The Center for International Environmental Law

Friends of the Earth
United States

HONG KONG BRIEFING PAPER,
DECEMBER 2005

FREE TRADE AGREEMENTS & SUSTAINABLE DEVELOPMENT: THE DIVIDE & CONQUER STRATEGY

As World Trade Organization (WTO) negotiations have dragged on over the past several years, the United States and European Union have increasingly chosen to pursue other negotiating paths. Alongside the multilateral negotiations at the WTO, bilateral and regional free trade agreement (FTA) talks have surged. Robert Zoellick, the former United States Trade Representative and current US Deputy Secretary of State, referred to this process as one of "competitive liberalization." After the collapse of WTO ministerial negotiations in Cancun, Zoellick famously said that he would henceforth distinguish between what he called the "can do" and the "won't do" countries.

But the rise in the number of bilateral and regional free trade negotiations did not begin only in response to difficulties in WTO negotiations. During the 1990s, there was already a substantial increase in the number of FTAs. While FTAs are being explored by almost all countries, both of the world's major trading blocs, the European Union and the United States, have specifically pursued FTAs with developing countries as a way of demanding concessions and receiving benefits that they have been unable to obtain at the multilateral level.[1]

With the proliferation of FTAs, concern is growing among trade and other experts, academics and civil society about the impact of this new international economic framework. The focus on trade rules in FTAs that often go far beyond what has been accepted in WTO negotiations has put developing countries in a disadvantageous position. The United States has even given implied, and perhaps explicit, threats to developing countries that they would lose trade benefits they currently receive under developing country preference schemes if they did not accept the terms demanded by US negotiators. Furthermore, the increase of FTAs and their systems of preferential treatment imply a departure from a long-standing adherence to nondiscriminatory multilateralism in trade.

Moreover, many of the problems of the multilateral trading system under the WTO are magnified at the bilateral and regional levels. Areas of particular concern include agriculture, intellectual property, services and investment. The implications of these agreements on equity and environmental considerations are also deeply troubling. In addition, the negotiating and dispute settlement procedures of FTAs, as well as the relationship with multilateral trade rules, raise a number of concerns. In sum, free trade agreements are being used as a "divide and conquer" strategy by the major trade powers as a way to gain the greatest concessions possible from their weaker trading partners, particularly developing countries.

[1] Since 2000, the United States has concluded free trade agreement negotiations with Jordan, Chile, Singapore, five Central American countries (El Salvador, Honduras, Nicaragua, Guatemala, and Costa Rica) and the Dominican Republic, Bahrain, Oman and Peru; is engaged in negotiations with Colombia, Ecuador, Thailand, United Arab Emirates, and the five members of the Southern African Customs Union. According to the US Trade Representative, those new and pending FTA partners taken together would constitute America's third largest export market and the sixth largest economy in the world. The United States is also actively pursing potential negotiations with Egypt, Switzerland, Malaysia and Thailand.

Trade Preferences, Conditionality & Negotiations

Developing countries that have been the beneficiaries of special preferential tariff programs from the United States and Europe are increasingly facing a hazardous dilemma posed to them by the developed countries: either negotiate FTAs on terms set by the developed countries, or face the risk of losing their existing levels of market access to those same developed countries. While threats about the possibility of losing preferential treatment have often only been implied, negotiations such as the US-Central America Free Trade Agreement and the US-Andean Free Trade Agreement have revolved around the benefits that the participating countries might lose.

These dynamics involving preferential trading schemes fundamentally undermine the original purpose of these systems and place developing countries at a definite disadvantage. The ability of many developing countries to compete in international markets is constrained by limited access to technology and dependency on a few commodities. In order to enable developing country participation, the earlier General Agreement on Tariffs and Trade (GATT) –now included in the WTO– incorporated certain exceptions to its provisions to permit special benefits for developing countries' products. Such an "enabling clause" allows industrialized countries to import products from developing countries at a lower tariff than otherwise non-discriminatory tariff levels, thereby "enabling" developing country participation. Generally, this "enabling clause" has been implemented via generalized systems of preferences (GSP), unilaterally designed and applied by Northern countries.

Often such preferential schemes have not only failed to adequately consider the developmental needs of the recipient countries, but more recently they have been utilized as leverage and bargaining chips to force developing countries to adopt certain economic policies. For example, the renewals of preference programs such as the Caribbean Basin Initiative and the Andean Trade Preferences Act have been used as leverage by the United States to force developing countries to settle any disputes – *i.e.*, pay compensation– involving U.S. investors in their territories. In addition, developing countries have repeatedly complained that preferential schemes force them to enter into bilateral or regional negotiations with Northern countries in order to maintain the market access related to existing preferences. In exchange for such expected security, developing countries are asked to agree to detrimentally high standards of protection for investment and intellectual property rights, as well as access to services markets in areas including essential services (energy, water, health, education, etc.), infrastructure, and financial services.

Agriculture

Many bilateral and regional free trade agreements include chapters or provisions on agriculture aiming at further liberalizing agricultural markets. As with multilateral talks, negotiations are largely driven by large agribusiness in industrialized countries, causing smaller farmers, especially in developing countries, to lose the most. For example, since the North American Free Trade Agreement (NAFTA) entered into force, subsidized U.S. corn has entered the Mexican market, selling at prices below the cost of production in Mexico, making it impossible for "campesinos" to compete and destroying their livelihoods. An estimated 1.5 million farmers have been forced to leave their land, and the rate of deforestation has increased dramatically in southern Mexico as poor farmers have used forest products to replace lost incomes and have opened up forested areas to expanded fields as a way to compensate for low prices.

Photo courtesy Pope & Talbot Ltd.

While the United States and the European Union are pushing for open markets in goods, services and investment through FTAs, they are generally hesitant to cut subsidies in agricultural sectors important to them or otherwise make substantial reforms to their agricultural systems. With respect to domestic support and export credits and food aid, the United States is taking the approach that these issues should be addressed at the WTO. However, at the WTO, these negotiations are proceeding very slowly and outcomes remain uncertain. Thus, many issues of concern and interest for millions of small-scale farmers dependent on agriculture for their livelihoods are often not addressed in bilateral and regional negotiations.

In the context of agriculture and FTAs, it is worrisome that there seems to be a growing trend for the United States to use bilateral trade agreements as a means to promote biotechnology, without leaving sufficient space for trading partners to adequately regulate biotechnology (science-based, comprehensive and rigorous regulation is necessary to avoid health and environmental risks). For example, the United States has placed pressure on Thailand ever since Thailand considered introducing requirements for the labeling of genetically modified food and placed a moratorium on growing genetically modified crops. Pressure grew with the negotiation of a free trade agreement (FTA) between the United States and Thailand, in which the United States insisted that Thailand allow the growth of genetically modified crops as a condition of an FTA.

Investment

As a result of opposition from developing countries and civil society to the inclusion of investment liberalization provisions in the WTO, negotiations on investment were finally shelved following the WTO Cancun ministerial in 2004. Earlier talks at the Organization for Economic Co-operation and Development failed to create a Multilateral Agreement on Investment. Yet, despite these rejections of investment disciplines at the multilateral level, bilateral and regional free trade agreements are being commonly used as a back-door to negotiate investment liberalization rules.

According to studies such as the World Bank's *Global Economic Prospects 2003* report, there is no empirical evidence that investment rules such as these lead to increased flows of investment to developing countries. Meanwhile, the investment rules found in FTAs restrict the efforts of domestic governments to protect the environment, health, and other areas of the public interest, while failing to adequately address the environmental and social ramifications of rapidly increasing investment. Investment rules may fundamentally compromise the ability of governments to fulfill their social rights obligations, particularly with respect to the rights to health, life, an adequate standard of living, and a healthy environment.

The potency of the investment provisions in FTAs is particularly great because they typically include "Investor-to-State" dispute settlement procedures that allow private business entities to bring claims directly against governments before ad-hoc international tribunals. In these cases, by asserting a violation of any of the broad substantive rights provided to investors, an investor can demand monetary compensation for the impact of governmental actions (including democratically enacted laws and regulations and local government actions) on the business's investment interest. The arbitrators typically are chosen for their expertise in international investment and thus may not have the requisite breadth of backgrounds necessary to consider the important environmental and other public policy questions involved in these cases. In addition, the investment disciplines that apply to the dispute differ from those in the trade portions of RTAs, are vague, and may invite second-guessing of good faith regulatory decisions. Finally, the proceedings themselves lack transparency and the opportunities for public participation appropriate given the nature of the issues involved.

Under NAFTA, for instance, more than 40 cases have been brought against Mexico, Canada and the United States, and both Mexico and Canada have already lost investment cases involving public interest protections. Cases under bilateral investment treaties (BITS) have similarly involved challenges to public interest protections and government actions, including *inter alia* tax, hazardous wastes, fisheries, and public health policies. For instance, Argentina currently faces potential liability in the billions of dollars in more than 20 investment arbitration cases brought by corporations demanding compensation for the impact of the emergency measures that the government took to address its 2001-2 economic crisis. Only one final decision has been rendered as of December 2005, where the tribunal ordered Argentina to pay US$133.2 millions to CMS Gas, a U.S. corporation.

These investment provisions thus pose a threat to democratic governance by allowing foreign companies to completely bypass domestic courts to challenge public interest safeguards. Particularly in developing countries with significant budget constraints, even the threat of expensive arbitration could place a chilling effect on efforts to enact needed laws and regulations and put undue pressure on governments to settle disputes.

A number of overly broad investment provisions included in FTAs could undermine efforts to put in place critical public interest protections, including:

- ***Vague Standards of Treatment*:** Investment rules include a vague standard of "fair and equitable treatment" that is inherently undefinable and invites international tribunals to second-guess government policymakers. In addition, interpretations of the fair and equitable treatment standard that purport to freeze the legal framework where an investment is made pose an obstacle to the development of health, safety, and environmental laws.

- ***Limitations on Policy Tools:*** Restrictions on "performance requirements" will limit developing country governments in efforts to adopt policies that promote linkages between foreign investment and local development. For example, the investment rules prohibit governments from requiring the use of a certain amount of locally produced content. Further, governments are prohibited from making tax reductions or other incentives conditional on investors meeting certain standards, such as local content requirements.

- ***Strict limitations on the Use of Capital and Other Financial Controls*:** Many leading economists and the International Monetary Fund have concluded that capital controls are a policy tool that should be available for developing countries to ensure economic stability. Constraints on such policies, as found in a number of recent FTAs negotiated by the United States, can be harmful to a developing country and ultimately to international financial stability.

- **Intellectual Property as Investment:** The current U.S. model of investment rules explicitly lists "intellectual property" as a form of investment. This means that investors can claim an expropriation of their investment if a government implements the Convention on Biological Diversity and imposes benefit-sharing requirements on the use of traditional knowledge or genetic resources for patented products such as seeds and pharmaceuticals.

Intellectual Property

FTAs increasingly incorporate comprehensive rules on intellectual property that extend significantly beyond the levels of protection established in the multilateral sphere. The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), while providing for far-reaching intellectual property rules, also provides some limited flexibilities that are crucial for developing countries to ensure that intellectual property acts as an effective instrument for sustainable development. Although these flexibilities are frequently difficult to implement, they do include the possibility of using compulsory licensing, of determining the exhaustion regime for intellectual property rights, and of protecting plant varieties through *sui generis* systems. Bilateral and regional intellectual property rules currently being developed, however, erode or even eliminate these flexibilities and seriously threaten countries' room to tailor intellectual property to correspond to their public policy objectives.

In relation to the conservation of biodiversity, for example, Article 27.3 (b) of the TRIPS Agreement allows countries to exclude plants and animals from patentability (except for the important case of microorganisms). Indeed, most commentators, including the Commission on Intellectual Property Rights established by the government of the United Kingdom, have emphasized that developing countries should not require patent protection for plants and animals, given potential restrictions on use of seed by farmers and researchers. Patents on life forms also raise ethical and moral issues for many countries, as well as concerns regarding the impact on biodiversity. Recent free trade agreements negotiated by the United States, however, include provisions obligating Parties to undertake efforts to provide patents for plants. Moreover, these provisions in fact preclude ongoing negotiations at the multilateral level that aim to review Article 27.3 (b) to improve the balance between private and public interests.

In addition, FTAs include a number of other provisions that raise concerns for sustainable development, including:

- ***Public Health and Access to Medicines:*** TRIPS-plus provisions that would undermine public health include: restrictions on the availability of data for clinical trials on drugs; extension of the term of patent protection; postponing the availability of generic medicines; and granting of overly broad patents by relaxing patentability criteria and limited grounds for revocation of patents.

- ***The Applicability of Non-violation Complaints to IP Provisions:*** This issue is still being debated in the Council for TRIPS, with most countries questioning the necessity and desirability of applying these types of complaints to the TRIPS Agreement.

- ***The Lack of a Preamble:*** The absence of a description of the objectives of intellectual property protection in a preamble –usually included in international agreements—and references to the Doha Declaration on the TRIPS Agreement and Public Health may tilt the balance of interpretation towards private rights.

- ***Access to Educational Material:*** TRIPS-plus provisions concerning copyright that would, for instance, undermine access to educational material include: extension of the term of protection; limited exceptions; and the inclusion of legal effective measures against technological circumvention.

Photo courtesy of UNICEF

Services

FTAs are gradually becoming the favored method of negotiating liberalization of services, extending the reach of services liberalization requirement substantially beyond that found in the WTO General Agreement on Trade in Services (GATS). The WTO currently allows developing countries to take on services liberalization commitments to the extent and rate they choose and to adapt the liberalization to suit their condition through the so-called "positive list approach." This means that countries commit only what they include in their respective schedules. FTAs commonly apply the less flexible "negative list approach." According to this approach all sectors are to be liberalized unless exceptions are specified by the country at the time the agreement is concluded, making it more difficult for countries, especially developing ones, to understand and foresee the extent and consequences of their liberalization.

- ***Threats to Policy Space for Development*:** Market access rules prohibit governments – including local or state governments –from establishing quantitative limits or even bans on service operations, including operations such as waste incineration and landfills, hotel construction, construction of pipelines and oil rigs, and major retail store development.

- ***Threats to Public Services:*** Market access rules can also require governments to allow private companies to enter a particular service market, even if public provision by government has been the primary mode for providing that service. This can directly undermine public provision of services in sensitive sectors such as water and health care.

- ***Threats to Policy Space for Development:*** As with investment rules, the "non-discrimination" national treatment provision for services severely restricts the ability of developing countries to promote local service providers. National treatment rules could also conflict with country obligations such as those restricting or banning the importation of hazardous waste.

Moreover, even where a country has made no specific commitments for "services" in the GATS or the services chapter of an FTA, services are actually covered through the side door by far-reaching investor guarantees under investment provisions in FTAs. Some of these provisions include pre-establishment rights that give investors access to foreign services markets.

Finally, problems identified at the multilateral level regarding the liberalization of essential services, such as water supply and health care, for example, are amplified at the bilateral level, where the negotiating powers of developing countries are particularly weak. The potentially negative implications of liberalization and possible privatization of essential public services are especially important in countries where domestic regulatory frameworks are weak.

Photo courtesy DSM Environmental Services, Inc.

Environmental Provisions

Free trade agreements can undisputedly have harmful effects on the environment. Increased trade promoted through FTAs, particularly in sectors such as forestry, agriculture and mining, can have serious ecological impacts. Moreover, concerns have arisen over countries that may be enticed to lower or freeze their environmental and other standards in order to attract foreign investment. When these effects are combined with trade and investment provisions in FTAs that inhibit governments from taking appropriate action to protect the environment, natural resources and health, the negative impacts of trade agreements can be substantial.

With these concerns in mind, and due to pressure by civil society, parties to FTAs have included environmental provisions in some FTAs. As a result, environmental considerations have often been reflected to a greater degree in certain FTAs than under the multilateral trading system. These environmental provisions in FTAs have sometimes included the creation of new institutions such as the Commission for Environmental Cooperation formed under a side agreement to NAFTA to examine claims that a party is failing to enforce its environmental laws. Similarly, recent FTAs negotiated with the United States or Canada integrate environmental and labor issues into their respective FTAs or side agreements, in part based on the NAFTA model.

Yet there are substantial gaps and loopholes in these environmental provisions. For the most part, environmental rules in FTAs have been focused on requiring governments to enforce already existing

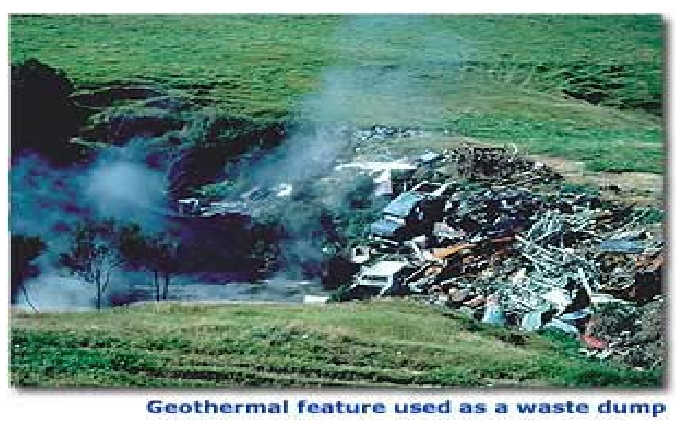

Photo courtesy of Environment Waikato

laws. The need to ensure that governments – in both developed and developing countries – improve and do not reduce their levels of environmental protection has not been addressed through mandatory and justifiable provisions. Perhaps most important, environmental provisions in FTAs have not required that countries adopt or implement critically needed multilateral environmental and sustainability agreements, including agreements on hazardous waste transport (Basel Convention), biological diversity (Convention on Biological Diversity and Biosafety Protocol), and transparency concerning environmental impacts (Protocol on Pollutant Release and Transfer Registers). These gaps amplify the environmental impacts that result from both the increase and the changing patterns of trade and investment.

Dispute Settlement

FTAs often include mandatory, binding, enforceable dispute settlement procedures, usually in the form of ad hoc arbitration. In these arbitrations, trade arbitrators are often called to decide important public policy issues. While it would seem warranted for citizens to know about these processes given the public policy implications, a cursory review of these processes reveals a major lack of transparency and public participation. These deficiencies need to be addressed strategically and systematically.

While FTAs generally provide for the settlement of disputes between states, many FTAs that contain investment provisions give foreign investors a direct right of action against the host country (as described above). In the past decade, individual investors have aggressively argued for expansive interpretations of the investment rules since they are not constrained, as governments are, by the possible downside of overly aggressive litigation, which could boomerang for governments acting against one another. As a result, the investor-to-state dispute mechanism is likely the single most powerful element of international dispute settlement and a central driver for a flawed approach to managing international investment flows.

Most notably, the dispute settlement mechanism is built on secretive commercial arbitration procedures rules, which were not destined to address public policy issues. Civil society groups are actively pursuing the reform of the procedural rules to make them more transparent and to increase public participation.

Conclusion

The international economic landscape is rapidly changing as a result of proliferating regional and bilateral trade agreements, posing significant challenges to sustainable development. The United States and the European Union have increasingly chosen to negotiate FTAs, where their political and economic muscle allows them to obtain concessions from developing countries that they cannot obtain at the WTO. In exchange for potential, though generally limited, gains resulting from increased access to Northern markets, or to avoid losing their benefits under general systems of preferences, often developing countries are forced to bind themselves to disciplines that compromise their ability to pursue sustainable development.

FOR FURTHER DISCUSSION ON THE TOPICS ADDRESSED HEREIN, PLEASE CONTACT:

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