Rules of origin for natural persons extend benefits to permanent residents in some agreements including those of EFTA (with the possibility of reservations for particular types of service suppliers). This is not the case for past or currently negotiated US or EU agreements, however.

Even if rules of origin are liberal overall, market access restrictions for services – such as maximum levels for foreign equity participation - still restrict coverage substantially in some

cases. In contrast, some countries such as Singapore have made significant market access commitments. EFTA's PTA partners – Singapore and Korea – seem to have committed to 'deeper' market access obligations in their PTAs with the US as well as in the agreement between themselves.

Swiss service providers (Modes 1, 2 and 4) covered under Asian PTAs can expect to be granted national treatment (NT) less often than investors (Mode 3). EFTA agreements list NT for services on a positive list basis and investments on a negative list basis, whereas EFTA's partners – Korea and Singapore – typically include NT on a negative list basis for both services and investments in their other agreements. Whereas an in-depth analysis of each country's sector and sub-sector schedules is necessary to establish whether obligations are more far-reaching in one agreement over the other, the negative list approach used in EFTA partners' other service agreements does indicate wider coverage.

Most PTAs include most-favoured-nation (MFN) clauses. There is no apparent pattern, however, as to which types of agreements exclude MFN provisions or a clear association between MFN disciplines and whether agreements are based on negative or positive list approaches. EFTA agreements include a wide exception to MFN treatment for all other PTAs in regional economic integration organisation (REIO) exception clauses. NAFTA-inspired agreements – such as the US agreements with Korea and Singapore - allow the parties to benefit from better treatment granted to third parties in another PTA signed after – but not before - the entry into force of the PTA. As more recent agreements tend to include wider commitments, the NAFTA approach to MFN-treatment – if still imperfect – is better able to multilateralize preferential commitments. In any event, the tendency towards permitting broad exemptions to MFN treatment reduces its practical relevance in the context of Asian PTAs.

In both NT and MFN clauses there are semantic differences across agreements, which could have important implications. Negative list service chapters use the term 'like circumstances' instead of GATS-like 'like service suppliers and services', which tends to be used in positive list agreements such as EFTA agreements. If future jurisprudence establishes that the first term is broader in cope, then Swiss service suppliers may have obtained lesser coverage as, for instance, US companies in Korea and Singapore. On the other hand, future jurisprudence might also clarify whether mentioning both 'services' and 'service providers' – as in EFTA agreements - entails wider coverage than only referring to the latter as is the case in US agreements with Singapore and Korea.

In contrast to treatment standards, investment protection typically doesn't vary depending on whether the investment is in services or in other sectors. The study focuses attention on key protection provisions found in the sample agreements reviewed, including umbrella clauses[5]*, transfer provisions, overall treatment standards, expropriation clauses and compensation requirements. Apart from certain exceptions, protection provisions are largely comparable to those of BITs.*

The EFTA agreements are the only agreements reviewed that include an umbrella clause. However, recent jurisprudence provides conflicting answers as to whether this clause allows investors to resolve contractual claims against host countries under arbitration provisions of the investment agreement, rather than under the dispute resolution provisions of the contract in dispute.

[5] An umbrella clause stipulates that the host country assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party and thus not only in connection with an investment agreement.

Transfers of capital in connection with foreign investments are protected in a relatively consistent and robust manner in Asian PTAs. Agreements guarantee investors the right to transfer current and capital transactions without delay, and to use a particular kind of currency at a specified exchange rate, subject to common exceptions in the case of serious balance-of-payments, exchange rate or monetary policy difficulties.

It is not clear from available case law whether 'fair and equitable treatment' is an independent treatment standard. If it is, then Swiss investors might have obtained stronger protection rights under EFTA PTAs than investors covered under agreements that a) don't include this standard; or b) include it but mention that it is similar to established customary international law as is the case in US agreements.

Apart from EU agreements, all reviewed PTAs with investment coverage more or less copy standard BIT-provisions on direct and indirect expropriation and compensation requirements. However, the EFTA-Singapore agreement refers to 'de facto' rather than 'indirect' expropriation and does not specify compensation requirements in detail. Whether this has important implications is again not clear from available jurisprudence, but is in this particular case doubtful given Singapore's overall investor-friendly environment and the fact that the two terms often are used interchangeably.

Except for EU agreements, all PTAs with investment coverage offer investors the choice of investor-to-state dispute settlement under ICSID or ad hoc procedures using UNCITRAL rules in most instances. Service investors will not be able to bring a dispute to investor-state arbitration if it relates to matters not covered by the investment-chapter, and they thus have to rely on ad hoc state-to-state arbitration. US service companies therefore have access to investor-to-state arbitration for all aspects covering investment in services, whereas NT and MFN for commercial presence are not covered by the investor-to-state mechanism in EFTA agreements.

Again in contrast to US agreements, the EFTA PTAs require consent by the disputing parties – though only in the case of pre-establishment disputes for the Korea agreement – and do not include explicit transparency provisions. EFTA agreements moreover don't allow for a consolidation of two or more separately submitted claims with a question of law or fact in common and arising out of the same events or circumstances.

The EFTA and US agreements with Singapore and Korea are compared in Table V.7. It is particularly in services where US agreements seem to have more comprehensive provisions by for instance providing service investors the same treatment standards as those offered to other investors. Other differences such as REIO clauses, umbrella clauses, etc. are cited above. It is notable that NAFTA-inspired provisions have been adopted in non-US PTAs such as Singapore-Korea, Chile-Korea, Japan-Mexico and this approach is thus proliferating (OECD, 2007).

De jure integration: assessing the effects of trade and investment agreements

The study review of the available literature confirms the fact that Asian integration has so far been driven mostly by market forces. However, it also points out that the recent surge in PTAs is likely to lead to an increased regionalisation of both trade and investment flows in Asia. It is important to remember that when compared to multilateral or unilateral liberalisation, such a process can represent a potentially significant source of discrimination against outsiders. Fortunately, there are reassuring signs that this process might not be as 'malign' in Asia as has been observed elsewhere. Many Asian PTAs include comprehensive liberalization commitments as well as far-reaching behind the border reforms and regulatory cooperation initiatives, which will most likely create more opportunities for trade and

investment for both Asian and non-Asian operators. The liberalisation of the service sector holds the potential to bring about substantial economy-wide benefits, as well as benefits both for specific service sector MNEs and for firms involved in regional production networks who depend on low service inputs. In this regard, a number of Asian countries – notably Singapore, Japan and Korea – have committed to GATS+ levels of market opening. Such liberalization could be regarded as a building block for further multilateral liberalization.

More problematic are complex and conflicting rules of origin for trade in goods, which could prove onerous for Swiss MNEs in the region. Investment diversion has been a genuine problem under some PTAs. It follows, then, that it would be in Switzerland's interest to advocate for a more comprehensive agreement on rules of origin (and stricter rules on their use in PTAs) in the WTO while also suggesting the desirability of tackling investment issues more comprehensively in the next multilateral negotiating round. To the extent that Switzerland wishes to confront or overcome such potential problems by joining the Asian PTA race, three basic policy recommendations follow from the review of existing literature.

First, it bears recalling that trade diversion is a problem not only for third countries but can also be problematic for signatory countries of PTAs from an efficiency perspective (Viner, 1950). In order for PTAs to create more economic activity than they divert, they therefore need to include deep tariff cuts in practically all sectors and goods.

Second, in order to lessen compliance costs (the so-called Asian noodle-bowl problem) stemming from the overlap of varying rules of origin, a simple and liberal approach is preferable. This has the added advantage of further decreasing the extent of possible trade diversion.

Third, the largest liberalisation benefits on offer, in Asia and elsewhere, are often to be found in non-goods trade, such as in services and FDI. A 'WTO-plus' approach with progressive reductions in restrictions to market access, national and MFN treatment in these areas could thus have large positive effects. This is particularly so given that production networks tend to encompass investment, service providers as well as trade in goods. "Shallow" PTA commitments on any one of the above trinity of issues is therefore not recommendable. Moreover, the ability of Swiss investors and service providers to derive third country benefits from Asian preferential trade and investment liberalisation requires that Asian PTAs continue to adopt liberal denial of benefits/rules of origin clauses in the services and investment fields.

As regards, finally, the influence of investment treaties (protection and liberalisation) on induced FDI activity, available studies suggest that is far from certain whether BITs promote investment. It seems safe to conclude, however, that BITs concluded between Asian countries should not have a substantial impact on investment flows in and out of Asia. Also, even though BITs have proven powerful in protecting Swiss and other investors, they are most likely not determinative instruments in promoting Swiss FDI to the region.

I. Introduction

Developing countries in Asia have a huge stake in maintaining an open global system of trade and investment. The integration of the region into the world economy has been largely driven by market forces, particularly by private foreign direct investment and the related rise of intra-industry trade. When assessing the growth of Asia's trade and the respective roles of policy, technology, and markets in influencing patterns of regional integration, a key conclusion that emerges is that technological change, markets, and the private sector, particularly multinational firms (hence FDI), have been crucial in deepening integration. To date, empirical studies suggest that bilateral and regional trade and investment agreements have had only a limited impact on Asia’s integration process, the most significant liberalization efforts having been unilateral in character.

Increasing trade integration within East and Southeast Asia has been closely associated with changes in industrial organization and the spread of international production sharing, or the fragmentation of vertically integrated supply chains. The attractiveness of East and Southeast Asia as production and investment platforms has been enhanced by a variety of measures that reduce the frictions and costs of trade, such as investments in ports and other infrastructure, the establishment of special economic zones and bonded industrial warehouses, and duty drawback schemes. These arrangements have allowed investors to take advantage of economies of scope and specialization.

There are, however, unmistakable signs that the dynamics of Asian integration are changing, not least because of the protracted difficulties encountered in multilateral trade negotiations but also in light of the emergence of – and concomitant competitive threats and opportunities from - China and India as regional giants.

Countries in Asia and in other regions are increasingly experimenting with preferential trade agreements, most often on a bilateral basis. Such a trend is today on a strong upswing throughout Asia and increasingly spans several regions. Indeed, Asia's "noodle bowl" is not only expanding, but is increasingly involved with complex agreements in other parts of the world. Such cross-regional agreements are driven by a variety of concerns such as energy security, access to minerals and other natural resources. They also represent efforts by Asian countries to "lock in" reforms by making them part of formal trade and investment treaties with a major developed country or region. Many such agreements are also motivated by political considerations, as countries seek to cement diplomatic alliances by providing economic benefits to partners.

As Asia's preferential trade and investment agreements are still for the most part at an early stage, this obviously complicates attempts at assessing their effects empirically and assigning structural influences to their core provisions. Yet during the time that they are implemented, such agreements will begin to impact on both regional and global trade and investment flows. Accordingly, it is important that preferential trade and investment liberalisation be conducted in such a way that it supports, rather than contradicts, the openness that has so far been a defining characteristic of Asia's trade expansion and its integration into world markets.

This study takes stock of recent trends in the services and investment dimensions of deepening economic integration in Asia and its likely implications for third country investors and service suppliers, including most particularly those from Switzerland.

The study is structured as follows. Section II provides the context for the study by depicting the forces underlying recent trends in Asian regionalism. The section draws particular attention to the distinction between *de facto* (i.e. driven by markets) and *de jure* (i.e. driven by formal institutional arrangements) forms of integration. Section III of the study offers a literature review of trade and FDI linkages in Asia, placing special emphasis on the implications of such evolving linkages for Swiss/third country operators in the region.

Section IV reviews the salient features of preferential attempts at liberalizing services trade in Asia, focusing attention both the process of services liberalization conducted among ASEAN countries as well as between individual ASEAN countries and a set of key third country partners in Asia and beyond. Section V attempts a similar exercise in the field of investment rule-making and liberalization, drawing on a sample of eighteen key preferential trade agreements featuring disciplines of various degrees of comprehensiveness governing the protection and liberalization of cross-border investment activity.

Section VI turns to the possible effects of the recent shift towards *de jure* or treaty-driven forms of integration services and investment liberalization and rule-making, offering insights on the implications of ongoing trends for third country investors and service providers operating in the region. Section VII offers summary and concluding thoughts.

II. Understanding the rise of Asian regionalism

Key issues addressed:

- The shift from *de facto* to *de jure* regionalism in Asia
- Contrasting the practice of regionalism in Asia and Latin America
- Asian regional integration: stylized facts and driving forces

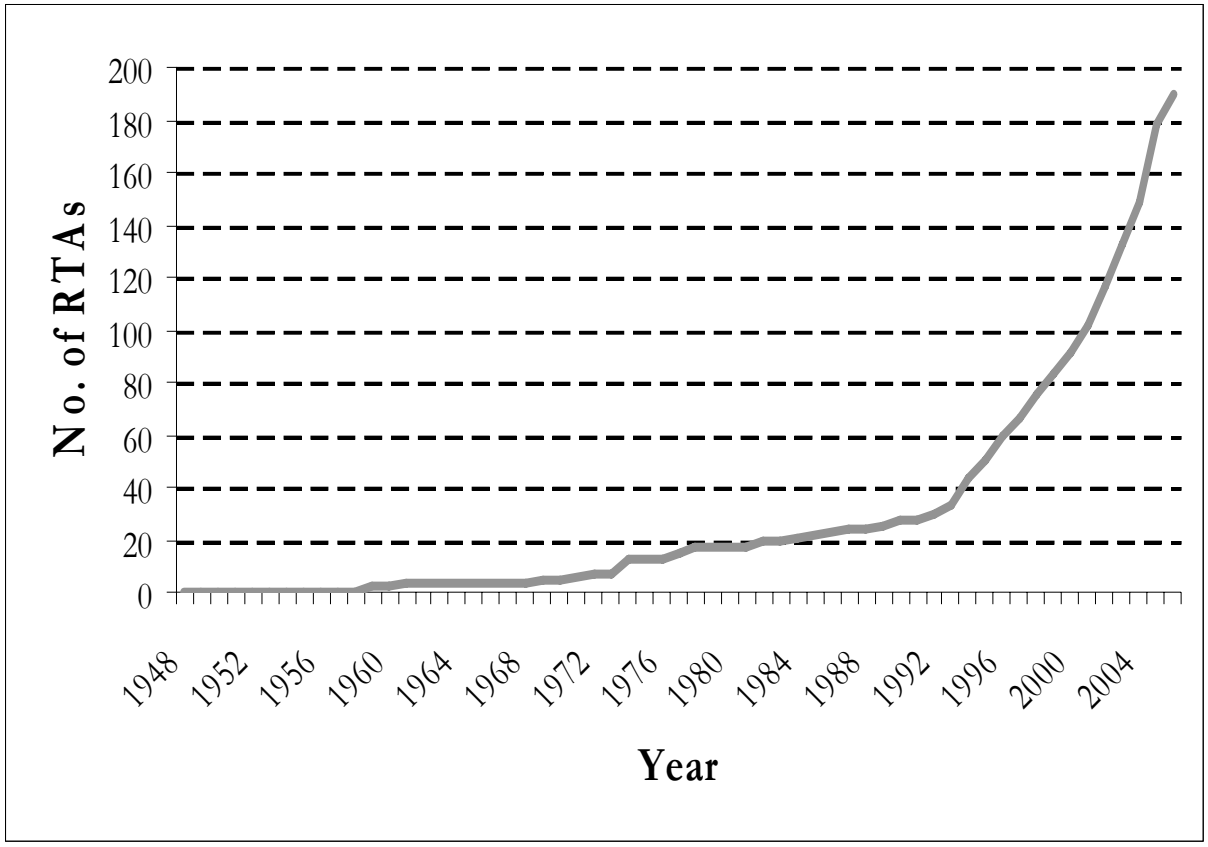
The last decade has witnessed a major transformation in the global governance of international trade relationships. The first major development occurred in 1995 with the creation of the World Trade Organization (WTO), the global institution governing the conduct of international trade. Rules contained in the Marrakech Agreement that established the WTO feature the most ambitious and comprehensive multilateral provisions ever ratified by member countries. Somewhat paradoxically, the period since 1995 has witnessed the second major development in international trade relationships—the proliferation of bilateral, regional and other preferential trade agreements among nations. As the WTO's Doha Development Agenda (DDA) continues to sputter, signs abound that recourse to preferential trade and investment liberalisation will proliferate further in the coming years. Such developments are forcing many WTO members, among them Switzerland, to review and reassess their trade policy strategies and priorities. The need for such a reassessment has arguably acquired greater salience now that Switzerland's largest trading partner - the European Union – has recently renounced the moratorium on new PTAs it informally decreed in 1999 and entered into formal PTA negotiations with India, Korea and the member countries of ASEAN.

The conclusion of preferential trade agreements (PTAs) is by no means new. But as Figure II.1 below shows vividly, the sheer number and the speed with which such agreements have been negotiated over the past dozen years are simply astonishing. All but one WTO member – Mongolia – today conduct some measure of their trade relations on a preferential basis under one or more PTAs, and it is estimated that more than half of world trade activity today is governed by preferential rules. This section of the study analyzes the recent history, characteristics and political economy of regional and bilateral trade integration from the viewpoint of two core concepts: *integration of markets vs. integration by agreements,* with a particular focus on the East Asian incarnation of these two phenomena.

As its name suggests, the concept of *integration of markets* focuses on the idea that economies can integrate among themselves by relying primarily on the forces of the marketplace, i.e. by allowing the private sector to be the vanguard of trade and investment

integration. This has at times been dubbed *de facto* integration. The second core concept is *integration by agreements,* which focuses on trade integration centred on recourse to *de jure* trade and investment treaties. This second channel of integration emphasizes the primacy of legal instruments to further economic integration among countries.

Figure II.1 Evolution in the number of multilaterally notified preferential trade agreements, 1948-2006



Source: WTO (2007).

There is little doubt that the two channels of integration described above are closely related and indeed ultimately complementary in nature. The integration of markets without formal trade and investment agreements can create uncertainty for businesses inasmuch as the institutional foundations of an integrating area may not be sufficiently clear, transparent or predictable. At the same time, *de jure* integration can be vacuous if the underlying economic forces are not favourable towards integration, as the early experiences at trade integration in Africa and Latin America in the 1960's and 1970's have so clearly revealed. In today's globalizing environment characterized by deeper forms of integration among nations and the operation of regional and global innovation (R&D) and production networks, the question

does arise of which means of integration is more successful and more fundamental in driving trade integration? Is there a logical sequence for policymakers to consider when examining these two channels of integration? Given that Asia and Latin America are two fertile regions in which various types of PTAs have been proliferating in recent years, we turn briefly to the experiences of these two regions in seeking answers to the above questions.

Compared to Latin America, Asia has long lagged in concluding formal trade agreements as key trading powers in the region – notably Japan, Korea, Singapore and Hong Kong, China had traditionally been more supportive of an open multilateral system, while China and Chinese Taipei themselves only recently joined the WTO.

The process of regional integration in Asia can be regarded as *de facto* in character even though since the end of 1990s most East Asian countries have shown considerably greater interest in *de jure* regionalism. The recent momentum towards formal *(de jure*) regional integration has been accompanied by the proliferation of bilateral PTAs not only within Asia but also with extra-regional countries, in particular with Latin America. Figure II.2 and Table II.1 below capture this process in a graphic manner, describing the intricate web of bilateral and plurilateral PTAs now in existence or under negotiation in the Asian region.

After a first wave of largely failed attempts promoting treaty-based forms of regional integration in the 1960's and 1970's, Latin American countries renewed with *de jure* integration efforts in the early 1990s, with two agreements - the 1994 North American Free Trade Agreement (NAFTA, linking Canada, Mexico and the United States, itself an extension of the 1988 Canada-United States Free Trade Agreement) and the 1995 Common Market of the South (MERCOSUR), linking Argentina, Brazil, Paraguay and Uruguay, setting a process in motion that would witness the emergence of a large and growing number of bilateral and regional PTAs among Latin American countries and with extra-regional countries by the end of 1990s (see Figure II.3 below). It is noteworthy that, given the different models of regional integration that have predominated in the two regions, intra-regional trade in Latin America remains considerably lower – by a factor of almost four to one - than that observed in East Asia despite Latin America's putative first mover advantage in *de jure* integration (see Table II.1).

Table II.1 East Asian and Latin American Intra-Regional Trade, Various Years

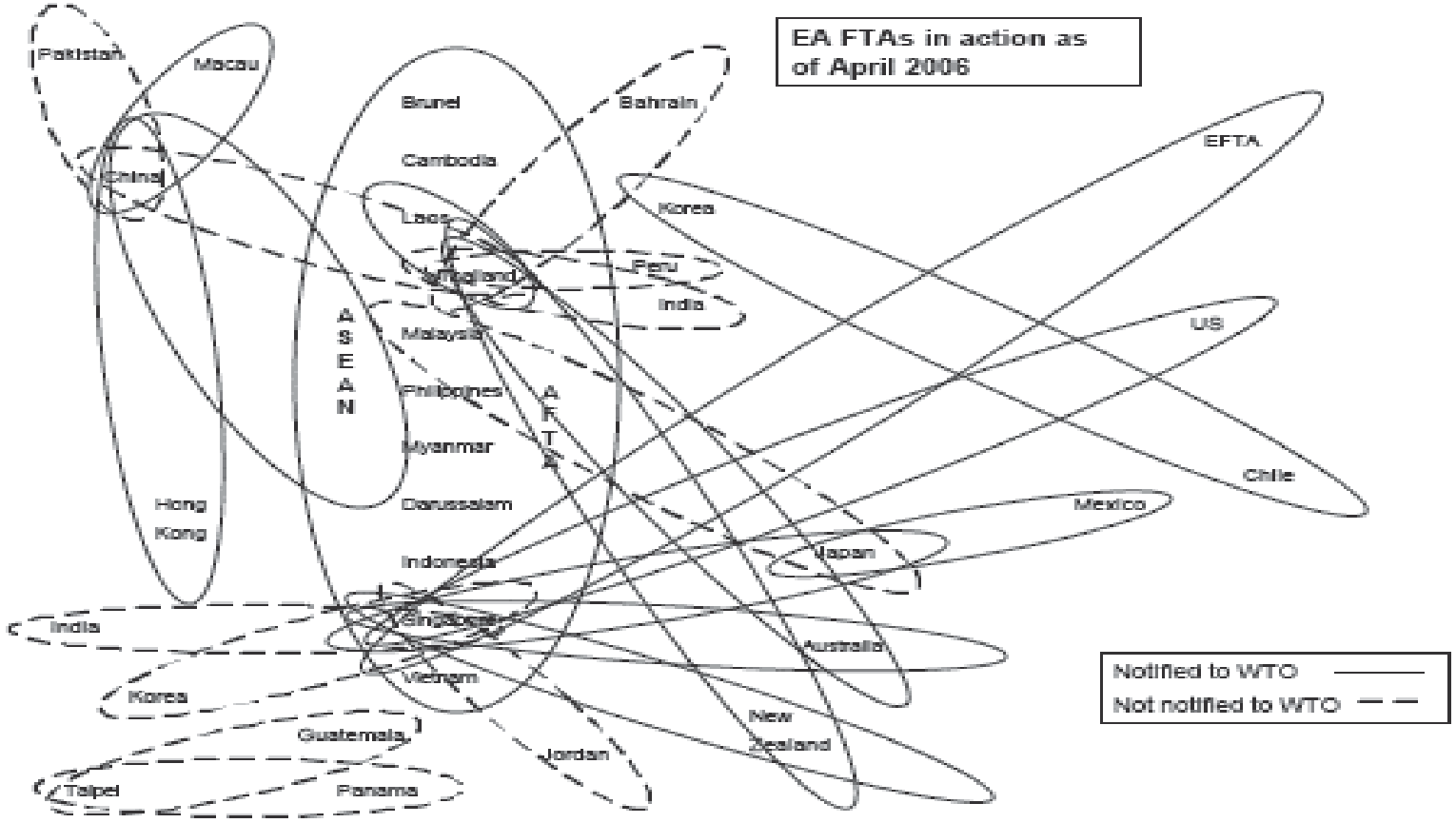
Year	Share of Intra-Regional East Asian Exports in Total East Asian Exports	Share of Intra-Regional Latin American Exports in Total Latin American Exports
1985	34,1%	10,0%
1990	39,7%	10,9%
1995	48,1%	17,2%
2000	46,4%	13,1%
2006	51,7%	13,1%

Source: Adapted from Aminian *et al*. (2007) based on UN COMTRADE Statistics.

The (timid) starting point of Asian *de jure* integration came with the Free Trade Area (AFTA) initiated by the member countries of the Association of Southeast Asian Nations (ASEAN) in 1992 (see Box II.1). This process had been preceded by the launch in 1989 of the Asia-Pacific Economic Cooperation (APEC) forum (Petri, 2006). APEC of course is not a formal regional trade agreement but a rather unique institutional setting – a best practice club of sorts – aimed at promoting trade and investment liberalization, economic and technical cooperation and regulatory convergence on a voluntary basis among its twenty-one member economies. Although APEC is not a PTA in legal terms, it features a roadmap – known as the Bogor Goals - to achieve free trade and investment in the region by 2010 for its developed country members and by 2020 for its developing country members.[6]

[6] At Osaka in November 1995, an agreement was reached on a set of fundamental principles to bring about the liberalization of trade and investment among APEC member economies. If the Bogor Goals are realized and the commitments of the twenty-one member economies are fully implemented, APEC countries could enjoy a substantial improvement in aggregate welfare through free trade and investment opportunities in the region, without however having formally entered into formal treaty arrangements. APEC adopted "open regionalism" as its underlying paradigm with the intention of sharing the benefits of free trade with non-members and thus trying to comply with the most favoured nation (MFN) principle of the WTO. The work of APEC in trade and investment liberalization has not however achieved the hoped for success so far. However, this need not necessarily be viewed as a failure of "open regionalism", but rather the result of the broadening of APEC's agenda, which now includes such topics as security, trade facilitation and best practices in regulatory reform.

Figure II.2 On the Rise: Asian PTAs, April 2006



Source: Nicolas (2006)

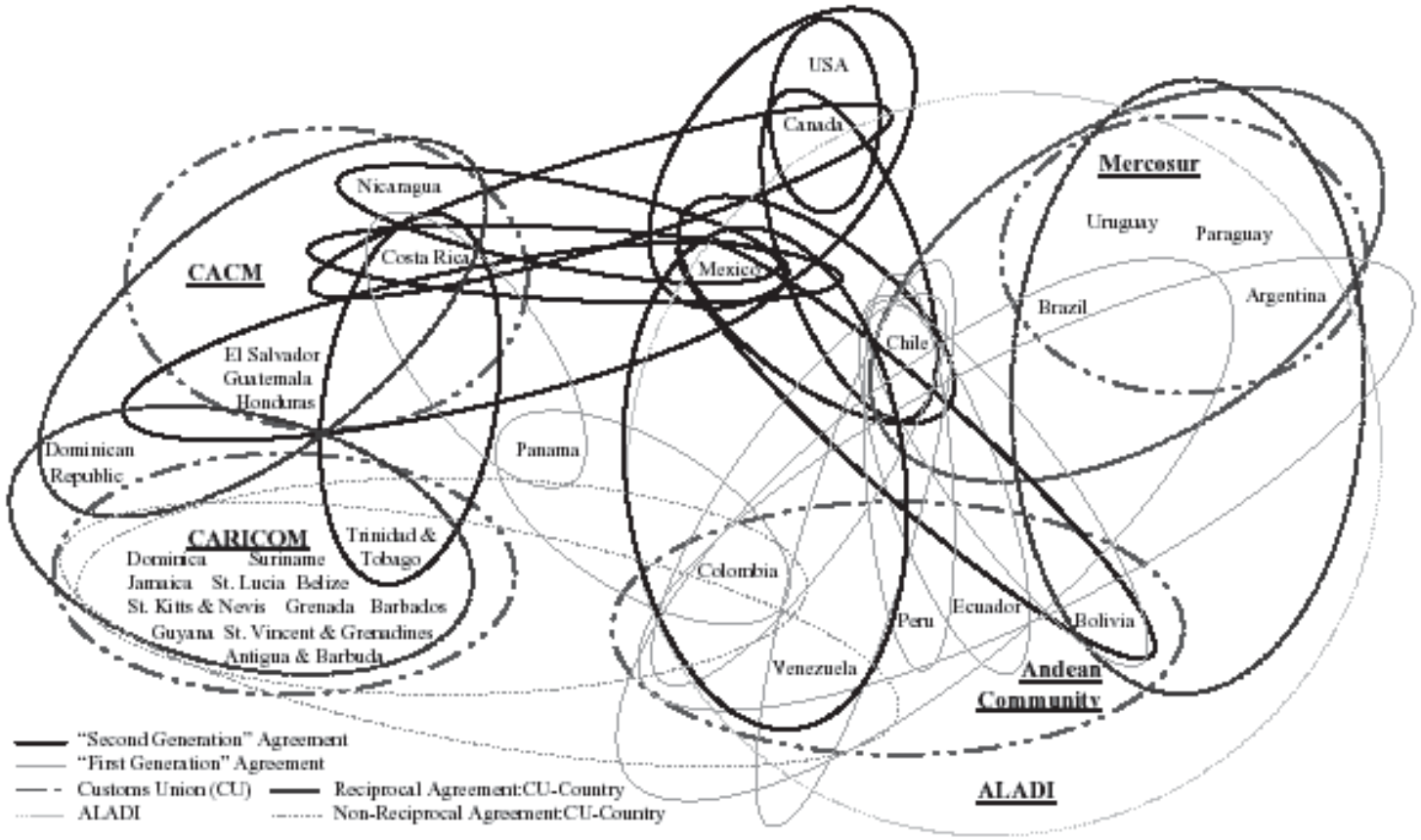
Table II.2 A typology of PTAs in Asia
(Entries in italics refer to agreements under negotiation)

Bilateral		Regional/Plurilateral	
Exclusively East Asian	**Geographically diverse**	**Exclusively East Asian**	**Goographically diverse**
Japan-Singapore (2002)	China-Pakistan (2005)	AFTA (1992)	APEC (1989)
Japan-Malaysia (2005)	China-Chile (2006)	China-ASEAN (2004	Singapore-EFTA (2003)
Japan-Philippines (2006)	*China-Australia*	(goods) and 2006	Korea-EFTA (2005)
Japan-Brunei (2007)	*China-New Zealand*	(services)	*Thailand-EFTA*
Japan-Indonesia	*Indonesia-Australia*	Korea-ASEAN (2006)	*ASEAN-India*
Japan-Korea	Japan-Mexico (2005)	*Japan-ASEAN*	*China-GCC*
Japan-Thailand	Korea-Chile (2004)		*China-SACU*
Japan-Vietnam	Korea-United States (2007)		Trans-Pacific (Singapore,
Korea-Singapore (2006)	*Japan-Australia*		Brunei, New Zealand, Chilei)
Malaysia-Korea (2005)	*Japan-India*		(2005)
Thailand-China (2003)	*Korea-Mexico*		*EU-ASEAN*
Thailand-Laos (2001)	*Korea-Canada*		*EU-India*
China-Hong Kong (2004)	*Malaysia-Australia*		*EU-Korea*
China-Macao (2004)	*Malaysia-New Zealand*		
	Malaysia-Pakistan		
	Malaysia-United States		
	Singapore-New Zealand (2001)		
	Singapore-Australia(2003)		
	Singapore-United States (2004)		
	Singapore-Jordan (2004)		
	Singapore-India (2005)		
	Singapore-Bahreïn		
	Singapore-Canada		
	Singapore-UAE		
	Singapore-Egypt		
	Singapore-Kuwait		
	Singapore-Mexico		
	Singapore-Pakistan		
	Singapore-Panama (2006)		
	Singapore-Peru		

	Singapore-Qatar *Singapore-Sri Lanka* Thailand-India (2003) Thailand-New Zealand (2005) Thailand-Australia (2005) Thailand-Bahrein (2002) Thailand-Peru (2005) *Thailand-United States*		

Source: Nicolas (2006); updated by author.

Figure II.3 A Western Hemisphere spaghetti bowl: the landscape of preferential trade agreements in the Americas, end-2005



Source: Stephanou (2007).

Box II.1 Trade and investment liberalization within ASEAN: stylized facts

The Association of South East Asian Nations (ASEAN) encompasses 10 South East Asian countries: Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Burma/Myanmar, Philippines, Singapore, Thailand and Vietnam. ASEAN has been one of the most successful regional groupings among developing countries to date. Its combined GDP (at purchasing power parity) totalled US$ 2.86 trillion at the end of 2006, roughly 4.3 of the World GDP, while its exports reached US$ 769 billion, approximately 8 percent of total world exports.[7] The ultimate objective of the ASEAN Free Trade Area (AFTA) is to increase ASEAN member countries' competitive edge as a production base geared towards the world market through trade and investment liberalisation and closer economic co-operation. Currently, four main ASEAN agreements seek to achieve this objective. These are:

(i) the Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (CEPT-AFTA), which was signed in 1992;
(ii) the ASEAN Framework Agreement on Services (AFAS), which was signed in 1995;
(iii) the Basic Agreement on the ASEAN Industrial Cooperation Scheme (AICO), which was signed in 1996; and
(iv) the Framework Agreement on the ASEAN Investment Area (AIA), which was signed in 1998.

T*rade in Goods*

The CEPT-AFTA is a cooperative arrangement amongst ASEAN Member Countries whose aim is to reduce intra-regional tariffs and remove non-tariff barriers. This process, which began on 1 January 1993, seeks complete tariff elimination by 2010 for the regional grouping's most advanced economies – the so-called ASEAN 6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) and by 2015 for its four poorest members, the so-called CLMV group (Cambodia, Laos, Myanmar, Vietnam).

ASEAN members have made significant strides in liberalizing trade in goods within the region under the AFTA. In January 2003, tariffs between member countries were reduced to 0-5% for all products, except those on the general exception and sensitive product lists of each member country.

The ASEAN Secretariat reports that tariffs on 98.99% (or 65,080 out of the total 65,743 tariff lines) of the products of the ASEAN-6 have been reduced to a 0-5 percent tariff range. For the four (CLMV) remaining members, 71.05% of tariff lines are today in the 0-5 percent tariff-range. Overall, 88.84% of ASEAN tariffs are now in the 0-5%, and 46,600 of these tariff lines are at 0% (Cordenillo, 2006).

Intra-ASEAN trade dominates ASEAN trade, followed by trade with Japan, the USA, the EU (15) and then China. The period since 1993 has witnessed important shifts in the structure of ASEAN trade flows, with reductions in the share of trade of Japan, the US and the EU (15) having been absorbed by intra-ASEAN trade, China and other markets. This shows that over the years, not only has intra-ASEAN trade grown, but that ASEAN countries have also diversified their markets. The most recent figures show that the fastest growing trading partners of ASEAN are Russia, India, China, Australia and New Zealand. With the exception of Russia, all are trading partners with whom ASEAN countries are currently involved in FTA negotiations.

[7] CIA(2007).

Trade in Services

The service sector today plays an increasingly important role in ASEAN economies, as reflected in the rising share of the service sector in GDP, employment and export performance. The ASEAN Free Trade Agreement on Services (AFAS) signed in 1995 recognizes such developments and aims at harnessing them for the mutual development of the region's economies. The year 2015 has been agreed as the end-date for the liberalization of all services sector across the region.

Under the AFAS, ASEAN countries endeavour to substantially eliminate restrictions to trade in services amongst themselves; to improve the efficiency and competitiveness of ASEAN service suppliers by progressively liberalising services sectors; and to promote cooperation amongst service suppliers across the region. Since its entry into force in 1996, 5 packages of commitments building on each Members' WTO GATS commitments have been agreed.

A number of sectors have been prioritised under AFAS, including: business services, communications, construction, finance, health-related services, recreational services, transport and tourism. In order to support the liberalization of trade in services, a Mutual Recognition Agreement (MRA) in engineering services was signed in 2004 and an MRA for nursing in 2006. MRAs in architecture, accountancy, land surveying and tourism are currently also under discussion.

Foreign Direct Investment

Foreign direct investment has historically played a prominent role in integrating ASEAN economies in regional and global production networks. Conceived in the immediate aftermath of the Asian financial crisis with a view to enhancing the region's battered investment climate, work towards achieving an ASEAN Investment Area (AIA) was formally launched in January 2003 through liberalisation of a temporary exclusion list for FDI in manufacturing. Its aim is to substantially increase the flow of investments into ASEAN from both ASEAN and non-ASEAN investors through a liberal and transparent environment.

While the AIA aims to attract greater doses of FDI in all sectors, it devotes particular attention to five sectors and to services incidental to such sectors. These are: (i) manufacturing; (ii) agriculture, (iii) fishery, (iv) forestry and (v) mining and quarrying.

FDI inflows to ASEAN grew by 39% to US$25.6 billion in 2004, the latest year for which FDI data is currently available. ASEAN's top FDI sources are the European Union, the United States and Japan. It bears noting that intra-ASEAN FDI is the fourth largest source of foreign investment in the region. Meanwhile, by sector, manufacturing, financial services and mining and quarrying are the top three FDI recipients.

In addition to the significant FDI inflows to the region, ASEAN member countries like Singapore and Malaysia today rank among the world's largest outward investors. Such developments suggest that a number of ASEAN firms have already established a track record among the world's leading investors and are actively pursuing portfolio diversification strategies to remain globally competitive.

As with the AFAS, investment liberalization under the AIA is undermined by extensive lists of sector-specific exemptions, revealing a reluctance of some member countries to make binding commitments in an area where domestic policy has long been quite open and where significant unilateral liberalisation has occurred (Sauvé, 2006). For Lao PDR, Vietnam, and Myanmar, the AIA will only become effective in 2010.

Starting in the late 1990s, leading Asian economies began to seek an accelerated path towards regional integration, namely via the conclusion of a growing number of preferential trade agreements. These typically took the form of free trade agreements or, when extended to new areas of economic cooperation, what came to be known as closer economic partnership (or relations) agreements typically featuring comprehensive disciplines on trade and investment liberalization. As noted above, the ASEAN Free Trade Area (AFTA) was set up formally to realize a free trade area within 15 years, beginning on 1 January 1993. In September 1994, AFTA's time frame was shortened to 10 years with the aim of achieving the Agreement's goals by 2003.

During this period, ASEAN's membership expanded to ten countries to include Cambodia, Laos, Myanmar and Vietnam, the so-called "CLMV" countries. ASEAN members agreed to eliminate tariffs among the original ASEAN six members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) by 2010 and by 2015 for CLMV countries. Moreover, the leaders of ASEAN announced that they aimed to transform the AFTA into an ASEAN Economic Area with full, EU-like, mobility of goods, services, capital and people by 2015.

The period since the late 1990's also saw key Asian trading powers progressively renounce their MFN-centric approach to trade policy and engage in preferential liberalisation initiatives within and outside the region. Japan initiated the movement by first seeking a PTA with Mexico so as to achieve *de facto* NAFTA parity in North American markets but negotiations with the Mexican government did not progress smoothly. The first PTA signed by Japan was a "New Age" free-trade agreement with Singapore in October 2002. The agreement included provisions aimed at promoting mutual recognition on some licensing procedures and increasing worker mobility between the two countries. Japan finally reached agreement on a PTA with Mexico in 2004. It has since concluded PTA negotiations with Brunei, Malaysia and the Philippines and is negotiating with Australia, Indonesia, India Korea, Thailand and Vietnam as well as with the whole of ASEAN.

China joined the WTO in 2001 and is in the process of implementing its ambitious set of accession commitments. The onerous nature of such commitments may explain why China's interest in regional trade agreements was initially somewhat muted. This however has since changed as China's economic diplomacy has been highly active in recent years, both within and beyond the Asian region. China today notably ranks among one of the countries with the most extensive network of bilateral investment treaties. On the trade front, China has acted decisively to assert its economic leadership in the region by concluding PTAs with ASEAN (initially on trade in goods in 2004 followed in 2006 by a PTA on trade in services). It has also

concluded PTAs with Chile and Pakistan and is negotiating PTAs with Australia, New Zealand, the member countries of the Gulf Cooperation Council (GCC) as well as with the member countries of the Southern Africa Customs Union (SACU).

Korea and Singapore have also been particularly active recent converts to the cause of preferentialism. As Table II.2 above reveals, Singapore operates the most extensive network of PTAs in East Asia and remains active on numerous negotiating fronts within and outside the region, aiming to consolidate its key role as a trade and FDI hub. Korea has similarly completed PTAs with a large number of countries in the region and beyond, including the member countries of the European Free Trade Association in 2005 and, most significantly, with the United States in 2007.

China, Japan and Korea have also been discussing and investigating the feasibility of a trilateral PTA. Separately, Japan and Korea have announced a desire to conclude a bilateral PTA. China appears hesitant for various historical and political reasons to enter into a bilateral PTA with Japan as it competes with the latter for economic and political leadership in the region. China secured a regional first mover advantage over Japan through its agreements with ASEAN, which Japan has yet to replicate. While China may have raced ahead with ASEAN as a group, Japan is further along with individual ASEAN member countries. Meanwhile, efforts are afoot to expand the circle of ASEAN-led integration to China, Japan and Korea (so-called ASEAN +3, and to link such a configuration to Australia, India and New Zealand (ASEAN +3+3, or the so-called East Asian Summit).[8]

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[8] The creation of an East Asian Community was agreed by East Asian leaders at a meeting held in Vientiane, Laos, in November 2004. The first East Asian Summit was held in Kuala Lumpur, Malaysia in December 2005, with the participation of ten ASEAN Members together with China, Japan, Korea (the so-called ASEAN+3 grouping) as wel as India, Australia and New Zealand. A second Summit was held in Cebu, The Philippines, in January 2007. The idea of creating an East Asian Community was first proposed by the East Asia Vision Group in 2001. The Vision Group called for reinforced cooperation among the ASEAN+3+3 countries in the areas of trade, finance, security, environment, culture and institutions. According to the Vision Group, the principal aims of an East Asian Community relating to trade and investment integration can be summarized as follows: (i) establishment of the East Asian Free Trade Area (EAFTA) and liberalization of trade well ahead of the APEC Bogor Goal (2020 for developing country members); (ii) expansion of the Framework Agreement on an ASEAN Investment Area to all of East Asia; (iii) promotion of development and technological cooperation among regional countries to provide assistance to less developed countries; and (iv) realization of a knowledge-based economy and establishment of a future-oriented economic structure. The Group thus envisaged the progressive integration of the East Asian economies, ultimately leading to a pan-Asian economic community. Once a region-wide FTA was formed and institutions for regional policy research, financial management and exchange rate coordination were established, the Group felt that the basic foundations for an East Asian economic community will have been created. Work towards the establishment of an Asian Economic Community raises important issues of economic and political leadership and governance in the region, particularly as regards China and Japan. To date, China has tended to favour an ASEAN+3 route towards regional policy consolidation whereas Japan has tended to favour an ASEAN+6 architecture. Meanwhile, work on the vision continues to benefit from concrete

The recent surge in Asian PTA negotiations can be seen as the region's response to a number of important factors. First, the halting pace of multilateral negotiations at the WTO combined with the success of deeper integration initiatives within the EU and NAFTA, have raised interest in efforts at closer economic integration with 'like-minded' countries, including in the neighbourhood (Bergsten, 1997). The most recent generation of PTAs typically cover a number of policy areas that go well beyond existing multilateral disciplines and offer deeper market access commitments (OECD, 2007). This includes 'behind the border' subjects such as services, investment and competition policy that can lower service link costs between production networks, a subject to which we return below (Kimura and Ando, 2005; Thorbecke and Yoshitomi, 2006).

A second main reason behind the rising interest in institutionalized integration owes to the much keener sense of Asian interdependence that took root in the aftermath of the Asian financial crisis of 1997-98 which, combined with the 'benign neglect' of multilateral financial institutions like the IMF, resulted in increased support for heightened regional coordination and integration (Van Hoa, 2002; Nicolas, 2007).

Before 1997, most economists considered Asian economic cooperation (through trade and investment) as an example of a successful *de facto* regionalism, i.e. explained by the predominant interplay of market forces. However, the financial crisis of 1997-98 revealed the weaknesses of informal regional cooperation arrangements. The financial crisis and its subsequent contagion to a number of economies in Northeast and Southeast Asia painfully demonstrated that the region's economies were closely intertwined and that a resolution of the crisis called for heightened regional cooperation in the trade and financial fields.

A rising sense of Asian identity has emerged since the crisis. After the proposal to create an Asian Monetary Fund (AMF) failed to materialize over US objections, ASEAN leaders responded by inviting China, Korea and Japan to join in an effort to achieve greater economic cooperation in the region. The ASEAN+3 summit in November 1999 produced a "Joint Statement on East Asian Cooperation" that covered a wide range of areas for regional cooperation. In the early 2000s, other new economic situations - such as the quick recovery and recurring growth in Korea, the emergence of China as an economic superpower and the continued stagnant state of the Japanese economy – provided fresh impetus to new forms of Asian economic regionalism, including PTAs.

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backing from leaders, one recent example being the decision to create a pan-regional economic policy research institute (to be called the Economic Research Institute for ASEAN and East-Asia or ERIA).

Although the financial crisis might have been the direct cause, a number of additional factors have contributed to the breakthrough and proliferation of the policy-led regionalism in Asia. First, regionalism was the natural result of decades of fast growth and the industrial transformations and economic restructuring that came in its wake. In a very tangible manner, *de facto* regionalism has paved the way and greatly facilitated the region's subsequent quest for *de jure* integration. The developments depicted above have created a new centre of Asian economic gravity that has begun to pose a genuine competitive challenge to North America and Europe in terms of its contribution to world output, trade and FDI. This is so even as two-way trade and FDI linkages between Asia and both regions have deepened.

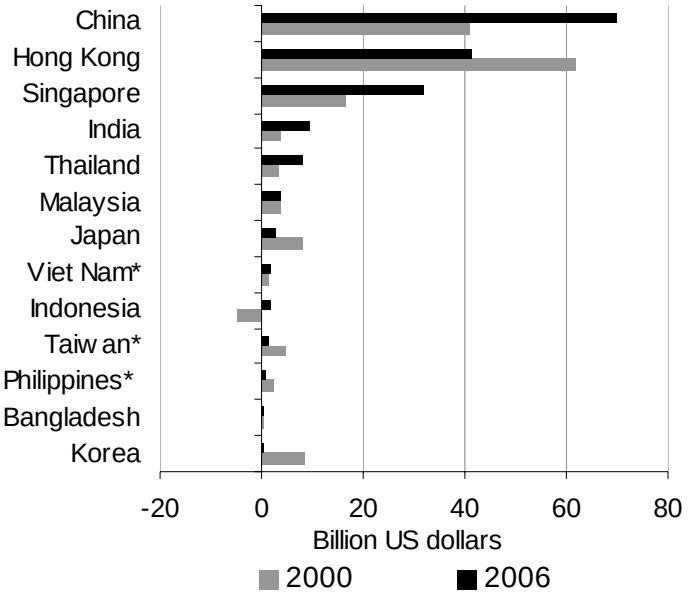
A third factor encouraging the trend towards de jure integration in Asia is also closely connected to the fallout from the financial crisis, and is linked to region-wide perceptions of "benign neglect" on the part of international financial institutions, particularly the IMF, in the aftermath of the Asian crisis. Policymakers in the region perceived that major international institutions and the main global trading powers, particularly the United States, fell short in their support for Asian economies or in the obstacles it placed on the path to deepened cooperation, particularly in the monetary and financial fields.

A final impulse is more inherently defensive in nature, owing to rising concerns throughout Asia over the competitive threats, including in terms of FDI attractiveness, of China's rise as the manufacturing hub of the world and of India's growing assertiveness in services innovation and trade.

There can indeed be little doubt that the rise of China and its growing economic and political influence and assertiveness in the region and beyond, appears to have elicited a more favourable view of regional and bilateral cooperation and agreements, notably in Japan whose private sector began to express fears over the loss of market shares, wild swings in currency values and declining FDI attractiveness (Pangestu and Gooptu, 2004; Masuyama, 2004; Gaulier et al., 2005; Damuri et al., 2006).

For countries like India, Malaysia and Thailand, who compete with China for horizontal FDI, Eichengreen and Tong (2006) note that these countries have experienced greater difficulties in attracting foreign investment as a result of China's emergence. The latter countries' version of the China threat – that of an "FDI sucking sound", has arguably provided them with a strong incentive to enter into PTAs (see Figure II.4 below).

Figure II.4 The rise of China: inward FDI-flows, 2000 and 2006



***** 2005 data.

Notes: UNCTAD notes that Korea's 2006 figure (0,5) is likely to be an underestimation.

Source: UNCTAD 2006 & 2007

Using the Asian Development Bank's Asian Regional Integration Center (ARIC) FTA Database, Kawai (2007) recently identified several key features of East Asian PTAs, focusing on their configuration, outward-orientation, scope (or "WTO+" nature) as well as the their rule of origin regimes. Box II.2 below summarizes the ADB findings.

Box II.2 Salient features of East Asian PTAs[9]

Configuration

East Asian PTAs can be divided into bilateral and plurilateral (regional) agreements. Bilateral refers to agreements between two countries, whereas the term "pluruilateral" covers agreements involving more than two customs territories, one territory (or territories) and a trading bloc, or two trading blocs. On the whole, East Asian countries are primarily opting for simple bilateral PTA configurations rather than the more complex plurilateral ones as the former may be easier and speedier to negotiate and may be preferred by leading trading partners. There were 25 bilateral PTAs concluded by East Asian countries as of mid-2007, representing 76% of all concluded PTAs). Among those currently under negotiation, bilateral PTAs also predominate, making up 80 % of the total. There are eight plurilateral agreements among concluded PTAs in East Asia, and an additional eight other agreements under negotiation.

[9] The ADB defines "East Asia" as comprising the following group of countries: the People's Republic of China, including the Special Administrative Regions of Hong Kong and Macau, Japan, the Republic of Korea, Mongolia and Taipei, China.

Orientation

Looking at East Asian PTAs, the high degree of outward orientation is striking. Of all concluded PTAs, 22 were with countries or groups of countries outside East Asia in mid-2007. The outward orientation of East Asian PTAs under negotiation is even higher at 85 percent. Having launched PTA negotiations with India, Australia and New Zealand, ASEAN as a group has most recently commenced PTA negotiations with the European Union. Singapore has concluded 8 cross-regional PTAs with a wide geographical spread from North and Latin America to the Gulf states. Korea, Thailand, China and Japan have also all concluded PTAs with trading partners in Latin America. China has concluded a PTA (goods only) with Pakistan and is negotiating PTAs with the member countries of the Gulf Cooperation Council as well as Iceland. The above trends lend support to East Asia's purported aim to maintain strong commercial ties with the rest of the world even as integration deepens internally.

Scope

The 33 PTAs (covering goods and/or services) concluded in East Asia can be broken down into four sub-categories based on their scope of coverage: (i) goods-only; (ii) goods and services; (iii) goods, services and the so-called "Singapore Issues" (e.g. trade facilitation, trade and investment, trade and competition, transparency in government procurement); and (iv) goods, services, Singapore Issues and deepened regulatory cooperation in areas such as labour standards, trade and environment, small and medium-sized enterprises, regulatory harmonization or convergence. Two thirds of PTAs agreed to date (i.e. by mid-2007) by East Asian countries – a total of 21 agreements, featured WTO+ provisions beyond goods and services trade (the treatment of trade-related intellectual property-related matters being subsumed under goods trade). Of the total, 9 feature disciplines on the Singapore Issues only while 12 are yet more comprehensive in scope by featuring disciplines on both the Singapore Issues and regulatory cooperation matters.

Rule of origin regimes

Rules of origin exist to determine which goods will enjoy preferential tariff treatment and thus prevent trade deflection among PTA members. Three such regimes can be found in PTAs: (i) a change in tariff classification (CTC) rule defined at a detailed Harmonized System (HS) level; (ii) a regional (or local) content or value-added rule requiring a product to satisfy a minimum regional (or local) value added (VA) in the exporting country or region of a PTA; and (iii) a specific process (SP) rule mandating a particular production process for individual goods or product categories. Of the 28 Free Trade Agreements (FTAs) concluded in East Asia, the majority – 18 – have adopted a combination of the three RoO regimes depicted above rather than applying one specific regime. Of the remaining, 3 adopt the VA rule, another 3 use a combination of VA and CTC rules, while another four combine VA and SP rules. The simplest rule of origin can be found under AFTA and the ASEAN-China FTA, which specifies a 40 percent regional value content (VA) across all tariffs. Many agreements involving Japan, Korea and Singapore tend to use a combination of rules of origin.

Source: Kawai (2007).

III. Trade and investment linkages and Asian economic integration: a literature review

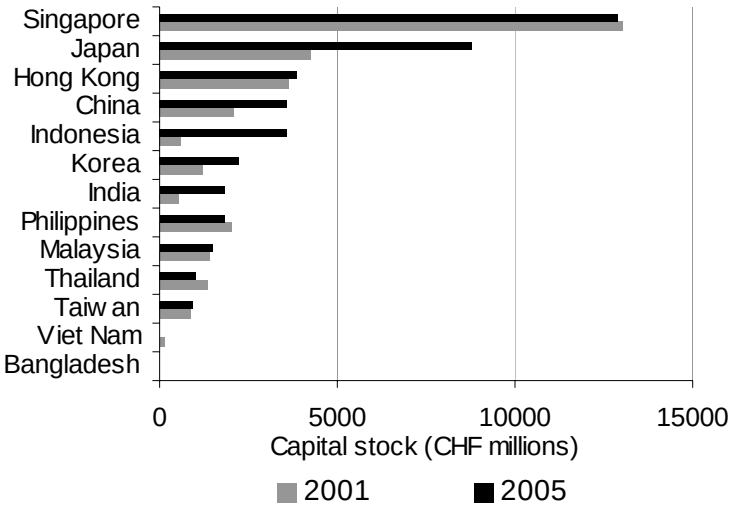
Key issues addressed:

- Recent trends in Asian trade and investment performance
- The rise of production sharing arrangements
- Determinants and evolution of trade and FDI linkages in Asia

III.1 Trade and investment linkages in Asia: key trends

FDI flows to Asia and Oceania reached a new high in 2006 of $230 billion - up 15% from 2005. The share of this region in total FDI to developing countries thus rose from 59% to 63%. In 2005, Swiss capital stock in Asia grew CHF 10 billion to CHF 45 billion. Singapore is the most important destination for Swiss FDI in Asia due to its function of serving as a hub of investments in other Asian countries (See Figure III.1).

Figure III.1 Swiss direct investment in Asia, 2001 and 2005

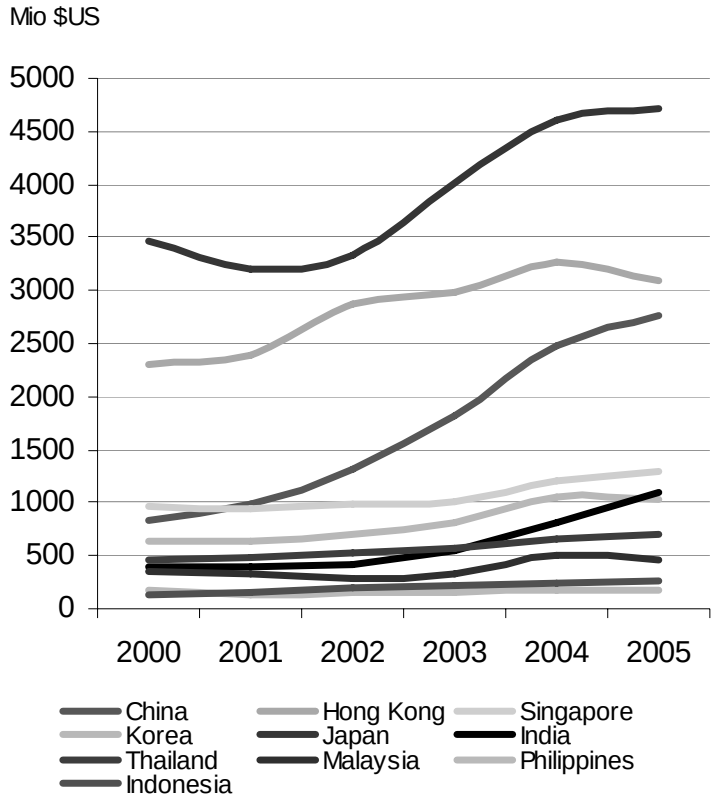


Source: Swiss National Bank 2006

Asian merchandise trade increased around 25 % from 2003 to 2004, and 16 % from 2004 to 2005. China is by far the biggest trader in the region, with merchandise imports worth $660 billion in 2005 and exports of $762 billion. In comparison, total ASEAN merchandise imports reached $594 billion, and total exports $653 billion. Japan and India exported for $595 billion and $95 billion, respectively, while imports were $515 billion and $135 billion. The bulk of Swiss exports to the region are destined to Japan, China and the two ports, Hong Kong and Singapore, often for re-exporting (See Figure III. 2).

In 2005, the value of world commercial services exports grew by 11 per cent, to US$2.4 trillion (see table IV.1 below). Cross-border commercial services exports expanded for the third year in a row less rapidly than world merchandise exports. Asia's commercial services exports and imports have been far more dynamic than world commercial services trade. China's and India's services trade expansion exceeded that of other Asian countries by a large margin, although incomplete information (China) and methodological changes in recording (India) exclude a precise year-to-year comparison at this moment (WTO, 2006).

Figure III.2 Swiss exports to selected Asian countries, 2000-2005



Source: UNCOMTRADE database

Compared to merchandise trade, the volume of Asian trade in commercial services remains of marginal (if growing) importance. Table III.1 documents the ratio of commercial services trade to total merchandise trade across major trading regions and countries at year-end 2005. ASEAN services exports amounted for just under a sixth (15,9%) of merchandise exports in 2005, a level significantly below that obtaining in the OECD area though marginally higher that that of MERCOSUR member countries (14,1%). A measure of SwitzerlanId's specialization in services can be gleaned by the fact that its ratio of 35,7 percent exceeds that of North America (28,7 percent) and the EU-25 (27,7 percent) by a

significant margin and is only slightly lower than that of the United States at 39,0 percent. Also noteworthy is the remarkably high contribution that services trade makes to India's overall trade performance, the country's ratio of commercial services exports to merchandise exports standing at 75,9 percent in 2005.

Table III.1 Ratio of commercial services trade to total merchandise trade, selected regions and countries, 2005 (percentages)

	Exports	Imports
North America	28,4	16,3
United States	39,0	16,7
EU-25	27,7	25,1
Switzerland	35,7	20,7
Asia	19,6	22,9
China	10,6	12,9
India	75,6	50,8
Japan	18,0	26,4
ASEAN (10)	15.9	22,3
MERCOSUR (4)	14,1	27,4

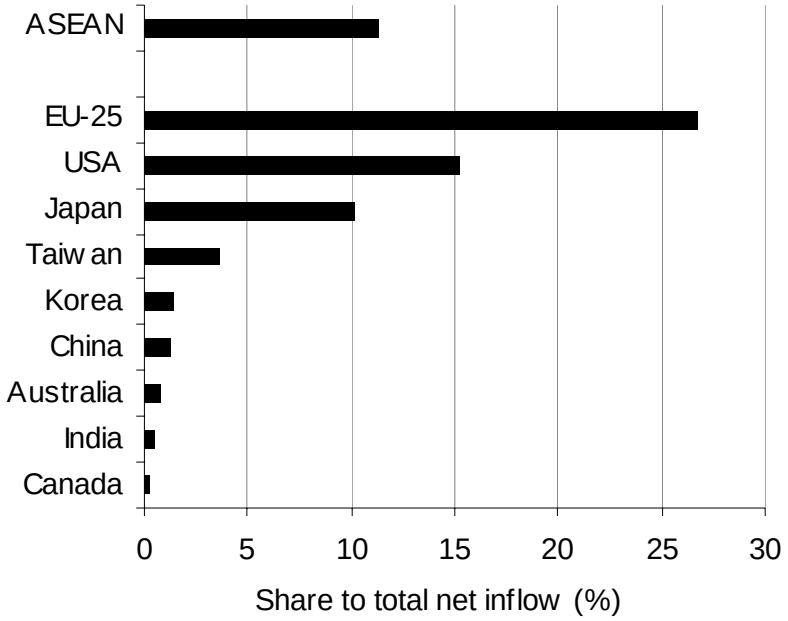
Source: WTO (2006)

Services trade will of course assume greater prominence throughout Asia in the not too distant future, however, as privatization and market liberalisation initiatives take root further, physical infrastructure improves, the supply of skilled human capital increases and as the relocation of service sector R&D, call centres and back-office operations of increasing sophistication continue to expand throughout the region and as the creation of regional and global supply chains redefine the international landscape of services trade and investment. Such a trend can already be observed in India, where trade in commercial services increased 22 % in 2003-05 compared to a 16 % increase in merchandise trade and where services exports accounted for three quarters of merchandise exports at the end of 2005. Also, while developed countries dominate services trade overall, Asian countries such as the Philippines, Singapore and Hong Kong have utilized their ports as hubs for international trade by becoming global players in sectors such as shipping and trade facilitation services.

Most FDI to and from the Asian region continues to come from the EU, the US and Japan. However, apart from Japan, other Asian countries are increasingly investing within the region (Figure III.3). Taiwan thus invested more than $4 billion in ASEAN countries during the 2001-2005 period, making the island economy the 6th largest investor in the ASEAN block. Korea and China are also investing heavily in the region, having become the 9th and 10th most important investors, respectively, to ASEAN from 2001 to 2005. During the same period,

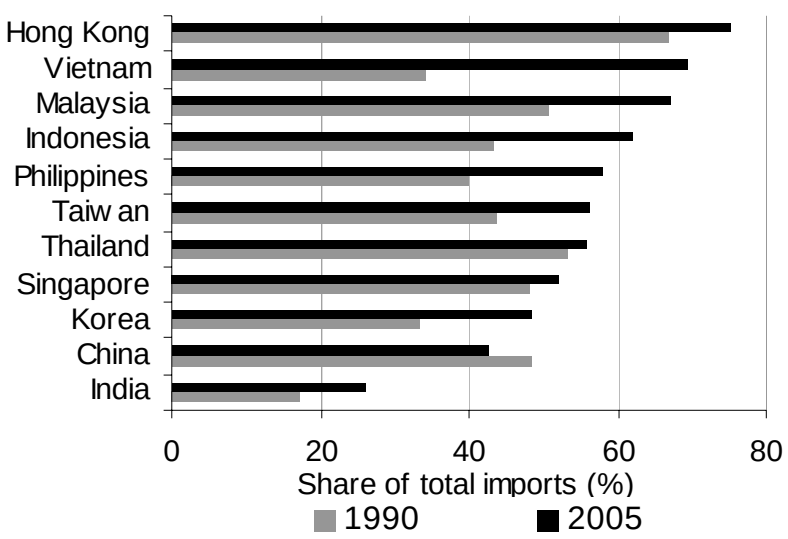
intra-ASEAN FDI was more than $13 billion, constituting 11 percent of total FDI to the region. As with FDI, there is a parallel rise in intra-Asian imports and exports (Figures III.4 and III.5). An estimated 14 % of world trade took place was among Asian countries in 2005, with 51 % of merchandise exports and 58% of merchandise imports staying within the region.

Figure III.3 ASEAN FDI net inflow from selected countries/regions, 2001-2005



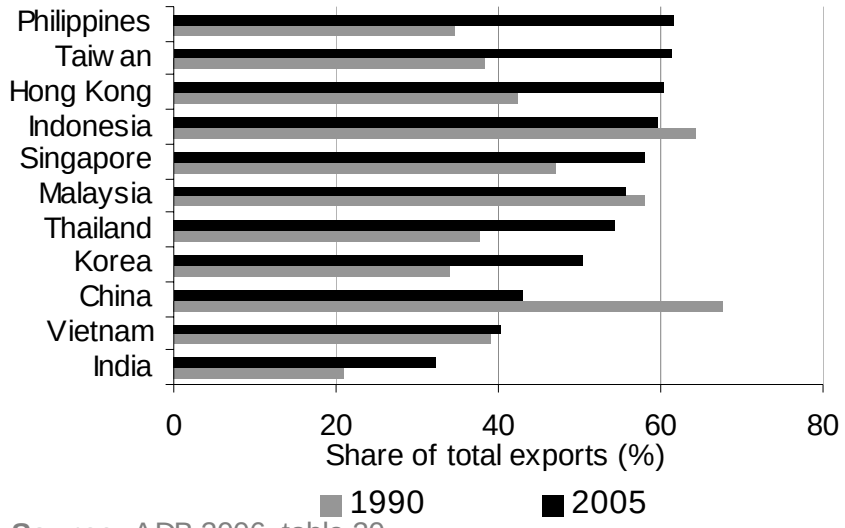
Source: ASEAN 2006, tables 26 & 27

Figure III.4 Merchandise imports from Asia, 1990 and 2005



Source: ADB 2006, table 21

Figure III.5 Merchandise exports to Asia, 1990 and 2005



Source: ADB 2006, table 20

III.2 The emergence of regional production networks

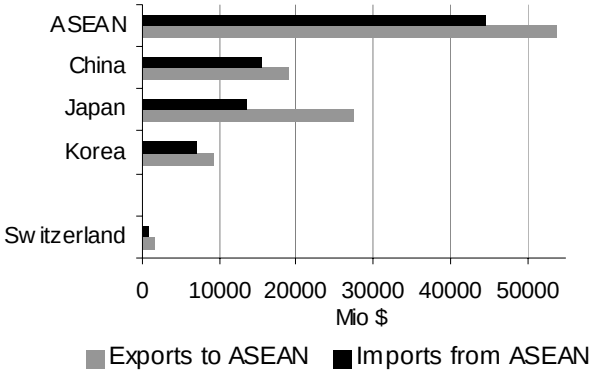
International production sharing - or the fragmentation of vertically integrated supply chains - is widespread in Asia (UNCTAD, 1993; Hummels et al., 1998; ADB, 2003). In turn, Asian production networks have contributed to a gradual 'upgrade' of comparative advantages and industrial capacities into products – goods and services - with higher sophistication and technological intensity (Gaulier et al., 2005; Damuri et al., 2006). In the following section, we review the voluminous literature devoted to the emergence of such networks, with a particular focus on East and South-East Asia.

While international/regional production networks have been observed between Germany, Hungary, and the Czech Republic in Europe and between US and Mexico in North America, their Asian brethren are distinctive since they:

i) have become a substantial part of each country's economy and trade;
ii) involve large numbers of countries at different income levels; and
iii) include both intra- and inter-firm relationships (Kimura and Ando, 2003).

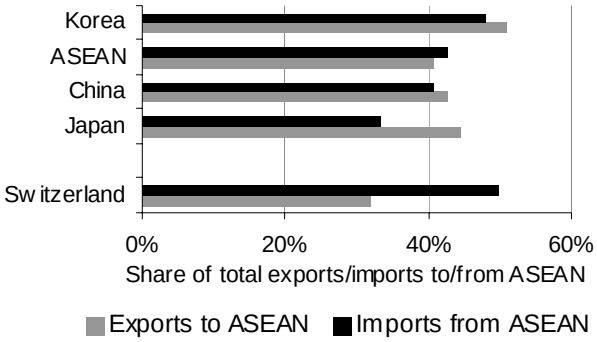
There are numerous quantitative indicators depicting the emergence of production networks and their effects. One such indicator looks at trade in machinery and parts (see Figures III.6 and III.7 and Appendix 2 for a definition). ASEAN and East- and North-East Asian countries trade heavily with each other in these intermediary product categories.

Figure III.6 ***Trade with ASEAN in machinery parts and components, 2005 (imports)***



Source: UN COMTRADE online database

Figure III.7 ***Trade with ASEAN in machinery parts and components, 2005 (exports)***



Source: Own calculations, based on UN COMTRADE online database

This suggests a large portion of back-and-forth transactions of intermediary goods in regional and international production networks. Firms from Switzerland are highly integrated into these networks, as almost 50% of Swiss imports from the ASEAN bloc consists of machinery parts and components (see Figure III.6). [10]

Using data for the ASEAN-5 economies[11], China, Japan, Korea, Hong Kong, and Taiwan, Thorpe and Zhang (2005) find that while intra-industry trade consisted of 25 % of all trade in 1971, the proportion increased to slightly more than half by 1996. Horizontal intra-industry trade (HIIT) dominated during this period, but vertical intra-industry trade (VIIT) also played a significant role throughout.

Fukao et al. (2003), Athukorala and Yamashita (2006), Wakasugi (2007) also find that production sharing through FDI has substantially increased VIIT in East Asia. The result has been that developing Asia's share of world trade in parts and components rose from 16 % in 1992 to 32 % in 2003, exceeding the share of NAFTA and equalling that of the EU in 2003 (Athukorala and Yamashita, 2005).

One crucial factor in the development of production networks has been the industrial policies of many developing (particularly East) Asian countries. Even though Asian latecomers, such as Cambodia, Laos, Myanmar and (less so) Vietnam (the so-called CLMV countries), all have low labour costs, poor government support policies have so far prevented them from being significantly connected to such networks (Kimura and Ando, 2003; Bui, 2004). Conversely, countries such as Singapore, South Korea, Taiwan, Hong-Kong, Thailand,

[10] Figures vary depending on the reporting country; in this case ASEAN records of imports/exports are used.
[11] Indonesia, Malaysia, Philippines, Singapore, Thailand.

Indonesia, the Philippines, China, and Malaysia, have all been relatively successful in implementing 'export processing zones', duty-drawback systems, etc.

Traditionally, the latter countries tried to promote a 'dual track approach'; i.e. fostering both import-substituting industries and export-oriented industries at the same time (Radelet, 1999, UNCTAD, 2002; Pangestu, 2003; Brooks and Hill, 2004). Over the last 20 years, however, most Asian countries have switched their industrial/FDI policies from a policy of selective acceptance to one predicated essentially on 'accepting everybody' (Kimura and Ando, 2003, 2005; Hill, 2004). Such a shift has coincided with increased activities linked to the outward investment by the region's more developed economies (see figure 3; Damuri et al., 2006). East Asian production networks have thus given rise to a 'triangular trade pattern': Japan and the newly industrialised countries[12] (NIEs) export capital and intermediate goods to ASEAN countries (excl. Singapore) and China, which in turn process them for exports destined to the US and European markets (Ng and Yeats, 1999; Gaulier et al., 2005; Kimura and Ando, 2003).

China is particularly interesting in this regard, as its economic development process is currently realigning production and FDI patterns throughout the Asia region (Wang, 2004). More than 80% of intermediate Chinese imports come from Asia and more than 60% of Chinese exports of parts and components are directed to Asia. China's share in intra-regional trade almost doubled from 1990 to 2002, from 10% to 20%. Both Asian and non-Asian multinational enterprises (MNEs) have thus turned towards China in recent years, and in particular to industrial clusters such as the Pearl and Yangtze River Deltas (Zhaoyong and Kang, 1997). Gaulier et al. (2005) report that 40 % of Chinese processed exports consists of intermediate goods supplied by Japan, Hong Kong, South Korea and Taiwan. Masuyama (2004) reports that many Japanese electronics firms thus either closed or reduced their presence in ASEAN countries during the late 1990s and early 2000s, while shifting investment to China, most of which is focused on exploiting production networks to build export platforms. For NIEs, investments in China typically constitute part of a larger international production network linked with firms in advanced economies (Masuyama, 2004). Taiwanese investments in China have for instance mostly focused on assembling IT products and components of companies such as Dell and IBM (Jenn-hwa, 1997; Masuyama, 2004). Major Korean conglomerates have similarly made substantial investments in high-tech sectors. China's emergence has contributed in no small measure to increased calls for regional cooperation and integration through trade and investment agreements in Asia.

[12] Hong Kong, Singapore, South Korea and Taiwan.

As the possibility and costs of production sharing varies substantially depending on the technique of production, vertical specialisation is stronger in some industries, such as the machinery and electronics sectors (Gaulier et al., 2005). In the electronics sector, intra-firm trade accounted for over 43 % of East Asian trade with Japan in 2000, for instance. Meanwhile, electronics MNEs from Singapore and Taiwan have relocated lower-end production to neighbouring countries such as Malaysia, Indonesia and the Philippines (Yue, 1997; Pangestu, 1997; Jenn-hwa, 1997; Ling and Yong, 1997; Alburo and Gochoco-Bautista, 1997). Lall et al. (2004) and Ernst and Guerrieri (1997) thus find strong East Asian networks in the electronics sector with substantial impacts on regional and extra-regional trade flows. To illustrate, Table III.2 below looks at trade with China in one specific product component of electrical machinery – telecommunications parts and accessories (SITC 7649). This is the 4-digit product most traded by Japan, China, and ASEAN 5 countries, accounting for 60 percent of electronics exports of East- and South East Asian countries (ADB 2007). Growth of trade in SITC 7469 has been fastest in China, and Japan, Hong Kong and Korea are playing particularly important – and growing - roles in this process. Korean exports of these components to China were for instance 35 times higher in 2005 than in 1995.

Table III.2 ***Trade with China in electrical machinery parts and components*, 1995 and 2005***

Exports/ imports (mio. $)	1995	2005
Switzerland	6,153	8,273
	0,721	5,550
UK	90,964	58,579
	12,602	324,098
Germany	66,206	171,846
	62,961	628,972
USA	400,996	467,602
	263,807	2387,952
India	0,000	2,107
	12,398	254,314
Philippines	0,914	15,579
	3,890	145,480
Indonesia	0,280	25,928
	15,935	44,256
Thailand	5,158	71,920
	14,639	308,491
Singapore	95,431	408,851
	128,044	1623,544
Japan	478,992	2891,724
	511,392	3412,969
Korea	136,535	4714,924
	120,849	965,906
Malaysia	13,795	251,335
	82,645	706,466
Hong Kong	3089,476	15057,711
	1304,285	8376,421

** SITC code 7649*
Source: UN COMTRADE database

It is important to recall however that even when the manufacturing sector is often the predominant focus of regional production networks, the service sector has a key role too. At a general level, the reduction in 'service links costs' - i.e. transport costs, telecommunication costs, and various search and coordination costs - allow investors to take advantage of economies of scale and specialization in the region (Kimura and Ando 2003). Well functioning providers of roads, ports, electricity, water supply, telecommunications and various business services are thus the very building blocks of the fragmentation of production.

Furthermore, service providers are no longer solely the 'instrument' of production

networks in the region. Efficiency seeking FDI is increasingly turning towards R&D, outsourcing and back office services, covering computer and related, business, professional and financial services (OECD, 2004a). As noted already, India has proven particularly adept in these areas, but countries such as Hong Kong, Korea, Malaysia, Singapore, Taiwan, and – to a lesser extent - Vietnam and the Philippines are becoming important players too. The above analysis suggests that considerable potential exists for economically beneficial reforms in the service sector, which would further strengthen Asian production networks to the benefit of all economic actors – domestic and foreign - present in the region.

III.3 Trade-FDI linkages

As Asian economic integration increases, a key question for third countries is what effect this will have on FDI and trade flows? At a general level, international trade and FDI can be either *substitutes* or *complements*. If multinationals tended to sell locally in host nations instead of exporting from the home or a third country, FDI would substitute for exports. One distinct reason for trade substitution is the case of 'tariff jumping', where investment is chosen over exports due to the high costs of cross-border trade. Alternatively, FDI complements international trade if the demand for intermediate inputs and other products from the home country as well as third countries increase as a result of FDI activity abroad. Also, multinationals abroad might facilitate marketing and distribution channels and thus create new opportunities for trade. Substitution effects would be detrimental to investor and third countries except in the case of tariff-jumping, where the welfare effects are ambiguous. Complementary effects are beneficial for both investor and third countries. After briefly reviewing the overall empirical evidence of the relationship between trade and investment, we address what the literature has found on these linkages in Asia.

III.3.1 General observations on trade-FDI linkages

Substitutes or complements?

In their studies on US investment abroad, Lipsey and Weiss (1981, 1984) find positive associations between exports and FDI, as well as a positive correlation between total exports of the parent and the local production of the affiliate. This result has been confirmed by several US-based studies. Sachs and Shatz (1994) investigate US bilateral trade with 40 countries and find that the share of intra-firm bilateral trade is associated with much higher overall US trade with the country considered. Buigues and Jacquemin (1996) examine US direct investment in the EU across six industries over ten years, and similarly find a complementary relationship between FDI and exports. In a later study, Hejazi and Safarian

(2001) also find that US exports are positively affected by outward FDI in both manufacturing and services. At the macro-level – as opposed to the firm or industry level - Eaton and Tamura (1994) investigate bilateral exports and FDI-flows between the US and about 100 other countries from 1985-1990, and find a large and positive relationship between outward FDI and exports. This is confirmed by Graham (1998). For the OECD area as a whole, OECD (1998) finds large FDI-associated trade flows for most OECD countries from 1980-1995. Using slightly more rigorous techniques, Henry (1994) comes to the same result.

The FDI-trade relationship is likely to vary across contexts, however. Investigating 458 of the world's largest industrial MNE's, Pearce (1990) concludes that the positive association between exports and FDI is particularly prevalent for intra-firm – as opposed to inter-firm - exports. This highlights the importance of vertical relationships among international affiliates, which is of particular relevance for Switzerland having one of the highest shares of intra-firm trade relative to other industrialised countries (OECD, 2002).

A related variation is explored by Swenson (2004), who distinguishes between trade in finished products and intermediate inputs. Swenson shows that FDI in the US by foreign firms leads to a decline in imports from host countries of the same finished *products*; i.e. there is a substitution effect. This result does not hold, however, for Germany and Switzerland. Also, Swenson notes that his results seem to indicate that the relationship between intermediate *inputs* and FDI are complements rather than substitutes. On this question, Fontagné (1999) cites evidence for both France and the US that even though exports of final products might be substituted by local sales, this is offset by increased demand for inputs largely provided by the parent or other subsidiaries of the same group often located in the investing country.

The relationship between FDI and trade furthermore varies over time. Bergsten *et al.* (1978) find that an initial complementary effect between FDI and US exports is turned into a substituting impact as multinationals become more competitive abroad. Pearce (1990) similarly finds that as internationalization advances, trade between affiliates in different host countries gradually replaces trade between the home country and affiliates.

Such impacts appear more likely for countries, which are smaller than the United States – such as Switzerland (Fontagné, 1999). Svensson (1996) concludes that the complementary relationship between Swedish FDI and exports found by Swedenborg (1979, 1982) was overturned in the 1980s. Home exports to other third markets was replaced by exports from affiliates to those markets, which might stem from the advanced stage of internationalisation

of Swedish MNCs. Blomström and Kokko (1994) and Andersson et al. (1996) similarly conclude that such conditions have impacted on the structure of Swedish production and, in turn, the relations between FDI and Swedish exports. At the industry-wide level in France, UK and the US, Fontagné (1999) confirms these results by finding exports of intermediate and capital goods to increase as a function of FDI in the short term, whereas substitution effects are more prevalent in the long run as internationalisation reaches more advanced levels.

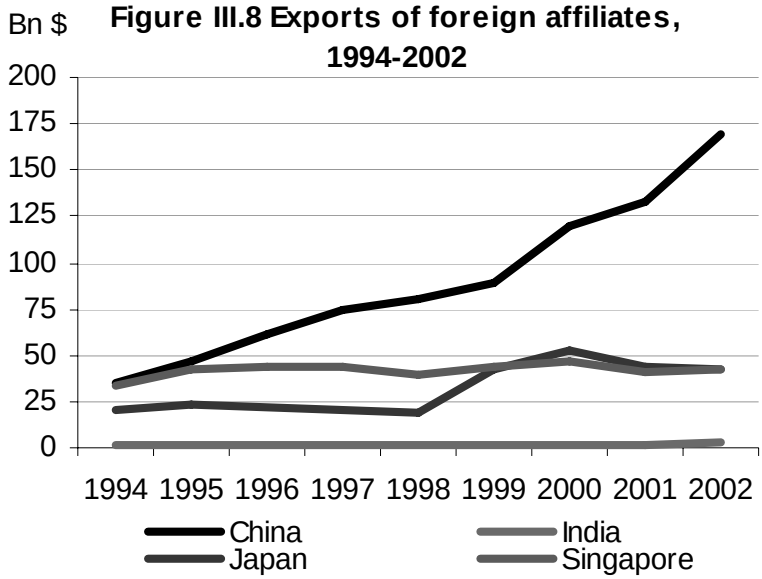
Tariff jumping

There have been relatively few studies testing the tariff-jumping hypothesis. Studies using *industry* measures have come to mixed conclusions (Grubert and Mutti, 1991; Kogut and Chang, 1996; Blonigen, 1997). Conversely, studies using more precise *firm*-level data of for instance antidumping duties have found robust evidence of tariff-jumping FDI (Belderbos, 1997; Blonigen, 2002). Blonigen's (2002) results strongly suggest that tariff-jumping is mostly observed for MNEs – as opposed to small exporting firms - in developing countries seeking to penetrate Western markets.

III.3.2 Trade-FDI linkages in Asia

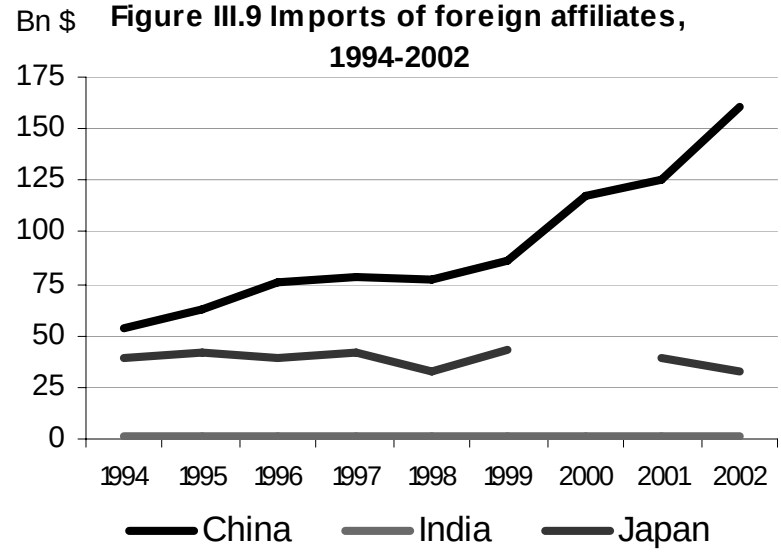
FDI has provided a major boost to Asian trade in recent decades (ADB, 2006). As noted earlier, production networks within the region have spurred trade in parts and components to other Asian countries, whereas vertical supply chains with countries outside the region have increased trade in capital goods, intermediate goods and final products. Through their global distribution and marketing chains, multinationals investing in Asia have played an important part in this process. This is reflected in the growing role of foreign-owned firms in exports for developing Asian countries (see Figure III.8; ADB, 2006).

Figure III.8 Exports of foreign affiliates, 1994-2002



Notes: For Singapore, data only refer to manufacturing.
Source: UNCTAD 2006

Figure III.9 Imports of foreign affiliates, 1994-2002



Notes: Data for Japan is not available for 2000.
Source: UNCTAD 2006

Trade and FDI in Asia: Substitutes or complements?

The 'rise' of Japan in the 1980s and early 1990s spurred numerous studies on Japanese FDI and its linkage to international trade. Eaton and Tamura (1994) find a complementary relationship between FDI and exports in the case of both Japan and the US. This result is confirmed by Buigues and Jacquemin (1996), Graham (1998), Kawai and Urata (1998),

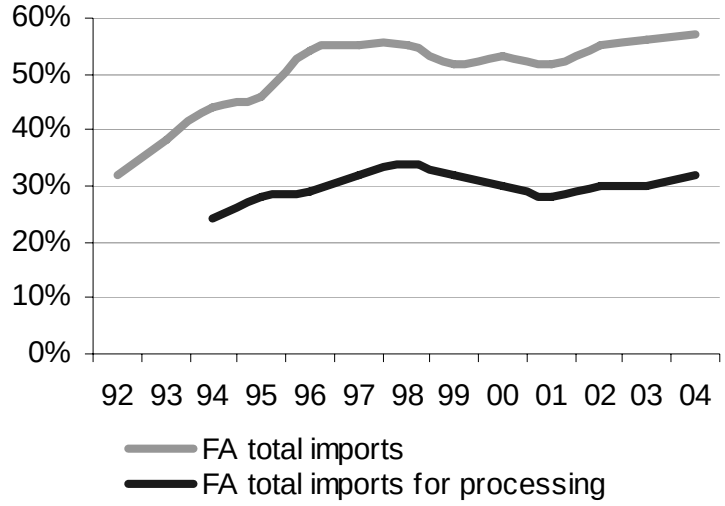
Lipsey (1999), and Lipsey et al. (2000). With 1986, 1989 and 1992 data, the latter study finds that parent firm exports from Japan to a foreign region are positively associated with production in that region by affiliates of that parent. Also, a Japanese parent company's worldwide exports are larger (relative to its output), the greater its production abroad. Barrel and Pain (1999) find that prior market penetration influence Japanese investment flows, confirming the intuitive notion that multinationals tend to facilitate marketing and distribution channels abroad and thus increasing the probability of future investments for the same or other firms. The complementary relationship between trade and FDI is not confined to Japan, but is also found for other Asian countries. Liu and Graham (1998) investigate the trade-FDI relationship for Taiwan and South Korea in 1994. Both countries' FDI is mostly concentrated in Asian countries (particularly in China in the case of Taiwan). The results confirm the studies cited above. Taiwanese and South Korean outward FDI and exports are thus complements and not substitutes. The export promoting effect of South Korean FDI is also confirmed by Abe (2002) and Lee (2002a). Surveys of multinationals in Thailand, Hong Kong and Malaysia, Phillipines and Indonesia (Dobson and Yue, 1997), similarly concludes that MNE's in Asia tend to rely on their home markets for imports of intermediate inputs – particularly through intra-firm trade. In turn, this means that the increased activity resulting from intra-Asian investment contributes to the increased regionalisation of Asian trade.

Also, the observed complementarity between FDI and exports suggests that outward direct investment is not associated with "hollowing out" or "deindustrialization" in Asian countries. Instead, Graham (1998) notes the opposite to be true: as direct investment abroad expands, affiliates of Asian MNEs increase demand for goods produced in the home economy, which in turn increase Asian exports. As mentioned above, there is an important distinction between trade in intermediate inputs and trade in final goods. Blonigen (2001) show that new FDI in the US by Japanese firms increases Japanese exports of related intermediate inputs for these products, whereas new FDI leads to a decline in Japanese exports of the same finished products. Again, this is similar to the results of Swenson mentioned above. Head and Ries (2001) show similar evidence when using Japanese firm-level data. As for the relationship between *inward* FDI and trade, Liu et al. (2001) examine bilateral FDI and international trade for China and 19 countries/regions over the 1984-1998 period. Their results indicate a synergy effect between China's inward FDI and trade: exports to China are followed by FDI from the same country. In turn, inward FDI leads to Chinese exports to that country. The latter is most likely a result of two factors.

First, FDI to China is still mostly efficiency-seeking (as opposed to market-seeking) due to China's still abundant endowment of relatively cheap labour. So after FDI has facilitated

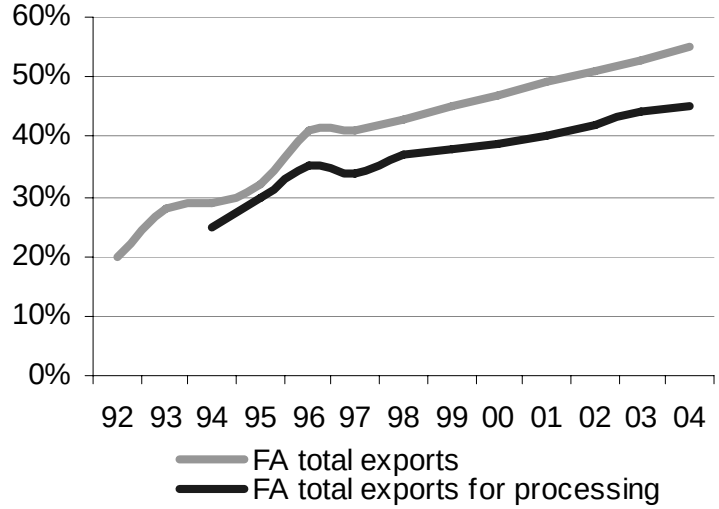
production in China, the final products are typically sold back to parent countries. Such efficiency-seeking investment is more likely to complement rather than substitute trade. Barboza (2006) thus estimates that about 60 % of China's manufactured exports is generated by foreign-owned firms and UNCTAD (2002) noted that foreign affiliates accounted for around 50 % of total Chinese exports in 2001 and 81 percent of technology-intensive products in 2000. Similarly, Gaulier et al. (2005) estimate that foreign affiliates accounted for between 60% and 70% of China's imports from Japan and NIEs in 2004 and for more than 60% of China's exports to Japan, Hong Kong and Singapore. (see Figures III.10 and III.11). Lee (2002b) finds that the vertical integration of South Korean and Japanese MNEs means that Japanese and South Korean FDI into China tend to stimulate Japanese and Korean intra-firm and intra-industry exports and imports.

Figure III.10 Share of foreign affiliates (FA) in total Chinese imports, 1992-2004



Source: Gaulier et al. 2005

Figure III.11 Share of foreign affiliates (FA) in total Chinese exports, 1992-2004



Source: Gaulier et al. 2005

Second, China's FDI policy has been predicated on encouraging foreign firms to export their products and particularly firms from newly industrialised countries use China as their main export platform. UNCTAD (2002), Wang (2004) and Gaulier et al. (2005) thus confirm the importance of export processing zones in China for promoting an interlocked FDI-export relationship.

The investment-trade complementarity for foreign firms is also found in Vietnam by Ngoc and Ramstetter (2004), where foreign multinationals have much higher trade propensities than Vietnamese firms. Athukorala (2006a; 2006b) similarly finds that MNEs in Asia are highly export-oriented. The same holds for Thailand, Hong Kong, Indonesia, Singapore and Taiwan, where companies with high foreign ownership shares show higher export propensities which is mostly due to sales of finished products back to parent- and other countries as was observed with China (Ramstetter, 1999; James and Ramstetter, 2005). These results hold after taking into account that trade propensity could be determined by foreign ownership shares due to policies allowing foreign firms to export a large portion of their output.

A related result, found by James and Ramstetter (2005) investigating the trade and FDI patterns of Thailand and Indonesia, is that liberal trade policies in electric, office and computing machinery industries facilitated rapid export growth of multinationals, while protectionist measures in the transportation machinery industry reduced the incentive to export among multinationals. Trade policies thus impacted the investment and trade decisions of MNEs, and lowering preferential tariffs among Asian countries could thus spur export growth of multinationals even more.

Asian tariff-jumping?

As for 'tariff-jumping', studies are mostly confined to the case of Japan. Dunning (1991), Encarnation and Mason (1994), Belderbos (1997) and Barrel and Pain (1999) find that Japanese FDI to Europe and the US in the 1980s was associated with protectionist measures against Japanese companies such as the regimes of 'voluntary export restraints' and antidumping measures used extensively – and directed in particular towards Japanese producers - during this period.

However, Mody et al. (1998) find that trade barriers do *not* have an impact on Japanese investment in Asia. The authors note that in contrast to Europe and the US firms investing in

Asia are not under threat of barriers to exports. Rather, they seek to participate in the rapid growth in Asia and tend to choose cheap production locations (Kimura and Ando, 2003). The motives for investing are thus quite different, and tariff-jumping is therefore far less prevalent in intra-Asian investment patterns.

IV. Preferential Services Liberalisation in Asia

Key issues addressed:

- Intra-regional services liberalization: ASEAN's Framework Agreement on Services
- Assessing the depth of AFAS market-opening and rule-making advances: a third country perspective
- Assessing the nature and scope of extra-regional services liberalization in Asia and its implications for Swiss traders and investors

IV.1 Overall Trends

ASEAN member states have been increasingly involved in the liberalisation of trade in services within the ASEAN region as well as with a growing network of countries in Asia, Europe, Oceania, America and the Middle East in recent years (see Box IV.1 and Figure IV.1 below). Such trends respond to the rising salience of services trade in the region's external accounts (see Table IV.1 below). The ASEAN Framework Agreement on Services (AFAS) signed in December 1995 provides the key framework for the progressive liberalisation of trade and investment in services between ASEAN member countries. Such a liberalisation process is carried out through successive negotiating rounds, resulting in packages of commitments by individual ASEAN members. Five such rounds have taken place to date, the latest of which having been completed towards the end of 2006.

With the aim of further facilitating trade and overcoming negotiating roadblocks arising from significant intra-ASEAN diversity (both economic and political), an amendment was introduced in 2003 allowing two or more ASEAN member economies press ahead with the liberalisation of services trade without extending agreed concessions to other members. Such variable geometry has so far been used mainly to advance intra-ASEAN market opening in professional services, namely through the conclusion of mutual recognition agreements.

Efforts at services liberalisation have in recent years extended well beyond the sub-region, and most ASEAN members are today highly active in negotiating preferential trade agreements (PTAs) that typically feature detailed provisions on the liberalisation of services trade (and investment). Such initiatives are increasingly seen, both within and outside the region, as offering a genuine alternative to the protracted set of multilateral negotiations carried out under the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) in the context of the Doha Development Agenda (DDA), despite the fact

that they can in some instances give rise to negative repercussions for third party suppliers, notably through possible trade and investment diversion.

Box IV.1 Asian PTAs and trade in services: stylized facts

25 agreements covering trade in services are in force in Asia, of which:

- 3 regional/plurilateral agreements (AFAS, AFAS-China, Trans-Pacific SEP)
- 22 bilateral agreements (including EFTA-Korea and EFTA-Singapore)

Such agreements involve 16 Asian countries; 11 non-Asian countries, including EFTA members and one non-WTO Member (Laos PDR)

2 in 5 (40%) Asian PTAs in services operate on the basis of a negative list approach to scheduling liberalization commitments

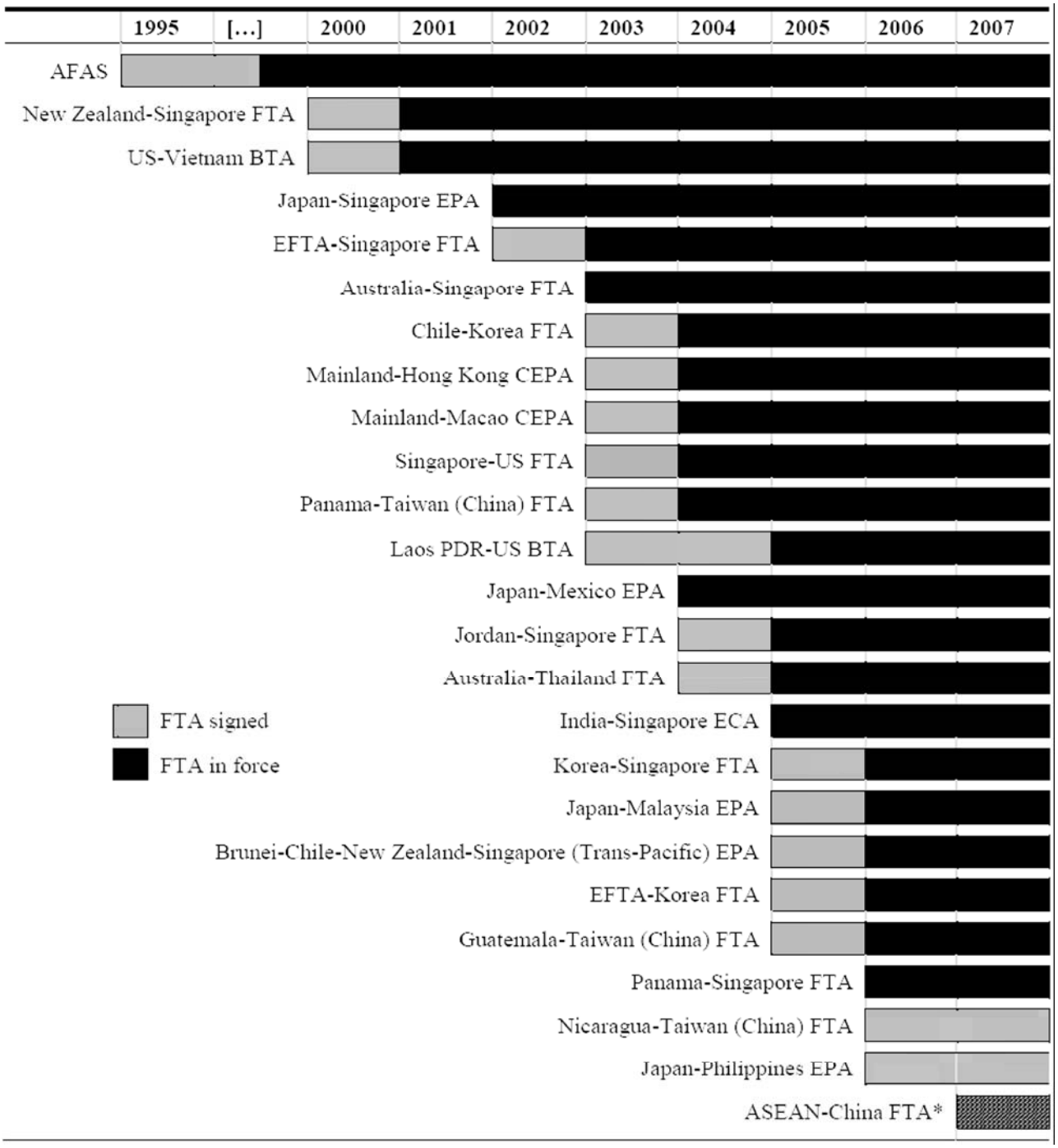
Close to half (48%) of Asian PTAs in services adopt a GATS-hybrid list approach to liberalization agreements (including the EFTA-Singapore and EFTA Korea agreements)

There are some 40+ such agreements currently under negotiation and involving countries or country groupings in the region, including EFTA-Thailand, Switzerland-Japan and EU-ASEAN.

This section of the study reviews recent and current initiatives towards the integration of services markets within the ASEAN region and between individual ASEAN members and a select group of key third country partners: China, India, Japan, Korea, Australia, New Zealand and the United States. The section also examines the relevance and likely effects of ongoing integration efforts for Swiss service providing firms, with particular emphasis placed on those sectors in which Switzerland maintains offensive interests and in which it has formulated market opening demands in the context of the DDA's ongoing set of collective requests under GATS.

The section is constructed as follows. It first examines the ASEAN Framework Agreement on Services (AFAS), its architecture and rulemaking, and assesses the scope and depth of liberalisation achieved to date. The section then examines ASEAN members' PTAs with key third country partners. It does so both in terms of the evolving architecture of services disciplines found in such PTAs and the GATS+ or AFAS+ levels of liberalisation achieved therein.

Figure IV.1 Asian PTAs featuring services provisions, 1995-2007



Source: Fink and Molinuevo (2007)

Table IV.1 World trade of commercial services by region and selected countries, 2005
(Billion dollars and percentage)

	Exports					Imports				
	Value	Annual percentage change				Value	Annual percentage change			
	2005	**2000-05**	**2003**	**2004**	**2005**	**2005**	**2000-05**	**2003**	**2004**	**2005**
World	2415	10	15	19	11	2361	10	14	18	11
North America	420	5	5	11	10	373	7	9	15	10
Europe	1233	11	19	19	7	1119	11	19	16	8
European Union (25)	1104	11	19	19	7	1034	10	19	16	7
Switzerland	45	10	15	24	9	25	10	11	25	7
Asia	543	12	10	26	19	595	10	10	25	15
Japan	107	8	8	25	12	136	3	3	22	1
China	81	22	18	34	…	85	19	19	31	...
Four East Asian traders*	175	8	9	18	9	165	8	8	21	10
India	68	33	21	66	...	67	29	23	53	...
ASEAN (10)	104	8	2	22	10	132	9	9	21	14

* Chinese Taipei; Hong Kong, China; Republic of Korea and Singapore.

Source : WTO (2006)

IV.2 AFAS and the liberalisation of services within ASEAN

The AFAS establishes a framework for the progressive liberalisation of trade in services among ASEAN members. Its objectives are to enhance cooperation in services with a view to promoting greater overall efficiency and improving the competitiveness of ASEAN economies as well as a diversification of production and supply. The AFAS aims at liberalising trade in services beyond the commitments of individual ASEAN members under the GATS, and to establish a PTA in services by 2015 as a part of the ASEAN Economic Community (AEC). Furthermore, the services provisions of AFAS aim to include GATS+ advances in rule-making, notably in the area of mutual recognition (ASEAN 1995).

Liberalisation of services trade under AFAS is conducted through the Coordinating Committee on Services (CCS), which has established negotiating groups in seven priority sectors agreed upon by ASEAN members. These are: (i) air transport; (ii) business services; (iii) construction; (iv) financial services; (v) maritime services, (vi) telecommunications; and (vii) tourism. The liberalisation process is carried out through successive rounds of negotiations, resulting in so-called packages of commitments by individual ASEAN members according to a GATS-like hybrid list approach.

The means of achieving liberalisation under AFAS differs from that employed under the GATS. Instead of relying on GATS-like “requests and offers”, the AFAS foresees recourse to a “common sub-sector approach” and the “minus X approach”. The common sub-sector approach holds that any particular sub-sector would be identified as a common sub-sector in the case that three or more ASEAN members have committed to this sector under the GATS or the AFAS. The minus X formula provides that any combination of two or more ASEAN members may conduct negotiations and agree to liberalise trade in services for specific sectors or sub-sectors without extending the benefits of such agreed commitments to other ASEAN members. The latter remain free however to join such a liberalisation process at a later stage (ASEAN 2003; Thanh and Bartlett 2006).

As far as services rule-making is concerned, AFAS can be argued to improve on the GATS in a few areas but also to fall significantly short in several other areas (see Table IV.2 below). GATS+ rule-making advances can be found in two areas: mutual recognition and rules of origin. ASEAN members have so far concluded two mutual recognition agreements (MRAs) in professional services. A first AFAS MRA on engineering services was concluded at the end of 2004. The agreement provides measures on recognition, qualifications and eligibility, guidelines on criteria and procedures and provide for an ASEAN Chartered Professional

Engineer status. It also deals with professional regulation, monitoring and supervision issues between national licensing authorities and creates several bodies to administrate the agreement and its implementation. A second ASEAN-wide MRA was adopted in the area of nursing services at the end of 2006. The MRA covers the practice of nursing care and encompasses preventive, curative and rehabilitative practices which may also include education and research services. It provides for rules similar to those applying to engineers, but refines the latter in the area of dispute settlement. ASEAN members are close to completing a third MRA in the area of architectural services, and are also involved in MRA discussions in the areas of accountancy, land surveyance and tourism (tour guides). In the case of rules of origin, or denial of benefits, AFAS extends the benefits of liberalisation to juridical persons with substantial business operations in the territory of any of the parties. Like many services PTAs, the AFAS does not develop particular criteria designed to establish what constitutes substantial business operations.

Beyond the two areas described above, the AFAS features provisions that are either identical to the GATS or drafted in a GATS-minus manner. The most significant GATS-minus provisions relate to transparency, domestic regulation, competition, and subsidies and emergency safeguards (ESM). The latter issues may be deemed as being GATS- minus by virtue of their absence from the AFAS.[13]

The AFAS features an MFN clause meant to extend the benefits of intra-ASEAN liberalisation to all members on a non-discriminatory manner. However, the minus X approach described above – agreed in response to the considerable diversity in service sector development levels between the original ASEAN six members and the more recently-acceded CLMV countries, is tantamount to a conditional MFN approach since it enables two or more parties to liberalise trade faster than others, without extending benefits to other ASEAN member states.

While the GATS provides for measures such as notification, publication, designation of enquiry points and official publications, as well as information-sharing requirements, the AFAS is completely bereft of provisions on transparency. The lack of AFAS disciplines on regulatory transparency is particularly troublesome given its importance in sectors characterized by considerable regulatory intensity. Such a shortcoming is somewhat

[13]. For countries that are advocating the introduction of an emergency safeguard measure (ESM) under the GATS, the lack of disciplines in this regard in FTAs will also be considered as a GATS-minus. For a fuller discussion of the question of ESMs for services, see Sauvé (2006a).

surprising given that transparency disciplines are found in almost every PTA covering services and often go further than those of Article III of the GATS. The lack of provisions on the issue of emergency safeguard measures for services is particularly telling, to the extent that much of the demand for such disciplines under GATS has emanated from ASEAN circles. Moreover, the ESM-like provisions found in the ASEAN Investment Area (AIA) do not cover investment in services.

The Vientiane Action Programme adopted by ASEAN member countries to drive economic integration from 2004 to 2010 identified 11 key sectors to be fully integrated by 2010, of which 4 are services sectors: (i) air travel services; (ii) information and communication technologies (ICTs); (iii) healthcare and (iv) tourism (ASEAN 2004). The five packages of liberalisation commitments concluded to date under the AFAS include the following seven main sectors (Thanh and Bartlett 2006):

- Air transport: sales and marketing of air transport services, computer reservation services, aircraft repair and maintenance services.

Table IV.2 AFAS Rules Benchmarked vis-à-vis the GATS

AFAS Disciplines	Differences with GATS
Type of agreement	Positive-list/hybrid
MFN	–
National treatment	=
Market access	=
Transparency	–
Domestic regulation	–
Mutual recognition	++
Monopolies , exclusive service suppliers and anti-competitive behaviour	–
Rules of origin	+
Timed commitment to eliminate trade discrimination	+
Emergency Safeguards	–
Subsidies	–
Dispute Settlement	–

- Business services: IT services, accounting, auditing, legal, architecture, engineering, market research, etc.
- Construction: construction of commercial buildings, civil engineering, installation works, rental of construction equipment, etc.
- Financial services: banking, insurance, securities and broking, financial advisory services, consumer finance, etc.
- Maritime transport: international passenger and freight transport, storage and warehousing, etc.
- Telecommunications: basic telecommunications services, mobile phone services, business networks services, data and message transmission services, etc.
- Tourism: hotel and lodging services, food/catering services, tour operator services, travel agency services, etc.

Table IV.3 provides a quantitative analysis of the number of sectors and sub-sectors committed by each member in each of the above seven priority areas. Although those sectors form the lion's share of ASEAN members' commitments to date, the packages include commitments in other sectors such as environmental, distribution, health, transport and education services.

A closer analysis of the 5 packages of liberalisation commitments conducted under the AFAS reveal a greater than 50% improvement (in numerical terms) in the sectoral coverage of AFAS commitments when compared to ASEAN members' GATS commitments. Such an improvement is however unbalanced as between ASEAN members, with some countries undertaking a greater number of GATS+ commitments than others. When compared to their GATS schedules, Brunei, Indonesia, Myanmar and the Philippines had the richest harvest of AFAS commitments. While not yet a WTO member, Laos also undertook far-reaching commitments in its PTA with the United States. Singapore, Thailand, Cambodia, Malaysia, and Vietnam had relatively less comprehensive AFAS commitments in view of the fact that their GATS schedules were already significantly more extensive. In the case of Cambodia and Vietnam, the latter situation owes significantly to the high entry cost embedded in their status as recently acceded WTO members.

Table IV.3 Quantification of Sectors and Sub-Sectors Committed by ASEAN Member States in the 5 Packages (Main Sectors)

	Air Transport						Business Services						Construction						Financial Services					
	I	II	III	IV	V	T[1]	I	II	III	IV	V	T	I	II	III	IV	V	T	I	II	III	IV	V	T
Brunei Darussalam	1	-	2	1	-	**4**	-	1	7	4	36	**48**	-	6	8	8	8	**30**	-	1	4	6	-	**11**
Cambodia	-	2	1	1	-	**4**	-	1	4	7	24	**36**	-	-	8	8	5	**21**	-	1	5	13	-	**19**
Indonesia	-	1	2	-	-	**3**	-	12	11	-	22	**45**	-	1	8	-	8	**17**	-	1	2	9	-	**12**
Laos	-	2	-	-	-	**2**	-	2	7	1	9	**19**	-	2	8	-	8	**18**	-	2	4	11	-	**17**
Malaysia	2	-	1	-	-	**3**	-	15	9	9	27	**60**	-	7	7	7	7	**28**	-	4	1	-	-	**5**
Myanmar	-	1	2	3	-	**6**	-	2	4	-	12	**18**	-	1	7	-	8	**16**	-	2	1	1	-	**4**
Philippines	-	1	2	-	-	**3**	2	7	9	-	20	**38**	-	7	8	-	6	**21**	-	5	4	1	-	**10**
Singapore	1	-	1	1	-	**3**	-	1	4	7	29	**41**	-	1	7	-	2	**10**	-	1	3	1	-	**5**
Thailand	-	2	3	1	-	**6**	-	10	6	9	27	**52**	-	4	8	8	8	**28**	-	3	2	1	-	**6**
Vietnam	-	3	4	4	-	**11**	-	4	4	4	19	**31**	-	7	8	8	8	**31**	-	7	1	15	-	**23**
Sub-Total	4	12	18	11	0		2	55	65	42	225		0	36	77	39	68		0	27	27	58	0	

	Maritime Services						Telecommunications						Tourism						Total sector and sub sector coverage in the 7 sectors
	I	II	III	IV	V	T	I	II	III	IV	V	T	I	II	III	IV	V	T	
Brunei Darussalam	2	-	-	-	2	**4**	-	2	4	9	15	**30**	1	-	1	1	3	**6**	133
Cambodia	-	-	2	3	2	**7**	-	-	3	12	-	**15**	-	3	3	3	5	**14**	116
Indonesia	3	-	1	-	5	**9**	-	9	9	-	26	**44**	2	2	6	4	12	**26**	156
Laos	-	2	-	-	2	**4**	-	2	6	-	8	**16**	3	2	3	2	3	**13**	89
Malaysia	1	-	-	2	9	**12**	-	4	1	9	20	**34**	2	-	3	2	9	**16**	158
Myanmar	-	1	2	3	5	**11**	-	2	1	5	17	**25**	4	1	3	1	5	**14**	94
Philippines	-	2	-	2	11	**15**	-	1	7	-	21	**29**	1	1	4	3	5	**14**	130
Singapore	-	1	2	2	7	**12**	-	1	1	14	13	**29**	1	-	3	2	7	**13**	113
Thailand	2	2	2	5	9	**20**	-	2	3	9	21	**35**	5	1	3	4	10	**23**	170
Vietnam	-	3	2	4	7	**16**	1	1	5	14	16	**37**	3	1	3	1	4	**12**	161
Sub-Total	8	11	11	21	59		1	24	40	72	157		22	11	32	23	63		

T – Total commitments in sector, by ASEAN member.

Source: Own calculations, Bureau of Trade in Services Negotiations, and Thanh and Bartlett (2006).

When measured in qualitative terms, i.e. in terms of the actual degree of new market opening afforded, the depth of ASEAN members' commitments under AFAS – i.e. the extent of elimination of trade barriers - falls short of the broad sectoral coverage achieved in the liberalisation packages. Applying the Hoekman approach[14] to measuring individual countries' levels of restrictions, Thanh and Bartlet found that the elimination of services trade restrictions under the first four liberalisation packages of AFAS was on average some 10% higher than that taken by ASEAN members under the GATS.

[14] The Hoekman approach is a frequency measurement of restrictiveness to trade in services. The approach classifies commitments made in services according to three levels : 1. If no restrictions are applied for a given mode of supply in a given sector, a value of 1 is assigned; 2. If no policies are bound for a given mode of supply in a given sector, a value of 0 is assigned; and 3. If restrictions are listed for a given mode of supply in a given sector, a value of 0.5 is assigned.

Despite overall improvements, including those realized in the latest package, and notwithstanding the very real achievements of ASEAN on the MRA front in a number of regulated professions, it would appear that the AFAS has yet to lead to a substantial reduction of services trade barriers beyond that achieved already or on offer at the multilateral level. By way of consequence, it may also be inferred that the potential trade and investment diversion effects of AFAS on third countries is likely to be marginal, all the more so given AFAS' liberal denial of benefits clause which provides third country investors – including those from Switzerland – with a level of investor access to ASEAN markets that largely approximates MFN treatment. At the same time, since the level of restrictiveness of ASEAN services regimes under the GATS remains high, there is considerable scope for greater services liberalisation in the region on either a bilateral, regional or multilateral basis.

Singapore and Malaysia, the biggest importers and exporters of services within ASEAN, have improved on their GATS commitments under AFAS in a marginal way when measured on a sectoral basis. Singapore and Malaysia have respectively scheduled only 22 and 39 new liberalised bindings under AFAS. Because of its recent WTO accession negotiation, Vietnam has not improved on its GATS commitments in the latest AFAS package and has in fact scheduled more commitments under the GATS than the AFAS. Many of Vietnam's "unbound" commitments across particular modes of supply under AFAS are already partly committed under the GATS.

The biggest margins of AFAS preferences in services concern Thailand, Indonesia and the Philippines, where more than 140 new partial and/or full commitments were scheduled under AFAS relative to these countries' GATS bindings. For these members, AFAS liberalisation may be expected to generate potentially greater trade diversion effects on third countries. They may thus be countries that Switzerland may wish to consider more closely in the context of potential future bilateral PTAs.

Similar results confirming the relatively modest improvements made by AFAS were found by Fink and Mulinuevo (2007). Their analysis shows that most schedules of commitments under AFAS offer little improvement over GATS schedules and that in fact only a small number of new sectors have been listed. The difference between their findings and the relatively higher number of newly committed sectors found by Thanh and Bartlet can be explained in terms of sectoral aggregation: many of the new sectoral commitments observed by Thanh and Bartlet are new sub-sectoral commitments in sectors already bound under GATS.

Table IV.4 Depth of Commitments in the first 4 packages of AFAS[15]

	GATS		GATS+AFAS (1-4)		Improvement [5]	
	'None' and 'Partial' [1]	'Unbound'	'None' and 'Partial'	'Unbound'	'None' and 'Partial'	'Unbound'
Brunei Darussalam	63	41	154	198	91	157
Cambodia [2]	343	241	415	293	72	52
Indonesia	119	125	276	104	157	-21
Laos [3]	-	-	-	-	-	-
Malaysia	275	213	314	302	39	89
Myanmar	72	72	216	216	144	144
Philippines	126	18	313	123	187	105
Singapore	288	120	310	134	22	14
Thailand	334	174	498	190	164	16
Vietnam [4]	295	261	281	323	-14	62
Total ASEAN	1915	1265	2777	1883	862	618

[1] 'None represents no restrictions for trade; 'Partial' represents bounded restrictions and partial opening; 'Unbound' represents non-binding.
[2] Cambodia was not a party to AFAS package one.
[3] Lao is not a WTO member and does not have GATS commitments.
[4] Based on its latest WTO offer.
[5] Improvement represents the difference in the number of sectors bounded in GATS and AFAS' four packages combined and GATS bindings. A negative number represents higher level of binding in GATS.

Source: Based on Thanh and Bartlett (2006).

Two additional observations regarding ASEAN members are that: first, the regulatory *status quo* - i.e. the actual level of trade restrictiveness - is typically lower than that which is bound under AFAS packages (as indeed under the GATS). This is not, however, always the case of individual ASEAN members in their bilateral PTAs. Second, such commitments cover less than half of the possible total sub-sectors covered by the GATS.

Summing up, AFAS has to date made only a modest contribution to opening intra-ASEAN services trade liberalisation over and above that on offer at the multilateral level. Such a conclusion holds even more with regard to the services rules found in AFAS, where evidence of GATS-minus provisions can be found. AFAS advances on mutual recognition in

[15] The approach used by Thanh and Bartlett for purposes of cross-country comparisons of liberalization levels provides little by way of qualitative information on the extent of actual market opening, on the relationship between bound commitments and the prevailing regulatory *status quo* as well as on the nature of limitations retained under unbound or partial commitments and the extent of their restrictiveness. Though time and resource constraints precluded the use of more sophisticated evaluation methodologies, it should be noted that such policy research tools have been developed. See notably the quantitative approach developed by the Swiss government in SECO (2005) available at http://www.seco.admin.ch/themen/00513/00586/00587/00589/index.html), as well as the frequency index first developed in Hoekman (1995).

professional services are an important exception and must however be viewed as a significant development in trade-facilitating services rule-making.

Despite its lofty ambitions, ASEAN's record on service sector trade and investment liberalization has been less than stellar. A recent assessment of a decade of attempts at prying open regional services markets noted that: "…AFAS's performance has not been impressive. Against only one performance criterion has AFAS's performance been rated higher than adequate. AFAS has achieved wider bound liberalisation than GATS, and it has removed restrictions to services trade amongst its constituent members. However, the margin of preference varies substantially by ASEAN Member Country, with the two biggest providers of intra-ASEAN services, Singapore and Malaysia, providing the least margin of preference. The depth of liberalisation, represented by the extent to which commitments are bound, is also poor." (Tranh and Bartlett, 2006).[16]

IV.3 AFAS advances: a look at individual ASEAN members

Japan, Korea, Australia, New Zealand and the US have been extensively involved in PTAs and their bilateral negotiations tend to involve all ASEAN countries apart from Cambodia, Laos and Myanmar. China, India and Korea have focused their efforts so far on Singapore, the Philippines and Thailand. Table IV.5 above shows that with the exception of Cambodia and Myanmar, all ASEAN member states have concluded or are negotiating PTAs with the non-ASEAN partners. So far, Singapore has been the most active ASEAN state in signing PTAs and had already concluded agreements with all ASEAN Plus countries, with the exception of China with whom it is currently in negotiations. Thailand has been also very active and concluded three PTAs and is negotiating several more. Malaysia and Indonesia are also in the process of engaging with several non-ASEAN partners.

The remaining part of this section examines ASEAN integration in services in two aspects. First, it analyses ASEAN members' sectoral commitments in their PTAs as well as in the AFAS, investigating how far they have gone beyond their GATS commitments. In so doing, special attention will be paid to those sectors that are of specific offensive interest to Switzerland (see Box IV.2 and Table IV.5 below). The section concludes with a discussion of GATS+ rule-making advances in ASEAN member states' PTAs with third countries.

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[16] Against this disappointing backdrop, the scorecard does however reveal some positive findings. Notably, good has been made in modes 1 and 2, both with respect to bound commitments and a genuine attempt to improve transparency and predictability through the obligation to report reasons for diverting from 'none' in these modes. Similarly, the fact that there is 50% more sub-sector coverage under AFAS than GATS when summed across all member countries should not be lost.

Box IV.2 Assessing Switzerland's offensive interests in services trade

A quantitative assessment of individual countries' interests in services liberalisation in foreign markets is generally difficult to perform since many of the traditional economic tools used in goods trade (such as Revealed Comparative Advantage indices) cannot be readily applied in the services field due in large measure to inadequate statistical information. Reliance must thus be made on qualitative information, to which evidence of significant export activity and/or domestic competitiveness can be added.

Alternative approaches for assessing a country's offensive interests in services trade can be based either on detailed industry surveys concerning barriers faced abroad, on detailed firm-level analysis detailing sources of competitiveness, or through observation of countries' requests for liberalisation directed towards third countries in GATS negotiations.

Since the first two options are not feasible given the time and resource constraints of the present study, a proxy of revealed Swiss offensive interests in services trade can be derived from those sectors that Switzerland has targeted in its bilateral negotiating requests in services trade as well as those where Switzerland features as a *demandeur* in the process of collective requests initiated pursuant to a decision taken at the December 2005 WTO Ministerial meeting, held in Hong Kong, China. Such collective requests, which remain for most countries complementary (and not substitutes) to the process of bilateral requests and offers, nonetheless provide some information regarding specific services and modes of supply of broad interest to Switzerland. They also help to identify – and gain a better overall sense – of the range and type of countries that are targeted by Switzerland's liberalisation requests. This data is complemented with other publicly available information concerning Switzerland's service industries interests (SECO 2002; WTO 2005; Leuthard 2007). [17]

It is generally accepted within services negotiating circles that bilateral requests are more finely representative of a country's offensive priorities, whereas participation in collective requests may respond to broader market opening or systemic considerations and not always reflect domestic priorities within countries formulating the collective request. For instance, although Switzerland has signed onto collective requests in the areas of environmental and air transport services, the sectors do not rank among its top negotiating priorities in bilateral request-offer discussions under the GATS. Similarly, Switzerland has not co-signed a collective request in two sectors – tourism and the movement of managers and specialists – in which it maintains strong offensive interests in bilateral discussions with its key trading partners.

Switzerland's requests in services concern some fifty WTO Members (with the EU as one). Industrialized countries, particularly the EU, Japan and the United States, are the country's key targets, as befits the sophisticated nature of Switzerland's most competitive service sectors. Least developed countries, and particularly countries in Sub-Saharan Africa, were in principle excluded from Switzerland's June 2002 bilateral requests. In general, Switzerland's requests in services trade take account of the development level of its trading partners. Switzerland has not submitted any requests to least developed countries (SECO (2002)).

[17] For further information, see
http://www.seco.admin.ch/themen/00513/00586/00587/00589/index.html

As regards the sectoral coverage of Switzerland's requests, they focus predominantly on the following six: (i) financial services (e.g. banking and insurance services); (ii) the mobility of managers and specialists; (iii) transport-related services (e.g. freight, cargo-handling); (iv) various business-related services (e.g. foreign legal consultants, engineering, accountancy, IT/computer-related services, as well as services linked to testing, maintenance and repair of equipment); (v) distribution services; and (vi) tourism-related services (e.g. hotel management and training and travel agency services).

Swiss requests do not concern market access in sectors such as education, health, road and railway transportation, postal as well as audio-visual services, which are excluded in light of Switzerland's view of public servicea or because of a lack of export interests in the above sectors.

Table IV.5 below summarizes the individual Asian countries targeted by collective requests in some sectors. Though this list cannot be used to infer the content Swiss requests, it indicates which ASEAN countries are more involved in GATS negotiations in the sectors concerned.

Table IV.5 Asian targets of DDA collective requests in services

Switzerland's interests	Target Countries in Bilateral or Collective Requests	
	ASEAN	**ASEAN Plus**
Architectural and Engineering services	Indonesia, Malaysia, Philippines, Singapore, Thailand	China, India
Transport-related services (freight, cargo-handling, logistics)	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand	China, India, Korea, US
Financial services (banking and insurance)	All countries[18]	All countries
Tourism services (hotel and travel agency services)	All countries	All countries
Modes 1 and 2	Brunei, Malaysia, Indonesia, Philippines	Australia, Japan, Korea, China, US
Mode 3	Indonesia, Malaysia, Philippines, Singapore, Thailand	Australia, New Zealand, China, India, Korea, Japan
Mode 4 (intra-corporate transferees - managers, specialists and other key personnel; business visitors)	All countries	All countries

[18] The term "all countries" excludes least-developed countries.

IV.3.1 Brunei

Brunei's commitments under AFAS duplicate to a considerable extent its GATS commitments. Added value of particular interest to Switzerland include Brunei's undertakings in architectural and engineering services, where extensive market access liberalisation has been implemented with some limitations on foreign equity. National treatment is completely liberalised for those sectors in modes 1 and 2 but is unbound in modes 3 and 4. Brunei has also scheduled extensive liberalisation in both market access and national treatment across modes 1, 2 and 3 in computer-related services, a sector in which Switzerland appears in the collective request target group. Overall, Brunei is more open with respect to modes 1 and 2, but remains protective for mode 3, with foreign equity limitations a recurring restriction across sectors. The chapter on services in the Brunei, Chile, New Zealand and Singapore Trans-Pacific Strategic Economic Partnership (SEP) Agreement does not include services commitments by Brunei, although the country is under the obligation to negotiate its commitments on services this year.

IV.3.2 Cambodia

Cambodia is not a signatory to PTAs with countries outside of ASEAN. Its commitments under the AFAS are similar to those under the GATS, probably due to the extensive liberalisation undertaken by Cambodia when it negotiated its way into the WTO. Among the most important improvements in access to the Cambodian services market is the removal of national treatment limitations for subsidies under modes 1 and 2, and in the field of financial services the right for all foreign banks to engage in deposit services provision without restriction. Cambodia has fully liberalised access conditions in several sub-sectors of architectural and engineering services, with the exclusion of mode 4. It is also extensively committed in computer-related services, telecommunications and education services.

IV.3.3 Indonesia

Indonesia has yet to conclude its ongoing PTA negotiations with Japan and Australia. Within AFAS, it has improved on its GATS commitments with full liberalisation commitments under Modes 1 and 2 of those sub-sectors in which it has made partial GATS commitments. Such a development is very much in line with Swiss interests in services trade. Architectural and engineering services, and a relaxation of foreign equity restrictions in many sectors in the light of recent liberalising changes to Indonesia's Investment Law, are additional areas of importance where broad AFAS undertakings have been made. Other improvements in liberalisation include AFAS bindings in sectors of which Switzerland is itself a target country

under GATS: education, computer-related services, and communications (telecoms and audio-visual services).

IV.3.4 Laos

As Laos is still not a WTO Member - it is currently negotiating its accession to the world trade body, its commitments under AFAS are the sole relevant benchmarks. As noted above, Laos' commitments in its bilateral agreement with the US are considered to be the most liberalised bindings taken by any country to date in services trade (meanwhile, the US is bound under the agreement to its GATS level of commitments. Laos has taken full national treatment commitments in all its service sectors for all modes of supply excluding mode 4. Extensive market access commitments were also scheduled, with Laos undertaking commitments in key sectors such as professional services, financial services, telecommunications, audiovisual, health, construction, tourism and distribution services.

IV.3.5 Malaysia

Overall, Malaysia has not significantly improved beyond its GATS commitments in its dealings with ASEAN members. The country's commitments under AFAS provide little advancement, although with regard to Switzerland's offensive interests in services trade, Malaysia did agree to new market opening commitments in the latest package of AFAS commitments in the areas of architectural and engineering services. In the field of architectural services, national treatment was almost fully liberalised across modes 1,2 and 3 and was fully liberalised for modes 1 and 2. The cross-border supply of engineering services has been further liberalised while foreign equity limitations have been maintained. Malaysia's FTA with Japan provides for enhanced liberalisation commitments in a range of new sub-sectors linked to the construction and engineering services. However, the extent of such new bindings remains rather limited.

IV.3.6 Myanmar

Myanmar has no bilateral PTA with non-ASEAN countries, owing in large measure to the nature of its domestic politics. While the country's AFAS commitments are wider than those taken under GATS, their depth and quality remain limited. Contrary to other ASEAN members, Myanmar offers in its AFAS undertakings full foreign ownership under mode 3 for several sectors. This is notably the case of construction, architectural and engineering services. Another commitment affecting competitive conditions in the country's logistics industry relates to the liberalisation of storage and warehousing services under services auxiliary to all modes of transport.

IV.3.7 Philippines

Commitments under the AFAS improve on the Philippines' GATS bindings under Modes 1 and 2, where it fully liberalised several professional services (including architectural and engineering services), tourism, telecommunications, and construction services. Some GATS+ improvements were also made with regard to mode 3, notably in the tourism sector where full ownership in luxury hotels is allowed. The Philippines also improved its liberalisation undertakings in architectural and engineering services with regard to mode 4, although important barriers such as economic needs tests and reciprocity requirements remain in place even for ASEAN country nationals. The PTA with Japan improves on liberalisation in many categories of construction and engineering services, as well as in health and health-related services. It also provides for limited liberalisation in environmental services (sewage services), an area of interest to Switzerland in which limited progress has to date been made at the multilateral level. Similar liberalisation in environmental services was also scheduled under the fifth package of AFAS. The Japan PTA also provides for notable GATS+ commitments in financial services, in marked contrast to their general absence under the AFAS. Moreover, the Philippines has made AFAS commitments in several sub-sectors relating to air transport, such as aircraft repair and maintenance services, services supplied by non-scheduled carriers, services auxiliary to all modes of transport, general sales agents, and cargo sales agents.

IV.3.8 Singapore

Singapore's AFAS commitments offer very little improvement over its GATS bindings despite the inclusion of several new sub-sectors. In line with its ASEAN partners, Singapore has made new commitments on architectural and engineering services (primarily relating to modes 1 and 2) while also maintaining limitations affecting mode 3 trade. Environmental services were also liberalised completely for modes 2 and 3 in sanitation-related services, cleaning of exhaust gases and noise abatement services. Singapore's bilateral PTAs with non-ASEAN members offer much wider liberalisation than the AFAS, and improves significantly on the range of sub-sectors covered by the GATS. Such wide coverage is notable, in particular as Singapore already ranked among those emerging economies with the most extensive set of GATS commitments. Singapore's experience suggests the clear GATS+ properties to be had from bilateral PTAs in services even with countries that have liberalised significantly at the multilateral level. Singapore's PTAs are notable for removing several restrictions on modes 1 and 2 and for developing some path-breaking provisions on trade in digital products. Singapore's liberalisation commitments in financial services has improved marginally under its PTAs. However, the Singapore–US agreement is an exception and provides for a phase-out of commitments under which Singapore agreed to liberalize its

entry regime for foreign banks within 18 months of the agreement's entry into force. The latter agreement also offers deeper market access commitments in the area of telecommunication services.

IV.3.9 Thailand

The AFAS provides for a modest extension of GATS liberalisation bindings for Thailand, particularly in terms of sectoral coverage. The fifth AFAS package saw Thailand liberalise several services of particular interest to Switzerland, notably architectural and engineering services, environmental services and services auxiliary to transport. In architectural and engineering services, Thailand has undertaken almost complete liberalisation for both market access and national treatment across modes 1, 2 and 3. Similar liberalisation steps were taken for several environmental services, such as sewage services, refuse disposal, sanitation and similar services, cleaning of exhaust gasses, noise abatement services, nature and landscape protection and other environmental protection services. Services auxiliary to all modes of transport liberalisation include custom clearance services and storage and warehousing services, but are of more limited scope. The Thailand–Australia features improved commitments in distribution and construction services, as well as substantially longer work permit periods for Australians supplying services on a temporary basis in Thailand under mode 4 (up to 5 years compared with 6 months under the GATS). The Thailand–New Zealand FTA has a built-in agenda for the liberalisation of services within three years of its entry into force (i.e. 2008) and thus does not yet include any provisions on services. Thailand's recently completed agreement with Japan features less liberalisation than is to be found under the AFAS in the areas of construction, architectural and engineering services, and there are no bindings made on mode 1 for both market access and national treatment in these sectors. Moreover, many sectors otherwise covered by the agreement (such as business services or communications) can hardly be described as subject to liberalisation commitments since they remain unbound for all modes of supply in respect of both market access and national treatment obligations. The agreement does however feature commitments on environmental services in the same sub-sectors as those advanced under the AFAS, as well as several partial commitments on financial services. Air transport services are covered in three sub-sectors covered by the GATS: aircraft repair and maintenance services; supporting services for air transport, computer reservation systems, as well as storage and warehouse services.

IV.3.10 Vietnam

Vietnam's AFAS commitments do not substantially deviate from its GATS undertakings. Architectural and engineering services were partially liberalised under AFAS's fifth package.

The latest round of AFAS commitments also saw limited additional liberalisation of environmental services that are not considered as public utilities, such as sewage services, solid waste disposal, cleaning of exhaust gasses and noise abatement services. The Vietnam–US bilateral trade agreement provides for substantial liberalisation in all major service sectors, with the exclusion of transport services. Under both the AFAS and in its BTA with the US, Vietnam's liberalisation commitments are extensive in scope and depth. However while foreign equity restrictions are lifted under AFAS, they were maintained under the US BTA albeit subject to a gradual phase-out in most areas. Vietnam's recent accession to the WTO saw it afford WTO members afford a considerable degree of parity of treatment to that found in the US BTA, including in financial services, where Switzerland maintains important offensive interests.

IV.4 Developments in Asian PTAs

The former section examined ASEAN member states' intra-regional liberalisation in services and the extent to which such liberalisation goes beyond that on offer under GATS. This section assesses individual ASEAN member states' initiatives to liberalise services trade with a select number of key countries from outside ASEAN's regional integration framework: China, India, Japan, Australia, New Zealand and Korea (hereinafter, ASEAN Plus). Table IV.5 below shows the matrix of existing and negotiated agreements between these countries. In what follows, an aggregate assessment of the depth and scope of liberalisation of Asian PTAs is attempted. This is followed by a country specific analysis as well as by an examination of the extent to which such agreements have achieved GATS+ advances in services rule-making.

Three issues merit elaboration from an aggregate level: (i) the depth of liberalisation beyond the GATS and patterns of sectoral commitments; (ii) the modalities or architecture of liberalisation; and (iii) the modal distribution of liberalisation commitments.

Table IV.6 A cross-tabulation of Asian PTAs in force and under negotiation[1]

	Asia				Oceania		North America
	China	**India**	**Korea**	**Japan**	**Australia**	**New Zealand**	**United States**
ASEAN	2003	2004	2006	N	N	N	
Brunei Darussalam				N		2005 (with Singapore and Chile)	
Indonesia				N	N		N
Malaysia				2006	N	N	N
Philippines				2007			N
Singapore	N	2005	2006	2002	2003	2001, 2005 (with Brunei and Chile)	2004
Thailand		N		2007	2005	2005	N
Cambodia							
Laos							2005
Myanmar							
Vietnam							2001

Signed

N Currently Negotiated

[1] Updated as to June 2007

IV.4.1 Depth of liberalisation

The depth of liberalisation varies considerably across ASEAN Plus agreements. On the one hand, several PTAs only marginally deepen liberalisation beyond the GATS. This is the case for instance of the Thailand–Australia and of the Malaysia–Japan PTAs. On the other hand, some agreements significantly deepen their members' GATS commitments in terms of the breath and quality of sectoral bindings (level of restrictiveness). The Laos–US Bilateral Trade Agreement lies at one extreme, with Laos adopting full national treatment commitments in all sectors as well as an extensive set of unrestricted market access commitments. Given the LDC status of Laos, it is arguable that the level of its services commitments is probably more reflective of the country's acute negotiating capacity constraints than its commitment to sweeping services liberalisation.

An aggregated measure of the GATS+ nature of market opening commitments in Asian PTAs in services can be found in the exhaustive analysis recently carried out by Fink and Molinuevo (2007). Such results, the sectoral breakdown of which is summarized in Figure IV.2 below[19], reveal that while GATS+ PTA advances are significant across all sectors, they are particularly noticeable in the areas of business services (reflecting the emergence of

[19] It bears noting that these aggregate figures drawn from Fink and Molinuevo's work include AFAS commitments.

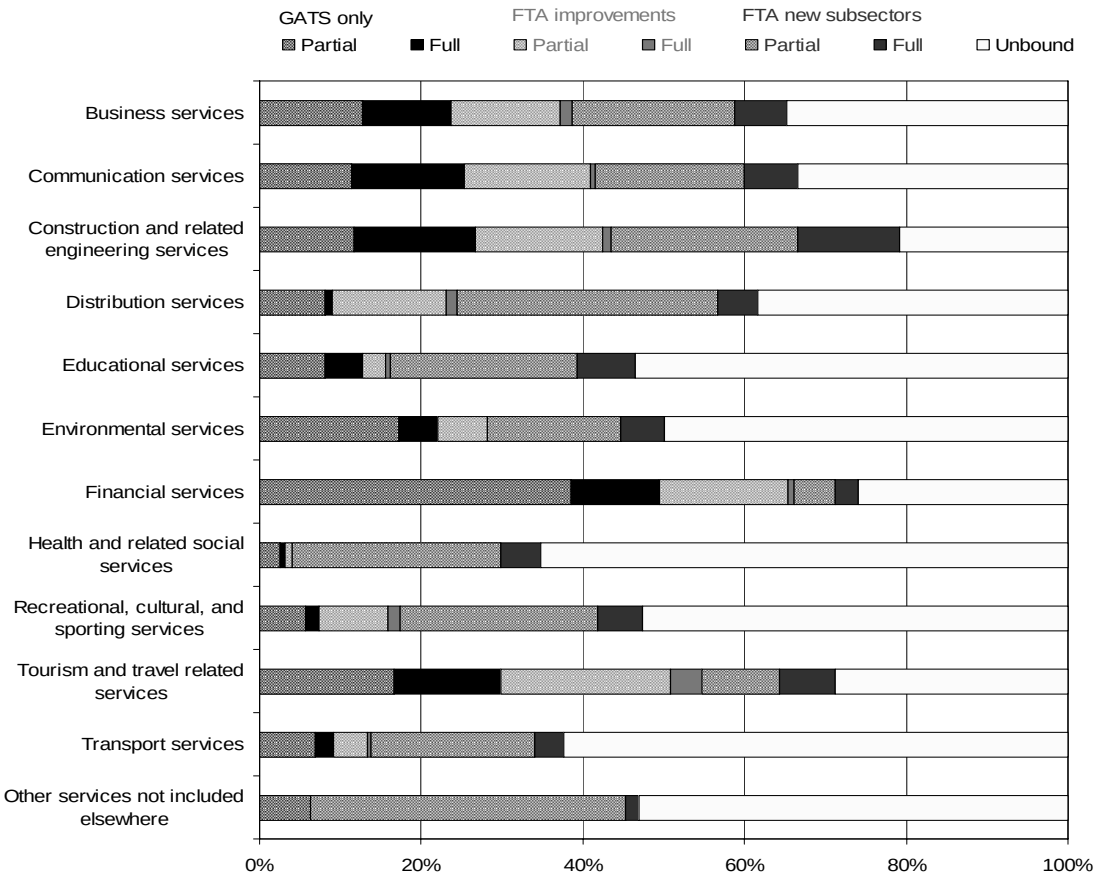
digital trade, e-commerce and the outsourcing revolution in services); distribution; education, health and transport services, all areas that have proven difficult in the WTO context in both the Uruguay Round and the DDA.

Meanwhile, the lesser relative progress registered in areas such as telecommunications and financial services recall that these are precisely the sectors where GATS negotiations have to date been most successful, lessening the scope or perceived need for significant new advances in a PTA context.

IV.4.2 Negotiating modalities

Significant variation exists regarding the liberalisation modalities used in PTAs between ASEAN countries and third countries. As Table IV.6 shows, three basic approaches to scheduling commitments can be found in East Asian services PTAs.

Figure IV.2 GATS+ advances in Asian PTAs covering services: sectoral breakdown



Source: Fink and Molinuevo (2007)

Table IV.7 Negotiating modalities in Asian PTAs covering services

GATS/hybrid list approach	Negative list approach	Pure positive list approach	Other approaches (only a list of sectors)
AFAS ASEAN-China Australia-Thailand EFTA-Korea EFTA-Singapore India-Singapore Japan-Malaysia Japan-Philippines Japan-Singapore Jordan-Singapore NewZealand-Singapore Vietnam-U.S.	Australia-Singapore Chile-Korea Guatemala-Taiwan Japan-Mexico Singapore-Korea Nicaragua-Taiwan Panama-Singapore Panama-Taiwan Singapore-U.S. Transpacific SEP (Brunei, Singapore, New Zealand, Chile)	China-Hong Kong China-Macau	Lao PDR-U.S.

Close to half (12 of 25, or 48%) of Asian PTAs covering services use a GATS-like hybrid list approach to scheduling liberalisation commitments, which combine a positive selection of sectors, sub-sectors and modes of supply and a negative listing of non-conforming measures maintained in committed sectors, sub-sectors and modes of supply.

The other method of scheduling is the negative list approach, whose presumption is that all measures affecting trade and investment in services are automatically fully bound at free (i.e. with no limitations) *unless* they are specifically reserved in annexes to the Agreement (including annexes affording scope for reserving future measures. Forty percent (10 of 25) of Asian PTAs covering services follow such an approach.

Yet a third approach involves a pure positive list, whereby Members agree to specify solely those measures that are free of restrictions in specific sectors, sub-sectors or modes of supply. As Table IV.5 reveals, only two such agreements can be found in Asia, both of them involving China with the separate customs territories that belong to it (Hong Kong and Macau). Finally, a fourth negotiating modality, found exclusively in the Laos-United States Bilateral Trade Agreement, consists of listing sectors in which trade can take place unencumbered.

A review of commitments in Asian PTAs in services suggests that the often-held belief that negative listing yields inherently greater and more transparent liberalisation requires some nuance. While such an outcome should be expected insofar as regulatory transparency is

concerned, the devil tends to be in the detail, such that some agreements using negative listing clearly provide a clearer roadmap of existing regulatory impediments whereas others fall short of expected transparency through recourse to sweeping sectoral or modal carve-outs[20] or by excluding entire categories of measures (for instance sub-national measures).

The evidence is also mixed in terms of the impact of negative listing on induced levels of liberalisation. Several hybrid list agreements have indeed achieved a greater degree of liberalisation than that on offer under negative list agreements by the same partners. Thus Singapore's positively listed commitments in its PTA with Japan are significantly greater in terms of coverage than Singapore's negatively listed commitments in its PTA with Australia. Done properly, however, there is little doubt that negative list agreements may yield important benefits by way of regulatory transparency and by locking in the regulatory *status quo*.

A new development of note in this regard, and which has been embedded to date in the most recent Japanese PTAs, aims to secure the best properties of negative and hybrid listing. The Japanese PTAs thus maintain a GATS-like hybrid approach to scheduling, preserving countries' right to pick and choose those sectors, sub-sectors and modes of supply in which they desire to make commitments, but assorts such flexibility with the twin obligations to: (i) schedule the regulatory *status quo* (i.e. no GATS-like right to schedule commitments that offer less access than that which exists under the scheduling country's current laws and regulations) and (ii) to exchange non-binding lists of non-conforming measures (i.e. a non-binding negative list of trade and investment restrictions in all sectors is embedded in the PTA) so as to promote greater regulatory transparency.[21]

IV.4.3 Modal advances

Asian PTAs in services confirm the partial nature of market opening in services. Such an observation is particularly apparent when commitments are analysed on a modal basis, as can be seen from Figure IV.3 below.

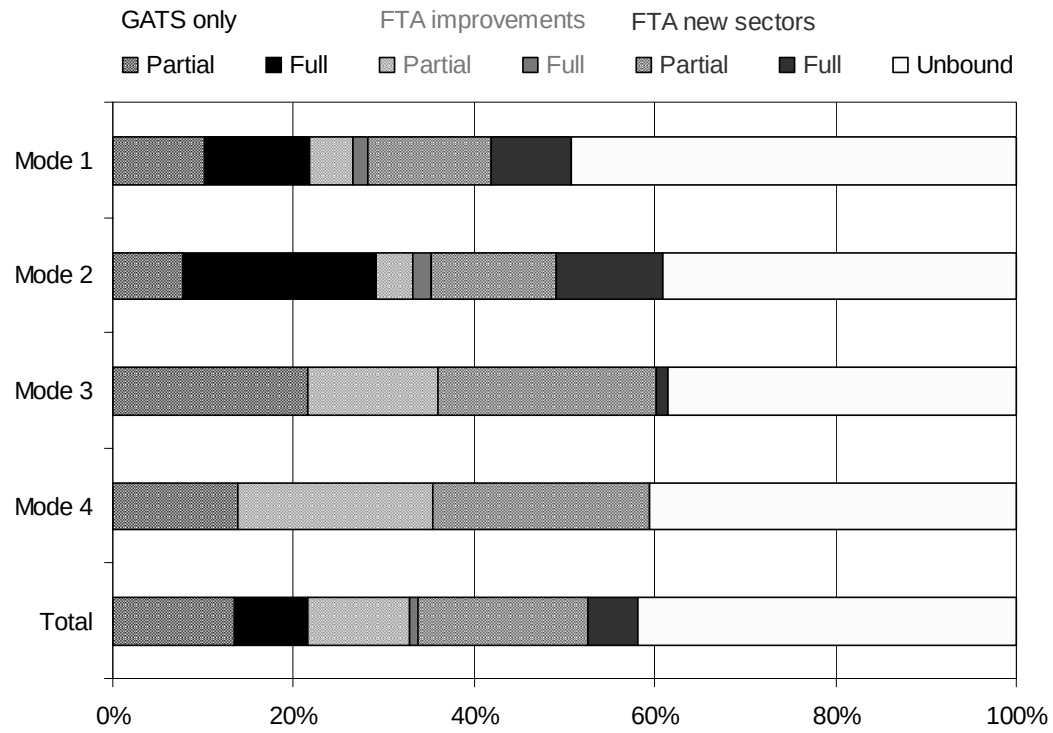
From a positive (albeit not entirely surprising point of view given the reluctance of countries to contemplate Mode 4 liberalization on an MFN basis), the most significant sources of

[20] One troubling example stems from recent US PTA practice, which increasingly sees sweeping negative list reservations that exclude all measures affecting services maintained at the sub-national level. Recent US PTAs are notable as well for excluding Mode 4 commitments.
[21] To date, Switzerland's approach to scheduling commitments on services trade has been a flexible one, using both the hybrid (i.e. GATS-like) or negative list approaches depending on the trading partners concerned.

GATS+ advances in Asian PTAs are to be found in respect of the two modes of supply that are likely to generate the strongest developmental returns: mode 4 (movement of natural persons) – the least committed of all modes under GATS – and mode 3 (commercial presence) – the most committed of all modes subject to GATS bindings.

The Asian PTA experience reveals, once again not surprisingly, lesser improvements with regards to modes 1 (cross border supply) and 2 (consumption abroad), reflecting, in the latter case, the limited capacity of home countries to influence Mode 2 trade determinants, as well, in the case of cross-border trade, the reluctance to commit that which host countries cannot (or cannot easily) regulate.

Figure IV.3 GATS+ advances in Asian PTAs covering services: modal breakdown



Source: Fink and Molinuevo (2007)

However, closer scrutiny reveals that the results described above require some nuance. Thus, mode 4 advances in Asian PTAs actually tend to be somewhat marginal (and always partial, as can be expected) and tend to result in quite minor (if potentially symbolic and

precedent-setting) changes to labour market outcomes.[22] At the same time, full liberalisation is more frequent for modes 1 and 2, possibly reflecting rising comfort levels towards digital trade and e-commerce (for Mode1) and the near impossibility of - and limited policy interest in – restricting transactions initiated by sovereign consumers (for Mode 2 trade).

Summing up, ASEAN members have moved beyond the GATS in their PTAs with non-ASEAN countries in several areas of potential interest to Switzerland. Such advances concern sectors such as architectural and engineering services, environmental services, financial services as well as services relating to air transport. ASEAN countries have also committed to deeper PTA liberalisation under modes 1, 2 and 3, all of which are of trade interest to Switzerland.[23] ASEAN members have, with a few exceptions, undertaken deeper and wider liberalisation in their PTAs with non-ASEAN countries than among themselves.

IV.5 Asian PTAs: GATS+ rule-making?

We conclude this section with an assessment of the extent to which ASEAN members deviate from - and go beyond - the rules set out in the GATS. Such an assessment is based on rule-making contained in the PTAs that Singapore, Thailand, Malaysia, the Philippines and Vietnam have reached with non-ASEAN countries. Tables IV.7-11 below provide country summaries of the GATS+ nature of PTA rules on services entered into by the five ASEAN members. Tables IV.8 to IV.12 provide country summaries of GATS+ advances in selected ASEAN member countries.

IV.5.1 Singapore

Singapore's PTAs follow three different modalities of liberalisation: positive/hybrid listing (in the GATS sense), negative-listing and a combination of both (i.e. positive listing and negative listing in different sections). All of its PTAs feature GATS+ advances on the rule-making front, though with some variance depending on the partner concerned, the time at which the agreement was concluded, and the level of reciprocal ambition embedded in the various PTAs it has signed. Government (i.e. public) services, transportation and related services,

[22] One example relates to the labour mobility provisions that have been associated to recent Japanese PTAs which feature novel provisions aimed at assisting partner countries with training in the home country prior to admission in Japan with a view to comply with Japanese licensing requirements in nursing and other health-related occupations. While the numerical quotas agreed to by Japan in these areas remains extremely low relative to the supply capacity (and negotiating interests) of sending countries, such provisions nonetheless represent a step forward in the treatment of Mode 4 issues in a context of population ageing and labour market shortages in OECD countries.

[23] It should be noted that some observers question ASEAN states implementation of their services commitments. See Vandoren (2005).

subsidies, investment (typically addressed in a generic chapter) and government procurement are generally excluded from the scope of the services chapters of Singapore's PTAs.

Excluding the PTA with New Zealand, Singapore's agreements with India, Korea, Japan, Australia and the US all provide for rules in financial and telecommunications services. The financial services framework shows variance across different PTAs and at times includes financial sector-specific investment disciplines, as in the case of the PTAs with Korea and Australia. Singapore's PTAs typically feature GATS+ disciplines on transparency (notably by introducing prior notification requirements) and sometimes on definitions (but not in the case of its PTA with India). GATS+ provisions also exist in some of the PTAs regarding dispute settlement in financial services. Several of Singapore's PTAs incorporate binding elements drawn from the GATS' Understanding on Commitments in Financial Services. While the PTA with Korea is based on a negative list approach, the section on financial services is characterised by positive-list undertakings.

The chapters on telecommunication services found in Singaporean PTAs typically exclude cable and broadcast distribution of radio and television programming, while providing new rules that extend beyond the GATS' Reference Paper on pro-competitive regulatory disciplines. Such rules relate to definitions, transparency disciplines, access to and use of public telecommunications transport networks and services, independent regulation, universal service obligations, licensing procedures, treatment of scarce resources, enforcement and dispute settlement. Also featured are disciplines aimed at curbing the potentially anti-competitive behaviour of dominant suppliers.

The PTA with Korea includes rule-making in maritime transport in addition to providing a list of sectors where additional commitments are taken. GATS+ provisions on mutual recognition in the South Korean PTA feature criteria for the development of professional standards, and also encourage the temporary licensing of professional service providers. Furthermore, with regard to engineers, South Korea committed to recognizing the degrees from 2 Singapore universities, while Singapore committed to recognising those from 20 South Korean universities. The chapters in the PTAs dealing with the temporary entry of business persons go beyond the GATS framework on the movement of natural persons by listing general principles and obligations for common disciplines governing temporary entry. The chapters also deal with information provision and dispute settlement. Furthermore, they typically grant specific commitments on temporary entry categories of business visitors, traders and investors, intra-corporate transferees, as well as specify durations of stay. The PTAs with

Australia and India also define service sellers and short-term service suppliers for the purposes of movement of natural persons. They also prohibit labour market testing on those persons permitted to move under the agreement.

Singapore's PTA with the United States was one of the first, alongside that concluded between the US and Chile (and later largely replicated by the EU in its own PTA with Chile), to feature a detailed set of provisions dealing with trade in digital products (goods and services).

IV.5.2 Thailand

Thailand has generally made only modest rule-making advances in its services PTAs to date. To some extent, such an outcome can be ascribed to the fact that it has yet to reach agreement with the United States and accept the range of GATS+ provisions (both in terms of rule-making and especially market opening) that a PTA with the US typically entails (Roy, Marchetti and Lim, 2006). Thailand's liberalisation modality for services tend to follow the GATS approach, notably in its PTAs with Japan and Australia, although in the case of the Japan PTA, it did agree to bind the regulatory *status quo* in scheduled areas and exchange a non-binding negative list of trade and investment-restrictive measures in services trade. Thailand's PTA with New Zealand features no current provisions on services – the two countries having agreed to negotiate at a later date (they are currently doing so). Government procurement, government services and access to the labour market are excluded from the scope of Thailand's services PTAs, none of which feature language on emergency safeguard measures, a topic on which Thailand has been an incessant *demandeur* in GATS discussions. The PTA with Japan also excludes air transport services and maritime cabotage.

Thailand's PTA with Australia includes rules similar to the GATS in the areas of financial services and telecommunications (i.e. adoption of the relevant GATS chapters), while its PTA with Japan is silent on these issues even though the sectors are covered for market opening purposes. GATS+ advances were made in Thailand's PTA with Japan regarding disciplines on (non-discriminatory) domestic regulation, as disciplines in this area (which are substantively rooted in GATS language) apply to all covered services and not only to those where commitments have been scheduled. The PTA with Australia features a new provision on deepened cooperation in services that include research and development, human resources and professional development, trade in services data management and small and medium-sized enterprises' capacity enhancement. Furthermore, it specifies education,

healthcare and tourism services as sectors for specific cooperation, and calls for the facilitation of temporary entry of business people.

IV.5.3 Malaysia

Malaysia has to date entered into only one PTA covering services, with Japan. This agreement follows a GATS-like positive/hybrid list approach that excludes from its scope air transport services, maritime cabotage, government procurement, government services as well as access to the labour market. Like many other PTAs in the region, it features a commitment towards future liberalisation (through periodic negotiations), but tends to replicate GATS language in almost every respect of rule-making. One exception however relates to the PTA's provisions on financial services, which incorporate disciplines drawn from the GATS' Understanding on Commitments in Financial Services (which Malaysia has not scheduled multilaterally) and provide for sector-specific rules on dispute settlement.

IV.5.4 Philippines

Like Malaysia, the Philippines has to date concluded only one PTA covering services with a non-ASEAN partner, that with Japan. The PTA follows a GATS-like positive/hybrid list approach along the lines featured in the Japan-Thailand PTA (i.e. an obligation to schedule the regulatory *status quo* and the provision of a non-binding negative list for purposes of regulatory transparency). The PTA with Japan mimics that with Malaysia and Thailand by excluding air transport services, maritime cabotage, government procurement and government services, as well as access to the labour market. It goes beyond the GATS in three aspects. First, it provides for more detailed rules on transparency and includes a commitment for detailed publication requirements, including at sub-national levels of government. Second, it achieved concrete progress on the movement of natural persons by adding a chapter on the entry and temporary stay of nationals for business purposes. This chapter provides principles, definitions, means of information-exchange, dispute settlement, and defines categories for business purposes according to intra-corporate transferees, investors, and nationals of a party who engage in professional business activities on the basis of a personal contract with a public or private organisation in the other party. Furthermore, the PTA includes provisions on natural people who engage in supplying services which require technology, special skills and knowledge, as well as special provisions on nurses and personal care workers featuring Japanese commitments to train such workers in the Philippines so as to enhance their technical competence and help them meet Japanese licensing requirements prior to entering the Japanese labour market. An annex to the PTA provides detailed rules concerning the categories of recognised natural

persons. Finally, the agreement adopts some of the provisions of the Understanding on Commitments in Financial Services.

IV.5.5 Vietnam

The bilateral trade agreement that Vietnam negotiated with the United States prior to its accession to the WTO features no GATS+ provisions. In many regards, this agreement was a precursor to GATS compliance, and Vietnam's accession to the WTO saw much effort directed at extending the terms of the US BTA to all WTO Members on an MFN basis. The BTA incorporates various GATS provision directly, such as the annexes on financial services and telecommunications services, as well as the telecommunications reference paper. The agreement can be said to be GATS-minus in respect of its generally weaker disciplines on transparency disciplines and domestic regulation.

Table IV.8 GATS+ Provisions: Singapore

	India	Korea	Japan	Australia	New Zealand	United States
Type of agreement	Positive-list	**Hybrid**	Positive-list	**Negative-list**	Positive-list	**Negative-list**
Rules and obligations						
MFN	=		=	=	=	=
National treatment	=	=	=	=	=	=
Market access	=	=	=	=	=	=
Transparency	=			=		+
Domestic regulation	=	=	=	=	=	=
Mutual recognition	=	+	+	=	+	+
Movement of natural persons	+	+	+	+		+
Monopolies , exclusive service suppliers and anti-competitive behaviour	+	+	+	+	=	
New provisions	+ Services-Investment linkages; Air services		+ Extension to non-party juridical persons constituted in a party		+ Extension to non-party juridical persons constituted in a party	= Prohibition on local presence requirement
Timed commitment to eliminate trade discrimination	+	+		+		
Sector-specific measures						
Exclusions	Government services Nationals seeking employment Shell companies	Investment Government procurement Subsidies Government services Transportation and non-transportation services	Air transport services Maritime cabotage Government procurement Subsidies Government services	Government procurement Subsidies Government services Air transport services (with exceptions) Natural persons seeking access to employment market		Air transport services Investment Government procurement Government services Nationals seeking employment
Financial services	=	+	+	+		+
Telecommunication services	+	+	+	+		+
Maritime transport services		+				

Table IV.9 GATS+ Provisions: Thailand

	Japan	Australia	New Zealand
Type of agreement	Positive-list	Positive-list	No obligations taken yet and services chapter to be negotiated
Rules and obligations			
MFN	=		
National treatment	=		
Market access	=	=	
Transparency	=		
Domestic regulation	+		
Mutual recognition	=	=	
Movement of natural persons	+		
Monopolies , exclusive service suppliers and anti-competitive behaviour	=		
New provisions		+ cooperation in services	
Timed commitment to eliminate trade discrimination	+	+	
Sector-specific measures			
Exclusions	Air transport services Maritime cabotage Government procurement Government services Nationals seeking employment		
Financial services		Subsidies Government procurement Government services Nationals seeking employment	
Telecommunication services		=	
Maritime transport services		=	

Table IV.10 GATS+ Provisions: Malaysia

	Japan
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	=
Domestic regulation	=
Mutual recognition	=
Movement of natural persons	=
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions	
Timed commitment to eliminate trade discrimination	+
Sector-specific measures	
Exclusions	Air transport services Maritime cabotage Government procurement Government services Nationals seeking employment
Financial services	+
Telecommunication services	
Maritime transport services	

Table IV.11 GATS+ Provisions: Philippines

	Japan
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	+
Domestic regulation	
Mutual recognition	=
Movement of natural persons	+
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions **Timed commitment to eliminate trade discrimination**	
Sector-specific measures	
Exclusions	Air transport services Maritime cabotage Government procurement Government services Subsidies Nationals seeking employment
Financial services	+
Telecommunication services **Maritime transport services**	

Table IV.12 GATS+ Provisions: Vietnam

	United States
Type of agreement	Positive-list
Rules and obligations	
MFN	=
National treatment	=
Market access	=
Transparency	
Domestic regulation	=
Mutual recognition	
Movement of natural persons	=
Monopolies , exclusive service suppliers and anti-competitive behaviour	=
New provisions **Timed commitment to eliminate trade discrimination**	
Sector-specific measures	
Exclusions **Financial services**	=
Telecommunication services **Maritime transport services**	=

V. Preferential investment liberalisation in Asia

Key issues addressed:

-The treatment of investment in selected Asian PTAs: lessons from practice and implications for third country investors
- A comparative assessment investment provisions in the Asian PTAs of EFTA and the United States: implications for Swiss investors and service providers

This section of the study focuses attention on the key investment provisions found in a sample of 19 Asian preferential trade and investment agreements (PTAs) and assesses their implications for third country – including Swiss - investors. As investors in services are often treated separately, interactions between the investment and service chapters of the agreements reviewed are also discussed. Box V.1 below lists the sample of Asian agreements featuring investment provisions under review.

Box V.1 Investment in Asian PTAs: agreements under review

Japan-Malaysia Economic Partnership (2006)
Japan-Mexico Economic Partnership (2005)
Japan-Singapore New-Age Economic Partnership Agreement (2002)
Thailand-Australia Free Trade Agreement (TAFTA) (2005)
EC-Chile Association Agreement (2003-2005)
Commission mandate to negotiate an EC PTA with ASEAN (excl. Myanmar, Laos and Cambodia) (2007)
Free Trade Agreement between EFTA and Singapore (2003)
Free Trade Agreement between EFTA and Korea (2006) (Norway is not a party to the investment chapter)
Trans-Pacific Strategic Economic Partnership among Brunei Darussalam, Chile, New Zealand and Singapore (May 2006) (not notified to the WTO)
The New Zealand-Singapore Closer Economic Partnership (2001)
Free Trade Agreement between the Republic of Korea and the Republic of Chile (2004)
Free Trade Agreement between the Republic of Korea and the Republic of Singapore (2006)
India-Singapore Comprehensive Economic Co-operation Agreement (2005)
Framework Agreement on ASEAN Investment Area (AIA) (1998) and the ASEAN Framework Agreement on Services (AFAS) (1995) as amended by the 2003 Protocol
Draft for Free Trade Agreement between the United States and the Republic of Korea (2007)
Free Trade Agreement between the United States and Singapore (2004)
Proposal by the United States for an investment chapter in a PTA with Thailand (2006)
Services chapter of the China-ASEAN Free Trade Area (2007)

V.1 Investment and commercial presence: definitions and relationship

Most PTAs follow the practise of the WTO by covering investments under separate chapters depending on whether they are services or not. Below we review the definitions of investments in both services and non-services – and thus the scope of the agreements - as well as the interaction between horizontal investment disciplines and services (see Table V.1).

V.1.1 Investor definitions

As is standard in the majority of BITs, most PTAs reviewed – including those of EFTA - use a broad and 'asset based' definition of investment. The definition is typically followed by an illustrative/open list including five categories of assets. The first is movable and immovable property (such as land) and any related property rights such as mortgages. In contrast to 'commercial presence' in service chapters (see below) this definition therefore covers legal interests in property that are less than full ownership. The second category is various types of interests in companies, such as shares, stock, bonds or any other form of participation. Portfolio investment is in other words covered and the foreign investor is not required to control the company. The exception is AIA, which explicitly excludes portfolio from the agreement (article 2.b). The third category is claims to money, claims under a contract having a financial value and loans directly related to a specific investment; i.e. long- and short-term contractual rights – such as management agreements – are included. The fourth is intellectual property rights such as trademarks, patents and copyrights. Finally, business concessions, including natural resource concessions are typically included. Variations in the precise language used to describe these categories are of minor importance because the list is illustrative, and an interest that doesn't fall within any of the categories is still an 'investment' if it can be considered an asset (UNCTAD, 2000c).

TAFTA and agreements entered into by the EC depart from this definition. TAFTA refers to the International Monetary Fund's (IMF) definition of FDI, which uses a 10 percent ownership threshold to distinguish FDI from portfolio investment, whereas EC agreements follow an 'enterprise based' approach as in most service chapters (see below). Instead of referring to investors, the EC-Chile agreement refers to juridical and natural persons performing an establishment, which covers direct investment, including branches[24].

[24] Inspired by GATS' definition of commercial presence, establishment is defined as: *'(i) the constitution, maintenance or acquisition of a legal person, or (ii) the creation or maintenance of a branch or a representative office (..)'.*

The GATS notion of 'commercial presence' is typically used to define investment in services. In contrast to the definition of foreign investment, 'commercial presence' is only regarded as direct investment in the context of the relationship with an enterprise. It typically encompasses any type of business or professional establishment, including the constitution, acquisition or maintenance of a legal person or the creation or maintenance of a branch or a representative office within the territory of a party for the purpose of supplying a service. This is also the approach used in the Commission's mandate to negotiate a PTA with ASEAN, where all investors are grouped into one based on GATS' definition of commercial presence. In order to extend the definition to non-service investors, the text replaces '*supply a service*' in the GATS-definition by '*seeks to perform or performs an economic activity*'[25]. The draft is based on the Commission's recent template chapter for EC-wide PTAs, which it intends to use in future agreements as well.

The GATS concept of commercial presence is much narrower than the definition of non-services investments as it only covers foreign investments in services, where the foreign investor – who is covered by the agreement - holds more than 50 percent of the equity interest or exercises control (GATS Article XXVIII(m)). Foreign investments with a minority equity stake and no exercise of control are thus not covered by service disciplines, though they would typically be covered by horizontal investment disciplines (see below). There are exceptions. While otherwise following the GATS approach, EC agreements do not include an ownership or control requirement in their definitions of a legal person. The same is the case in the Trans-pacific and New Zealand Singapore agreements.

V.1.2 Relationship between services and horizontal investment disciplines

By applying separate provisions for service investors and their investments, there is a risk of inconsistencies between services and investment disciplines. Most reviewed agreements include rules to confront this (see Table V.1)

Investment in services is completely removed from the scope of investment disciplines in the AIA with the exception of services incidental to manufacturing, agriculture, fishery, forestry,

[25] The full definition of an 'investor' is: '*any natural or juridical person that seeks to perform or performs an economic activity through setting up an establishment'.* 'Establishment' is defined similarly as in the EC-Chile agreement: '*any type of business or professional establishment through: (i) the constitution acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or representative office within the territory of a Party for the purpose of performing an economic activity'.*

and mining and quarrying. The interaction between AFAS and AIA thus relies on the rules of interpretation of international law (OECD, 2007). The India-Singapore, US-Thailand[26] and Japan-Malaysia agreements give precedence to service chapters in case of inconsistencies. For the latter agreement the precedence only applies to the investment chapter's obligations on NT, MFN, and performance requirements.

EFTA agreements and the New Zealand-Singapore agreement have chosen a more transparent approach by specifying that the two overlapping obligations in the investment and services chapters - NT and MFN for commercial presence – are governed by the services chapter alone. Note, that NT and MFN obligations in the same agreements still apply to those forms of investments not covered by the services chapter such as investments with a minority equity stake and no effective foreign control, whereas the EFTA-Singapore agreement extends the non-application of NT and MFN to all investments in services (Fink and Molinuevo, 2007).

US-agreements with EFTA's partners – Korea and Singapore – as well as the Japan-Mexico, Chile-Korea, and Singapore-Korea agreements have used an even simpler approach by having investment in services governed by the investment chapter. Instead of *parallel* rules for investors in manufacturing and services, these agreements thus have *complementary* rules that are even more transparent than those in EFTA agreements. This also has implications for the coverage of investor-to-state arbitration clauses, as we will return to below.

As mentioned above, the EC mandate to negotiate with ASEAN intends to inscribe commitments in one single schedule. This completely avoids inconsistencies between services and investment disciplines, and is somewhat similar to TAFTA, which – in contrast to the EC mandate – has separate chapters for service and non-service investments, but nonetheless inscribe commitments in one single schedule.

Finally, the Japan-Singapore agreement doesn't establish a rule defining the relationship between the two sets of disciplines. Since service commitments are based on a positive list basis and investment commitments on a negative list basis without identical sector coverage this approach is far from transparent and has a real danger of inconsistent rules (Fink and Molinuevo, 2007). In order to confront this Singapore (but not Japan) gives precedence to the services disciplines in case of inconsistencies with the investment chapter's obligation on NT and performance requirements.

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[26] Based on the US proposal.

In sum, EFTA agreements follow the practice in most PTAs by using a broad and asset-based definition of investments and an enterprise-based definition of service investments. The definition of commercial presence requires ownership or control by a natural or legal person covered under the agreement (as defined by rules of origin; see below).

US agreements with EFTA partners use a more transparent and simple approach than EFTA-agreements by covering both service and non-service investors in the agreements' investment chapter instead of applying two sets of disciplines. The EC's recent template to negotiate with ASEAN does not include the broad and asset-based definition of investors, but is highly transparent as one single chapter governs all investors.

V.2 Rules of origin[27]

Along with investment-definitions, rules of origin – also referred to as denial of benefits clauses - define the scope of commitments in PTAs. Liberal rules of origin open up preferential market access to companies from non-member countries and thereby reduce potential investment- and trade diversion (see also literature review). On the other hand, more restrictive rules can (in theory) promote learning-by-doing processes by infant industries - since they alone benefit from preferential treatment - thereby preparing them for global competition. Table V.2 offers a synthetic depiction of origin rules affecting investment (including investment in services) in Asian PTAs

V.2.1 Juridical persons

Two PTAs – TAFTA and India-Singapore - stand out as having relatively restrictive rules of origin. For these two agreements benefits are limited to domestically-owned or controlled firms. This is only allowed under GATS article V.3b if both parties to the preferential agreement are developing countries. Countries that are not least-developed countries can decide for themselves whether they are to be considered 'developed' or 'developing' countries under the WTO. Like all measures affecting services subject to the GATS, such a decision can be challenged by other WTO members.

Ownership is defined in the two agreements as domestic persons holding a majority equity share in the company and control is defined as domestic persons having the power to name

[27] This section borrows heavily from the work on services rules of origin by Fink and Nikomborirak (2006), and Fink and Molinuevo (2007).

the majority of directors or otherwise directing the juridical person's actions. The domestic ownership or control requirement does not apply to the Australia-Thailand agreement's investment chapter. In contrast to service investors, Swiss manufacturing investors therefore do not have to be established through minority joint ventures with local companies in order to enjoy preferential treatment under the agreement. For the India-Singapore agreement, the requirement applies to services supplied through mode 3 as well as to non-service investors. However, for modes 1 and 2 the agreement allows a party to deny preferential benefits if a juridical person is owned or controlled by persons from the denying part.

Such requirements are highly restrictive as most service providers typically prefer to enter into foreign markets through majority or fully owned affiliates. It is thus fortunate, from a Swiss (third country) investor perspective, that in all other agreements reviewed juridical persons generally *don't* have to be owned or controlled by nationals of a PTA (see, however, the section below on 'market access'). Benefits typically extend to juridical persons constituted or otherwise organized under the laws of a party with substantial business operations in the territory of that party. For all PTAs but the Japan-Malaysia agreement, this includes branches of enterprises of third states. Swiss investors with activities in the region (i.e. more than just 'mail-box' companies) can in other words take advantage of commitments under most non-Swiss/EFTA PTAs. Swiss service suppliers can typically also use a commercial presence in one location to serve the whole PTA, when delivering services on a cross-border basis (Mode 1) or through consumption abroad (Mode 2)[28]. The New Zealand–Singapore agreement goes even further, by only requiring establishment or registration under a party's applicable laws irrespective of whether the investor has substantial business operations there.

For Mode 1, restrictions would typically arise for certain categories of regulated professional service providers in light of intra-ASEAN mutual recognition agreements using nationality as a basis for the mutual recognition of professional licenses held by ASEAN natural persons.

Several agreements – including the EFTA-Korea agreement as well as the recent EC mandate to negotiate a PTA with ASEAN - extend benefits to service investors with substantial business operations in *any* PTA party, and not just the PTA territory in which the juridical person is constituted.

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[28] Most service chapters of PTAs apply to Mode 1 and 2 services that are supplied '*from or in the territory of another party';* i.e. preferential treatment is granted when services originate within the territory of the exporting party.

ASEAN's investment agreement – AIA – addresses foreign equity requirements in manufacturing by allowing foreign companies to comply with local equity requirements of any ASEAN member country by counting the local equity participation in all other ASEAN countries on a cumulative basis towards that local requirement. Indirect holdings in related entities can be included in the cumulative total. For instance, say Thailand requires 51 percent equity ownership by nationals, but Thai nationals only own 30 percent of the equity in a manufacturing enterprise, with a Swiss multinational taking 49 percent of its shares. In this case the enterprise will not be granted AIA benefits. However, if the other 21 percent equity interest of that manufacturing enterprise is owned by nationals of Malaysia, then the enterprise qualifies as an ASEAN investor, as the ASEAN cumulative equity is 51 percent, and thus complies with Thailand's national-equity requirements.

What exactly constitutes 'substantial business operations' is left undefined in most agreements. Implementation is therefore left to the parties of the agreement. Typical options are the possession of a business or service license, payment of local profit taxes, owning or renting premises and a certain level of sales or years of establishment. As for the concept of 'constitution or other organization', juridical persons arguably cover non-incorporated legal entities such as branches or representative offices (as long as the substantial business criterion is met). One exception is the investment chapter of the Japan-Malaysia agreement, which excludes branches of enterprises of third states from the definition of 'investor of the other party'; i.e. Swiss non-services branches in either of the two countries are not covered by the agreement.

Finally, it is worth noting that a number of agreements have incorporated foreign policy-related exceptions to otherwise liberal rule of origins. In particular, several agreements allow a party to deny PTA benefits to a juridical person from a non-party if i) the denying party does not have diplomatic relations with the non-party; or ii) the denying party prohibits transactions with the enterprise in question. It is not clear, however, whether such provisions are in accordance with GATS article V.

V.2.2 Natural persons

All reviewed agreements extend trade benefits to nationals - or 'citizens' - of the signatory parties. Moreover, a number of agreements extend benefits to individuals that have the right to permanent residency in a PTA member. This is typically regardless of whether individuals actually reside in the territory of a party or not. For instance, a Swiss citizen with permanent

residency status in Chile but living in Thailand is still covered under the Chile-Korea agreement. US and EC agreements generally don't extend benefits to permanent residents.

In the EFTA agreements' service chapters, permanent residents qualify for trade preferences if the importing party grants substantially the same treatment to permanent residents as it does to nationals in respect of measures affecting services trade. This requirement is not matched by EFTA's PTA partners – Korea and Singapore – in other agreements with the exception of AFAS and the New-Zealand agreement for Singapore.
In sum, the most restrictive origin criterion for juridical persons – ownership and control – is only applied in two of the agreements reviewed. Swiss juridical persons constituted or otherwise organised under the laws of a party with substantial business operations in a party to a PTA – or in some cases in any party to a PTA – therefore enjoy preferential treatment under most agreements.

Some agreements – including those of EFTA (with reservations for service suppliers) – extend benefits to permanent residents. This is not the case for past or currently negotiated US or EC agreements, however. Nonetheless, the overall picture of rules of origin in the Asian region, as applied for services and investment, is fairly liberal.

V.3 The treatment of investment and services

In customary international law, states are obliged to treat foreigners and foreign investments with a minimum level of fairness, but there are no requirements to treat all aliens equally or as favourably as nationals (Sornarajah, 1994). To confront this, treatment standards are typically included in trade- and investment agreements. Main provisions that determine the treatment of investment and services include market access, national treatment (NT), and most-favoured nation treatment (MFN). Tables V.3 to V.5 summarize the treatment provisions found in Asian agreements covering investment.

V.3.1 Market access for services

In the investment chapters of PTAs, liberalisation and general treatment commitments are covered under NT and MFN provisions, whereas service chapters typically adds provisions on 'market access'. Under the GATS, market access provisions cover restrictions on 1) the number of service suppliers; 2) the value of service transactions or assets; 3) the total number of service operations or total quantity of service output; 4) the total number of natural persons that may be employed; 5) the form of legal establishment; and 6) foreign equity participation. Even though the GATS does not distinguish between pre- and post-

establishment on this matter, market access provisions clearly cover both (OECD, 2007). The overlap between these market access and national treatment provisions is addressed in GATS Article XX:2, which specifies that measures inconsistent with both provisions should be scheduled under market access and are then considered as a limitation on national treatment as well.

In order to ensure consistency with multilateral disciplines almost all PTAs reviewed have reproduced the GATS approach by including disciplines on market access in their services chapters. OECD (2007) notes that PTAs with market access provisions as specific commitments that apply only in sectors and for modes of supply inscribed in a member's schedule (i.e. a 'positive' list basis as in GATS[29]) include fewer sectors and have more limitations, when compared to PTAs using a negative list approach (as in NAFTA). Many AFAS members, for instance, still reserve the right to restrict foreign equity participation in their market access schedules. So even if AFAS covers a Swiss service provider constituted - and with substantial business operations - in an ASEAN country through a majority or fully owned affiliate, this does not necessarily mean that it is granted market access in particular sectors and sub-sectors. It is important to recall, however, that circumvention of statutory ownership is widespread by multinationals in parts of Asia. A country such as Thailand, for instance, has foreign equity participation restrictions in most service sectors. Nevertheless, Thailand often fails to prevent foreign companies exercising control over companies that are directly majority owned by Thai natural or juridical persons (Fink and Nikomborirak 2006). Service suppliers ultimately owned and controlled by Swiss persons may therefore still be able to enjoy the benefits of the PTA in practise even if market access provisions (or rules of origin) are put in place to prevent it.

Not all positive list agreements include significant market access restrictions. Singapore, for instance, has made very few reservations to its market access commitments in its agreements even though many are on a positive list basis (OECD, 2007). So whereas Switzerland has almost the same schedule of commitments in the EFTA-Singapore agreement as it has in GATS, this is not the case of Singapore, which goes further than its GATS-obligations by including market access commitments on distribution services, educational services, environmental services and health-related and social services. The same goes for Japan that similarly has signed several PTAs with positive lists of market

[29] Note that we refer to the GATS-approach as 'positive' although this strictly speaking hides that the fixing of the level of openness in sectors inscribed involves elements of both negative and positive listings.

access obligations but nonetheless has expanded its service liberalisation commitments considerably.

EFTA's two PTA partners in the region – Korea and Singapore – include market access provisions (excluding Mode 3) on a negative list basis in their own PTA as well as their agreements with the US (including Mode 3). The Chile-Korea agreement similarly includes market access on a negative list basis. This is in contrast to the EFTA-agreements. So while acknowledging that positive list agreements don't necessarily entail fewer commitments as mentioned above, it nevertheless seems that by choosing the 'NAFTA-' rather than the 'GATS-approach', Switzerland's PTA-partners have been willing to extend market access commitments further than they do in the EFTA-agreements.

Finally, it is worth mentioning that four negative list agreements—Korea-Singapore, Singapore-US, Singapore-Korea and the Trans-Pacific agreement—do not cover restrictions on foreign equity participation under market access. Arguably, this should have no implications, however, since such limitations are covered under the agreements' NT commitment, as they are discriminatory by nature (Fink and Molinuevo, 2007).

In sum, market access provisions for services are included in most Asian PTAs. Some countries such as Singapore have made significant commitments whereas others haven't. EFTA's PTA-partners – Singapore and Korea – seem to have committed to 'deeper' market access obligations in their PTAs with the US as well as the agreement between themselves. The latter outcome should perhaps not be surprising for two reasons: first, it is arguable that Singapore and Korea had little choice in accepting the negative list template the United States has been using in virtually all its post-NAFTA agreements; and second, the US FTAs were subsequent to the EFTA negotiations, and most assuredly entailed greater negotiating pressure applied to countries whose dependence on the U.S. market is generally higher than on those of EFTA member countries.

Even though Swiss investors and service suppliers may still in practice benefit from preferential treatment under service agreements, foreign equity restrictions continue to limit the benefits of PTAs for third party investors as they increase trade and investment diversion in services.

V.3.2 National treatment

National treatment (NT) ensures that foreign investors covered under the PTAs are not faced with more restrictive policy measures than domestic investors. For service providers, GATS

grant NT in sectors and sub-sectors mentioned in a country's schedule. Most PTAs in Asia include NT for both services and non-services sectors (See Tables V.4 and V.5).

The majority of investment chapters in reviewed agreements include NT on a negative list basis pre- and post-establishment, as is the standard case in BITs. The opposite approach has often been taken in service-chapters, where only six of the agreements reviewed include NT on a negative list basis. All others have NT for services on a positive list basis as in the GATS. The major differences in treatment standards thus seem to be within services rather than manufacturing, and Swiss service providers covered under Asian PTAs can thus expect to be granted NT less often than investors in other sectors.

As with market access obligations, EFTA's PTA partners – Korea and Singapore – have granted NT for services on a negative list basis pre- and post-establishment in their own agreement as well as their agreements with the US[30]. The Chile-Korea agreement similarly grants NT on a negative list basis. This is in contrast to EFTA agreements, which list NT for services on a positive list basis. Even though it must be stressed again that positive and negative list agreements in principle can cover the same obligations, it nevertheless seems that EFTA's PTA partners again have been willing to commit to more extensive liberalisation and treatment obligations for services in their other agreements. In support of this, Fink and Molinuevo (2007) find that negative list PTAs are often – but not always - associated with a wider inclusion of sub-sectors and modes of supply.

NT standards typically depend on whether foreign and domestic investors/investments or service providers/services are considered alike. The service chapters with positive lists - such as the EFTA-agreements - have adopted the language of GATS Article XVII, which mandates no less favourable treatment to *'like services and service suppliers*'. As mentioned, the EC has in its negotiating mandate with ASEAN grouped services and non-services investments into one chapter, and like service suppliers are therefore covered under the term '*like investors*'. By contrast, NT clauses in negative list agreements use the term '*like circumstances*'. Here the comparison shifts to the general context of the investment/services instead of the nature and characteristics of investors/service suppliers and investments/services (UNCTAD, 2000d). This includes the Singapore-EFTA investment chapter, and EFTA's PTA partners – Singapore and Korea – similarly use this term in their

[30] Financial services in the Korea-Singapore are an exception as they are scheduled on a positive list basis, and the US-agreements use positive lists of cross-border trade in financial services.

agreements using the negative approach. The term '*situations'* is used instead of circumstances in Singapore's agreements with EFTA and New Zealand however.

A further distinction is made in that the NT provision of US agreements with Korea and Singapore only applies to service suppliers, whereas the other four negative list agreements refer to both services and service suppliers. Investment chapters in the same agreements refer to both investors and investments. The EFTA-Singapore agreement refers to service suppliers and services as well as investors and their investments, whereas there is no reference to like investors, investments or circumstances in the investment chapter of the EFTA-Korea agreement. This corresponds to the Swiss model BIT, and UNCTAD (2000d) notes that the EFTA-Korea approach has the widest coverage, since any matter, in principle, can bet considered when establishing whether the foreign investor is being given national treatment or not.

What is a 'like' investor; situation or circumstance needs to be determined on a case-by-case basis, which is often not easy, as the experience of GATT/WTO Dispute Panels has shown (Mattoo, 1997). For example, where NT refers to both services and service suppliers, Fink and Molinuevo (2007) ask that if only services are "like" but service suppliers are "unlike" is the criteria of likeness then met? Or do both services and service suppliers have to be "like"? Similar questions could be posed for non-service investors and investments. In the EC-Chile agreement, reference is thus only made to juridical and natural persons, but not – as in the new EC-ASEAN negotiating mandate – to '*all measures affecting establishment'.* Finally, does likeness extend across different modes of supply for services? Future jurisprudence might clarify these issues and therefore also, which standard of 'likeness' is narrower or broader.

In sum, service providers covered under Asian PTAs can expect to be granted NT less often than investors in other sectors. EFTA agreements list NT for services on a positive list basis and investments on a negative list basis, whereas EFTA's partners – Korea and Singapore – typically include NT on a negative basis for both services and investments in their other agreements. Whereas an in-depth analysis of each country's sector and sub-sector schedules is necessary to establish whether obligations are more far-reaching in one agreement over the other, the negative list approach in EFTA-partners other service agreements does indicate wider coverage.

Available case law has not yet determined whether the terms 'like services and service suppliers'– as used in EFTA-agreements – are narrower than the term 'like circumstances'

as used in numerous other agreements entered into by EFTA-partners. If it turns out that the latter term is broader, then Swiss service suppliers haven't obtained the same coverage as, for instance, US companies. On the other hand, future jurisprudence might also clarify whether mentioning both 'services' and 'service providers' – as in EFTA agreements - entails wider coverage than only referring to the latter – as in US agreements with Singapore and Korea. Such semantic differences could thus turn out to have important implications.

V.3.3 Most-favoured-nation treatment

It is general practise to include MFN-clauses in bilateral, regional and multilateral investment-related agreements. The MFN rule is particularly relevant for non-service investors since they don't enjoy MFN treatment at the multilateral level, as service providers do under the GATS. In general, the MFN principle found in PTAs relates to two sets of investors: investors within an agreement involving more than two countries and investors from countries not party to the agreement. For the first set of investors, MFN can ensure treatment no less favourable than that accorded to other investors covered under the agreement. For the latter, it can ensure treatment no less favourable than that obtained in the partner-country's other PTAs, in particular in more recent agreements that could offer more favourable treatment (see Tables V.4 and V.5).

In this context, it is worth recalling that the scope of application of the MFN clause has been subject to debate (UNCTAD, 2007e). The prevailing – but not universally accepted - view is that a MFN clause can generally only be used to improve the terms of substantial rights already granted under a PTA (UNCTAD, 2005b; Roughton, 2007). For instance, if two treaties to which Switzerland is a party contain expropriation provisions but with different terms, Swiss investors may be able to claim the benefit of whichever treaty provides more favourable provisions under the (extra-regional) MFN obligation. On the other hand, an MFN clause would not generally allow Swiss investors to benefit from an investor-to-state dispute settlement mechanism in another PTA, if none exist in the PTA under which they are claiming.

The most important Asian PTA involving more than two countries is ASEAN. AFAS/AIA – as well as ASEAN-China – requires that trade preferences are granted on an MFN basis *among* members. There is not, however, a requirement that trade preferences accorded to non-parties are extended to ASEAN members. Future Swiss preferences from PTAs with one or more ASEAN members are thus not automatically extended to all ASEAN members. Interestingly, the agreements allow two or more members to liberalize faster than in their

AFAS/AIA-schedule without extending these so-called ASEAN-X commitments to the remaining ASEAN members.

For PTAs only involving two countries, the MFN principle is particularly relevant in the context of preferences granted to third parties. Nonetheless, investment-chapters of the Japan-Singapore, India-Singapore, EC-Chile and Korea-Singapore agreements only refer to 'best-endeavour' or similar international soft-law disciplines. Even though they encourage an extension of other PTA benefits to the other party, they don't establish binding extra-regional MFN obligations as such. Investment-preferences in the US-Singapore agreement, for instance, are therefore not automatically extended to Korea under the Singapore-Korea agreement. For services, the three above-mentioned agreements are joined by the TAFTA, Chile-Korea, and New Zealand-Singapore agreements, which don't grant MFN treatment either.

All other agreements reviewed include MFN-provisions pre- and post-establishments. There are typically major exceptions to MFN treatment, however. EFTA-agreements – as well as the Chile-Korea agreement – include so-called regional economic integration organisation (REIO) clauses. For Switzerland this means that an extension to Singapore, Korea, Chile, etc of the more favourable treatment granted to members of future Swiss PTAs on an MFN basis is not required. Potential new PTA-partners of Switzerland therefore know that negotiated preferences will not automatically be extended to others, and it should thereby make Switzerland a more attractive PTA-partner. On the other hand, Switzerland doesn't automatically enjoy the benefits of other agreements entered into by EFTA-partners - Korea and Singapore - either. Moreover, the possible discriminatory treatment between the parties of different PTAs signed by Switzerland is unfortunate in economic terms and reduces transparency in a set of already complicated and overlapping rules.

There are two ways of limiting this risk of investment distortion. First of all, agreements with REIO-clauses allow for extending the more favourable treatment of parties to the agreement simply through a joint meeting or exchange of letters between the parties (OECD, 2007). When GATS-inspired agreements – such as the service chapter of Japan-Malaysia – doesn't have a REIO exception clause, it is assumed that the commitments are already reflecting the 'most favoured' treatment available in a PTA but includes a non-binding provision that the better treatment granted to a third party in another PTA is extended to the parties of the agreement (OECD, 2007). Secondly, investment distortions can be minimized by negotiating PTAs with the same liberalisation commitments and same reservations. OECD (2007), notes that this seems to be what most countries have done since schedules of commitments made

by the same country in different agreements are more or less consistent. However, OECD also notes that more recent agreements tend to include more commitments, which Switzerland will not enjoy the benefits of due to the REIO clause.

There are certain variations in the content of the REIO-clause. One is the recent EU mandate to negotiate a PTA with ASEAN. The derogation of MFN treatment is here limited to regional economic integration agreements '*requiring the parties thereto to approximate their legislation'*. Such agreements includes, for instance, EEA or EU-accession processes but not future EC PTAs in the Asian region, such as the proposed agreement with India. Secondly, service chapters in EFTA-agreements specify that other PTAs exempted from the MFN clause have to be notified under GATS article V. Third, even though they are not referred to as REIO-clauses, NAFTA-like agreements often also have exceptions to MFN treatment. These are listed as a non-conforming measure in the annex of the agreement and regards commitments made in other regional or multilateral agreements signed before – but not after[31] - the entry into force of the PTA. In other words, Swiss investors or investments covered under, for instance, the Japan-Mexico agreement - that entered into force in 2005 - will not be extended the benefits of NAFTA but will enjoy benefits of the Japan-Malaysia agreement since it entered into force in 2006. Note, however, that in contrast to GATS-inspired agreements, this approach allows for new exceptions and non-conforming measures, when sectors are listed in parties' schedules of commitments.

When granted, MFN treatment tends to apply to all covered investments and investors as well as services and service suppliers, although exceptions may be added through schedules of commitments. Fink and Molinuevo (2007) note that - as in the case of NT – service chapters with negative list provide for MFN treatment in 'like circumstances' whereas positive agreements use the terms 'like services' and/or 'like service suppliers'. As is also the case for NT, most investment chapters refer to 'like circumstances'. This is the same in the EFTA-Singapore agreement though the term 'circumstances' is again replaced by 'situations'. As for the agreement's NT provision, 'like services and service suppliers' is used in the EFTA-Korea PTA, whereas there is no reference to like investors, investments or circumstances in the investment chapter. This should have no important implications, however, as international law has generally recognised the *ejusdem generis* principle for MFN treatment; i.e. a MFN clause can only apply to the same subject matter (OECD, 2004). Nonetheless, the exact scope of application of the MFN principle is not always clear, and the interpretive

[31] In some agreements this is with the exception of aviation, fisheries and maritime matters (incl. salvage). In NAFTA itself, telecommunications is also exempt from MFN treatment.

questions raised in the context of NT, such as what like circumstances are, etc. holds for MFN clauses also (Fink and Molinuevo, 2007).

Again, if future jurisprudence establish that the term 'like circumstances/situations' entails wider coverage than the GATS-language of 'like investors/investments' or 'like service suppliers/services', then Switzerland's service suppliers covered under the EFTA-Korea agreement, for instance, have obtained 'weaker' treatment standards than US service suppliers under the US-Korea (draft) agreement.

In sum, there is no clear pattern as to how MFN provisions are being applied in Asia. Moreover, there is not a clear association between MFN disciplines and whether agreements are based on negative or positive approaches. There are two exceptions.
First, EFTA and other positive list agreements include a wide exception to MFN treatment for all other PTAs, whereas NAFTA-inspired agreements allow the parties to benefit from better treatment granted to third parties in another PTA signed after the entry into force of the later one. This latter approach – if still imperfect – is better able to multilateralize preferential commitments, particularly because recent agreements tend to have wider coverage.

Secondly, the negative-list service chapters use the term 'like circumstances' instead of 'like service suppliers and services' as in positive-list agreements such as EFTA-agreements. The interpretative questions of these terms raised in the context of NT apply in for MFN clauses too.

In any event, the scope for MFN-clauses to level the playing field for foreign investors is severely limited and - apart for non-discrimination among parties to PTAs with many members - one can therefore question the practical relevance of the provision in the context of Asian PTAs (OECD, 2007).

V.4 Investment protection and dispute resolution

BITs have been the traditional instrument to protect investors abroad. Increasingly, PTAs have begun to include protection provisions, however, and in cases where their content and coverage are considered to be more comprehensive to those in BITs, the latter are typically replaced (OECD, 2007). This is the case with the EFTA-Korea agreement, which replaces Switzerland's BIT with Korea. In contrast, the Singapore-Swiss BIT as well as BITs of the EU and ASEAN countries coexist alongside their PTAs. Table V.6 summarizes the investment protection and dispute settlement provisions found in Asian investment agreements.

Note that for all PTAs reviewed, protection disciplines apply to service investments also because the broad asset-based definition of investment includes 'commercial presence', which service disciplines are typically based upon (OECD, 2007). Even when the service chapter includes protections from the investment chapter – as in the India-Singapore agreement as well as some financial services chapters – the investment chapters' protections apply to other investments that meet the asset-based definition of these chapters (OECD, 2007).

V.4.1 Umbrella clause

Only EFTA-agreements include a so-called 'umbrella'-clause, which stipulates that the host country assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party and thus not only in connection with an investment agreement. UNCTAD (2007) notes that around 40 percent of all BITs include umbrella clauses, but they are typically not included in recent agreements[32] (UNCTAD, 2007). One reason a country like the US has refrained from including umbrella clauses in agreements is the recent investment disputes involving this provision. Above all, the two cases mentioned in the literature review involving the Swiss-based multinational Société Générale de Surveillance (SGS), generated conflicting jurisprudence on the precise nature and effect of this obligation – and thus also its scope in EFTA's PTAs. The arbitrators in the Philippines-case argued that a breach of a state contract was a breach of the umbrella clause in the BIT, whereas the tribunal in the Pakistan-case argued it wasn't. It can thus be argued that the latter judgement, *de facto,* deprived the umbrella clause of any independent meaning.

In sum, recent jurisprudence involving the Swiss multinational SGS does not provide a clear answer as to whether umbrella clauses allow investors to resolve contractual claims against host countries under arbitration provisions of the investment agreement, rather than under the dispute resolution provisions of the contract in dispute. It thus seems that future case law will have to clarify,whether Swiss investors have obtained stronger protection rights in their PTAs with Singapore and Korea than for instance the US (see Table V.7).

V.4.2 Transfers

Transfer clauses guarantee investors the right to transfer current and capital transactions without delay, and to use a particular kind of currency at a specified exchange rate. These

[32] Important exceptions are Chinese BITs, which still consistently include umbrella clauses.

are included in all agreements reviewed, and typically include exceptions in the case of serious balance-of-payments, exchange rate or monetary policy difficulties. The EC-agreement with Chile allows for free movements of capital relating to direct investment and the liquidation of these capitals (with reservations). From the draft available it is not clear whether this is also the case for the Community's mandate to negotiate with ASEAN. But since capital movements fall under Community competence and transfer-provisions have been included in all EC PTA-agreements to date (Szepesi, 2004), there is no reason to suspect they will be excluded from future agreements.

A transfer clause is included in both service and investment chapters in the Korea-EFTA agreement. In the service chapter the provision briefly prohibit restrictions on international transfers and payments for current transactions relating to the supply of a service with another party, whereas the investment chapter (to which Norway is not a party) has more detailed provisions as is standard in investment chapters. This should have no implications, however, as both transfer obligations apply to investments in services, and parties have to abide by the higher standard in cases of conflict as stipulated by international law (OECD, 2007).

In sum, transfer of capital in connection with foreign investments is provided in a relatively consistent manner in Asian PTAs.

V.4.3 Standard of treatment

BITs and PTAs typically oblige parties to grant foreign investors *fair and equitable treatment*. There is a debate, however, as to whether mentioning fair and equitable treatment provides a separate standard for foreign investors and their investments, or the standard is no different from general obligations under customary international law. UNCTAD (2007) points out that future jurisprudence clarifying this question will have substantial implications, since a breach of this obligation will probably be found in fewer cases if it simply confirms customary international law than if it entails higher standards. Moreover, given that the violation of any other provision included in the agreement would mean that the host state has mistreated the foreign investor, it could also constitute a violation of the fair and equitable treatment standard.

EFTA-agreements refer to fair and equitable treatment. This is not the case, however, for the Japan-Singapore, New-Zealand Singapore, EC-Chile and India-Singapore agreements. Moreover, several PTAs that do include the term stipulate that fair and equitable treatment does not entail any treatment beyond customary international law and that the violation of

other obligations in the PTAs does not mean a violation of this standard. This is the case with the Korea-Singapore, Korea-Chile as well as US-agreements.

In sum, if future jurisprudence establishes that 'fair and equitable treatment' is an independent treatment-standard, Swiss investors could have obtained stronger protection rights under EFTA-PTAs, than investors covered under agreements that i) don't include this standard; or ii) include it but mention that it is similar to established customary international law.

V.4.4 Expropriation and compensation for losses

Customary international law states that if property of aliens is taken – either through direct or indirect expropriation - it must be for public purposes, non-discriminatory, with compensation, and under due process of law (Sornarajah, 1994). Most PTAs have adopted these basic principles.

Of PTAs with investment coverage, it is only EC agreements that exclude expropriation provisions. This is because expropriation falls under exclusive national competence in the EC, and certain member states still refuse to include them in Community-wide agreements (Poulsen, 2006). These matters therefore continue to be mostly left for individual EC countries' BITs, and the EC is thus in the process of developing two levels of law (in addition to multilateral disciplines) for their investors abroad.

All other PTAs with investment coverage include obligations for both direct and indirect expropriation and require such measures to be for a public purpose, on a non-discriminatory basis and under due process of law. The New Zealand-Singapore agreement does not include expropriation provisions as such, but grant NT and MFN treatment for protection, expropriation matters, compensation and transfers.

Direct measures of expropriation include outright nationalization and large-scale taking of land. Indirect measures are defined by UNCTAD (2000a) as the slow and incremental encroachment on one or more ownership rights of a foreign investor that diminishes the value of its investment without directly removing the legal title to the property. Examples could be forced divestment of shares, interference in the right of management and excessive taxation. Moreover, regulatory takings in relation to the environment, health, morals, culture or economy that destroys the ownership rights of an investor in its tangible or intangible assets are in some cases covered also. If such takings take place by the host state, PTAs'

typically require compensation to be prompt, effective and adequate and settled in a freely convertible currency without delay. This is also the standard in most BITs.

Instead of 'indirect' expropriation the EFTA-Singapore agreement refers to *'de facto* expropriation'. The Switzerland-Singapore BIT refers to 'indirect' expropriation. These two concepts are overlapping though not indistinguishable. In contrast to *de jure* expropriation, a *de facto* expropriation takes place without a formal legislative decree. However, it covers 'direct' and immediate measures since it can include physical seizure or appropriation of property. The exact implications of the different terms and to what extent certain *de facto* governmental measures amount to indirect expropriation, for instance, is far from clear in available case law (Heiskanen, 2006). Future jurisprudence will therefore have to establish the implications of this term in the EFTA-Singapore agreement, when compared to the language of other agreements. However, it is seems safe to conclude that since the two terms are used interchangeably in many contexts, and Singapore is a highly investor-friendly environment, these differences are perhaps not critically important.

There is a second difference between the Singapore-EFTA agreement (and Switzerland-Singapore BIT) and the EFTA-Korea agreement as well as several other PTAs entered into by both Singapore and Korea. The EFTA-Singapore agreement doesn't specify in detail the issue, which has raised most debate among developing and developed countries in the context of BITs and PTAs - namely what amounts to adequate compensation (UNCTAD, 2007). It simply states that expropriation has to be '*accompanied by the payment of compensation. The amount of compensation shall be settled in a freely convertible currency and paid without delay to the person entitled thereto without regard to its residence or domicile*'. In contrast, AIA, US-agreements as well as the EFTA-Korea, Singapore-Korea, Chile-Korea, Japan-Singapore and India-Singapore agreements go in more detail specifying that compensation has to represent the fair market value of the expropriated investment immediately before the expropriatory action was taken or - in some cases - became public knowledge, whichever is more favourable. Moreover, most of these agreements also specify that compensation shall include interest at a (normal) commercial rate from the date of dispossession until the date of payment. Such specifications are not included in the EFTA-Singapore agreement. These differences are mirrored in BITs, which also vary in their specification of compensation standards, but the implications still remain to be seen in future jurisprudence (UNCTAD, 2007).

In sum, apart from EC agreements, all reviewed PTAs with investment coverage more or less copy standard BIT-provisions on direct and indirect expropriation and compensation requirements.

Future jurisprudence might establish whether the EFTA-Singapore agreement has important differences with other agreements by referring to 'de facto' rather than 'indirect' expropriation and not specifying compensation requirements in detail.

V.4.5 Investor-to-state dispute resolution[33]

As mentioned in the literature review, Switzerland has consistently included investor-to-state arbitration clauses in the BITs it concluded after 1981, with the exception of the 1985-BIT with Morocco and the 1997-BIT with Thailand (Liebeskind, 2002). The latter refer to ICSID conciliation and arbitration, but shall only enter into force the day Thailand becomes a member of the Washington Convention and thus ICSID. Thailand signed the Washington Convention in 1985 but has yet to ratify it. In contrast to Swiss BITs with China, Pakistan, Philippines[34], Laos, Vietnam, Hong Kong, and India, Swiss investors can thus not file a claim directly under BITs with Singapore, Indonesia and Malaysia as these agreements were signed before 1981[35].

All reviewed PTAs offer recourse to investor-to-state tribunals in the case of a dispute. The one exception is EC agreements, however, which don't include the investor-to-state dispute settlement option even though it is legally possible under EC law (Karl, 2004). This situation arises as a result of the issue of shared competence between the European Commission and member states in the investment field.

Unlike their American counterparts, Swiss investors enjoy access to international arbitration solely on matters relating to investment protection and not to market access (i.e. investment liberalization), a decision the Swiss authorities have voluntarily renounced. In contrast to protection disciplines, the coverage of investor-to-state dispute settlement clauses depends on the rules that define the relationship between trade in services and horizontal investment chapters (Fink and Molinuevo, 2007). Swiss service suppliers cannot therefore bring national treatment or MFN violations to international third-party investor-to-state arbitration under

[33] Treaty provisions on state-to-state arbitration will not be covered here.
[34] Cf. cases concerning Pakistan and Philippines mentioned in the section on umbrella clauses.
[35] Several Swiss BITs are currently under (confidential) re-negotiation.

EFTA agreements[36]. This stands in contrast to US agreements, where all horizontal investment disciplines apply to investments in services (see Table V.7).

Most agreements allow recourse to investor-to-state dispute tribunals, both pre- and post-establishment. Pre-establishment disputes are excluded from the AIA, TAFTA and the India-Singapore agreements however. In the latter agreement, India has agreed to subject pre-establishment disputes to compulsory investor-state settlement procedures in the agreement, if India does so in any other international agreement with third-countries (given that Singapore provides the same undertaking to India).

No agreements – including those of EFTA - require local remedies to be exhausted before an international claim can be pursued, such as the case in the Swiss-Jamaica BIT for instance. So even though investors typically are obliged to attempt to settle a dispute amicably through consultations or negotiations before initiating a legal claim, they are free to pursue internationalized remedies.

In most agreements, several choices of international venues for settling disputes are included. Most refer to the institutional system of the International Centre for Settlement of Investment Disputes (ICSID) under the auspices of the World Bank and *ad hoc* procedures using the internationally accepted United Nations Commission on International Trade Law (UNCITRAL) rules of arbitration. A few agreements furthermore allow other *ad hoc* rules – such as those of the Permanent Court of Arbitration - to be used as long as both parties agree. In the Thailand-Australia agreement, only UNCITRAL rules can be used, owing to the fact that Thailand is not a member of the Washington Convention and thus ICSID[37]. Disputes under the ASEAN investment agreement can be taken to ICSID, *ad hoc* procedures using UNCITRAL rules, the Regional Centre for Arbitration at Kuala Lumpur or any other regional centre for arbitration in ASEAN. It bears noting moreover that unlike other investment agreements, ASEAN host states can also bring disputes against foreign investors under the AIA.

Typically the investor chooses the venue - whether national or international. There are exceptions though. Both disputing parties have to agree on a suitable body for arbitration

[36] As mentioned above, the Singapore-agreement excludes all sectors – scheduled or not – whereas the Korea-agreement only excludes sectors covered in the services and financial services chapter. The agreement has a specialized investor-to-state arbitration mechanism for disputes concerning financial services.

[37] The agreement could, however, have allowed for ICSID Additional Facility Rules in case one party is not a member of ICSID.

under ASEAN. If they don't within a period of three months, an arbitral tribunal consisting of three members shall be formed (with one member selected by the investor, one by the host state and the third by both). If that fails too, the President of the International Court of Justice is allowed to make the required appointments. The EFTA-Singapore agreement also requires consent by both parties, though this is not explicitly spelled out in the agreement itself, and the EFTA-Korea agreement requires consent by both parties for pre-establishment disputes before they can be taken to either ICSID or an *ad hoc* procedure using UNCITRAL rules[38]. This contrasts US agreements with both Korea and Singapore as well as the Korea-Singapore agreement, where prior consent has been given for investors to choose the venue except if the choice is an *ad hoc* venue not using UNCITRAL rules, in which case consent is required. Singapore's PTA with India does not allow for *ad hoc* venues not using UNCITRAL rules, but automatic consent is granted regardless of whether the investor choose UNCTIRAL or ICSID rules/jurisdiction. EFTA agreements have in other words not provided Swiss investors and service companies with the same guarantee that disputes can be taken to international third-party settlements as other agreements entered into by EFTA partners[39].

US-modelled agreements have detailed rules on the circumstances surrounding dispute proceedings based on the 2004 US-model BIT. US agreements with Korea and Singapore, for instance, allow disputing parties to request a consolidation of two or more separately submitted claims with a question of law or fact in common and arisen out of the same events or circumstances. This right is also included in the Japan-Mexico and Chile-Korea agreements but not in the EFTA agreements. The latter do not feature a specific safeguard against inconsistent jurisprudence on disputes relating to the same subject matter. Valid arguments of judicial economy can be made against allowing multiple disputes arising out of the same set of events or circumstances, which has been illustrated by the more than 40 claims against Argentina after the country's financial crisis.

In contrast to EFTA agreements, US agreements with Singapore and Korea include specific provisions on transparency. Tribunal hearings shall be open for the public and pleadings, memorials, briefs, minutes, transcripts, awards and decisions of the tribunal shall be made publicly available to the extent that they don't reveal sensitive information. In the same vein, US agreements allow *amicus curia* submissions in the case of disputes. Whether such provisions are an advantage or disadvantage of course depends on the perspective one

[38] Note, however, that a party to EFTA agreements cannot block state-to-state tribunals.
[39] In Swiss BITs, it was not until 1990 that the issue of consent of the state parties to arbitration has been expressly addressed but not always guaranteed (Liebeskind, 2002).

takes. On the one hand, increased transparency and third-party access to disputes may help to increase the democratic legitimacy of dispute settlement procedures, but on the other hand public and political pressure might undermine a rules-based and predictable arbitration mechanism (UNCTAD, 2007). One could further argue that non-participation of third countries in dispute settlement can be an advantage for the investor to the extent that such participation may otherwise slow down and/or increase the cost of arbitration procedures. It should be noted that while Swiss BITs do not feature transparency provisions, matters arising from such treaties are routinely discussed in the federal Parliament.

In sum, except for the EC agreements, all PTAs with investment coverage offer investors the choice of investor-to-state dispute settlement under ICSID or *ad hoc* processes using – in most cases -UNCITRAL rules.

In contrast to US agreements, disputes arising from national treatment and MFN commitments for commercial presence cannot be taken to international investor-to-state arbitration under the EFTA agreements.

EFTA agreements require consent by the disputing parties – though only in the case of pre-establishment disputes for the Korea agreement – and Swiss investors are thus not guaranteed access to international third-party arbitration if host states refuse. Again, this is in contrast with US agreements with EFTA's PTA partners. These latter agreements also include transparency provisions and allow for consolidation of disputes, which is not the case under EFTA agreements.

Table V.1 Investment and commercial presence: definitions and relationship

Agreement	Definition of investment	Definition of commercial presence in services chapter	Relationship between investment in services and horizontal investment disciplines
Japan-Malaysia	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Service chapter prevails in case of inconsistencies with the investment chapter's obligations on NT, MFN, and performance requirements.
Japan-Mexico	Asset based– closed list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
Japan-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Relationship not expressly defined. Singapore has scheduled a reservation giving precedence to the services disciplines in case of inconsistencies with investment chapter's obligation on NT and performance requirements.
TAFTA	FDI as defined by IMF.	GATS definition of commercial presence.	One single schedule of commitments for services and investment.
EC-Chile	Direct investment incl. branches	GATS definition of commercial presence. Ownership or control not necessary.	Services chapter solely governs commercial presence.
Draft EC mandate for EC-ASEAN[1]	Builds on GATS provisions of commercial presence and extends them to investors in non-services sectors. Ownership or control not necessary.		One single schedule of commitments for services and investment.
EFTA-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	The investment chapter's NT and MFN obligations do not apply to commercial presence in any service sector.
EFTA-Korea	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	The investment chapter's NT and MFN obligations do not apply to commercial presence in sectors covered by the services chapter.
Trans-Pacific SEP	Investment chapter still under negotiation.	GATS definition of commercial presence. Ownership or control not necessary.	No investment disciplines yet, only services disciplines apply
New Zealand – Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence. Ownership or control not necessary.	The investment chapter's NT and MFN obligations do not apply to commercial presence as governed by services chapter.
Chile – Korea	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
Korea – Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
India – Singapore	Asset based– open list: Includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence.	Service chapter prevails in case of inconsistencies.
AIA/AFAS	Asset based– open list. Excludes portfolio investment.	Not explicitly defined, but implicitly follows GATS.	Does not apply to investment in services.
US-Korea draft	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	GATS definition of commercial presence for financial services.	Investment disciplines apply.
US-Singapore	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.		Investment disciplines apply.
US-Thailand[2]	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	No draft available.	National treatment provision in investment chapter does not apply to services. Service chapter prevails in case of inconsistencies.
ACCEC draft	Investment chapter still under negotiation.	GATS definition of commercial presence.	No investment disciplines yet, only services disciplines apply

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.2 Rules of origin/denial of benefits[1]

Agreement	Natural persons		Juridical persons		
	Extended to domestic nationals (or 'citizens')	**Extended to permanent residents**	**Limited to domestically owned or controlled service suppliers/investors**	**Extended to judicial persons constituted under domestic laws and having substantial business operations in the domestic territory**	**Other provisions**
Japan-Malaysia	Yes	No (Japan) Yes (Malaysia)	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply. Investment chapter does not extend benefits to branches of enterprises of third states.
Japan-Mexico	Yes	No	No	Yes	Parties can deny FTA benefits to investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.
Japan-Singapore	Yes	No (Japan) Yes (Singapore)	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)
TAFTA	Yes	No	Yes (for services and main investment disciplines)	Yes (for investment chapter)	
EC-Chile	Yes	No	No	Yes	
Draft EC mandate for EC-ASEAN[2]	Yes	No	No	Yes	Benefits also extended to juridical persons with substantial business operations (*'possesses a real and continuous link')* in the territory of any party.
EFTA-Singapore	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)
EFTA-Korea	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any WTO-member, if service supplier is owned or controlled by person of a party (services chapter only).
Trans-Pacific SEP[3]		Yes	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only).
New Zealand – Singapore	Yes	Not automatically.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only). No substantial business operations test in investment chapter.
Chile – Korea	Yes	Yes	No	Yes	Parties can deny FTA benefits to investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply (investment chapter only).
Korea – Singapore	Yes	Yes	No	Yes	
India – Singapore	Yes	Yes	Yes (for services supplied through commercial presence and investment disciplines)	Yes (for services supplied cross border and through consumption abroad)	Benefits can be denied if the juridical person is owned or controlled by persons of the denying party (only for modes 1 and 2 in services).
AFAS/AIA	Yes	Yes for investors. Not automatically for service suppliers.	No	Yes	Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only). Investment chapter allows for cumulated equity calculations.
US-Korea draft	Yes	No	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain normal economic relations or where certain trade sanctions apply.
US-Singapore	Yes	No	No	Yes	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.
ACCEC draft[3]	Yes	No	Yes (for commercial presence)	Yes	

1: No draft available for the US-Thailand agreement. 2: Excl. Myanmar, Laos and Cambodia. 3: Only for services (investment chapter not finalized).

Table V.3 Treatment of investment

	Establishment				Post-establishment			
	NT		MFN		NT		MFN	
	positive list	negative list	positive list	negative list	positive list	negative list	positive list	negative list
Japan-Malaysia		+		+ (not vis-à-vis ASEAN members for Malaysia)		+		+ (not vis-à-vis ASEAN members for Malaysia)
Japan-Mexico		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements))
Japan-Singapore		+		Request		+		Request
TAFTA	+			+		+		+
EC-Chile ***(does not replace BITs)***	+		No MFN clause or request		+		No MFN clause or request	
Draft EC mandate for EC-ASEAN[1] ***(does not replace BITs)***	+			+ (REIO-like clause)	+			+ (REIO-like clause)
EFTA-Singapore		+		+ (REIO clause)		+		+ (REIO clause)
EFTA-Korea *(replaces and suspends Swiss BIT)*		+		+ (REIO clause)		+		+ (REIO clause)
Trans-Pacific SEP	No investment disciplines yet.							
New Zealand – Singapore		+		+		+		+
Chile – Korea *(replaces and suspends BIT)*		+		+ (REIO clause)		+		+ (REIO clause)
Korea – Singapore		+		Request		+		Request
India – Singapore	+ India	+ Singapore		Request	+			Request
AIA ***(does not replace BITs)***		+		+ (intra-regional)		+		+ (intra-regional)
US-Korea Draft		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
US-Singapore		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
US-Thailand[2]		+		+ (not past agreements, and three sectors in future agreements)		+		+ (not past agreements, and three sectors in future agreements)
ACCEC draft	Investment chapter under negotiation. No draft available.							

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.4 Treatment of services[1]

Agreement	Establishment						Post-establishment					
	Market access		NT		MFN		Market Access		NT		MFN	
	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list	+ve list	-ve list
Japan-Malaysia	+		+			+ (not binding for preferences under other PTIA)	+		+			+ (not binding for preferences under other PTIA)
Japan-Mexico				+		+ (not past agreements, and 3 sectors in future agreements)				+		+ (not past agreements, and 3 sectors in future agreements)
Japan-Singapore	+		+			Request	+		+			Request
TAFTA	+		+			Request	+		+			Request
EC-Chile	+		+		No MFN clause or request		+		+		No MFN clause or request	
Draft EC mandate for EC-ASEAN[2]	+		+			+ (REIO-like clause)	+		+			+ (REIO-like clause)
EFTA-Singapore	+		+			+ (REIO clause)	+		+			+ (REIO clause)
EFTA-Korea	+		+			+ (REIO clause)	+		+			+ (REIO clause)
Trans-Pacific SEP		+		+		+ (not past agreements, and 3 sectors in future agreements for Chile, New Zealand and Singapore)		+		+		+ (not past agreements, and 3 sectors in future agreements for Chile, New Zealand and Singapore)
New Zealand – Singapore	+		+		No MFN clause or request				+		No MFN clause or request	
Chile – Korea				+		Request				+		Request
Korea – Singapore		+ (not mode 3)		+ (not financial services)		Request	+	+ (not mode 3)		+ (not financial services)		Request
India – Singapore	+		+			Request	+		+			Request
AFAS	+		+			+ (intra-regional)	+		+			+ (intra-regional)
US-Korea draft		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)
US-Singapore		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)		+		+ (not mode 1 in financial services)		+ (not past agreements, and 3 sectors in future agreements)
ACCEC draft	+		+			+ (intra-regional)	+		+			+ (intra-regional)

1: No draft available for the US-Thailand agreement. 2: Excl. Myanmar, Laos and Cambodia.

Table V.5 Specifications in treatment standards

Agreement	NT				MFN				NT/MFN to other party's:		NT/MFN to other party's:	
	Services treatment to 'like':		Investment treatment to 'like':		Services treatment to 'like':		Investment treatment to 'like':					
	Circum-stances	Service suppliers/ services	Circum-stances	Investors/ investments	Circum-stances	Service suppliers/ services	Circum-stances	Investors/ investments	Service suppliers	Service suppliers and services	Investors	Investors and investments
Japan-Malaysia		+	+			+	+			+		+
Japan-Mexico	+		+		+					+		+
Japan-Singapore		+	+			+ (request)	+ (request)			+		+
TAFTA		+	+			+ (request)	+			+		+
EC-Chile		+	+ (*'economic activity'*)		No MFN clause or request					+	*'legal or natural persons'*	
Draft EC mandate for EC-ASEAN[1]	Like investors (incl. service suppliers) and 'all measures affecting establishment'[2]				Like investors (incl. service suppliers) and 'all measures affecting establishment'							*'investors'* and *'all measures affecting establishment'*
EFTA-Singapore		+	+ (*'situa-tions'*)			+	+ (*'situa-tions'*)			+		+
EFTA-Korea		+	No reference to factual comparisons			+	No reference to factual comparisons			+		+
Trans-Pacific SEP	+		No investment disciplines yet.		+		No investment disciplines yet.			+	No investment disciplines yet.	
New Zealand – Singapore		+	+ (*'situa-tions'*)		No MFN clause or request		+ (*'situa-tions'*)			+		+
Chile – Korea	+		+		Do not mention factual comparison in request		+			+		+
Korea – Singapore	+		+		Do not mention factual comparison in requests					+		+
India – Singapore		+	+		Do not mention factual comparison in requests					+		+
AFAS/ ASEAN	*'discriminatory measures'*			+		+		+		+		+
US-Korea draft	+		+		+		+		+			+
US-Singapore	+		+		+		+		+			+
US-Thailand[3]	No draft available		+		No draft available		+		No draft available			+
ACCEC draft		+	No investment disciplines yet.			+	No investment disciplines yet.			+	No investment disciplines yet.	

1: Excl. Myanmar, Laos and Cambodia. 2: The definition of establishment can be found in footnote 3 of the analysis. 3: US proposal

Table V.6 Investment protection and dispute settlement

Agreement	Umbrella clause	Transfers	Standard of treatment/ Fair and equitable	Compen-sation	Expropriation		Dispute settlement		Scope of application of investment protection disciplines to goods and services
					Direct	Indirect	State-state	Investor-state	
Japan-Malaysia		+	+	+	+	+	+	+	All protections apply.
Japan-Mexico		+	+	+	+	+	+	+	All protections apply.
Japan-Singapore		+		+	+	+	+	+	All protections apply.
TAFTA		+	+	+	+	+	+	+ (Post-establishment only)	Protection applies to commercial presence.
EC-Chile		+	References to BITs				+		Protection applies to free transfers.
Draft EC mandate for EC-ASEAN[1]	?	?	References to BITs				+		Protection applies to free transfers.
EFTA-Singapore	+	+	+	+	+	'de facto'	+	+	Protection applies to commercial presence.
EFTA-Korea *(replaces and suspends Swiss BIT)*	+	+	+	+	+	+	+	+	Protection applies to commercial presence.
Trans-Pacific SEP	No investment disciplines yet.								
New Zealand – Singapore		NT and MFN		NT and MFN			+	+	Protection applies to commercial presence.
Chile – Korea *(replaces and suspends BIT)*		+	+	+	+	+	+	+	All protections apply.
Korea – Singapore		+	+	+	+	+	+	+	All protections apply.
India – Singapore		+		+	+	+	+	+ (Not for NT or post-establishment)	The services chapter incorporates selected protections of the investment chapter to be applied to commercial presence. The protection of the investment chapter applies to other investments.
AIA *(does not replace BITs)*		+	+	+	+	+	+	+ (Post-establishment only)	Protection applies to investment in services.
US-Korea draft		+	+	+	+	+	+	+	Protection applies to commercial presence.
US-Singapore		+	+	+	+	+	+	+	Protection applies to commercial presence.
US-Thailand[2]		+	+	+	+	+	+	+	Protection applies to commercial presence.
ACCEC	No investment disciplines yet.								

1: Excl. Myanmar, Laos and Cambodia. 2: US proposal.

Table V.7 EFTA vs. US agreements with Singapore and Korea

			SINGAPORE		KOREA	
			EFTA	**US**	**EFTA**	**US (draft)**
Definition of investment			Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.	Asset based– open list: includes FDI, portfolio investment and various forms of tangible and intangible property.
Definition of commercial presence in services chapter			GATS definition of commercial presence	Investment in services covered by investment chapter	GATS definition of commercial presence	Investment in non-financial services covered by investment chapter. GATS definition of commercial presence for investment in financial services.
Relationship between investment in services and horizontal investment disciplines			The investment chapter's NT and MFN obligations do not apply to commercial presence in any service sector.	Investment disciplines apply.	The investment chapter's NT and MFN obligations do not apply to commercial presence in sectors covered by the services chapter.	Investment disciplines apply for non-financial services.
Rules of origin for natural persons	**Extended to domestic nationals (or 'citizens')**		Yes	Yes	Yes	Yes
	Extended to permanent residents		Yes for investors. Only for services if the importing party grants substantially the same treatment to permanent residents as to nationals in respect of measures affecting services trade	No	Yes for investors. Only for services if the importing party grants substantially the same treatment to permanent residents as to nationals in respect of measures affecting services trade	No
Rules of origin for juridical persons	**Limited to domestically owned or controlled service suppliers/investors**		No	No	No	No
	Extended to judicial persons constituted under domestic laws and having substantial business operations in the domestic territory		Yes	Yes	Yes	Yes
	Other provisions		Benefits also extended to juridical persons with substantial business operations in the territory of any party (services chapter only)	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain diplomatic relations or where certain trade sanctions apply.	Benefits also extended to juridical persons with substantial business operations in the territory of any WTO-member, if service supplier is owned or controlled by person of a party (services chapter only).	Parties can deny FTA benefits to service providers and investors from non-parties with which a party does not maintain normal economic relations or where certain trade sanctions apply.
Treatment pre- and post-establishment for investment	**NT**		Negative list for investors and investments in like situations	Negative list for investors and investments in like circumstances	Negative list for investors and investments with no factual comparison	Negative list for investors and investments in like circumstances
	MFN		Negative list for investors and investments in like situations but with REIO clause	Negative list for investors and investments in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.	Negative list for investors and investments with no factual comparison but with REIO clause	Negative list for investors and investments in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.
Treatment pre- and post-establishment for services	**Market access**		Positive list	Negative list (don't mention foreign equity restrictions)	Incorporates article XVI of GATS; i.e. positive list	Negative list (don't mention foreign equity restrictions)
	NT		Positive list for like services and service suppliers	Negative list (not for mode 1 in financial services) for service suppliers in like circumstances	Incorporates article XVII of GATS; i.e. positive list for like services and service suppliers	Negative list (not for mode 1 in financial services) for service suppliers in like circumstances
	MFN		Negative list for like services and service suppliers but with REIO clause.	Negative list for service suppliers in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.	Negative list for like services and service suppliers but with REIO clause.	Negative list for service suppliers in like circumstances. Excludes past PTIAs and three sectors in future PTIAs.
Umbrella clause			Yes	No	Yes	No
Transfers			Yes	Yes	Yes	Yes
Standard of treatment/ fair & equitable			Yes	Yes but similar to customary international law	Yes	Yes but similar to customary international law
Compensation			Yes (not specified in detail)	Yes	Yes	Yes
Expropriation			Direct and de facto	Direct and indirect	Direct and indirect	Direct and indirect
Investor–to-state dispute settlement			ICSID or UNCITRAL rules with no automatic consent.	ICSID, UNCITRAL or other institutions/rules with automatic consent for the first two. Allows for consolidation and includes transparency provisions.	ICSID or UNCITRAL rules with no automatic consent for pre-establishment disputes.	ICSID, UNCITRAL or other institutions/rules with automatic consent for the first two. Allows for consolidation and includes transparency provisions.
Protection applies to investment in services			Yes	Yes	Yes	Yes

VI. Assessing the effects of de jure trade and investment integration

Key issues addressed:

- De jure integration in Asia: impacts on third country trade performance
- De jure integration in Asia: impacts on third country FDI performance
- The influence of investment rule-making on induced FDI flows

As discussed in Section II of this study, regional economic integration can be regarded as a process driven via the marketplace or by the effects of legally binding agreements entered into by governments. Market-driven integration is facilitated by the private sector and technological developments, whereas rule-driven integration is facilitated by legal instruments. In recent years, the latter have typically taken the form of international trade and investment treaties. The two processes are of course complementary, but the distinction is nonetheless useful for detecting the main forces driving Asian integration and their implications for third country multinationals.

In what follows, the study reviews the overall empirical evidence on the importance of rules and agreements in the context of Asian integration of trade and FDI flows. While there is little doubt that Asian integration has long been market driven, this dynamic is currently undergoing significant change. Since Asia's interest in bilateral and regional trade and investment agreements is a rather recent phenomenon, we have to rely - to a certain extent - on experiences with non-Asian preferential trade and investment agreements in order to gauge the likely outcome of this process and its potential implications for Swiss investors in the region.

VI.1 The rise of preferential trade and investment agreements and their likely impacts

The general consensus iin policy research circles is that the process of economic integration in Asia has so far been driven primarily by economic forces due to the FDI-induced integration of production networks, as well as by the impetus flowing endogenously from continued region-wide growth which, *ceteris paribus,* naturally increases trade and investment activity at the regional level (Dobson and Yue, 1997; Kimura and Ando, 2003; Damuri et al., 2006). ADB (2002a) thus find that, while PTAs have the potential to increase intra-regional trade and investment flows - as observed most markedly in the case of the EU and NAFTA - their impact on the Asia-Pacific region has to date been small.

However, this dynamic might very well be changing. Asian countries have increasingly turned towards far-reaching bilateral PTAs rather than the 'open regionalism' pursued by ASEAN and APEC in the past (Scollay, 2004; ADB, 2006). In particular, Japan, India, South Korea, Singapore and Thailand have all been active in trying to facilitate economic integration – and to some extent countenance the rise of China - through negotiations of formal trade agreements featuring comprehensive disciplines on investment on a bilateral or regional basis. The same countries have also been active signatories of bilateral investment treaties, both within and outside the region, as the scale of their own FDI outflows has grown.

Likely impact on trade flows

Based on what we know about PTAs in general, the rush towards regional and bilateral integration could have important implications for the future of trade and investment flows in Asia. In a recent 'meta-analysis' of all relevant econometric studies of preferential trade agreements, the World Bank (2005) found that regional/bilateral trade increases as a result. Such an outcome is confirmed by general equilibrium simulations (e.g. Krueger, 1999) and there is thus clear evidence that PTAs contribute to the increased regionalisation of world trade patterns (Pelagidis & Papasotirou, 2002).

The more interesting question for Switzerland, though, is whether increased intra-regional trade comes at the expense of third country suppliers. Athukorala (2006a) finds that even though there has been a rapid expansion of components trade within AFTA, this has been complemented by increased trade in final goods with countries outside the region.[40] Furthermore, as noted above - and also pointed out by Dobson and Yue (1997) and more recently by Kawai (2007) - increased regionalisation in Asia is offset by continued dependence on non-Asian markets and MNEs. The end result is that even as the Asian region continues to experience greater integration, its dependence on the global economy continues to constrain inward-looking policy choices.

Will the recent shift towards PTAs change such a pattern? When compiling all the regression estimates of authoritative studies, the World Bank (2005) is unable to reach any definitive conclusions as to whether PTAs are in fact trade- or FDI-diverting *per se*. It seems that some

[40] Production-sharing leads to massive double counting of published trade data as goods cross multiple borders in the course of their production. If not controlled for, this will overestimate the importance of intra-regional trade, and underestimate the importance of extra-regional trade and thus generate misleading inferences as to regional integration trends in trade (Athukorala, 2003; Athukorala and Yamashita, 2006).

agreements can induce such effects are while others do not. The devil, as always, lies in the details of individual agreements. So what, then, may explain some of the variations observed?

First, PTAs that are open to trade with third countries and cover practically all economic sectors are typically found to be less trade-diverting on average. Too high external tariff barriers relative to preferential tariffs and too many exceptions will lead to trade diversion and thus likely hurt third-country suppliers. Also, since East Asia continues to rely significantly on *extra*-regional trade for its growth dynamism, trade diversion would hurt Asian countries themselves (Athukorala and Yamashita, 2006).

Until recently, the tendency had been towards declining margins of regional preference – i.e. the difference between the average MFN and preferential tariffs – for ASEAN members, indicating that trade liberalization conducted multilaterally was moving faster than that conducted along regional lines (Ando and Kimura, 2003; Damuri et al., 2006).

The recent acceleration of tariff cuts under AFTA, the proliferation of preferential trade agreements and the continued negotiated gridlock in Geneva, suggest however that the relationship described above has been somewhat reversed over the course of the Doha Round. At the same time, it must be emphasized that third country traders and investors such as Switzerland have benefited from the continued commitment of Asian countries to liberalize their trade and investment regimes, as well as their regulatory regimes in services, on an autonomous basis. Simply put, third countries have often enjoyed *de facto* MFN treatment in their trade and investment relations with Asian countries. To date, there is very limited evidence of trade and investment policy backtracking in Asia, such that the wedge between actual (applied) and bound policies and measures and the fact that third countries are not direct beneficiaries of the protective properties of policy bindings have not proven unduly problematic.

Many of the recent or currently negotiated Asian PTAs focus on economy-wide liberalisation rather than creating 'carve-outs' to serve particular rent-seeking sectors and interests (ADB, 2006; Plummer, 2006). For this reason, Frankel (1997), Fink and Primo Braga (1999), Li (2000), Clark and Tavares (2000), Gilbert, Scollay and Bora (2001), and Soloaga and Winters (1999) all find that AFTA has been more trade creating than diverting. Also, recently concluded negotiations over an ASEAN-China PTA, while initially limited to goods trade (a services complement has since been added), liberalises 98% of all tariff lines and includes trade in agricultural products which can help create momentum for further agricultural liberalization in the Asia-Pacific region (Cheong and Kwon, 2005; Feridhanusetyawan, 2005).

There are of course important exceptions to the trends depicted above. Some of the recent PTAs of Thailand and a number of agreements entered into by India appear to have been driven more by mercantilistic than liberal ideals and feature highly selective preferential tariff dismantling rather than comprehensive liberalisation, ultimately calling into question their WTO compatibility (Sally, 2006). Nonetheless, most Asian PTAs – both those in existence today and those under negotiation – tend to be liberal in character and maintain relatively small margins of preference for regional producers (ADB, 2006; Plummer, 2006; Kawai, 2007; see Box VI.1).

An important question of course is whether such a benign policy environment will continue to define the norm or whether the region's recent conversion to PTA-centric forms of integration will raise new hurdles for third countries. The latter

Box VI.1 ***Tariff reduction in selected Asian PTAs***

AFTA*:* Negative list approach, 0 percent target. The CEPT scheme allows countries to maintain temporary exclusions, sensitive products list and general exclusion lists. Commodities are phased into inclusion gradually, and there is a longer timeframe for the CLMV countries. ASEAN6 reached 0-5 % tariff in 2003 and Vietnam in 2006. Lao PDR and Myanmar are to do so in 2008, and Cambodia in 2010.

Japan-Singapore*:* Positive list approach. Tariffs on Singapore's imports from Japan will be 0% immediately. Complete tariff elimination in Japan with 10-year transition period. Japan maintains some exceptions, including meat and meat products, fruit and vegetables, dairy products, and cane and beet sugar.

ASEAN-China**:** Negative list approach. Under the normal track, tariffs will be eliminated by 2010 for ASEAN6. Under the sensitive track, tariff reductions will start in 2012, to reach 0-5 percent tariff levels by 2018. ASEAN4/CLMV countries are given five more years to follow a similar tariff reduction scheme. Tariffs on goods under the Early Harvest Program, which includes agricultural products (Chapters 01 to 08 of the HS code), will be reduced to zero for ASEAN6 and China.

ASEAN-India: Positive list approach. Progressive elimination of tariffs in substantially all trade in goods. Under the normal track, tariffs will be reduced or eliminated by 2011 for India, Brunei, Indonesia, Malaysia, Singapore and Thailand, and by 2016 for other ASEAN members. Specific treatment is foreseen for sensitive products. The early harvest program follows a positive list approach.

Source: Feridhanusetyawan, 2005

Box VI.2 *Rules of origin in AFTA and the Japan-Singapore PTA*

AFTA: Rules of origin are relatively simple and liberal. A product has to satisfy 40 percent of its content originating from any member states. Cumulative rules of origin state that inputs for finished products eligible for preferential treatment in other member states shall be considered as originating in the member state where working or processing of the finished product has taken place, provided that the aggregate ASEAN content of the final products is not less than 40 percent.

Japan-Singapore: Rules of origin are less liberal and rather complex. Liberal rules of origin typically apply a general rule that the local content of the product has to be at 40–50 percent. In the Japan-Singapore agreement, rules of origin are product specific, or the originating content must be no less than 60 percent of the total value of the materials. The material must undergo the final production process in the territory of either party. Simple cutting, mixing, and packaging are not considered sufficient transformation for rules of origin. Origin can accumulate bilaterally.

Source: Feridhanusetyawan 2005

question arguably assumes heightened importance as the European Union – Switzerland's most important trading partner and a key competitor in world markets– engages anew in preferential trade and investment negotiations, including with key partners in Asia (e.g. India and ASEAN).

A second source of potential variance in the effects of PTAs relates to the design of rules of origin. Lacking a harmonized global rule of origin regime, PTAs with too strict or complex rules of origin have been shown to exert trade-diverting effects that can nullify or impair some of the new trade opportunities a PTA is supposed to create (Panagariya, 1998). One study has shown that the origin rules found in the NAFTA was equivalent to an added tariff of 4.3 percent (Estevadeordal and Suominen, 2004). It is therefore unfortunate that Asian PTAs have so far failed to adopt simple and transparent rules of origin for trade in goods.[41] This is notably the case of an otherwise 'benign' agreement such as that between Japan and Singapore (see Box VI.2 above).

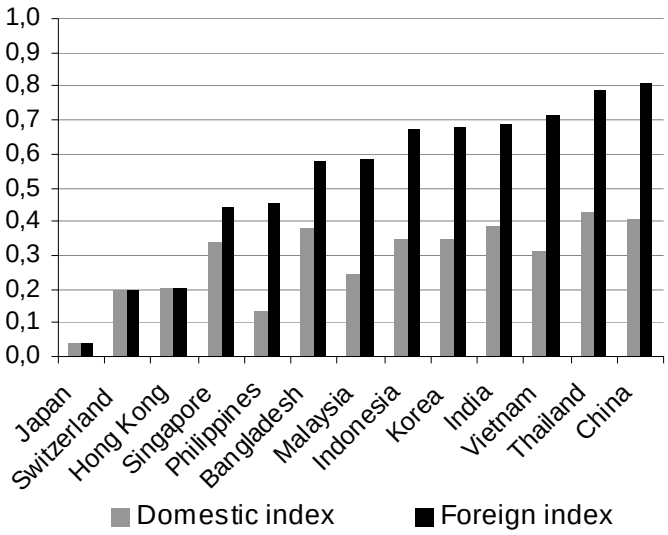
Moreover, even though AFTA rules of origin are relatively simple, the Asian Development Bank (2006) finds that one of the reasons why the promotion of intra-regional trade in AFTA has not fulfilled its full potential relates to the costs of complying with regional rules of origin, especially when compared to the relatively small margins of preference granted by AFTA tariff concessions. It seems that only multinationals in very high-tariff sectors such as automobiles have found it worthwhile to go through the bureaucratic procedures of obtaining an AFTA rule of origin certificate. Cuyvers *et al.* (2005), Plummer (2006) and Baldwin (2006) all note that one of the great challenges, for both Asian and non-Asian countries, is to

[41] In contrast, rules of origin as applied for services and investment in the Asian region are fairly liberal. These are analysed in the chapter on key investment provisions in Asian PTAs.

prevent Asian PTAs from creating a 'noodle bowl' of criss-crossing rules which would increase the cost of trade within the Asian sub-region. If this is not done, many firms will find it cheaper simply to pay the MFN duty rather than complying with complex rules with fewer new trade opportunities the likely result.

Another important characteristic that can help to minimize the potentially adverse impact of PTAs on third country producers is to have them integrate 'deeper' and 'wider' than is possible at the multilateral level: i.e. address more sectors, liberalize more comprehensively and address a wider set of regulatory impediments to trade and investment. Even if tariffs are fully removed, the business environment in Asia is still far from borderless (Ando and Kimura, 2003). Technical barriers accompanying inspection procedures for exports and imports are for instance prevalent (Wakasugi, 2007). Moreover, it is most likely in non-goods trade that the greatest benefits can accrue from integration via PTAs. For instance, trade in many key service sectors – such as telecommunications (see Figure VI.1 below) is still restricted by excessive or discriminatory regulation. This can be problematic for service sector MNEs, but also for firms in manufacturing and in other sectors that are connected to production networks throughout the region.

Figure VI.1 Trade restrictiveness index for telecommunications services, 2001



Notes: Index takes values 0 to 1, where high values indicate substantial restrictions on establishment and conducting ongoing operations. The foreign index covers discriminatory and non-discriminatory restrictions, the domestic index covers non-discriminatory restrictions.
Source: Productivity Commission (2001)

As discussed above, one of the basic pillars of regional and international regional and international production sharing is low trade facilitation and service link costs. Gains from

services liberalisation in Asia (and elsewhere) have generally been found to exceed those from goods liberalisation by significant margins, up to a factor of five according to one study (Robinson et al., 1999). Dee and Hanslow (2000) find that APEC countries could realise gains of US$110 billion from liberalising services trade, and that China alone could benefit by as much as US$70 billion by removing its stringent service sector restrictions. Chadha (2000), Brown et al (1996), Chada et al (2001), Benjamin and Diao (2000) come to similar results. (see Box VI.3).

Even though the largest economic gains from services liberalisation come from non-preferential market opening, PTAs can be useful tools for moving forward in what are often politically sensitive areas (McKibbin and Wilcoxen, 1996; OECD, 2004).

To convey the sense of the shared will to engage in economic cooperation beyond the reciprocal exchange of market access commitments, the newer generation of preferential trade agreements in Asia, such as those agreed between Singapore and Japan, ASEAN and China, ASEAN and Japan, as well as the India-ASEAN agreement, all explicitly use the term "comprehensive economic partnership" (CEP) rather than "free trade agreement" (Feridhanusetyawan, 2005).

In services, Asian PTAs typically adopt a GATS+ approach, whether in terms of agreed rules or (especially) negotiated market opening commitments (Roy, Marchetti and Lim, 2006; Fink and Molinuevo, 2007). Many such agreements also feature cooperative initiatives relating to the movement of natural persons, including in the realm of mutual recognition agreements in regulated professions (UNCTAD, 2007).

Box VI.3 *Studies on protectionism in selected service areas*

Finance and banking: Claessens and Glaessner (1998), Mattoo (1998), and Mcguire and Schuele (2000) all find – with different methodologies – that Asian economies are more restrictive and discriminatory than North American and European countries. Kalirajan et al (2000) find price impacts of non-prudential restrictions on foreign banks to be highest in Indonesia, the Philippines, Malaysia, Singapore, Korea and Thailand. Hong Kong has very low non-prudential regulations on foreign banks.

Distribution: Kalirajan (2001) finds that the most restricted markets are India, Indonesia, Korea, Malaysia, Philippines and Thailand. It is important to note, though, that significant unilateral liberalisation has taken place in Asia in the last few years, little of which is however bound in PTAs.

Professional services: Nguyen-Hong (2000) find that professional services are most restricted against foreigners in Indonesia, Malaysia and the Philippines all having nationality and residency requirements for the delivery of professional services.

Telecoms: Warren (2001) finds that the highest barriers in the Asian region are found in India, Indonesia, Korea and Thailand. These countries have major limitations on FDI in fixed network and mobile phone services (see also figure 13). Again, this is a sector that continues to witness autonomous (but typically unbound) market opening.

Laos, Vietnam, Japan, Singapore and Korea have all made notable commitments on services trade and investment in their PTAs. On the other hand, countries like Thailand, Malaysia and Indonesia have tended to schedule very limited commitments over and above those taken in the Uruguay Round (with the obvious exception of AFAS for intra-ASEAN trade and investment in services). In the goods area, the Singapore-Japan agreement is a prime example of a PTA that – apart from its chapters on investment and services - goes far 'behind the border' in addressing infrastructure and rules, costumes procedures and a variety of other indirect measures affecting trade flows. Such advances have prompted Hertel *et al*. (2001) to conclude that the so-called 'new-age' agreement between Singapore and Japan would not likely be trade-diverting overall; i.e. third countries would not lose out.[42] The rise of bilateralism in Asia has, with few exceptions, generally been characterised as a 'WTO-plus' process, which, *ceteris paribus,* should help create a better institutional setting for markets to function across borders and should therefore stimulate greater trade among partners, including third countries.

Likely impact on investment flows

Chase (2003) notes that bilateral or regional integration should be of particular interest to multinationals, since proximity has obvious benefits for firms spreading production across borders. Unfortunately, studies investigating the effect of PTAs on investment flows are relatively few. Stein and Duade (2001), Yeyati et al. (2003), and Medvedev (2006) find that PTAs do increase intra-bloc investment. Similarly, a recent study by the OECD (2007) finds that PTAs with comprehensive investment provisions exert a strongly positive impact on induced FDI flows among partner countries. Such results would appear to indicate that the recent surge in Asian PTAs should increase investment flows among Asian countries. This is particularly the case since the most substantial impact on FDI seems to occur when PTAs coincide with domestic liberalization and concerted efforts at macroeconomic stabilization among member countries. These are precisely the conditions obtaining in Asia in recent years (Blomström and Kokko, 1997; 2001; Graham and Wada, 2000).

Once again, the interesting question for third countries is whether PTA-driven integration is due to investment diversion or creation? Some evidence suggests that investment diversion is a genuine concern under some PTAs, with adverse third country effects. The World Bank

[42] Such a result, however, is based on *ex ante* calculations and not the actual effects of the agreement.

(2000) finds that FDI declined in EFTA members following the phase-in of the EU Internal Market Program (IMP) and did not recover until the establishment of the EEA. In addition, Luis and Lederman (2005) show that NAFTA resulted in diversion of FDI from other countries in Latin America, as Mexico's share of US-sourced investment remained stable throughout the 1990s while the share of other countries declined.

The evidence for PTA-induced investment diversion is not clear cut, however. Echoing the more recent findings of the OECD, Adams *et al*. (2003) and Dee and Gali (2003) show that strong investment provisions in PTAs have a net investment creation effect. Kimura and Ando (2003; 2005) note that; i) the generally low margins of preference among Asian countries will tend to mitigate biases against foreign firms, and ii) the existence of sophisticated production and distribution networks encouraging activities of *all* MNEs in East Asia will mean less of an asymmetric impact of PTAs and could thus be in the interest of MNEs in the region.

'New age' agreements promote economic ties through various investment facilitation activities, some of which also benefit third country MNEs. As discussed above, the framework agreement of the ASEAN Investment Area and the Singapore-Japan agreement both foresee information sharing, simplification and transparency of procedures and rules, etc. Such provisions stand to benefit not only PTA members but also non-Asian MNEs investing in Asian markets as they enhance service links between production networks (Thorbecke and Yoshitomi, 2006). Te Velde and Bezemer (2004) thus find that membership of a PTA can lead to further *extra*-regional FDI inflows, i.e. the increased opportunities for investment among partner countries also stimulate FDI from third countries. This is confirmed in the case of MERCOSUR, where most of new FDI came from outside the PTA (Chudnovsky and López, 2001) as well as of the Canada-United States FTA (subsequently NAFTA), where FDI to Canada from Europe increased much more than that from the US (Globerman, 2002).

VI.2 (How) do bilateral investment treaties work?

Bilateral investment treaties (BITs) are another legal instrument used to promote economic integration. The aim of host countries in signing BITs is to enhance the investment climate (i.e. serve a "signalling" function vis-à-vis foreign investors) and attract more FDI by granting strong protection rights against discriminatory (investment liberalization) or confiscatory (investment protection) state conduct.

Most Asian countries have signed numerous BITs. China has for instance signed BITs with over 100 countries and Korea and Malaysia with more than 60 each. Most such agreements are North-South in character and involve treaties entered into between Asian and home countries from the OECD area, but intra-Asian BITs are also becoming increasingly common.

With 111 such agreements - some of which have yet to enter into force - Switzerland has the second largest network of BITs in the world after Germany, covering around 44 % of total Swiss outward investment stock (OECD, 2005a). Switzerland is currently re-negotiating its network of BITs based on its 1995 BIT model.

Switzerland has concluded BITs with the vast majority of countries in Asia (excluding the EFTA-ASEAN PTA that features an investment chapter and to which Switzerland is party (See Box VI.4). Swiss BITs with Asian countries address matters of investment protection and feature post-establishment treatment provisions. Such treaties thus follow the 'European' BIT-model – as opposed to the more encompassing North American model – and include no commitments on investment liberalisation. Most-favoured-nation treatment is included in most treaties. National treatment, on the other hand, is rarely included in Asian BITs, and when it is, derogations are typically allowed. In the Swiss agreement with Indonesia, for instance, derogations from the national treatment principle are allowed by the Indonesian state if based on developmental considerations. Differences also exist relating to the settlement of disputes between investors and host states (Liebeskind, 2002). Not all Swiss BITs allow for investor-to-state dispute settlement. Box VI.5 highlights recent investment disputes involving Asian countries.

Box VI.4 *Swiss BITs with Asian countries*

Partner:	Signature	In force
Cambodia	12-Oct-96	28-Mar-00
Vietnam	3-Jul-92	3-Dec-92
Laos	4-Dec-96	4-Dec-96
Thailand	17-Nov-97	21-Jul-99
Philippines	31-Mar-97	23-Apr-99
India	4-Apr-97	16-Feb-00
Pakistan	11-Jul-95	6-May-97
Sri Lanka	23-Sept-81	12-Feb-82
China	12-Nov-86	18-Mar-87
Hong Kong	22-Sep-94	22-Oct-94
Singapore	6-Mar-78	3-May-78
Singap-EFTA	26-Jun-02	1-Jan-03
Malaysia	1-Mar-78	9-Jun-78
Indonesia	6-Jun-74	9-Apr-76
South Korea	15-Dec-05	1-Sept-06
North Korea	14-Dec-98	15-Nov-00
Mongolia	29-Jan-07	9-Sept-99

Notes: The Korea-BIT is replaced by the EFTA (minus Norway)-Korea investment agreement.

Source: UNCTAD online investment treaty database; see also: www.seco.admin.ch/themen/00513/00594/index.html

In theory, BITs can be an important instrument in promoting FDI to Asia from multinationals headquartered in OECD countries and in enhancing host countries' investment regimes.

Box VI.5 Recent investment-treaty disputes with Asian countries

1) SGS Société Générale de Surveillance S.A. (Switzerland) v. Republic of the Philippines

ICSID arbitration with stakes at around $170,000,000. Tribunal was registered June 6th 2002 and constituted September 8th 2002.The Philippines awarded SGS, a Swiss business group a contract to provide comprehensive import supervision for goods prior to shipment to the Philippines and specialized services to assist in improving the customs clearance and control processes. Part of the service was undertaken overseas. A dispute arose between SGS and the Philippines concerning alleged breaches of the services contract. SGS submitted certain monetary claims to the Philippines which were subject to various attempts for amicable settlement before submitting the dispute to arbitration. SGS invoked the provisions of the Swiss-Indonesia 1997 BIT. However, on January 29th 2004 the tribunal held the contractual claims to be inadmissible because of the claimant's failure to pursue the exclusive dispute resolution procedure specified by the contract.

See: www.bg-consulting.com/docs/icsid_042004.pdf, www.worldbank.org/icsid/cases/SGSvPhil-final.pdf

2) Fraport AG Frankfurt Airport Services Worldwide (Germany) v. Republic of the Philippines

ICSID arbitration with stakes at around $500,000,000. Tribunal was registered October 9th 2003 and constituted Feb 11th 2004. A consortium including Fraport won a concession to build and operate a new terminal at Manila's Aquino International Airport. The Supreme Court of the Philippines voided the contract in May 2003, citing administrative irregularities. Claimant says it was stripped of its investment because a new government came into power. Fraport is pursuing BIT arbitration, and its consortium, PIATCO, is pursuing contract arbitration. Case is pending.

See: www.americanlawyer.com/focuseurope/treaty0605.html

3) ABN AMRO Bank N.V. (The Netherlands), ANZEF Limited (U.K.), BNP Paribas (France), Crédit Lyonnais S.A. (France), Erste Bank der Oesterreichischen Sparkassen AG (Austria), Standard Chartered Bank (U.K.), Credit Suisse First Boston (Switzerland) v. Republic of India

Ad hoc arbitration with stakes at around $290,000,000 launched December 10th 2004. One of several BIT disputes flowing from the Dabhol power project in Mumbai. The firms allege that the Government of India failed to protect their loans in the Dabhol project after the plants closure in 2001, and is liable for damages under investment treaties concluded by India with the UK, Austria, France, the Netherlands and Switzerland. The US Government and the Overseas Private Investment Corporation have also mounted an arbitration under the terms of a 1997 US-India Investment Incentive Agreement. This state-to-state arbitration parallels a pair of ongoing investor-to-state arbitrations launched by General Electric and Bechtel (the majority shareholders in the Dabhol project), as well as an unclear number of commercial arbitrations proceeding under the terms of the Dabhol project contracts. The seven arbitrations initiated by the European banks are arbitrated under the UNCITRAL rules of arbitration.

See: www.iisd.org/pdf/2004/investment_investsd_dec17_2004.pdf, www.opic.gov/foia/awards/GOI110804.pdf, http://in.news.yahoo.com/041210/137/2ie3i.html

However, empirical studies devoted to the subject matter conclude that BITs exert an indeterminate influence on investment flows between signatories. Hallward-Driemeier (2003), Tobin and Rose-Ackerman (2004) and Yackee (2006) find either no or (somewhat counter-intuitively) even a negative impact of BITs on induced FDI flows. In contrast, Neumayer and Spess (2005), Salacuse and Sullivan (2004) and Banga (2003; 2006) find strong and positive associations between the number of BITs a country has signed and its FDI inflows. However,

association is different from causation, and Aisbett (2007) shows that these latter studies fail to take into account that BIT signatories tend to experience large FDI inflows *before* signing the agreement, and that there is no marginal effect of BITs by themselves after they have been signed. Moreover, BITs do not seem to 'substitute' for property-rights - as Neumayer and Spess (2005) claim; i.e. investors do not regard BITs as a sufficient safeguard against a general disrespect of property rights by host governments. This does not rule out, however, that investors value the usefulness of BITs when deciding where to invest, particularly as confidence in the robustness of investor-state arbitration procedures increases in the context of heightened judicial activism.

Secondly, BITs should not be seen in isolation of broader integrating trends. One recent study suggests that BITs might influence investment behaviour when complemented by an investor-friendly political and economic environment (Tobin and Rose-Ackerman, 2006).

Thirdly, there is scant evidence on whether BITs matter more for FDI flows in certain sectors than in others (in either manufacturing or services), or for some types of investments rather than others (i.e. resource- vs. efficiency- vs. market-seeking FDI. Expropriation risks are typically greatest in natural resource industries for instance, such that BITs may have a particularly useful role to play in such sectors despite their more marginal use in other areas (Aisbett, 2007). Finally, it is still unsure whether BITs with pre-establishment rights, such as those negotiated by Canada and the United States, exert greater impacts on investment flows relative to agreements limited to post-establishment rights. In any event, the empirical evidence currently available suggests that BITs do not on the whole exert determinative impacts on the investment decisions of multinational firms.

VII. Concluding remarks

When assessing the growth of Asia's trade and the respective roles of policy, technology, and markets in influencing patterns of regional integration, a key conclusion that emerges is that technological change, markets, and the private sector, particularly multinational firms (hence FDI), have been crucial in deepening integration. To date, empirical studies suggest that bilateral and regional trade and investment agreements have had only a limited impact on Asia's integration process, the most significant liberalization efforts having been unilateral in character.

Outside the arena of formal trade and investment agreements, a number of important factors have been driving trade and FDI activity in Asia. Increasing trade integration within East and Southeast Asia has been closely associated with changes in industrial organization and the spread of international production sharing, or the fragmentation of vertically integrated supply chains. The attractiveness of East and Southeast Asia as production and investment platforms has been enhanced by a variety of measures that reduce the frictions and costs of trade, such as investments in ports and other infrastructure, the establishment of special economic zones and bonded industrial warehouses, and duty drawback schemes. These arrangements have allowed investors, both domestic and foreign, to take advantage of economies of scope and specialization. The above trends have resulted in burgeoning cross-border trade in manufactured parts and components and in the assembly of final goods, while also casting new light on the economy-wide importance of enhancing the quality of key infrastructure and business services that play a central trade- and FDI-facilitating role.

Assessing the impact that preferential trade agreements (PTAs) have had in promoting regional trade and investment patterns remains an arduous task, not least because Asian countries are such recent converts to the practice of discriminatory trade and investment agreements. Yet there can be little doubt that integration is on the move, and intra-regional trade and investment in developing Asia has grown at a faster pace than the rate of growth of world trade in recent years. But in addition to the factors cited above, rising intra-regional trade shares have also been a direct consequence of fast regional economic growth itself. Other things being equal, trade among countries that are growing fast will tend to rise more quickly than trade among countries where growth is slower. The Asian Development Bank recently noted that, while at a worldwide level PTAs have probably increased trade, their impact on the Asia and Pacific region has been quite small. For instance, the ADB estimates that intra-bloc trade within the Association of Southeast Asian Nations (ASEAN) Free Trade

Area (AFTA) would appear to be no larger than it would be without the agreement (ADB, 2002a).

There are, however, unmistakable signs that the dynamics of Asian integration are changing, not least because of the protracted difficulties encountered in multilateral trade negotiations but also in light of the emergence of – and concomitant competitive threats and opportunities from - China and India as regional giants.

Countries in Asia and in other regions are increasingly experimenting with preferential trade agreements, most often on a bilateral basis. Such a trend is today on a strong upswing throughout Asia and increasingly spans several regions. Indeed, Asia's "noodle bowl" is not only expanding, but is increasingly involved with complex agreements in other parts of the world. Such cross-regional agreements are driven by a variety of concerns such as energy security, access to minerals and other natural resources. They also represent efforts by Asian countries to "lock in" reforms by making them part of a formal trade treaty with a major developed country or region. Many such agreements are also motivated by political considerations, as countries seek to cement diplomatic alliances by providing economic benefits to partners.

The proliferation of preferential trade and investment agreements is a very recent phenomenon in developing Asia. Before 1995, only three of them involved developing member countries of the Asian Development Bank as notified to the WTO. By 2006, a total of 36 agreements had been formally notified to the WTO. The region is currently the theatre of more than 40 ongoing PTA negotiations, a hyperactivity that knows no equivalent elsewhere in the world. Asian PTAs range from minimalist agreements that simply exchange partial tariff preferences or extend tariff concessions from more to less developed countries to "full-blown" agreements that reach well behind border management issues. The latter agreements are becoming increasingly common. Agreements notified under the enabling clause (between developing countries) tend to be less comprehensive than agreements notified under GATT Article XXIV. In recent years, full-blown PTAs tend to extend coverage to services, which must be notified separately under GATS Article V. Increasingly, preferential trade agreements go beyond countries' WTO commitments and also address new issues such as investment, competition policy, as well as labour and environmental issues.

As Asia's preferential trade and investment agreements are still for the most part at an early stage, this obviously complicates attempts at assessing their effects empirically and assigning structural influences to their core provisions. Yet during the time that they are

implemented, such agreements will begin to impact on both regional and global trade and investment flows. Accordingly, it is important that preferential trade and investment liberalisation be conducted in such a way that supports, rather than inhibits, the openness that has so far been a defining characteristic of Asia's trade expansion and integration into world markets and the ability of third country traders and investors – including from Switzerland - to take part in, benefit from and contribute to such growth.

The trend towards PTAs involving developing countries in Asia cannot readily be described as an overt desire to create an Asian trade bloc to compete with the EU or North America. Asia's dependence on the markets of the two other blocks – Europe and North America - remains of paramount importance, all the more so as producers in the region – which remains on the whole generally open towards foreign direct investment - are tightly connected in global and regional supply chains that require an open trade and investment regime to thrive. The need for such openness extends to the underlying services infrastructure in the region, without which cross-border trade cannot durably prosper and for which unilateral liberalization and non-trade-centric forms of regulatory and infrastructural cooperation remain important driving forces.[43] Solace can moreover be taken from the outward orientation of Asian PTAs. This is most patently the case of East Asia, a region that encompasses some of the world's major trading powers (China, Japan, Korea), and where two thirds of existing PTAs and fully 85% of agreements currently under negotiation involve countries or regional groupings outside the region.

Though this study concludes that the effects of regionalism in Asia have so far proven fairly benign for third country investors and service suppliers, such developments cannot however be discounted as risk-free. This is all the more given the novel character of Asian PTAs. Such risks include those, common to all integration processes predicated on discriminatory access, that a proliferation of PTAs may entail in terms of possible trade and investment diversion effects. A related danger is that growing recourse to bilateralism could polarize trade and FDI opportunities, favouring large trading "hubs" at the expense of more isolated, weaker trading "spokes." Additional risks relate to the transaction costs, pressures for protectionist capture and greater overall complexity in the business environment that a multiplicity of overlapping disciplines, particularly rules of origin for goods and services (Mode 3) trade, can pose to third country traders and investors.

[43] One example is the creation of trade-facilitating corridors – in road, rail and inland waterway transport – currently being developed in several parts of Asia.

Care must thus be taken to ensure that the rise of PTAs, in Asia and elsewhere, remain (as has largely been the case to date in the region), building blocks for the WTO and for multilateral engagement more broadly rather than stumbling blocks. It is indeed likely that stronger multilateral disciplines will be needed to generate “best practice” PTAs and ensure that their systemic downsides are properly mitigated. The adoption and effective implementation of some basic principles over and above the Doha Round’s timid (yet useful) advances on enhanced transparency and multilateral surveillance, would indeed help to minimize the potential damage from PTAs while also allowing for properly designed agreements to lead to trade and investment creation and efficient behind-the-border reforms. Box VII.1 highlights the key elements of best practice PTAs that Swiss businesses, both traders and investors, and policy-makers should be advocating (and monitoring) in Asia and elsewhere, and for which new (notably for investment) or strengthened existing disciplines (on rules of origin, services, and preferential trade agreements) may be needed in the WTO.

Box VII.1 Towards ‘best practice’ preferential trade and investment liberalization

Preferential trade agreements should ensure:

- Wide coverage of goods with few exclusions. Agriculture and manufacturing tariffs and non-tariff barriers should be eliminated on a clear and fast timetable.
- Wide coverage of services and coverage of all modes of service delivery.
- Mutual recognition and convergence/greater cooperation in matters of domestic regulation as a trade-facilitating complement to market access commitments in goods and services trade.
- Symmetrical and simple rules of origin based on a positive standard or test. They should have transparent and consistent implementing regulations (e.g., accounting practices, paperwork for certification of origin) that are chosen at the minimum level needed to prevent trade deflection.
- Adoption of a liberal, substantial business operation, test as a rule of origin for services and investment, so as to allow established third country service suppliers and investors to compete and take advantage of opportunities within an integrating area.
- Even-handed and transparent customs procedures. Valuation should be transparent, offering few or no chances for corruption (use of electronic data interchange).
- Enforcement of intellectual property rights in a non-discriminatory manner. This should be consistent with the World Trade Organization (WTO) Agreement on Trade-Related Intellectual Property Rights, reinforcing international conventions on copyrights, patents, etc.
- National treatment embodied in foreign direct investment regulations and investment provisions. Any performance requirements should be based on a "negative-list" approach and should provide protection in law for foreign investors to prevent expropriation or unwarranted actions against such investors' interests.
- Establishment of dispute-settlement provisions, to adjudicate conflicts in a timely and fair fashion by using objective panels of experts. Antidumping findings should be subject to review by such panels with proceedings held in a fair and transparent manner.
- Open competition and non-discrimination among members for government procurement and as little discrimination against non-members as possible.

- Transparent and non-discriminatory competition laws and regulations. To the extent possible, they should be harmonized among members once tariff-free trade has been achieved so as to eliminate use of antidumping (as distinct from antimonopoly) measures.
- Clear and simple codes that guide technical barriers to trade, such as product standards and phyto-sanitary standards to protect public health and safety (based on the WTO agreements on standards). Likewise, agreements that cover environmental and labour standards should embrace the rights of partners to establish and implement their own laws and regulations in conformity with existing international obligations in the areas of environmental protection and labour rights and conditions.

Source: Adapted from Plummer (2006) in ADB (2006).

Beyond ensuring that bilateral agreements are designed to mitigate trade and investment diversion problems, it bears recalling that preferential liberalisation may provide a springboard for "deeper integration," either through measures that go beyond World Trade Organization (WTO) agreements or through reductions in behind-the-border barriers. To the extent that PTAs can help achieve such objectives, the gains from preferential liberalization may well mitigate and possibly offset any losses entailed by discriminatory market-opening. Bilateral and regional compacts that help to reduce trade transaction costs, liberalize cross-border investment and promote regulatory convergence and cooperation may indeed afford opportunities for sizable income gains, including on the part of third country investors and service providers.

The trends depicted in this study raise important challenges for Swiss policy-makers and the country's business community. Though likely less pronounced than in goods (manufacturing) trade, progress is being registered in opening up Asia's services markets to greater competition via trade and investment agreements – both internally among Asian nations, and particularly within ASEAN, as well as through formal agreements reached with parties outside of Asia, especially agreements with the United States, Japan, Australia and New Zealand.

To date, the trend towards deeper Asian integration in the fields of services and investment has generally proven benign for third country traders and investors, owing to the adoption of liberal rules of origin governing the participation of third country investors (Mode 3) in services markets, reliance on unilateral market opening in services trade and investment and the continued outward-orientation of Asian countries' trade and investment regimes even as intra-regional trade and investment ties are rising noticeably.

There is little doubt however that some recent PTAs, notably those entered into by several Asian countries with the United States and (to a lesser extent) Japan, place the latter countries' service suppliers and investors in a privileged position in Asian markets across several modes of supply and service sectors of priority interest to Switzerland. In some sectors, the degree of access achieved and the quality of the rules agreed (especially on investment) appear qualitatively superior to those enjoyed by Swiss operators under the two agreements which Switzerland, as an EFTA member country, has completed to date in the region (with Singapore and Korea).

The scope for reassessing Switzerland's negotiating priorities and the substantive elements of its approaches to rule-making in services and (especially) investment may also be heightened by recent neighbourhood considerations, notably the decision of the European Union – Switzerland's most important trading partner and home to many Swiss firms' - large and small - main competitors in world markets, to renounce its DDA-induced moratorium on PTA activity and enter into an ambitious set of preferential trade negotiations with key partners in Asia (India, Korea, ASEAN). One the central aims of the EU will be to secure high levels of market access and WTO+ rule-making outcomes in services, investment and related regulatory issues in key emerging country markets and regions. Such a major policy development is one to which Switzerland, either on its own (bilaterally) or through EFTA, may wish to respond by deepening and better serving its already important existing ties in the world's fastest growing region by contemplating its own expanded network of preferential trade and investment agreements. In so doing, Switzerland might wish to deepen the regional (preferential) dimension of its existing trade policy arsenal, thereby complementing first-best efforts at non-discriminatory market opening in the World Trade Organization.

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APPENDIX 1: Towards an EU–ASEAN PTA

On April, 23rd 2007, member states of the EU mandated the European Commission to negotiate a PTA with the ASEAN countries, as well as with Korea and India. This decision was taken following a long period where resistance for bilateral integration with ASEAN countries was strong, mainly for political economy considerations. This appendix the possibility of an EU– ASEAN PTA by applying a political economy analysis examining EU considerations for such an agreement, followed by a more detailed discussion of the feasibility and benefits of such an agreement and its likely substantive content.

(i) Political Economy Considerations

Broadly speaking, seven main issues can be seen as underlying prospects for a EU– ASEAN PTA. First, the EU had long been among the strongest advocates of multilateral liberalisation through the WTO, in effect adopting a moratorium on new PTAs during the course of the Doha Round. This policy, which was championed by the former Commission, and notably by its Trade Commissioner Pascal Lamy, has been increasingly questioned under the current Commission, in large measure as frustration over the prospects of completing an ambitious Doha Round has mounted.

Second, in connection with frustration from liberalisation at the multilateral level, the EU has not been indifferent towards the surge in preferential trade and investment agreements concluded of late, particularly in the fast-growing Asia region. The rise in bilateral and regional deals conducted by ASEAN members, as well as by other main trading partners, such as the US, China, India, Japan and Australia, has led to growing concerns within EU business and governmental circles that EU competitiveness is being eroded and that these agreements were adversely affecting the EU. The fear of a loss of competitiveness vis-à-vis the US and China has also been one of the main drivers behind the Lisbon Strategy and to a large extent is a recurring issue in EU internal discourse.

Third, EU frustration over the expected outcome of the DDA concerns not only the level of liberalisation to be achieved but also likely rulemaking advances. It is already obvious that a WTO deal will not include some of the main areas of importance for the EU. Two notable examples are the area of services, where the GATS' built-in agenda had yielded no tangible results so far, and the Singapore Issues (trade facilitation, transparency in government procurement, investment and competition). The latter were a priority for the EU, and yet were sacrificed at the WTO's Cancun Ministerial. The EU's reluctant decision to abandon negotiations on the Singapore Issues and to remove them from the DDA's Single Undertaking has exacted a high price in the minds of some Member states and the Commission, a price that is widely believed to have been inadequately matched by some of the EU's key trading partners. At the same time, experience gained in other PTAs reinforces the view that WTO+ progress on these (and other) issues can readily be achieved outside the multilateral system..

Taken together, these first three issues contributed to a gradual shift in the EU position, where it now believes that a PTA with ASEAN countries and other key traders in the Asian region (India and Korea notably) would compensate for some of the lost benefits from a weaker (or non-existent) WTO deal, and may even lead to an improved outcome.

Furthermore, the above considerations lead to another, fourth, issue concerning the optimal negotiation strategy for the EU in the WTO. From a tactical point of view, such a policy

change can be regarded as a signalling game with other key countries in the WTO. When the EU insisted in the past on a multilateral deal, it was a hostage, under the WTO's Single Undertaking. to a veto by other trading partners, who could also extract bigger concessions from it. By signalling that there is an alternative to a negotiated WTO agreement, the EU can soften the demands of other trade parties, who are likely to lose significantly from a failed DDA. Finally, the PTA approach also expands the EU's bargaining power position with individual countries. It is clear that any agreement with ASEAN members will include provisions and chapters concerning services, investment, intellectual property rights and other areas, which these countries might otherwise oppose or show greater reluctance towards in the WTO arena.

Fifth, it is apparent that the EU's policy shift towards preferentialism was being considered for several years, particularly as several studies and business lobbies contributed to pushing EU trade policy in such a direction. However, the institutional setting of decision-making in the EU, coupled with the 2004 enlargement to 10 new Member States (now already 12 with the 2007 enlargement) imposed a number of policy constraints. The newly enlarged EU has highlighted the growing divergence of trade interests among member states with differentiated economic structures.

Sixth, the EU's existing network of preferential agreements cover almost all of Europe, the ACP countries, the Middle East and some countries in Latin America (Mexico and Chile and ongoing negotiations with Mercosur), with Asia the only region with which the EU had yet to reach any PTA. A PTA with ASEAN would thus help to remedy the gap in the geography of EU preferential trade ties. It would also match the EU's preference to negotiate regional trade agreements over bilateral ones, though the latter route is being pursued in the case of India and Korea.

Finally, the EU has shown some reluctance to negotiate bilaterally with ASEAN due to the human rights and political situation in Myanmar. These have been and are still areas of major contention for the EU. In April 2007, the EU renewed its sanctions against the military regime of Myanmar. It is possible that the Myanmar issue may yet prove to be a stumbling bloc in negotiations with ASEAN, such that the EU may need to consider a bilateral approach with individual ASEAN countries and still receive the benefits from agreements that ASEAN has concluded with other third country partners.

(ii) Projected benefits and side effects

An EU – ASEAN FTA is projected to impact the EU, ASEAN and third countries in both positive and negative ways, generating both static and dynamic effects. Overall, on the basis of a report made by a joint qualitative and quantitative assessment group of ASEAN countries and the EU[44], an EU – ASEAN FTA is projected to yield wide economic and strategic benefits to the parties of such an agreement. The following is a summary of results of this report, with some reference to possible impacts on Switzerland:

Trade in manufactured goods – trade in the goods area is generally less hampered by traditional trade barriers, such as tariffs, and does not constitute the most significant obstacle to trade between the EU and ASEAN. However, gains can be made from the liberalisation of several sensitive products where tariff peaks apply, such as in agriculture or the automotive sector. The reciprocal liberalisation of agricultural trade between the EU and ASEAN could

[44] See Hedi Bchir and Fouquin (2005). The cost-benefit analysis for ASEAN is not covered in this document, but is a part of the assessment report. The report tested various scenarios, including dismantlement of tariffs on goods with or without the exclusion of sensitive products, liberalisation of the services sector, as well as a scenario where the other PTAs being negotiated by ASEAN and the EU are concluded with third parties.

generate trade diversion effects on Switzerland, although the importance of farm trade between ASEAN and Switzerland remains relatively modest. The highest level of trade protection in the EU-ASEAN area is associated with non-tariff barriers. These affect both parties, but are most evident for ASEAN exports to the EU. Such NTBs take the form of onerous technical standards and regulatory requirements (particularly, environment and food safety standards) that entail high costs for ASEAN producers, as well as tariff quotas for specific sensitive agricultural products. From a practical point of view, benefits are projected to result from the establishment of common disciplines on technical barriers to trade (TBT), sanitary and phyto-sanitary (SPS) standards, as well as through the advent of less stringent rules of origin.

Trade in services - the main benefit for the EU is expected to accrue from the liberalisation of trade in services. In this area, benefits would flow from the abolition of numerous trade and investment restrictions and burdensome regulatory requirements. A PTA including services (and investment) is widely expected to improve on the probable outcome of the DDA. It is estimated for instance that the liberalisation of business services could result in a 29% increase in EU exports to ASEAN (€7.9 billion), and generate an 80% increase in ASEAN exports to the EU (€14 billion). An EU-ASEAN agreement on services trade could be detrimental to Switzerland, depending on both the nature and extent of liberalisation in specific sectors and horizontal issues.

Because Swiss laws and regulations are already largely EU compliant in the services field, and because Swiss service providers tend to be more competitive than most of their ASEAN counterparts, the risk of trade diversion does not so much lie in the EU market as in key ASEAN markets of interest to Swiss investors. Such effects could however be mitigated if a prospective EU-ASEAN PTA featured a liberal rule of origin/denial of benefits clause with regard to Mode 3.

Trade and investment – current trade and investment relations between ASEAN and the EU are asymmetrical. It follows from the analysis that in several industries and sectors there remains considerable scope for trade and investment complementarities. For the EU, these exist in knowledge-based services, where a comparative advantage clearly prevails, while for ASEAN such complementarities arise mainly in manufacturing. For the EU, the main obstacles to trade and investment within ASEAN countries arise in the services sector, particularly via foreign ownership limitations as well as in state subsidies and support directed to several manufacturing industries. Inter-regional FDI flows are generally expected to benefit strongly from a prospective PTA.

Differentiated benefits and scope – given the economic and development diversity that prevails within ASEAN, whose memberships features countries at polar extremes of the income/per capita GDP ladder, an EU-ASEAN PTA would quite clearly yield differentiated benefits. Heterogeneity within ASEAN need not be an obstacle to a PTA and could allow for differentiated levels of ambition, coverage and depth of liberalisation across various issue areas in line with the variable geometry that both the EU and ASEAN have practiced in various policy domains.

Strategic benefits – A PTA would extend the commercial reach of EU suppliers in ASEAN markets, the only region of the world (as part of Asia in general) not currently covered by EU preferential trade agreements. Such an outcome is likely to be enhanced by the natural play of markets and the expected continued strong growth in the region. Moreover, a PTA would help establish and promote a more stable, visible and predictable environment for investment and the enforcement of intellectual property rights, a major offensive export interest for the EU (and Switzerland). It would also decrease or attenuate the scope for trade- and investment-diversion effects on the EU likely to result from existing and future PTAs negotiated between ASEAN countries (both as a block and as individual countries) with third

countries in Asia or beyond. The latter consideration is of potentially high significance for Switzerland, given the scope and coverage of ASEAN PTAs. For ASEAN countries, engagement with the EU is a major element in its competitive strategy towards China and India. A PTA would most likely provide a boost to FDI inflows and may act as an external lever in pursuing needed structural reforms. From a development standpoint, a PTA may lead to some (marginal) preference erosion under the current GSP and EBA schemes with the least advanced ASEAN counties. The extent of such erosion is not clear, since EBA preferential treatment is underused, owing primarily to complex rules of origin in EU sensitive products such as textiles and clothing. A relaxation of such rules would greatly enhance the developmental benefits of the PTA for ASEAN, particularly the CLMV countries.

(iii) Elements of an EU - ASEAN PTA[45]

The EU view of a FTA with ASEAN is of a comprehensive agreement, based on ambitious coverage and extensive liberalisation. Such an agreement will prioritise market access for goods and services, and will include provisions on regulatory transparency, standards and conformity assessment, sanitary and phyto-sanitary rules, intellectual property rights, investment, trade facilitation and customs, public procurement, trade and competition, including state aids, as well as provisions on co-operation on trade and sustainable development, including both environmental and social elements.

1. The **trade in goods** package would be based on the symmetrical liberalisation of trade over a period of 10 years, allowing flexibility of transition periods for different ASEAN members. Sensitive products would be treated via special provisions, such as differentiated transition periods. The scope of liberalisation is to include substantially all trade, yet as in other cases there is no interpretation of what substantial liberalisation stands for (the EU practice is 90%). Although clear asymmetry exists between the EU and ASEAN countries insofar as development is concerned, such asymmetry is not addressed in terms of the scope and coverage of liberalisation, other than flexibility of transition periods (10 years). Other issues to be addressed with regard to trade in goods will include rules of origin, financial responsibility clauses concerning errors in the application of rules of origin and anti-circumvention measures. Provisions on standards and conformity assessment aim to go beyond WTO provisions and to include the adoption of recognised international standards, the streamlining of testing requirements in priority areas, as well as regulatory convergence and cooperation measures.

2. **Non-Tariff Barriers** - The liberalisation of trade in goods would also include restrictions on the use of non-tariff barriers (NTBs), other than those justified by general exceptions, intertwined with provisions and procedures to ensure their elimination. It should be noted that there appears to be a logical gap between the EU's intention to comprehensively eliminate "un-justified" NTBs, and the formula suggested by the Commission to negotiate the abolition of NTBs on a request-offer formula basis.

3. Disciplines on **sanitary and phyto-sanitary measures** would be based on WTO provisions, and in particular would address the issue of transparency and the establishment of a mechanism for the recognition of equivalence. Such a mechanism would include prelisting of food-producing establishments, and aim at the recognition of the disease-free health status of the EU and ASEAN countries. While allowing for minimal border checks, the PTA would apply the principle of regionalisation for both animal and plant diseases. It would also include animal welfare within its scope.

[45] Based on the Draft EU-ASEAN FTA Negotiating Directive.

4. **Anti-dumping and countervailing measures** would aim at WTO+ treatment by including EU rules, such as use of a public interest test, adoption of a lesser-duty rule and additional consultations.

5. **Services and investment** constitute a priority for the EU in the PTA, and are to be treated under the same framework. Although liberalisation would be in accordance with Article V of the GATS, and thus not excluding a-priori any sector or mode of supply, the EU is reluctant to negotiate the liberalisation of national maritime cabotage, domestic and international air services (with minor exclusions), as well as audio-visual services. The Commission's negotiating leeway in health and education services, two areas of likely ASEAN interest, is somewhat unclear. Although the prospective agreement's negotiating modality has yet to be specified, it appears likely that commitments would follow a GATS-like positive/hybrid list approach, though Commission have expressed interest embedding provisions similar to those found in recent Japanese PTAs with ASEAN members that aim at locking in the regulatory status quo in voluntarily scheduled sectors.

6. **Government procurement** constitutes an additional priority area for the EU in ASEAN countries, all the more so as most of its Members (with the exception of Singapore, Cambodia and Vietnam) are parties to the WTO's plurilateral GPA while other ASEAN members have long maintained discriminatory procurement regimes as key elements of industrial and SME policy. The EU objective is to encourage the progressive liberalisation of government procurement markets at the national and sub-national levels. Such liberalisation would aim at greater market access based on non-discrimination and transparency measures.
7. **Trade and competition** provisions would include provisions aimed at defining and restricting the scope of anti-competitive behaviour. More specifically, the PTA would aim to develop rules on restrictive business practices, vertical restraints, abuse of dominance, mergers and state aids.

8. Rules on **intellectual property rights** in the PTA would extend the disciplines already covered under existing multilateral agreements (so-called TRIPs+ provisions that are commonly found in US PTAs). However, the EU would also intend to include specific rules on geographical indications and their recognition, protection and enforcement.

9. **Other provisions** in the proposed PTA would include trade facilitation, trade and sustainable development issues including the liberalisation of environmental goods, services and technology, and measures concerning regulatory transparency.

10. Promoting **regulatory convergence** with the EU is an important goal for the EU. In such a case, third countries, like Switzerland, that are already in compliance with most EU regulatory regimes, can be expected to enjoy positive spillover effects from ASEAN countries' greater regulatory alignment with EU standards and regulations.

APPENDIX 2: Definition of machinery parts and components

HS classifications: 840140, 840290, 840390, 840490, 840590, 8406, 8407, 8408, 8409, 8410, 8411, 8412, 8413, 8414, 841520, 841590, 8416, 8417, 841891, 841899, 841990, 842123, 842129, 842131, 842191, 842199, 842290, 842390, 842490, 8431, 843290, 843390, 843490, 843590, 843680, 843691, 843699, 843790, 843890, 843991, 843999, 844090, 844190, 844240, 844250, 844390, 8448, 845090, 845190, 845240, 845290, 845390, 845490, 845590, 8466, 846791, 846792, 846799, 846890, 8473, 847490, 847590, 847690, 847790, 847890, 847990, 8481, 8482, 8483, 8484, 8485, 8503, 850490, 8505, 850690, 8507, 850990, 851090, 8511, 8512, 851390, 851490, 851590, 851690, 851790, 8518, 8522, 8529, 853090, 8531, 8532, 8533, 8534, 8535, 8536, 8537, 8538, 8539, 8540, 8541, 8542, 854390, 8544, 8545, 8546, 8547, 8548, 8607, 8707, 8708, 870990, 8714, 871690, 8803, 8805, 9001, 9002, 9003, 900590, 900691, 900699, 900791, 900792, 900890, 900999, 901090, 901190, 901290, 9013, 9014, 901590, 901790, 902490, 902590, 902690, 902790, 902890, 902990, 903090, 903190, 903290, 9033, 9110, 9111, 9112, 9113, 9114, 9209.

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