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THE TIES THAT BIND? REGIONALISM, COMMERCIAL TREATIES AND THE FUTURE OF GLOBAL ECONOMIC INTEGRATION

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INTRODUCTION

A revolutionary shift in international cooperation is currently underway. Many governments, frustrated with dissension hampering multilateral trade reform at the World Trade Organization, are now turning to bilateral and regional treaties to forward their commercial interests.¹ Under these agreements, which rocketed from fewer than 350

¹ This shift, though having escaped thorough and sustained attention from the legal academy, has been followed closely in the U.S. print media. See generally, Tom Wright, Trade Focus Now Shifts to Regional Deals, N.Y. Times, July 26, 2006; Constant Brand, EU Forges Ahead With Free Trade Plans, Houston Chronicle, May 13, 2006; Edwin Chen, Bush Keeps Campaigning for Free Trade, L.A. Times, Nov. 7, 2005; David Greising & Andrew Martin, U.S. to Pursue Regional, Individual Trade Talks, Chi. Trib., Sept. 14, 2003. Foreign media, too, have directed considerable resources charting the shift in treaty-making. For just a sampling, see
in 1990 to over 2,400 today,² states have relinquished key aspects of their economic sovereignty to participate in two-party pacts and regional trade clubs like the North American Free Trade Agreement and the European Union. Through such cooperation, most countries may no longer easily levy tariffs, subsidize their domestic industries, or expropriate foreign investment without compensation. Instead, states are increasingly bound by what some commentators describe as a “spaghetti bowl”³ of side arrangements and special commitments that restrict their ability to extract rents from participants in their economic alliances.

Though academics have occasionally discussed whether regional and bilateral instruments threaten the hegemony of the multilateral trading system, no attention has been paid to equally fundamental and far-reaching tensions arising between regional and bilateral agreements themselves. Scholars have instead almost universally treated bilateral and regional agreements as functionally indistinguishable. This article argues, however, that bilateral instruments comprise a distinct and important mode of cooperation that at times operates inconsistently with the aims of some regional organizations and their members. Besides seriously undermining the collective bargaining efforts of regional organizations, bilateral agreements potentially alter the economic relations between an organization’s powerful and weaker members. Generally, big countries in regional organizations are positioned to craft internal and external regional policies that protect their own sensitive markets while liberalizing those of other smaller members. Bilateralism unsettles this arrangement by at times granting smaller states opportunities to leverage relationships with outsiders and liberalize their markets on terms more favorable than those available regionally.


The conflict between overlapping bilateral and regional regimes, what the article refers to as “structural inconsistency,” carries substantial implications for international economic law. Unlike bilateral treaties, which as nondiscriminatory arrangements are not designed to keep counterparties from signing future agreements with other parties, regional treaties are at times exclusive arrangements that foreclose independent economic commitments with non-member states. In doing so, regional agreements keep members from maximizing their own welfare—as well as that of the region as a whole. This insight suggests that regional treaties hold implications for efficiency in bilateral settings that are potentially as far reaching as regionalism’s impact on multilateral forums, where regional institutions often stymie efforts to initiate broad global reforms.

The article is organized as follows. Part I begins by examining the principal theoretical arguments regarding the implications regional organizations (frequently referred to in the literature as regional integration arrangements or “RIAs”) have for international economic discipline. It argues that the conventional terms of academic debate center on the comparative merits of regionalism and multilateralism, and in doing so overlook the most common form of international cooperation—bilateralism. Examining the most common bilateral commercial agreements—bilateral investment treaties and free trade agreements—the article argues that bilateralism challenges the traditional terms of that debate by expanding the universe of possible forms of economic cooperation and integration to include two-party arrangements. In such formats, the kinds of bargains struck often differ from multiparty contexts. Faced in a bilateral negotiation with more concrete gains than multiparty deals may provide, and yet without coalitions and credible hold out opportunities to eke out more benefits from counterparties, many capital hungry states will in bilateral negotiations often cede more benefits to counterparties than in regional arrangements. However, because RIAs increasingly govern the economic relations of their members with third party states, such concessions may prove unacceptable, especially where a lucrative bilateral agreement is concluded between a member state and a rival to the RIA. RIAs or other members may demand in response the termination or amendment of the bilateral accord.

To provide an empirical grounding for these claims, Part II considers several instances in which structural inconsistency has dramatically informed the interaction between bilateral and regional cooperative regimes. The first case study examines the European Community’s demand of its accession candidates in 2004 that they terminate their U.S. bilateral investment treaties as a precondition for accession. In documenting important policy discrepancies between the BITs and EC law, it addresses structural inconsistency in what this article describes as “closed” RIAs—that is, those regional institutions that formally bar or restrict member states from entering into independent bilateral
agreements.\footnote{This language is largely adapted from conventional debates on the usefulness of RIAs in the multilateral context, where scholars largely define “open” regionalism as that which extends the terms and benefits of regional integration to the rest of the world and “closed” regionalism that locks in special benefits for members.} The second case study features Venezuela’s attempts to use the regional norms of the Andean Community and Mercosur, South America’s largest regional organizations, to obstruct its regional partners from entering into bilateral trade agreements with the United States. In doing so, it illustrates the significant political obstacles to bilateral cooperation present in even “open” RIAs that grant members liberty to fashion their own economic foreign policies. It also demonstrates the serious organizational spillovers that the political dynamics in one RIA may have for the development of other (closed \textit{and} open) RIAs.

Part III draws upon the case studies to argue that regional integration poses challenges to efficiency in bilateral contexts that are potentially as significant as regionalism’s impact on the World Trade Organization, where RIAs often obstruct multilateral liberalization efforts. It shows that in undermining bilateral treaties promoting free trade, regionalism imposes negative net effects on global efficiency. And even where regional integration provides net benefits to RIA members as a group, it is likely that these gains will not be distributed evenly. Big countries will generally benefit more than small ones, and due to their size likely block measures to more evenly allocate gains. Similarly, early members to RIAs may benefit more from membership than latecomers. Consequently, for such strategically disadvantaged countries, bilateral agreements may provide more benefits than some regional programs. In such circumstances, states will generally be enticed to defect from regional commitments—though not all countries will be equally positioned to do so. Rational choice theory suggests, along with the practicalities of regional politics, that it will be generally more difficult for small countries to retreat from unproductive regional commitments than their larger neighbors since they likely depend more on strong reputations within the group to effectuate policy goals. The article thus concludes that the larger a country is, the better positioned it will be to not only write regional rules benefiting themselves—thereby spurring the structural inconsistency problem—but to also defect from regional rules if and when better bilateral deals present themselves.

I. INTEGRATION AND ECONOMIC DISCIPLINE

A. Regionalism—and Whether Second Best is Really Optimal

Multilateral economic integration, embodied most comprehensively in the World Trade Organization, has long enjoyed premier status in the
literature on global economic discipline. Many scholars, united by a common commitment to core principles like nondiscrimination, have argued that worldwide liberalization increases global welfare by breaking down unproductive national barriers to more efficient providers of goods and services. Resources, in short, will find their best and most economically productive use. Proponents of multilateral trading thus argue that it is thus of paramount importance to promote economic reform as broadly and amongst as many countries as possible. Where countries refrain from applying discriminatory taxes and policies to imports, competition is maximized, and consumers around the world can enjoy optimal prices and an efficient allocation of resources.

The expansion of the multilateral trading system suggests that many countries agree at least in part with such views. Since its inauguration in 1994, the World Trade Organization (“WTO”) has increased its membership from 128 states to just under 150 members today. This growth, accompanied by new rounds of tariff reduction, has heralded a vigorous multilateral framework facilitating the free flow of goods and the equal treatment (or “nondiscrimination”) of foreign capital and goods.

Still, for all the WTO’s growth, multilateralism has not been the dominant font on which recent plurilateral economic reform has been realized. Instead, regional organizations have witnessed the most impressive growth over the last two decades—with the near doubling of market representation under the European Community and the Association of South East Asian Nations (“ASEAN”) and the creation of nearly 20 RIAs, including South America’s largest, Mercosur. Under these more geographically limited pacts—which escape the WTO’s general obligation of nondiscrimination and now facilitate nearly one third of world trade—select (usually neighboring) member states pledge to adopt common legal rules or principles regarding, at a minimum, the preferential treatment of goods from other members of the organization. Signatories to regional organizations agree to certain obligations such as most-favored nation treatment (“MFN”), whereby a state accords to a counterparty the same favorable terms it offers in agreements with other nations, and national treatment, in which countries afforded one another’s nationals the same benefits and treatment they afford their own. Some RIAs like the European Union go further to also address policies concerning investment and services, and NAFTA and CAFTA grant one another’s investors standing to sue countries where a state fails to live up to their treaty commitments. Thus if a member state decides to discriminate against a foreign investor, that investor, if a citizen of an

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5 World Trade Organization, Members and Observers, http://www.wto.org/English/thewto_e/whatis_e/tif_e/org6_e.htm (noting that were 149 members as of December 11, 2005).

6 Maurice Schiff & Alan Winters, Regional Integration and Development, 1 (2003). See also infra note 17 (describing the WTO rules permitting RIAs).
RIA member state, would be able to compel arbitration with the host state government in order to attain compensation.

The surge in RIA popularity is in part attributable to the limitations of global reform initiatives. The failed efforts of the Organization for Economic Cooperation and Development, an international organization comprised of wealthy industrialized countries, to realize a worldwide agreement on investment in 1998, legitimized the then recently completed NAFTA and other burgeoning regional initiatives addressing investment. Similarly, the persistent inability of the WTO in achieving consensus amongst its members as to trade reform—demonstrated most recently in the breakdown of the organization’s Doha Round of trade talks—has led many countries to set upon more narrow paths of consensus building for which RIAs are increasingly key.7 Because many governments are more familiar with (and at times similar to) their neighbors than far-flung multilateral interlocutors, RIAs are increasingly viewed as superior forums for promoting liberalization along terms commensurate with their national interests. Administrators of RIAs, cognizant of the trend, have further situated RIAs as initial points of departure for regional policymaking and even negotiations with third party countries seeking to affect multilateral liberalization through a gradual series of regional agreements.8 In doing so, developing countries in particular have been attracted to RIAs as a means of enhancing their collective voice and improving their ability to articulate their interests with outsiders.

Regional integration is also a response to what many political elites view to be the apparent success of the European Union, which has created a powerful and prosperous single market through the harmonization of its commercial policy. With the rapid advance of developing countries in the world economy, as well as intensifying pressures to seek ever greater efficiencies for their domestic firms,

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7 The Doha round was launched in Doha, Qatar, in 2001, to lower trade barriers around the world while accelerating the participation of least-developed countries in the global economy. Particular emphasis was placed on lowering tariff barriers and subsidies concerning agricultural goods, a policy that met significant resistance by both the United States and the EU. Ultimately, in July 2006 parties failed to reach an agreement on the matter, resulting in the formal suspension of trade talks. For an account of the various interests involved in the round’s collapse, see generally Peter Sutherland, The Doha Debacle, Wall Street Journal, August 2, 2006, at A10, available at http://www.eviangroup.org/p/1326.pdf.

8 In order to restart the process, the WTO has initiated efforts at “quiet diplomacy” in which WTO officials coordinate informal discussions with government officials and lawmakers of the organization’s various members. According to the WTO, full-fledged negotiations will only come when members “put numbers to the flexibilities they have already expressed in general terms on key issues.” Director-General’s remarks at the informal TNC, 16 November 2006, http://www.wto.org/english/news_e/news06_e/tnc_dg_stat_16nov06_e.htm.
governments have embraced regional integration as a means of ensuring, like the EC member states, both international relevance and enhanced economies of scale.\(^9\)

Of course, the swath and degree of integration espoused by RIAs varies widely. In some institutions like the African Union and Mercosur, regional integration comprises increasingly centralized and interventionist capacity building in a range of important sectors.\(^{10}\) Other
RIAs, in contrast, involve much more minimalist policymaking frameworks. The U.S.-led free trade agreements NAFTA and CAFTA, in particular, exhibit few institutional organs with policymaking authority, and the prospect of deepening integration remains dubious (though even here, as seen in CAFTA’s WTO coordination provisions, some political polities are created with potentially expanding authority). Still, the process in which all countries are embracing some form of regional consolidation has made tremendous strides and shows few signs of slowing. Nearly every country belongs to at least one of such blocs, and the scope of the alliances increasingly extends beyond trade to include cooperation in such areas as investment, competition, domestic regulation and policies, standards and even foreign policy.\textsuperscript{11}

RIAs nevertheless comprise a hotly contested issue in the literature on international economics\textsuperscript{12} despite their popularity with national governments as many scholars consider them to be, at best, a “second best” option to global multilateralism.\textsuperscript{13} For these critics, three possible worlds exist. The first is a world of ubiquitous tariffs, one in which no free trade exists. In such a world, trade distortions such as tariffs and subsidies reduce global welfare, raise costs of imports, and inefficiently allocate capital. An alternative to this framework is what can be described as the regionalized world, where existing members to an RIA agree upon lowered trade barriers among themselves, and, in the case of a customs union, uniform tariffs regarding non-members. In this regionalized scenario (the status quo), members reap the benefits of cheaper goods, information spillovers from other investor states, more efficient specialization and the opportunity to industrialize behind protective borders. The third option is multilateralism in which all states join global agreements in which tariffs are removed against any country that wishes to participate. Thus according to this view, regionalism presents a better alternative to tariffs, though is not as attractive as multilateralism. In a world of open multilateral free trade, global participation would fully facilitate consumer choice and maximize the developed a sophisticated legal architecture with harmonizing powers far beyond those provided by many other RIAs.

\textsuperscript{11} Id.

\textsuperscript{12} See Schiff & Winters, supra note 6, at 10 (discussing the lack of consistency in the vast range of empirical results regarding the merits of regionalism). For more on the reasons behind the debate, see infra note 26 and accompanying text.

\textsuperscript{13} See Regionalism, http://web.worldbank.org (follow “topics” hyperlink; then follow “Trade Topics” hyperlink; then follow “Regionalism Research” hyperlink; then follow “Regionalism” hyperlink); see also Ken Heydon, After Cancun, the Danger of Second Best, OECD Observer (December 2003), available at http://www.oecдобservation.org/news/fullstory.php/aid/1180 (posing a “serious weakening” of the multilateral trade system since regionalism often entails “two-speed liberalisation” and “opt-outs” to open global trade, thereby creating vested interests that will make global free trade “even more difficult than it already is”).
competition producers face creating efficiency gains. However, in a regionalized world, only members in an RIA are able to participate in the liberalized trade. Regionalism is thus a necessarily limited form of globalization, proffering only limited benefits and efficiency gains, as outsiders to the RIA are excluded from participation.

A harsher version of this argument contends that regionalism is not only a less desirable form of economic cooperation, but also a “stumbling block” to achieving multilateral free trade. RIAs, it is argued, eventually cause a reduction in aggregate global welfare as they compete with both non-member states and other RIAs and retain or raise higher tariffs against outsiders. As political configurations, RIAs fight for, and receive, exceptions in multilateral frameworks like the WTO from most favored nation clauses as pertaining to benefits granted to its members, thereby softening the move towards fully comprehensive arrangements. Global welfare is thereby diminished because RIA member products are at least partially protected irrespective of whether they are of the same quality or their industries are as efficient as those of their non-member counterparts. Consequently, the argument goes, RIAs do not so much “create” trade by allowing cheaper products from bloc partners to substitute for more expensive domestic production. Instead, they “divert” trade by substituting intra-bloc imports for what would otherwise be imports from outside the group. The gains RIAs provide

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14 Schiff & Winters, supra note 6, at 23-25.
15 For another summary of the stumbling block thesis, see Sunjoon Cho, Breaking the Barrier Between Regionalism and Multilateralism: A New Perspective on Trade Regionalism, 42 Harv. Int’l L.J. 419, 430.
16 Id.
17 Specifically, as customs unions RIAs comprise the main exception to the MFN principle. WTO rules allow countries in RIAs to afford one another preferential treatment, so long as the RIA meets certain conditions. The specific exception is memorialized under Article XXIV of the General Agreement on Tariffs and Trade, Oct. 30, 1947 61 Stat. A-11, 55 U.N.T.S. 194 hereinafter GATT. Id. Namely, they must not on the whole raise protection against excluded countries; they must reduce internal trade tariffs to zero and remove “other restrictive regulations of commerce” other than those justified by other GATT articles; and they must cover “substantially all trade.” Though these requirements are not in themselves easy to realize, countries that have undergone regional integration may view further competition as undesirable, and thus find the RIA exception an attractive option. Jamie de Melo, Regionalism and Developing Countries: A Primer (Apr. 7, 2004) (unpublished manuscript), available at http://www.unige.ch/ses/ecopo/demelo/Cdrom/RIA/Readings/demelo_RP.pdf.
18 See Schiff & Winters, supra note 6, at 33 (noting that the concepts of trade creation and diversion continue to dominate the discussion of RIAs). This scenario would arise where, for example, goods from outside the regional bloc would be cheaper if all suppliers faced the same tariffs, though the fact that goods from a member state inside the bloc no longer face tariffs, the member states are granted a
internally to members are outweighed by distortions they cause in the global trading system.\textsuperscript{19} 

Drawing upon the same tripartite vision of the world, other academics view regionalism as a valuable liberalizing force in the world. Along the lines of the “building block” argument, regionalism paves the way to a multilateral consensus by initially organizing protectionist states into free-trade associations and breaking down many long-held market distortions. The argument goes that RIAs not only condition states to liberalization, making members more amenable to true multilateral trade, but they also become amenable to true multilateral trade. Some commentators have additionally argued that even after the establishment of multilateral agreements, regional initiatives often work to establish rules not yet covered through multilateral platforms.\textsuperscript{20} Regional agreements involve a more finite number of players and interests, reducing the costs of negotiation and making agreement easier to reach—even pertaining to areas such as monetary policy and investment, which are harder to negotiate multilaterally.\textsuperscript{21} Once agreements are reached, they often influence the multilateral system, either by example or where RIA members push through the force of collective action for more liberal sectoral reforms.\textsuperscript{22} Also citing the WTO as an example, these arguments point out the WTO agenda has expanded since its inception to include new and more far-reaching rules along the lines of RIA provisions.\textsuperscript{23} Consequently, RIAs function as valuable policy transfer mechanisms.\textsuperscript{24} Though perhaps formally “second best” options, they are in practice an important, and perhaps necessary, means to more optimal multilateral forms of open free trade.

competitive edge. In such a circumstance, the importing, preference-granting country absorbs increased costs, reducing marginal levels of efficiency. These increased costs will likely consist of more than just a wealth transfer from consumers in the taxing state to the exporting state. Because the real cost of imports has risen insofar as the exporter is less efficient than the non-member state competitor, real resources are wasted by the diversion. \textit{Id.} at 12. For a more recent critical account, noting how the potentially beneficial (i.e. competitive) effects of regionalism are often subverted, creating trade diversion, see Schiff & Winters, \textit{supra} note 6.

\textsuperscript{19} \textit{Id.}


\textsuperscript{21} Schiff & Winters, \textit{supra} note 6, at 113 (“RIAs allow countries to make commitments in more areas than can be done multilaterally.”).

\textsuperscript{22} Lucian Cernat & Sam Laird, North, South, East, West: What’s the Best? Modern RTAs and their Implications for the Stability of Trade Policy \textit{in} Can Regional Integration Arrangements Enforce Trade Discipline? 73 (Zdenek Drabek ed., 2005).

\textsuperscript{23} \textit{Id.}

\textsuperscript{24} \textit{Id.}
An end to the debate is unlikely—if for no other reason than that identifying and distinguishing between trade creation and trade diversion is not empirically straightforward insofar as it requires divining what trade would have looked like if no RIA had been formed as well as the direction regionalism will eventually lead. Consequently, it is nearly impossible to gauge the respective benefits and costs of the phenomenon. Commentators do, however, agree as to what are considered the immediate salutary effects of what are referred to as “deeply integrated” or “deep regional” economic blocs, which are dominated by the effects of the members states’ reduction of barriers against imports that often accompany imports from outsiders. Deep regionalism is generally referred to as a kind of integration that moves beyond tariff or market integration provided in the form of free trade areas or custom unions to encompass broad objectives such as competitive government procurement, technological and scientific cooperation, common competition policies, and monetary integration. Generally speaking, economists expect deep integration to proffer forms of institutional cooperation throughout member states that provide incentives to adhere to economic liberalization. Deep integration requires, for example, forms of fiscal discipline—such as inflation targeting, exchange rate anchors, and debt controls—that minimize the incentives of countries to directly and indirectly limit trade. Furthermore, deep integration leads to improved governance and transparency as members adopt common rules on corporate behavior, trade, investment and other commercial matters. With the imposition of more unitary legal structures and enforcement mechanisms characteristic of deep regionalism, along with higher levels of political commitments by states to the objectives of integration, the benefits of such cooperation are argued to be apparent in both regional and multilateral settings.

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25 See De Melo, supra note 17, at 5 (noting that “it is not clear what kind of agricultural policy would have emerged in the absence of European integration” making the topic of regionalism “contentious”).
26 This is largely due, perhaps to the fact that “in recent years, both multilateralism and regionalism evolved to go beyond tariffs or non-tariff border measures ... to become an essential feature of both multilateral globalization and regionalization.” Cernat & Laird, supra note 22, at 74.
27 Drabek, supra note 20, at 57.
28 Id. According to most economists, deep integration provides “scale and competition gains” relevant to either context, even though it involves “far more complex policymaking than would a looser free trade agreement.” De Melo, supra note 17, at 9.
29 Id.
B. Why Bilateral Treaties Matter—and Don’t Mix

The conventional debate on the utility of regionalism is useful insofar as it highlights the once neglected tension between, and challenges facing, regional and multilateral systems of economic cooperation. Nevertheless, the descriptive theories promoted by both critics and proponents of regionalism overlook a third crucial form of economic cooperation and liberalization between states—bilateralism—and with it the implications regionalism holds for bilateral instruments and alliances.31

The failure to comprehensively address bilateralism is in many regards surprising given the increasing frequency to which states resort to bilateral deals. Especially popular have been bilateral investment treaties (BITs), of which over 2,265 have been signed since 1989, and bilateral free trade agreements (BFTAs), whose aggregate numbers have more than doubled in the last fifteen years to more than 150 today.33 Like RIAs, these bilateral agreements regulate the treatment of goods and capital between states through a series of MFN and national treatment commitments between signatories—though each covers only a slice of the various economic sectors covered by RIAs. BITs on the one hand regulate the treatment of investment, and like some RIAs allow investors to sue signatories where a party expropriates the assets of a

31 Though virtually nothing has been done on the relationship between bilateralism and regionalism, a good deal of work has centered on the implications bilateralism holds for multilateral institutions. Perhaps most groundbreaking work has concerned what some scholars describe as “nested bilateralism”—the use by governments of bilateral agreements within larger multilateral frameworks to, amongst other things, forward multilateral objectives (particularly liberalization). According to proponents in this field, bilateral agreements can “substitute for multilateral treaties, with new bilateral understandings replacing those earlier multilateral goals and outcomes.” See John P. Willerton et al., Complex Security Institutions: Nested Bilateralism in Commonwealth of Independent States, paper presented at Shambaugh/TRAG Conference, “Building Synergies: Institutions and Cooperation in World Politics” Iowa City, Iowa, Oct. 12-14, p. 2. Here, too, however, scholars collapse regionalism and multilateralism under one term—here “multilateralism”—and in doing so again fail to chart a clear conceptual path for the study of the (at times dissonant) interaction of bilateralism and regional integration.

32 Besides commercial agreements like trade and investment treaties, tax treaties, not to mention commitments relating to extradition, judicial assistance, and even drug control, are all routinely executed on a bilateral basis.

33 United Nations Center on Trade and Development, BITs Database, http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3150&lang=1 (indicating the aggregate number of BITs in place in both 1989 and 2003); see also http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3150&lang=1 (providing a chart indicating number of regional and bilateral trade agreements registered with the WTO).
foreign investor. BFTAs, in contrast, though at times addressing investment (particularly in the absence of a BIT), generally govern the treatment of goods and thus memorialize matters of tariff application and enforcement. Both instruments reduce risk for exporters of goods and capital and signal to investors—at times at great costs to host states—a transparent and predictable regime for the treatment of foreign capital and goods. They are also designed to realize even lower negotiation costs than RIAs since only two parties’ interests must be accounted for, often in only very limited sectors bilateral instruments do not require or seek deep political cooperation between parties, but are almost entirely economic in their objectives. Due in part to their simplicity, BITs and BFTAs have come to comprise some of the most popular legal mechanisms for promoting economic discipline as states and firms have sought to achieve greater efficiencies and economies of scale.

Everybody’s Up To Something: A Sampling of Participation In International Trade and Investment Agreements

<table>
<thead>
<tr>
<th>Country</th>
<th>WTO?</th>
<th>RIAs</th>
<th>BITs</th>
<th>BFTAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
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<td>2, (2*)</td>
<td>39 (3)</td>
<td>13, (19)</td>
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<td>EU</td>
<td>Yes</td>
<td>0, (9*)</td>
<td>0</td>
<td>14, (5)</td>
</tr>
<tr>
<td>Mexico</td>
<td>Yes</td>
<td>7</td>
<td>12</td>
<td>8, (1)</td>
</tr>
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<td>Japan</td>
<td>Yes</td>
<td>1*, (2)</td>
<td>11</td>
<td>4, (8)</td>
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<tr>
<td>Singapore</td>
<td>Yes</td>
<td>3*</td>
<td>21</td>
<td>7, (12)</td>
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<tr>
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<td>5*</td>
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<td>0</td>
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<td>3*, (1)</td>
<td>72</td>
<td>18, (1)</td>
</tr>
</tbody>
</table>

Sources: Tuck School of Business Trade Agreements Database, UNCTAD and Bilaterals.org

One plausible explanation for the literature’s lacuna is its inability to distinguish bilateralism as a mode of international cooperation distinct

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34 The above table includes treaties that have not yet been notified to the WTO. Parentheses “( )” indicate for RIAs and BFTAs the number of agreements currently under negotiation. Stars “*” indicate that at least 1 (and at most 3) of the referenced treaties do not involve membership in an RIA, but a country’s liberalization agreement with an RIA.
from regionalism. At the WTO, for example, bilateral BFTAs are alongside regional accords officially classified as “regional trade agreements.”35 BITs and BFTAs are furthermore routinely identified in the economics literature as sub-variants of regionalism due to their similar legal mechanics and insofar as many of their provisions have been incorporated into recent regional agreements like NAFTA and CAFTA.36 Indeed, it was not until this year that scholars began to conceptualize multiple levels of rule-making and the implications it may have for economic discipline.

Bilateral agreements are also periodically overlooked as independent governance mechanisms because at least ostensibly they comprise comparatively less effective means of achieving international economic discipline than broader platforms. Bilateral agreements generally have more limited scope than multilateral arrangements. As a result, some economists characterize them as “shallow” instruments of integration with limited utility for systems of international economic governance.37 Both of these views are, however, largely inaccurate. For all of the similarities bilateral agreements may have with some RIAs, by definition they expand the possibilities of the forms of economic cooperation and integration to include dyadic arrangements. This is an important point since in many agreements the two parties have unequal bargaining power: one party is usually from a developed country (the investor country), whereas the other is typically a developing country (acting as the capital-seeking host state).38 According to classical negotiation theory, in a two-party negotiation, the decision rule is simple—where both parties fail to agree, there is an impasse.39 Thus under multilateral frameworks, subsets of negotiation parties—often groups similarly situated or otherwise aligned developing countries—unite in coalitions to buffer or indirectly promote the interests of capital importing states.40 In

36 See id. at 15 (describing BITs as “early RIAs” that were “activist and interventionist”).
37 Schiff & Winters, supra note 6, at 10d.
38 For a comprehensive analysis of this dynamic, see Elkins et al., Competing for Capital, The Diffusion of Bilateral Investment Treaties, 1960-2000, available at SSRN: http://ssrn.com/abstract=578961, at 7 (discussing how generally BITs have been primarily “agreements between countries of starkly varying property rights traditions and resources”). This trend has, however, begun to change as an increasing number of bilateral investment treaties have been formed between developing countries. See List of Parties to Bilateral Investment Treaties, http://www.worldbank.org/icsid/treaties/intro.htm.
40 Of course, developed states too may impede the multilateral liberalization, especially where they fear the application of liberalization as applied to their own
bilateral environments, however, host state governments, left without the opportunity to form coalitions, have to cede more export-friendly protections than would be available multilaterally. If host states hold out, they stand to lose more than their developed counterparty. Consequently, BFTAs and BITs provide stronger, distinguishable means of economic liberalization than under regional and multilateral frameworks.

Bilateral instruments additionally refine dominant conceptions of the relationship between different levels of integration. Studies that have examined the diversionary aspects of RIAs focus, as noted above, exclusively on the compatibility of multilateral and regional systems and the problematic provision of exceptions in multilateral systems like the WTO for regional alliances that do not always espouse free trade. BITs and BFTAs further problematize some economic effects of RIAs by making possible additional avenues for obstructing market liberalization.

industries. This was the case, for example, in the failed OECD-sponsored Multilateral Agreement on Investment. In this agreement, not only did developing countries have problems with various formulations that they thought would impede national sovereignty and regulatory prerogatives, but also Canada and France objected to the measures out of a fear that an unrestricted capital market would potentially lead to swamping of their cultural industries by the U.S. entertainment industry—as will be seen below, a recurring issue in multilateral forums. See M. Sornarajah, The International Law on Foreign Investment, 292 (2004); see also discussion of E.U. protection of audio-visual services infra notes 67-70 and accompanying text.

Indeed, from the U.S. perspective, many advocates of BITs view the agreements as a kind of foreign aid. This is not to say, however, that all host-states, particularly quickly developing ones, enter into BITs. Particularly in Asia, successive rounds of treaty negotiations between the U.S. emerging economies in the region have ended in failure. These states distinguish themselves from many LDCs insofar as they “are sophisticated and independent enough to resist a U.S. dictation of terms.” Michael R. Reading, The Bilateral Investment Treaty in ASEAN, 42 Duke L.J., 679, 691 (1992). Still, their economic models do not allow them to adopt more open investment policies.

By way of example, only two RIAs—the North American Free Trade Agreement and the Central American Free Trade Agreement—provide for unilateral dispute resolution against the host state at the insistence of the foreign investor where a cause of action arises, a common feature of many BITs. Furthermore, other RIAs such as ASEAN that do directly regulate investment even amongst its members do not provide other common features of U.S. BITs like the inclusion of portfolio investment under the definition of “investment” or the pre-establishment of national treatment of foreign investment. Id. at 700. Because of the relative strength of BITs, they have been the preferred instrument of the United States, and even in multilateral negotiations such as the MAI, the U.S. government has striven to make clear that BITs would continue to be in effect.

See, e.g., Schiff & Winters, supra note 6, and Cho, supra note 15.
RIAs, especially deeply integrated ones, generally provide a greater scope or array of liberalizing programs and initiatives than bilateral trade and investment treaties. RIAs, as mentioned above, often cover trade and investment, and may provide for additional liberalization coordination in other sectors like services, intellectual property and tax. Still, because of both the more finite number of interests and the at times uneven negotiation leverage, bilateral instruments often provide greater depth as to the commitments to investor protections they entail. For example, like many regional frameworks, bilateral agreements may adhere to principles such as MFN and national treatment; they may do so, however, more comprehensively than some RIAs, and apply the standard to all stages and sectors of investment. In providing at times greater depth, bilateral agreements differentiate relationally from RIAs in a way unlike that of RIAs vis-à-vis multilateral regimes. RIAs, in short, are often more protectionist than multilateral initiatives like the WTO; bilateral investment and trade instruments, on the other hand, despite comprising disaggregated commitments involving fewer players, are often more liberal than their regional counterparts.

Importantly, bilateral instruments may further contrast with regional objectives even where RIAs provide comparable benefits to bilateral arrangements, as they might still conflict with the political objectives of RIAs or their member states. History, as well as classical and neo-functional theories on trade, suggests that plurilateral integration by states in one sector often necessitates or drives further action, often political, in related ones (such as investment). These spillovers push international bureaucratic organizations, including RIAs, to take on political identities. For example, in the EC, what was originally a customs union moved to create an internal market in which the free movement of goods and eventually services between member states would be envisioned along with protectionist polices applied against outsiders. Common trade policy then led to deeper financial integration and monetary union. And under the framework provided by economic integration, shared concerns regarding security and globalization lead to integration in other sectors, often with the explicit aim of establishing Europe at the forefront of international politics. Such a trajectory, notably, is not confined to Europe, and many RIAs such as the African Union and Mercosur have adopted socio-political institutions and

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45 See the EC’s FDI investment framework, discussed in Part II, as well as remarks on ASEAN, supra note 39—confirm in text and accompanying text.
47 Id.
49 See Schiff & Winters, supra note 6, at 7-9 (listing explicitly stated objectives for regionalism by politicians and in investment instruments themselves).
agendas with advanced strategic interests and often considerable sophistication.50

The theoretical point is that in the face of regional political integration, bilateral instruments—particularly those crafted between members or aspiring members of RIAs and third countries (“outsiders”)—may not respond to, or even consider, regional political expectations or legal requirements. Unlike RIAs which often double as customs unions, cultural alliances and economic clubs, bilateral instruments are not designed to keep non-participants out, and are anything but exclusive arrangements. Instead, they create open, nondiscriminatory policies, and allow any non-participant, even potential rivals to RIAs and member states, to enter into similar agreements that provide equal access to member state markets. In doing so, bilateral initiatives may undo intra-state pacts and even common foreign policy initiatives agreed upon between member states of regional organizations.

As a matter of predictive theory, how RIAs ultimately respond to structural inconsistencies will be context dependent. Some RIAs, which this article refers to as “closed” regional organizations, foreclose independent economic commitments with third party countries. Thus where inconsistencies arise between bilateral and regional frameworks, formal legal or political action may be taken by member states or, if applicable, the RIA executive organ, to enforce compliance and induce uniformity from all member states. On the other hand, other “open” RIAs may have only diffuse or indirect decision-making apparatuses, and additionally lack a clear policy regarding uniformity. States may consequently be empowered at least legally to adopt their own economic policies and accords towards third countries. Nevertheless, strong member state preferences, political constellations or institutional norms may still pull members towards collective action. In such circumstances,

50 For example, the African Union, a regional organization of 53 states established in 1994 to replace the more loosely aligned Organization of African Unity, has as an expressed objective the political integration of the continent. Modeled largely after the European Union and adopting such institutions as a Commission, Council, Parliament and Court of Justice, it actively forwards policies concerning not only economic development, but also international affairs, security, and defense. In South America, too, both the Andean Group and Mercosur have evolved over time to encompass not only free trade areas, but also political fields. Mercosur in particular expressly looks back to colonial exploitation and what many leaders view as a backwards heritage of European and North American domination in order to develop its economic policy and foster economic and social development. As a result, the organization has taken a variety of steps to eschew and diminish American influence in the region, and is largely viewed as a rival to the US-led Free Trade Area of the Americas. Gudynas, Mercosur and the FTAA: New Tensions and New Options, http://www.globalpolicy.org/globaliz/econ/2003/1111mercosurftaa.htm; see also Part II.B. and accompanying text (describing tensions between Brazil, Argentina, and Venezuela with the United States).
where states choose to opt for bilateralism, they may still face significant political or reputational costs.

The institutional design of most RIAs suggests that of the major bilateral instruments promulgated by states, trade treaties create the most likely prospects of structural inconsistency with RIAs. Most RIAs are founded as free trade areas—where states merely commit to lowering tariffs amongst each other—or, to a significantly lesser extent, customs unions. Few, as mentioned above, have yet wrested control of additional economic domains from member states. As a result, although there is a greater number of bilateral investment treaties, which points at least superficially to the likelihood of such domains comprising the most frequent area of tension with RIAs, these accords lay largely beyond the competence of most RIAs. This is not to say that disputes will not arise in the other domain as the EU Enlargement context demonstrates below; it does, however, suggest that regional organizations are at this point more permissive as regards to divergent investment policies.

What’s Kept Out?: Comparison of Trade and Investment Policies of Selected Regional Organizations

<table>
<thead>
<tr>
<th>RIA</th>
<th>Closed Trade Policy?</th>
<th>Closed FDI Policy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Community</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Caribbean Community and Common Market</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>NAFTA</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Mercosur</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>South African Development Community</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Andean Community</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Structural inconsistencies will also most likely arise and indeed be more acute where third party states to regional organizations are large or economically powerful states. Big states have a large economic impact, no matter their trading partner. Both legal and economic theory indicates that where one country has superior or privileged access over other similarly situated countries, the impact of any trade advantage will be greater as pertaining to regional partners. And it is with large states that the structural inconsistency problem will be most acute. It is there where choices between regional and bilateral regimes become difficult, and where the political and economic rivalries (and passions) most fierce. Again, this is not to say that states will not enforce economic
treaties with weak states. Indeed, RIAs or their constituent members may enforce such treaties nonetheless as a matter of principle, and to avoid precedent permitting regional deviations that could incentivize similar defections with larger states in the future. Nonetheless, in many cases the political and economic costs of enforcement may outweigh the benefits of achieving compliance, which may encourage less than a robust regional response.

This observation has, of course, particular salience for the United States, which is not only the largest economy in the world, but has in the last ten years most aggressively pushed bilateral liberalization schemes, a process heightened as the executive’s trade promotion authority comes to expire.\(^{31}\) And it is indeed no coincidence that the two case studies below—which illustrate the problem of structural inconsistency in two different sectors in two very different parts of the world—involve U.S. economic and political interests. Still, it is premature to view structural inconsistency as a purely “American” problem. Traditionally, many of the world’s largest and most rapidly growing economies have shielded their domestic industries from outside competition, and have thus avoided entering into bilateral agreements with robust reciprocal obligations. However, as most of these countries increasingly adopt more externally-oriented policies, they, too, may be exposed to similar legal and political challenges when engaging states that are members of tightly-knit RIAs.

II. CONFLICTS OF INTERNATIONAL ECONOMIC LAW: TWO CASE STUDIES

As a new descriptive theory, the above account warrants careful corroboration. Thus in this section, I consider two instances in which overlapping bilateral and regional regimes have been informed by structural inconsistency. The first case study examines the European Community’s call to accession candidates in 2004 that they terminate their bilateral investment treaties with the United States because the treaties were economically more liberal than existing EC policy. In doing so, it illustrates how structural inconsistency potentially arises in “closed” RIAs—intitutions requiring legal consistency amongst members. The second case study features Venezuela’s attempts to use the Andean Community’s regional norms and laws to obstruct its regional partners from independently entering into free trade agreements with the United States. By doing so, it illustrates the political obstacles

\(^{31}\) The Office of the U.S. Trade Representative has been trying to sign a variety of bilateral agreements including BFTAs with a diverse list of countries including South Korea, Malaysia, Thailand, Ecuador, Panama and the United Arab Emirates.
to bilateral cooperation that may be present in even “open” RIAs that at least formally permit independent agreements amongst member states.

A. U.S. Investment Treaties in Europe

1. EC Laws Implicating Foreign Direct Investment

Clashes between regional and bilateral treaties can have significant legal implications. One of the most dramatic cases of structural inconsistency occurred in 2004, when the European Community (“EC”) demanded of countries seeking EC membership that they denounce investment treaties that they had signed with the United States in the early 1990s as a precondition to joining. The EC announced that the treaties—which broadly prohibited, amongst other things, discrimination against foreign investment—violated European (protectionist) laws that had governed central economic policies for nearly fifty years. A watershed in East-West relations, the announcement hailed the first broad de-liberalization of Eastern European economic policy with the United States. It also illustrates many of the theoretical underpinnings and practical implications of structural inconsistency.

To fully understand the event, it is necessary to outline generally the EC’s laws implicating foreign investment. Ironically, despite the deep integration generally characterizing the EC, the organization lacks a formal policy governing FDI. Instead, foreign direct investment is addressed only indirectly by EC regional programs and multilateral commitments. The most basic regional policy, at least from a conceptual standpoint, is the Common Agricultural Policy (“CAP”), a regional program adopted in 1962 that requires EC members the broad

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52 Drabek, supra note 20, at 55.

53 Although Article 57 of the EC Treaty after Maastricht indicates that the EC’s Council of Ministers may, with certain restrictions, adopt measures on the movement of direct investment, the EC’s authority over foreign direct investment has been frequently interpreted as limited. Instead, much more scholarly and practical focus has been placed on the extent to which any more fundamental EC authority is conveyed under the more bedrock exclusive competency the EC wields over “commercial policy”—a domain under which investment has been found by the European Court of Justice to only partially fall. Attempts have consequently been made to bring investment more directly under the scope of commercial policy. Most recently, Article I-13 of the failed European Constitution would have extended the definition of common commercial policy to include foreign direct investment (Article III-315). Prior to that point, Finland sought during the Nice Summit more expansive language in Article 133 that would grant the EC exclusive competence in intellectual property and investment. Internal squabbling between the different EC member states, however, regarding other provisions in the suggested language, along with a strong predilection against the formal forfeiture of national prerogative, forced the tabling of such an agreement.
application of tariffs, investments and subsidies in their various agricultural initiatives.\textsuperscript{54} The program reflects both the economic and political realities of Western European countries shortly after WWII. In exchange for its early support for a common market, France insisted on a system of deep agricultural subsidies. The CAP, at that time a means of rehabilitating the continent’s decimated agricultural industry, was viewed as a mechanism for facilitating such support.\textsuperscript{55} The utility of the program has now, however, come under intense scrutiny insofar as the CAP has created immense costs throughout the region. As a program facilitating unequal treatment of foreign and EC investment and businesses, the CAP has removed virtually all foreign competition and caused Europe’s agricultural sector to become inefficient and outdated. Europe’s food prices are now amongst the highest in the world,\textsuperscript{56} and the EC’s investment in farm subsidies alone takes up most of the EC’s 85 billion Euro annual budget.\textsuperscript{57} Nevertheless, the CAP remains notoriously difficult to reform, largely due to the resistance by France, which still receives over 20% of the program’s funds.\textsuperscript{58}

The second major framework is the General Agreement in Trade and Services ("GATS"),\textsuperscript{59} which the EC signed alongside its individual member states in 1994 and governs in part the treatment of foreign investment.\textsuperscript{60} Under the terms of the GATS, which does not speak to agriculture, the EC committed to apply Most-Favored-Nation Treatment or National Treatment standards to their trade in services (and the investment therein). Under the MFN standard, “any benefit or concession with regard to trade in services covered by the GATS,

\textsuperscript{54} GATT is largely inapplicable as agriculture is removed from several of the agreement’s customary trade provisions. Agriculture is instead accorded exceptional treatment under Articles VI, XI, XVI and XX, which together prohibit quantitative restrictions other than tariffs on the importation and exportation of products and allow for “primary” and “non-primary” products to be treated differently.


\textsuperscript{56} Id. at 187.

\textsuperscript{57} See EC says CAP doesn’t fit, at http://news.bbc.co.uk/2/hi/europe/4407792.stm.

\textsuperscript{58} In 2003, under the British EU Presidency, France reached an agreement on CAP reforms. This ostensibly ambitious agenda has, however, preserved the underlying framework for CAP subsidies. EU agrees ‘radical’ farm reform, http://news.bbc.co.uk/1/hi/business/3021728.stm.

\textsuperscript{59} General Agreement on Trade in Services, in Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1167 hereinafter GATS.

\textsuperscript{60} Importantly, GATS is not an agreement on investment as such. It addresses investment as one of several different ways of gaining access to a market, insofar as the investment comprises service “through commercial presence” in a member state. Sornarajah, supra note 40, at 299.
whether granted unilaterally or negotiated bilaterally or plurilaterally,” was to be extended unconditionally to all other signatories to the treaty. Similarly, under the national treatment criteria, the GATS required that each signatory “accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.”

These obligations are not, however, universally applicable. Aware of the potentially significant implications of universal liberalization of its services sectors, the EC, like other signatories, exercised rights under the GATS to opt-out of liberalizing economically sensitive sectors in which there were important strategic interests or where European businesses were uncompetitive. Two are of particular relevance. The first is the air and road transport services exemption, which was a response to the EC’s policy of protecting European markets from the infiltration of domestic markets by foreign airlines services. Though in favor of creating a “free international EC aviation market” to both bring about free access to all destinations within the EC and provide synergy between European airlines, the EC-sponsored trend of liberalization has not extended to lowered barriers between the United States and individual Member States. For EC policymakers, “European carriers are in danger of being legally, commercially and airpolitically

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62 GATS, supra note 59, Art. XVII.
63 The GATS permits signatories to tailor liberalization according to their own interests. MFN is in principle mandatory, though members may opt out of the obligation for specific sectors on the basis of existing preferences. Similarly, national treatment obligations are not mandatory at all, but instead require opting in by sector. This means each country negotiates with other signatories its concessions and files an individual schedule of national treatment commitments. Each country’s schedule is then annexed according to Article II to the GATS and is incorporated into the agreement. The GATS also permits some important permanent exceptions from the application of the MFN obligation. The first of these relates to benefits conferred pursuant to economic integration agreements such as the Treaty of Amsterdam or the NAFTA, and labor market integration agreements. GATS, supra note 59, at Art. V. Parties to such integration agreements can be exempted from the MFN obligation provided the agreements include substantial sectoral coverage and eliminate substantially all discrimination. Id. at Art. V. Article VII also allows members to conclude certain recognition agreements on a non-MFN basis, whereas Article XIII provides for an exception to the MFN obligation in the case of government procurement.
overwhelmed by the US” and its carriers. Consequently, the EC has until recently sought to fend off US market penetration through bilateral air transport agreements with individual countries and traditionally resisted liberalization in the sector.

The EC also opted out of applying MFN and national treatment in audio-visual services. This exemption, the so-called “cultural exception,” is an outgrowth of the EC’s so-called Television Without Frontiers’ Directive, which provides that Member States may “ensure where practicable and by appropriate means, that broadcasters reserve...for...European works...a majority proportion of their transmission time.” The opt out facilitates this objective insofar as local content requirements and subsidies are consequently permitted in the production and broadcasting of audio-visual works like films, television programs, and radio shows. The purpose behind this policy is ostensibly to promote national cultural values of EC Member States and preserve linguistic and cultural diversity in Europe. However, there are also strong economic considerations. Over the last 50 years, the audiovisual goods and services sector has developed alongside other types of trade, with the United States as the primary beneficiary. “U.S. films represent eighty percent of the films distributed in European movie theaters, and more than fifty-five percent of the films shown on European television networks.” As a result, U.S. businesses have largely viewed the program as a pretext of establishing protectionist trade barriers against U.S. goods in a crucial area for trade.

Like the CAP, the regional programs shielded through the GATS exemptions had special beneficiaries. The British, on the one hand, have

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65 Id. at 91. According to the European Commission, the U.S-sponsored open-skies system distorts and fragments the European single market because each country is acting only in its own interests, rather than in the best interests of the market. Furthermore, by opening up access to flights in some countries, non-participating countries would be discriminated against. Daniel Dombey, Complex EU Legal Net Closes in on Aviation Deals, Financial Times, Feb. 1, 2002, pg. 3.

66 This resistance shows signs of loosening as both the EC and the United States have agreed in principle to the idea of opening access to airline markets. Both sides have, however, been unable to negotiate concrete guidelines. See Bengt Ljung, U.S., EU Fail to Reach Deal on Open Skies, International Business & Finance Daily, Friday, January 12, 2007.


69 Id. at 281.

70 Id. at 281-82.
benefited greatly from the air and transport services exemption with Heathrow Airport, Europe’s busiest airport, closed to competition from most U.S. carriers.\footnote{U.S.-E.U. Open Skies Agreement: with a focus on DOT’s NPRM regarding “actual control” of U.S. air carriers Before the Subcomm. on Aviation of the H. Comm. on Trans. and Infrastructure, 109th Cong. (2006), http://www.house.gov/transportation/aviation/02-08-06/02-08-06memo.html (Background).} As a result, they, along with Germany and Italy, have maintained longstanding policies denying market access without reciprocal inroads into U.S. markets.\footnote{Id.} Similarly, French businesses again benefit disproportionately from the cultural exception, since the country has amongst the most protectionist audio-visual policies in Europe—no more than 40% of television programs are permitted to be of non-European origin, and French law requires television channels to invest 15% of their turnover in the production of "original French works."\footnote{Karen Rinaman, 
French Film Quotas and Cultural Protectionism, \texttt{http://www.american.edu/ted/frenchtv.htm}.} 

2. The “Termination” and Subsequent Amendment of U.S. BITs

The CAP, the GATS, and the regional initiatives underlying the GATS exceptions had all, until 2004, implicated only the 15 original member states of the EC as to their relations with outsiders, including the United States. However, on May 1, 2004, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia and the Czech Republic joined, at which point, becoming subject to the dictates of EC law. This regime change required some adjustment for the new member countries, particularly in the field of investment. Up to that point, investment policy towards the United States had primarily been governed by bilateral treaties enacted in the early 1990’s.\footnote{Eastern European countries, free to follow their own economic and foreign policy, overwhelmingly flocked to bilateral investment treaties (BITs), with eight countries signing BITs within five years of independence. For a discussion of the general content of the treaties see Nancy Goodman, \textit{International Trade: Poland Bilateral Investment Treaty—A Reflection of United States Efforts to Shape the Economic Development of Eastern Europe}, 32 Harv. Int’l L. J. 255, 259 (1991).} Hungry for capital, Eastern European countries wanted to become more attractive destinations for American capital. And like many other nations at the time, most thought that one way to do this—as well as sustain U.S. interest in the area—was to enter into two-party commitments with the United States informing investors that they would not change the conditions of investment once investment was made.
Whatever their merits, the BITs created legal obligations that ultimately surpassed the GATS regime. Substantively, BITs pushed the core principles of MFN, national treatment, and free access even further than what was agreed upon in GATS insofar as no exceptions for audio-visual services or agricultural investment were adopted. Consequently, no government intervention (e.g. subsidies) or discriminatory treatment towards investors was generally permitted. Furthermore, the BITs extended national treatment protection to the pre-establishment stage GATS. In doing so, the BITs limited the ability of host states to impose pre-investment conditions on the ability to invest within their borders. Again, no comparable provisions for third party countries had existed in the audio-visual directives, “internal” regional investment regimes like the CAP, or sectoral opt-outs under GATS. Instead, European countries had consistently opted out of such concessions in order to be able to extract maximum rents from even potential foreign investors.

These inconsistencies raised complex legal questions as to the viability of BITs under EC law. The EC has long had as a fundamental premise the commitment of members to the basic constitutional structure, laws, and policies of the European Union and the European Community, collectively termed the *acquis communitaire*. As a closed RIA, this commitment must be accepted by applicant nations in order to join, and where either a member or candidate exercises authority in an area where the Community has concluded a treaty in pursuance of a common policy it will be overridden to the extent that it conflicts with EC law.

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75 However, some BITs, like Poland’s exceptions to national treatment and MFN as pertaining to air and rail transportation.


79 *Id.* This principle has been applied to existing EC member states in the course of several cases by the European Court of Justice. In the first important case to articulate the principle, Case 26/62, Van Gend en Loos Onderneming v. Nederlandse Administratiedier Belastingen 1963 ECR 1, the ECJ ruled that the aim of creating a uniform common market between different states would be undermined if Community laws could be made subordinate to the national laws. The principle was then applied to countries acceding to the EC in the course of the 1969 and 1974 accession talks, during which the United Kingdom, Denmark, and Ireland were informed by the EC’s Council of Ministers that they had to adopt the EC’s treaties and policies in order to initiate accession negotiations. According to the then
Closely related to this broad doctrine of preemption is the required uniformity of a “common commercial policy.” Ex-Article 116 obliges Member States to act in concert when matters of particular interest to the common market arise in international economic organizations.\(^8\) And under the current Article 133, the EC demands that the common commercial policy “be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.”\(^8\) As an element of EC commercial policy, the GATS constitutes an authoritative framework for investment and trade.\(^8\) Treaties negotiated with EC member states are consequently required to conform with their objectives and the policies undergirding them. Against the backdrop of these regional legal requirements, the European Commission (“Commission”), charged with ensuring adherence to the acquis as well as uniformity of commercial policy with third countries, declared the treaties in violation of “EC Law.”

The Commission consequently informed member states, at least initially, that the treaties would have to be terminated for candidate states to gain admission to the EC.\(^8\) This call was, however, met with considerable outcry from American interests, and the Commission attenuated its position, albeit in some regards only slightly.\(^8\) Instead of requiring termination, the Commission declared that all incompatible BIT provisions would have to be removed from the treaties in order for states to gain admission. After being presented with a confidential list of potential conflicts between the BITs and EC law, the United States reluctantly amended the instruments, removing the incompatible provisions identified by Commission.\(^8\)

President of the Council, Foreign Minister Harmel of Belgium, any problems of adjustment could be sought in ‘transitional measures’ and “not in changes of existing rules,” thereby making adoption of the acquis a condition that has been imposed in all subsequent accessions. Goebel, supra note 78 at 34.


\(^8\) Id.

\(^8\) Fight Over Bilateral Investment Deals, supra note 77, at 6.


\(^8\) Business interests throughout the United States objected to the EU’s position, with the United States Council for International Business spearheading protests from the U.S. business community. See, eg., Model BIT Letter to Host (Latvia), available at http://www.uscib.org/ index.asp?documentID=2228 (August 1, 2002) (protesting the “discriminatory set of rules” U.S. businesses would face vis a vis their European competitors and other firms from countries with BITs still in place).

Tellingly, the actual amendments focused almost entirely on the preservation of protectionist policies already in place in Western Europe. Accession candidates were allowed to impose EU performance requirements in agricultural and audio-visual sectors, although existing investors in affected sectors were granted 10 years of further protections. Furthermore, candidates were permitted to impose national treatment and MFN exceptions in, amongst other areas, audio-visual and agricultural sectors to the extent necessary to meet a country’s obligations under EC law. This focus on the internal mechanics of the EC substantive trade and investment policies belies, not surprisingly, a deep concern not so much with the integrity of the EC’s investment framework, but instead for EC protectionism. Quotas would be legally permitted, along with other requirements dictating content sourcing from other EU member states.

Ultimately, the EC’s intervention increases the prospect of future challenges to other candidate state BITs as the EC moves towards further enlargement. Despite the failure of the EC Constitution, the EC opened further accession discussions with Croatia in April 2005, and six months later with Turkey. Furthermore, EC policymakers are actively contemplating the eventual entry of additional Balkan states like Albania to the EC. Each of these scenarios, however, presents inconsistencies of the same nature as those identified in the BITs of first round accession candidates with EC regional accords. As a result, if the EC adopts the same reasoning as in the first round of enlargement, these BITs, too—faced with the structural inconsistency problem—will eventually have to be modified or terminated.

B. U.S. Trade Treaties in South America

87 See id., at Article IV.
89 Turkey’s BIT with the United States—one of the first six ever completed by the United States with another country—offers only one sectoral exception to the MFN and national treatment obligations also provided for in the GATS (air transport). In such a way, it can be likened to Romania’s BIT with the United States, which prohibits performance requirements and provides no sectoral exceptions overlapping with the EC. Croatia’s and Albania’s BITs are similarly broad and, though providing for some post-establishment protections, proffer few sectoral exceptions to MFN and national treatment obligations and prohibit virtually all performance requirements.
1. Turmoil in the Andean Community

The European Community is not the only institution to face structural inconsistency. Yet even more tumultuous—and recent—have been the experiences of the Andean Community (the Comunidad Andina de Naciones or “CAN”), South America’s second largest trading bloc. In April 2006, Venezuela, one of the organization’s members, evoked both the historical policy objectives and procedural rules of the organization in an attempt to pressure CAN members Peru and Columbia to refrain from signing bilateral free trade agreements with the United States. When Peru and Columbia nevertheless signed the agreements, Venezuela withdrew from the CAN in protest and joined South America’s largest RIA, Mercosur. As a full member of Mercosur, Venezuela now wields effective veto power over bilateral agreements any of those members may seek to sign, complicating U.S.-backed liberalization efforts.

Unlike the EU BIT renegotiations, this geostrategic reconfiguration has largely political, as opposed to legal underpinnings. One of the earliest efforts of economic integration in the Western hemisphere, the Andean Community was formally inaugurated on May 26, 1969, when Bolivia, Chile, Colombia, Ecuador, and Peru signed the Cartagena Agreement, a socialist accord setting the framework for deepening economic and political integration amongst the signatory countries. Originally envisioned to spur industrialization through import-substitution mechanisms, the CAN’s policy mandate was based almost entirely on “high tariffs as walls” towards outsiders. This platform proved popular in the region, particularly in lieu of the failures of earlier regional efforts at achieving broad and equitable development. Venezuela joined as a sixth member in 1973.

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90 At the time, the institution was originally called the “Andean Group.”
92 Regionalization had earlier been spearheaded by the Latin American Free Trade Association, or LAFTA. Launched in 1960 and consisting of all of South America’s Spanish-speaking countries, LAFTA had been viewed by many elites as reproducing on a regional scale hegemonic relationships characteristic of North-South relations. Gordon Mace, Regional integration in Latin America: A Long and Winding Road, 412 XLIII International journal, 404, 412 (1988). Argentina, Brazil, and Mexico had all increased trade at a faster rate than any other members, though were still unwilling to extend to smaller countries special preferences allowing them to become dynamic participants in LAFTA. William P. Avery and James D. Cochrane, Innovation in Latin American Regionalism: The Andean Common
Nevertheless, few concrete steps towards economic integration were made for over twenty years as states embarked upon independent and at times divergent paths of development. Instead, it was only in the wake of the economic crisis and a new interest in economic liberalization, that regionalization efforts were fully launched. Reeling from falling commodity prices and the apparent failures of national protectionist policies, CAN members, starting in 1985 (with Bolivia) and into the late 1990s (with Peru), embarked upon a series of domestic reforms aimed at increasing exports, reigning in inflation and reducing debt. These collective paths lead to increasing policy convergence and consensus as to where and how to liberalize intra bloc relations. In 1992, CAN members agreed to adopt a more friendly investment regime for foreign investors. Then in 1994, three CAN member states adopted a common external tariff (CET) for third party countries, the cornerstone of the Andean foreign commercial policy and the inauguration of the group as a customs union. Finally, in July 2005, the CAN signed an agreement with Mercosur, the third largest trade bloc in the world behind the EU and NAFTA, in which the two RIAs granted each other’s members reciprocal “associate member status.” Though not committing to

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Hufbauer and Kotschwar, supra note 91, at 43.

9 Id. (indicating how all member states undertook privatization and unilateral steps to decrease barriers to international trade).

9 Id. at 44; Andean Community, Chronological Sequence of Events, http://www.comunidadandina.org/ingles/quienes/events.htm.

political integration, the enhanced affiliations envision the removal of trade barriers over the next 15 years.97

The CAN remains, however, a largely imperfect customs union. Underlying differences among member states in the level and composition of trade, and the destination of exports, has made consensus and wider adoption the CET difficult. Bolivia—the only landlocked Andean country and subject to rules imposed by Chile regarding the use of its ports, cargo handling, and other important matters—maintains its own tariff, though its application remains subject to CAN administration.98 Peru meanwhile does not participate at all in the CET. Because it began its economic liberalization only in 1992, later than the other members of the CAN, it has consistently chosen steeper liberalization programs to “catch up” economically with the other member countries.99 These departures have left Colombia, Ecuador and Venezuela the only full participants in the customs union. And even here, generous policy reservations are afforded member states. Each, pursuant to Andean Community Decision 598, is empowered to negotiate independently trade agreements with third countries or regional or multilateral organizations. Thus despite its tariff harmonization initiatives, the CAN remains a quintessentially “open” RIA.

This is not to say that members fail to recognize the advantages of collective action. Indeed, the CAN has traditionally sought as a matter of principle to act as much as possible as a bloc. Decision 598, which permits bilateralism, nonetheless deems such engagement “exceptional” courses of action to be undertaken only where regional agreement is not possible.100 Furthermore, when securing agreements with third party states, members “should take into account the commercial sensitivities of the other Andean countries.” Where states do finally opt for bilateral programs, the CAN obliges members to notify the CAN Commission to enhance policy coordination with other members.101

Not surprisingly, the purpose behind these measures is to leverage the collective bargaining power of the group. As in Europe, Andean officials have long held that where members work together, they can enjoy more bargaining power towards the rest of the world—particularly

101 Id.
with countries like the United States with large economies. Cooperation and coordination are thus institutionally encouraged.

Ironically, however, it was precisely the size and power of the U.S. economy that in April 2006 spurred dissension as to the desirability of collective action and closer economic relations with Washington. Peru and Colombia, since the 1990s fervent backers of free trade policies, pushed for the completion of treaties with the United States that would liberalize the treatment of goods and investment from their countries. In doing so, the leaders of both countries hoped for deeper integration with and penetration of U.S. markets. On the other hand, radical changes in the Venezuelan and Bolivian governments, particularly the elections of leftist Presidents Hugo Chavez and Evo Morales, had inaugurated deeply anti-American policies and national outlooks. Dissatisfied with what they claimed to be the unsatisfactory economic performance of their economies since adopting neoliberal reforms, both leaders found the treaties repugnant to Mercosur’s initial aspirations—the economic and social integration of South America. For them, free trade would permit the United States to flood Andean markets with its goods, and attain even greater political sway in the region.

Faced with unlikely prospects of regional consensus, Peru and Colombia exercised their rights under Decision 598 and negotiated on their own BFTAs with the United States in February 2006. Their independent streak infuriated Bolivia and Venezuela, which complained that they had not been properly consulted as required. The two also objected to the substance of the agreements, which worked contrary to backbone principles of solidarity. Venezuela’s officials noted in the press that Colombia granted the United States quotas in products like

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102 On their own, the argument went, Andean countries possess little leverage in negotiating favorable terms for economic agreements since the U.S. economy dwarfed that of the CAN’s. Together, however, they not represent one third of South America’s market, but also an important source of two “strategic” commodities to the United States—petroleum and narcotics—which give the region an enhanced strategic importance and bargaining position. Garcia et al., Preface, in The Andean Community and the United States: Trade and Investment Relations in the 1990s, 49 (Rodriguez et. al, editors) (1997), available at http://www.sice.oas.org/TUNIT/books/CAF/intro.pdf.

103 Between the two presidents Morales and Chavez branded such attempts as betraying South American integration (Peruvian president Alejandro Toledo was described as a ‘traitor’ for signing the agreements) and signaling the “death” of the Andean enterprise. Carlos Malamud, Venezuela’s Withdrawal From the Andean Community of Nations And The Consequences For Regional Integration, Part I, Real Instituto Elcano, May 5, 2006, available at http://www.realinstitutoelcano.org/analisis/983.asp hereinafter Part I.

rice that Venezuela had historically provided, and that the BFTAs would facilitate the entry of strongly subsidized US products into Venezuela through its neighbors; it furthermore gave advantages to the United States pharmaceutical industry that would likely drive up the prices of medicines and generate unemployment. Bolivia, similarly, criticized the agreements insofar as it would reduce the market for Bolivian soybeans, essentially ruining the economic prospects of its domestic farmers.

Responding to the treaties, President Chavez, at the time holding the bloc’s rotating presidency, announced that his country would withdraw from the CAN. In dramatic fashion, he argued that Colombia and Peru’s embrace of neoliberalism effectively rendered the organization “dead.” Venezuela would consequently place its confidence in a broader South American integration, and the country’s membership into Mercosur, South America’s largest trade bloc, would be expedited. Bolivia, too, was rankled by the BFTAs, though it refrained from withdrawing altogether. As the country’s Vice President admitted, Bolivia was of all the countries in CAN the most dependent on its neighbors—much more so than oil rich Venezuela. Because Bolivia’s exports to the larger countries in the block account for a significant portion of its overall exports—nearly 17%—the country could ill afford to defect from the RIA.

Though Venezuela eventually entered into a rapprochement with the remaining CAN members, the Andean Community’s political debacle illustrates in profound fashion how structural inconsistency may arise even where constituent states are granted considerable leeway to pursue independent foreign and economic affairs. Open regional frameworks empower members to embrace the policies of their choice with outsiders, regional cooperation may remain a powerful organizational norm or expectation constraining the options of members.

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105 Id.
106 Id.
107 Id.
108 This translates into $466 million annually. Id.
109 Nevertheless, as a show of support, Bolivia joined other initiatives fomented by Chávez, like the Alternativa Bolivariana de las Americas and the Peoples’ Trade Treaty (Tratado de Comercio de los Pueblos or TCP). Id.
110 Venezuela has, for example, agreed to form a Working Group with Mercosur’s remaining members to propose regulations for the trade between the parties. If successful, few substantive changes will be made in the economic relationship between Venezuela and CAN members, though the status of their alliance will be frozen at the level of liberalization that existed as of April 22, 2006—the day at which Venezuela denounced the treaty. Nevertheless, some commentators predict that due to Venezuela’s evolving strategic interests and rivalries, the breakaway appears both legally and politically irreversible.
2. Mercosur’s Uncertain Future

Venezuela’s decision to leave the CAN for Mercosur was, as some journalists have suggested, far from a naive one. Founded in 1991 by the Treaty of Asunción, the customs union between Brazil, Argentina, Uruguay, Paraguay moves over US$150 billion in annual trade, as opposed to the CAN’s US$9 billion. It is thus much more significant from Venezuela’s point of view even though, as mentioned above, CAN members enjoy “associate member” status in Mercosur with certain trade benefits.111

Venezuela’s accession nevertheless poses serious challenges for Mercosur. Venezuela’s full membership confers a more active role in Mercosur than it had as an associate. This fact has not pleased Argentina and Brazil, Mercosur’s two largest members. Both are skeptical of Venezuela’s attempts to align with Paraguay and Uruguay, the organization’s smallest members and countries they have long dominated economically and politically.112 Indeed, Venezuela’s announcement of its withdrawal was made during a summit with Bolivia, Paraguay, and Uruguay, a conference of “Mercosur” conspicuously omitting the two regional powerhouses. Moreover, the announcement served as a platform for which Paraguay, and Uruguay, bolstered by Venezuela’s cry against economic imperialism, decried how they, too, had been economically “mistreated” by Argentina and Brazil.113 Echoing long held criticisms of “sub-imperialism,” the two argued that Argentina and Brazil had long orchestrated programs that disproportionally benefited their larger domestic markets. Thus according to their view, radical

111 Malamud, Part I, supra note 103.
112 Id.
changes in regional policy were needed. Still, Uruguay and Paraguay differed dramatically from Venezuela in terms of their proposed policy solution: As opposed to greater integration amongst members, the two countries called for closer bilateral cooperation—particularly with the United States in the form of BFTAs—in order to dilute Brazil and Argentina’s regional influence.

These divergent policy objectives have increased the prospects of significant structural inconsistency in Mercosur. Like the EU, Mercosur comprises a closed regional system. Under Mercosur Resolution 32, no trade or economic agreements may be negotiated individually with other countries, a clause which effectively grants veto rights to members. This poses significant challenges for both Paraguay and Uruguay if they indeed decide in the future to pursue free trade initiatives. Brazil and Argentina have sought, as noted above, to deter any relationships with smaller countries in the region that they themselves have historically dominated. They have even announced in advance that bilateral BFTAs with the United States would be vetoed. Venezuela also clearly finds U.S.-backed BFTAs repugnant to its own strategic interests. As a result, if Paraguay or Uruguay ever wished to enter into BFTA negotiations, the likelihood of veto would force the country to downgrade its status in Mercosur from a full to associate member.

Importantly, Paraguay and Uruguay are not the only countries whose bilateral initiatives could face challenges. Indeed, the recent hardline approaches taken by Venezuela, Brazil and Argentina also bode ill, at least potentially, for a variety of trade agreements already entered into by Mercosur’s associate members Chile, Columbia and Peru (the Andean Community). Each has BFTAs in place with a variety of third countries. Such initiatives could prove repugnant to Brazil and Argentina, the regional hegemons. Furthermore, Venezuela, which has warned of its willingness to tear down the current Mercosur and create, if necessary, a “new” Mercosur more responsive to his own socialist dictates. As a full member, Venezuela could either request that the

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114 Id.
115 Marquez, supra note 104.
117 Besides Colombia and Peru, whose BFTAs with the United States sparked Venezuela’s ultimate termination of its membership in the CAN, Chile, a third associate member, has signed 15 BFTAs, including agreements with the US, EU, China and Korea. Chile is currently in the process of negotiating other BFTAs with a variety of countries, among them India and Japan.
118 Malamud, Part II, supra note 113. When announcing its intention to join Mercosur, Chavez proclaimed that “if Mercosur has to die for true integration to be born, then so be it.” Id. He also warned Mercosur’s member states that if the organization “did not undertake a profound restructuring, laying greater emphasis on social issues, it might endure the same fate as the CAN.” Id. Part of this
three countries denounce their BFTAs, petition that the three withdraw altogether from Mercosur, or, as at least one commentator has speculated, withdraw itself from Mercosur, potentially casting the RIA into political turmoil.\footnote{Id.}

The reciprocal nature of regional integration also, however, poses considerable challenges for Venezuela, particularly as the country’s leadership charts new programs aimed at integrating left-leaning countries in the region. In April 2005 Chavez and Cuban President Fidel Castro proposed the Alternativa Bolivariana de las Americas (ALBA), a trade pact based on socialist ideals, as an alternative to the US-backed Free Trade Area of the Americas. As a first step towards its creation, the two joined Bolivia's President Morales in signing the Tratado de Comercio de los Pueblos (TCP), a free trade treaty which provides oil in exchange for produce, and agricultural products. At the time they became effective, the agreements were relatively easy to consummate since Venezuela was not a signatory of Mercosur. Forging onwards with the grander ALBA will, however, be made more difficult as a full member of Mercosur. Inconsistencies could well arise between the integration of objectives of Venezuela, on the one hand, and the foreign policy interests of more moderate countries like Brazil and Argentina—not to mention the center right governments of Uruguay and Paraguay. Trade programs will, however, require the acquiescence of all Mercosur member states. In the wake of severe discensus, Mercosur could, like the Andean Community, split—or, as some analysts have warned, even collapse.\footnote{Malamud, Part I, supra note 103.}

III. IMPLICATIONS FOR THE GLOBAL POLITICAL ECONOMY

Structural inconsistency holds important implications for debates introduced in Part I concerning integration and economic discipline. In this section, I argue that insofar as RIAs subvert bilateral regimes promoting free trade, regional integration has repercussions for global efficiency beyond even the erosion of WTO institutions and values. In such cases, the net effect on the global economy will necessarily be negative. For RIA members as a group, however, the welfare effect will be ambiguous benefits. Nevertheless even where RIAs enjoy positive net benefits, it is likely that structural inconsistency will promote the interests of some members over others, highlighting significant

\footnote{Id.}

“fairness” tradeoffs concomitant to some forms of regional legal and economic integration.

A. Consequences for Global Efficiency

The notion of incompatible regional and bilateral legal instruments requires a refinement and reconsideration of prevailing policy debates concerning the optimality of regional integration. As mentioned above, most criticism of RIAs has centered on the extent to which regional clubs undermine the multilateral trading system. Many commentators are concerned that regionalism makes possible alternative institutions to the WTO in which members not only lower duties and taxes for partners, but also raise or preserve tariff walls for the rest of the world. When only members in a regional club can benefit from free trade, RIAs potentially substitute more efficient imports from outside the group with lower-tariff, though less efficient, intrabloc imports.

Structural inconsistency adds to these concerns by suggesting that RIAs may also undermine important bilateral initiatives that promote liberalization and free trade. Closed RIAs may on the one hand cordon off or subvert a member state’s bilateral initiatives that do not meet the legal requirements of its club or that are subject to vetoes by other states seeking to protect their own domestic industries. Similarly, the dynamics of even open RIAs may make some bilateral agreements politically untenable for even proponents of such programs.

RIAs consequently pose challenges to efficiency that are potentially as far-reaching as regionalism’s implications for the WTO. As with the global trading system, the termination or undermining of BFTAs could divert trade away from efficient outsider producers to inefficient regional companies. And because investment treaties grant investors more credible protections for their investment, the denunciation or weakening of BITs would make foreign investment more vulnerable to potentially unproductive and illegitimate host state interference. In both cases, resources will be wasted and prevented from being put to their best or most productive use.

B. Regional (Group) Welfare Considerations

How these inefficiencies impact the welfare of RIA member states as a group will depend on a variety of factors. It is possible, however, to sketch out some of the most important factors. In terms of trade, the termination of a BFTA entails a switch from low-cost to high-cost sources. Faced with a decision between a more expensive import from an outsider (due to high duties) and a lower priced albeit inefficiently produced intrabloc import, a consumer will, all things being equal, choose the intrabloc import. This inefficiency is internalized by the group, however, because real resources are lost by the importing member
state: Where a member’s consumers used to pay x for widgets from an outsider, they now pay for intrabloc imports x plus y, the higher cost per unit for a product.121

Importantly, standard trade economics suggests that this loss will not necessarily be offset by a fellow RIA member’s gain.122 Much will depend on the gains the RIA exporter enjoys compared to the wasted consumer surplus in the importing state. To envision in basic terms what this means in real terms, imagine a trade relationship wherein consumers in Italy can but cars in either Germany or Japan. The cost of producing a car in Germany is $10,000, whereas the cost of producing the functional equivalent in Japan is $8,000. However, if tariffs on each Japanese car amount to $4,000, then consumers in Italy will choose the German car for $10,000 over the (more efficient) Japanese model now costing $12,000. Under such circumstances, there is for each car sold a $2,000 excess over the price of which a consumer would be normally willing to pay for a commodity (in economic terms referred to as wasted consumer surplus). In those circumstances where a consumer nevertheless opts for a Japanese car, there is a wasted consumer surplus of $4,000 for each car sold.

Generally, two sources of RIA revenue will offset these losses. First are tariffs on outsider import. Where, for example, a consumer opts for the Japanese car, the $4,000 in wasted consumer surplus will be offset by the $4,000 in tariffs collected by the Italian government. Within the EU, however, since countries do not impose tariffs on one another’s goods, intrabloc sales will not be taxed. Instead, the primary source for offsetting gains will be in the income gained for selling exports above costs (e.g. profit).123 In the example above, a German car would have to be sold for more than $2,000 profit (or $12,000) for the trade diversion to provide a net benefit to the group. Obviously, for any competitive market there will be limits as to how high the price can go for any good; for a product to be competitive, the price per unit cannot exceed the difference between the price of imports from its closest competitors. Since Japanese cars comprise costs and tariffs of $12,000, if cars are sold for over $2,000, the RIA’s “profit” margin will likely be thin. Thus even

121 Schiff & Winters, supra note 6 at 34-35.
122 Id.
123 For purposes of simplicity, I am assuming here surplus production capacity in Germany. If there was, on the other hand, full employment, one sector would theoretically have to contract for Germany’s factories to produce more cars (to meet increased demand from trade diversion). This contraction would have to be factored into the losses incurred by the RIA. I am also bracketing for the moment demand curve analysis. Presumably, if tariffs were removed on Japanese automobiles, more Italian consumers would be able to afford cars. Depending on the relationship between the price of the good and the amount or quantity the consumer is willing and able to purchase (the “demand curve,”) more Japanese cars would be sold, comprising additional possible losses to the RIA.
where tariffs are significant, the benefits of trade diversion may prove illusory.

Like trade agreements, investment treaties contribute to efficiency by removing inefficient barriers to foreign business activity. The welfare calculation where investment treaties are terminated differs from trade insofar as the benefits granted third parties under a BIT are internalized by host states as costs. Investment treaties lower the risk and cost of capital for foreign investors and in doing so become more attractive destinations for capital. They do so, however, by prohibiting certain forms of host state interference. BITs limit a country’s ability to change the terms of investment and exploit foreign enterprises. Such restrictions on rent-seeking impose costs on the host state. These costs can be significant. As Andrew Guzman has explained in his seminal work on BITs, investment treaties “make the market for foreign investment much more competitive by allowing competition in the ‘price’ of investment, that is, the terms under which investment takes place.”\(^\text{124}\) In other words, many states enter into BITs in order to pull investment away from other similarly situated countries.\(^\text{125}\) Yet as states engage in successive iterations of one-upmanship, they bid down the price of investment and reduce the degree to which host states may take value from foreign investment. In the process, a country’s margins on gains from foreign investment are effectively squeezed.

As a result, collective decisions by RIA members not to sign BITs or to denounce existing ones will not necessarily erode their collective resources. Theoretically, such organization could solve coordination problems for members and allow the group to extract more value from foreign investments. Though inefficient from a global standpoint, collective action would at least set the group on the path to achieving monopoly power over investment terms.\(^\text{126}\) Coordination would render the market for foreign investment and RIA resources imperfectly competitive. As a result, investment would remain subject to the goodwill of the host state, and RIA governments could capture a larger share of the rents without losing the investment beyond drops in aggregate levels of investment due to rising costs of capital.\(^\text{127}\)


\(^\text{125}\) Guzman, supra note 124 at 683-84.

\(^\text{126}\) Id. at 681-82. To be sure, a firm could choose to repatriate its capital outside the RIA in the face of adverse governmental conduct, and a country could be subject to reputational costs slowing future investment. Nevertheless, repatriation would entail its own transaction costs. And though reputational damages could be significant, the very fact of BITs suggests that there is no reason to think that reputational concerns are enough to cause countries to honor all of their commitments. Id. at 682.
Monopoly gains are only possible, however, if the investment into any particular RIA as a group is insensitive to the terms on which that investment is made as compared to the flows into an individual member state. In other words, it must be more likely that investors will switch from one member state to another in response to a change in costs than switch to an outsider. Otherwise, investment will be repatriated to other regions causing a net loss to the RIA both in terms of lost investment and collateral benefits such as technology transfers and employment. This will, of course, be an empirical question dependent at least in part on the RIA in question and the purpose of the investment venture. Most investment is mobile, particular that where foreign investors seek low-cost, low skilled labor. Effective locales supporting these kinds of inputs are widespread and thus rises in input costs could result in repatriation outside an RIA. Some investment, however, may be more asset specific, particularly that where investors seek access to markets and economies, special inputs such as natural resources, or a highly-educated workforce. In such cases, RIAs may more effectively realize market power.

These observations suggest that structural inconsistency holds highly differentiated, and at times case dependent outcomes for group welfare. In the trade context, the termination of efficient BFTAs will most likely provide gains where tariffs are significantly higher than the marginal difference between RIA and outsider goods. Similarly, the termination for BITs will provide net benefits to the group only where RIA members achieve through collusion monopoly power. These insights do not definitively posit RIAs as an inferior mode of international cooperation vis a vis multilateral or bilateral integration where these conditions are not met, though they do highlight important possible tradeoffs concomitant to regional integration.

C. The Distributive Welfare Problem

1. Theorizing Likely Winners and Losers

Critically, whatever gains collective bargaining makes possible, the benefits of integration may not necessarily be distributed evenly amongst members in a regional club. Instead, structural inconsistency suggests that the allocation of benefits may be determined by factors unrelated to pro rata economic contributions by members. This dynamic again pushes the available literature on RIAs by indicating important “fairness” tradeoffs embedded in regional economic and legal integration.

As noted above, the logic of regional integration is derived largely from the advantages of collective action. For example, European unification, the first modern effort at regional integration, speaks in large measure to a concern with what national elites view as their waning clout in the wake of American and Asian economic resurgence. To counter
the trend, promoters of deeper integration have argued for “a share of more effective power” through cooperation with member states rather than “exclusive control over a less effective or wholly ineffective power.”128 By increasingly speaking with one voice—a process enabled by the supremacy of EC law—promoters envisioned engaging the United States and new rising powers like China “on equal terms.”129 Similarly, the CAN has historically had as its ultimate objective not only the liberalization of markets, but also the realization of an Andean strategy of social cohesion and a strengthening of common foreign policy in order to play a larger role in the world economy.130 Indeed, from the Association of South East Asian States to the Economic Community of West African States, RIAs, particularly those comprised of developing countries, are increasingly viewed as not only instruments of economic liberalization, but also vehicles through which the common interests of constituent members can be enabled.131

Practically, however, RIAs do not consist of homogenous constituent member states and interests. As the CAN’s tortured development indicates, even where members are geographic neighbors or culturally similar, they may exhibit (at times widely) varying priorities and agendas, especially in economic matters. One state may, for example, have competitive strengths in certain sectors like textile manufacturing and may wish to encourage liberal exports with large third party markets; a less advanced regional partner, however, may seek to protect their domestic industries with high tariffs until they can compete globally. Thus though RIAs may be envisioned to promote common group

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128 Gabriel A. Almond et al., European Politics Today 456 (2002).
129 See Allan Rosas, The External Relations of the European Union: Problems and Challenges 59, article presented at the Forum for U.S.-E.U. Economic Affairs, Helsinki, Sept. 16-19, 1998. As Charles A. Kupchan notes, “The French used to be alone in looking to the EC as a counterpoise to America, but the other members have now joined in. Tony Blair has asserted, ‘Whatever its origin, Europe today is no longer just about peace. It is about projecting collective power.’ Germany’s Chancellor Gerhard Schroeder called for a ‘more integrated and enlarged Europe’ to offset U.S. hegemony. According Romano Prodi, the former President of the European Commission, the EC’s executive body, one of the chief goals of the union is to create ‘a superpower on the European continent that stands equal to the United States.’ Even Goran Persson, the Prime Minister of Sweden, a country that long ago renounced power politics, recently remarked that the EU is “one of the few institutions we can develop as a balance to U.S. world domination.” Charles A. Kupchan, The End of the West, Atlantic Monthly, Nov. 2002, at http://www.theatlantic.com/doc/prem/200221/kupchan.
130 See Schiff & Winters, supra note 6, at 20-21 (arguing that such pooling may enhance the effectiveness of medium and small-size states, though cooperation of this kind does not necessarily require trade preferences).
interests towards outsiders, the actual constellation of interests amongst members may be extremely divergent.

Inconsistencies are likely to be most acute where RIAs are comprised of states of disparate sizes and market power. Under such circumstances, economic theory suggests that some members—by virtue solely of their size—will likely benefit from integration more than others. Big members typically gain from RIAs because they enjoy a trade surplus. Large countries tend to be more developed, and as such produce protected goods that are then exported to smaller neighboring countries. There, at least in initially, they are taxed and compete with other goods from outsiders. However, unlike their competitors, as goods originating from RIA members, they are sold free of tariffs. This dynamic often constitutes one-sided gains: Big countries enjoy a competitive edge over potentially more efficient outsiders while smaller countries lose tariff revenues. Smaller countries may benefit from increased access to the markets of big countries in terms of commodities or raw materials, though generally they will have a higher import demand—and thus benefit less than their larger neighbors.

Size has additional advantages in the actual distribution of gains. In theory, a compensatory mechanism could be in place to allocate efficiency gains more equitably. Small countries are, however, often in a weak position to negotiate better terms for trade and investment. Though RIAs create a medium through which states may pool their collective market power in their interactions with outsiders, they do little to cure power imbalances between members of the group. See Mancur Olson Jr., The Logic of Collective Action: Public Goods and the Theory of Groups, 3 (1965) (noting that “in the sharing of the costs of efforts to achieve a common goal in...groups, there is...a surprising tendency for the ‘exploitation’ of the great by the small”). Big countries usually recognize the economic and political usefulness of retaining productive relationships with smaller countries. Indeed, even industrialized countries continue the drive for regional integration in hopes of liberalizing services to counter what some regard as unfair competition due to, for example, piracy or poor labor standards. They also desire to open up markets for their services sectors, where they have a comparative advantage. See Agustín Carstens, Deputy Managing Dir., Int'l Monetary Fund, Making Regional Economic Integration Work, Address at the Annual Meeting of the Pakistan Society of Development Economists (Jan. 12, 2005), http://www.imf.org/external/np/speeches/2005/011205.htm.
country’s special markets, or even the goodwill of its neighbors.\textsuperscript{134} As a result, big states, or coalitions of bigger states, will—as seen in such programs like the CAP and the EC’s air and transport—frequently be positioned to craft regional policies that, though creating regional tensions, create disproportionate gains for themselves.

Importantly, small states are not the only relative “losers” in regional organization. Similarly skewed distributive gains (and losses) are identifiable amongst early and late members of RIAs insofar as early members will likely reap disproportionate benefits from regional integration. RIAs are ultimately like any other network insofar as groups of individual countries enter into cooperative agreements in which they adopt common standards (like MFN) in various sectors (like trade). And like any network, economies of scale heighten positive feedback dynamics that reinforce the desirability of the network and the standards embraced by it.\textsuperscript{135} For example, where a cell phone provider offers users of its service free “anytime” calls to others who use the phone, as the number of people who use the service increases, the attractiveness of the service increases amongst those outside the system. Similarly, RIAs possess similar “external” attractiveness. Where organizations grow in membership, the markets they represent become more attractive from the standpoint of economies of scale and institutional maturity and coherence. As networks acquire a critical mass of participants, benefits external to the network itself such as the ability to cooperate with others who use it becomes more important.\textsuperscript{136}

The dynamic quality of network power means that once established, RIAs exhibit a staying power of their own as coordinating mechanisms.\textsuperscript{137} Change, in short, becomes very difficult. Incoming states will generally be in a poor position to negotiate new policies.\textsuperscript{138} And once a state attains membership, the prospect of initiating reforms frequently remains dim—particularly in light of popular organizational rules that in requiring unanimity or a supermajority in the approval of new initiatives make possible “hold-up” opportunities for winners under

\textsuperscript{134}Many small countries enter into RIAs with hopes of attaining an advantage over other similar countries in attracting foreign direct investment (FDI). “Raising the level of FDI—or domestic investment, for that matter—requires making a country attractive vis-à-vis other countries. Increasing market size helps in this regard. Ensuring market access to a major market by entering a PTA may be one way of achieving this.” Id. Only where the size of an RIA grows may a large country due to the economies of scale produced by a regional integration stand more to lose from failed cooperation—though even then still less on an individual basis than a small state


\textsuperscript{136}Id.

\textsuperscript{137}Id. at 131.

\textsuperscript{138}This will especially be the case where, as in the EC, candidate states are small or geographically isolated, thereby leaving few viable partners for regional integration.
the existing dispensation of surplus. As a result, early decisions have lasting repercussions; network power, bolstered by organizational inertia, effectively freezes payoff schemes from earlier bargaining iterations.139

These significant policy and power relationships complicate the premises underlying conventional arguments either promoting or implicitly extolling the values of collective action. First, they again show that RIAs, like most cartels, may be highly inefficient. Internal dynamics may, far from promoting competition, impede the adoption of the most efficient or competitive policies from even a group perspective. Furthermore, they illustrate how even under regional umbrellas the rents extracted by an RIA may not be evenly distributed to group members. Coordination variables—power asymmetries, network power, rent-seeking and strategic action—may also skew distributions of gains accrued by collective action. Some states may be bigger winners than others who lose out on what could be viewed as their equitable share of benefits. Together, these two insights suggest that “collective action” carries an array of possible configurations, and any notion that it will always secure more gains for individuals than bilateralism is an oversimplification of both the descriptive theory and available data. For all of their potential welfare benefits, RIAs may impose a variety of costs on their members that offset gains from collective action, adding another logic—beyond the prisoner’s dilemma—as to why states might defect from regional commitments.

Indeed, the inference from the preceding section is that at times bilateral initiatives by members may provide maximum benefits for the group. Obviously, this could be the case where a state enters into a special trade or investment pact with large state like China or the United States, whose markets may dwarf those of entire regions. Still, there are other less obvious though equally noteworthy possibilities. Drawing from the Andean Community’s experience, suppose, for example, that regional member State A is empowered through organizational rules to hold out on, or block, regional member State B’s bilateral free trade treaties with State C, an outsider of the RIA, because State A’s exports in a particular sector to State C may suffer due to competition with State B. Now suppose that if the BFTAs were adopted, the marginal difference in price per unit good would permit State B to sell enough goods to State C that eventually the benefit accrued by State B would be greater than the cost to State A in lost exports. Under such circumstances, the availability of independent, bilateral engagement by State B would not only allow State B to avoid State A’s hold up, but also to enter into an agreement that maximized the group’s aggregate welfare.

Similarly, the very availability of bilateral alternatives could work to level the power imbalances within regional organizations presented by asymmetric leverage and market power. In practice, bilateralism expands for member states the competitive market of potential

139 Barry & Pogge, supra note 135, at 131.
collaborators. If, to take cue from the EC episode, State A wishes to impose unproductive (protectionist) policies in the formulation of a common policy in a sector like agriculture that disadvantage smaller members, States B and State C, where bilateralism was practicable the two could opt out of the regional program for more liberal policies with third country State D. The ability of states to exit regional frameworks—an option at least conceptually predicated upon an open regional framework with immaterial political costs—would likely prompt a reassessment by regional members of their internal policies.

The point here is not that bilateral cooperation is always possible or normatively preferable from the standpoint of RIA member states. Clearly, the CAN demonstrates that opt outs are not seamless events, even where states adopt ostensibly “open” regional frameworks. Moreover, even if bilateralism is available and even welfare maximizing in one iteration amongst repeated exchanges, it does not mean that RIA membership on the whole, from an aggregate accounting of policies, will not produce greater gains for members. Indeed, even in the EC, states which had to abide by the CAP were through other programs afforded generous structural adjustment funds to help them modernize a variety of sectors, including agriculture. What is apparent, however, is that bilateral cooperation—a reality predating and in some instances superseding regional pacts—need not always comprise a welfare-minimizing approach for members of some groups, or for groups beset by coordination problems.

2. Identity Politics and Defection

Though bilateralism may, at least in some discrete instances, comprise a welfare maximizing approach for some countries, not all states are equally positioned to take advantage of bilateral opportunities. Ultimately, a state’s choice will be informed not only by the relative benefits of membership in a particular RIA, but also by the variety of costs tied to opting out of that regime. To borrow from the rational choice theory, we can expect a state to opt out or “defect” from their regional clubs, where the surplus value produced by a new relationship is greater than the costs of defection and the surplus value produced by an older alliance.

What precisely these costs actually entail has long been a matter of interest among scholars of international law. Generally, commentators have characterized responses to defections from specifically economic commitments as either “reciprocal” or “reputational” in nature. Reciprocity refers to retaliation by states harmed or ‘victimized’ by

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defection.\textsuperscript{141} In some treaties like the GATT that regulate the exchange of private or club goods like trade, the breach of a particular commitment, such as the adoption of impermissible tariffs and subsidies, exposes the breaching country to retaliatory action by the country against which the commitment was not honored. Aggrieved member states may either pursue money damages or they can engage in trade retaliation by suspending equivalent “concessions or other obligations” against the scofflaw state.\textsuperscript{142} Modification imposes similarly robust costs under Article XXVIII. A state may effectively modify or increase a tariff to which it has agreed in a prior negotiation; however, if the withdrawing state does not reach agreement with any state that would be affected by the proposed new tariff, the affected state is permitted to withdraw substantially equivalent concessions.\textsuperscript{143}

In contrast to reciprocal responses, reputational costs refer to the negative consequences that follow from states readjusting their estimates of the defecting state’s expected reliability. States make a variety of commitments as international personalities. Some commitments are formal, memorialized in legal instruments like treaties or memoranda of understanding. Conversely, other obligations are coerced, at times tacitly, as countries impose their expectations on other (usually weaker) states. In either case, though to perhaps varying degrees,\textsuperscript{144} social regularities may evolve—norms—which countries feel obligated to follow out of a fear of extra-legal repercussions.\textsuperscript{145} If a state fails to comply with legal rules or expectations, the affected countries will readjust their view as to the state’s attractiveness as an ally in the future: “When a member of an organization goes back on a commitment, it compromises in some degree its reputation as a reliable partner and jeopardizes its ability to continue to reap organizational benefits.”\textsuperscript{146} Other states, simply put, will be less willing to enter into future agreements.\textsuperscript{147} As a result, rational governments often seek to maintain strong reputations even when their short-term interests may not clearly dictate such compliance.

Between the two responses, reputational costs comprise the most important factor informing compliance in regional organizations. Sanctioning authority is rarely, if ever granted individual member states.

\begin{itemize}
  \item \textsuperscript{141} Id.
  \item \textsuperscript{142} GATT, supra note 17, at art. XIX.
  \item \textsuperscript{143} Jide Nzelibe, The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization’s Dispute Resolution Mechanism, 6 Theoretical Inquiries in Law 215, 221 (2005).
  \item \textsuperscript{144} Norms and political expectations represent weaker compliance mechanisms than law.
  \item \textsuperscript{145} Downs & Jones, supra note 140 at S98.
  \item \textsuperscript{147} Downs & Jones, supra note 140 at S96.
\end{itemize}
Instead, “retaliation” is facilitated through either executive enforcement or special tribunals. In the latter case, countries have little involvement in securing another member’s compliance beyond perhaps informing the commission of a violation of regional law; thereafter, the commission acts as a kind of policeman enforcing compliance to regional laws. In the former scenario, where tribunals are instituted, disputes between states are generally carried out by proxy insofar as a person or company of one state initiates a claim seeking compensation or injunctive relief against another regional member state. Countries generally seek to avoid direct confrontation with one another to avoid eroding diplomatic relations. Moreover, like many private parties, countries are increasingly skeptical of the arbitration; not only is the process difficult and costly, but even where countries are involved, and a party secures a favorable judgment, enforcement of that judgment may comprise an onerous process.

As a result, reputational costs usually figure more centrally in a country’s calculus as to whether or not to comply with or honor regional commitments. Having a strong reputation as a reliable regional partner helps a country ensure cooperation from its neighbors, a crucial strategic objective for most states. Regional economic ties are generally more interdependent than those between far flung countries, heightening the need for robust collaboration in the governance of regional economies. Furthermore, economic or social crises in one country often have important spillovers for its neighbors, and thus require close regional coordination. Having a strong reputation helps a country foster regional solutions for such problems, as well as others that cannot be solved on a local or multilateral level. On the other hand, where states fail to live up to their commitments or institutional norms, they will attain “bad” reputations will that will inform the degree to which other states will be willing to work with them within the regional umbrella to pursue common goals and agendas in the future. Indeed, even where states fail to live up to the policy expectations of their neighbors, they may incur serious reputational costs due not so much to noncompliance with formal commitments, but instead because of a perceived inability to respect regional norms or customs. In such circumstances, a state may become viewed by its neighbors as not so much a partner, but instead as an adversary.

Yet for all of the importance of reputation for states, it is conceivable, and indeed likely, that defection holds differentiated reputational consequences for the members of an RIA. Recent IR theory has suggested in similar contexts that the relative size of a state is important. Big states, the argument goes, have less to fear from defecting from small states insofar as mid and larger-sized countries will

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148 At least historically, countries develop deep trade and investment ties with one another’s neighbors before venturing to far flung destinations.
149 See generally Downs & Jones, supra note 140 at S103-08.
discount its non-compliance. “While states have reason to revise their estimate of a state’s reputation following a defection or pattern of defections, they have reason to do so only in connection with agreements that they believe…are valued the same or less by the defecting state.”

The inverse argument can, however, be made in the regional context on even more practical grounds. Where defections in an RIA occur, the reputational consequences are not so much tied to the size of the victim, but the size of the defector and the importance of that member to the policy goals of the RIA. Cooperation is, in short, most valuable to those “who must coordinate with others in order to remain relevant” in the institutions in which they participate. Under such circumstances, a track record of adhering to institutional norms, member state expectations and regional laws may enhance a member’s status among its peers and influence with the group. On the other hand, where a small state fails to live up to the expectations of large members or defects from its regional commitments, it may risk incurring sanction. Regional members might conclude that the state is a “bad” partner and seek to evoke that state’s membership or isolate it politically.

Reputational dynamics are different when a big state defects. To be sure, regional members will reevaluate their estimations of the big country’s reliability; nonetheless, a bad reputation may have few real implications or costs for the big country due to its importance. Unlike broader multilateral environments where a variety of big, medium and small countries interact, in an RIA there is a limited number of actors—and options—where a state looks to achieve a regional goal. As a result, the participation of the big state may be necessary in any or all of the RIAs endeavors, either due to its (internal or external) political influence or market size. Member states such as Bolivia may not consequently have the option of coordinating efforts around the state where countries do not meet their expectations; a big state may attain a bad reputation, though incur no or few reputational costs. To be sure, small states

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150 Id. at S97.
152 See id. at 707-08 (describing how “norms regulate behavior by taxing and subsidizing actions associated with defection and compliance”).
153 Obviously, the relative size of a regional organization also comprises a crucial independent variable informing the implications of any particular state’s defection. Where RIAs have few members, disparities between big and small states become crucial since small states will be unable to forge coalitions to coordinate policies around larger members. Insofar, however, as RIAs are comprised of many members, small states may find opportunities to in effect contract around a larger state in the formulation of policy. Furthermore, where the cooperation of all states is necessary in order to properly effectuate a common goal, a small state’s participation may become more important, and its power enhanced. Under such circumstances,
may, in some instances, enjoy similar benefits—particularly if they are members of a small RIA with few members; similarly too, may be mid-sized countries (like Venezuela), particularly where they operate in small RIAs with similarly sized members that may be dependent on each and every actor to effectuate successful goals. Nevertheless, these observations do not detract from the section’s theoretical point: the bigger state, the fewer the practical implications of defection in an RIA.

This insight, when read in conjunction with the coordination problems described above that beset many, if not all RIAs, leads to a disconcerting implication: big states will likely not only benefit more from regional integration than smaller states, but they will also be best positioned to take advantage of welfare-enhancing bilateral defections. Regionalism benefits, in short, big countries on both the front and back end of the integration process. On the one hand, they are positioned to create rules that allow them to capture more of the surplus generated by regional cartels. At the same time, if they defect, they generally do not have to worry as much as much as smaller countries about the effects their noncompliance will have for their strategic regional goals. Though they could conceivably face opprobrium by small states—indeed some could withdraw altogether from RIAs—the chances of such conduct is rare where there are significant differences in the size of countries and big countries lie at the center of its smaller neighbors most valued cooperative relationships.

D. A Program for Further Inquiry

In identifying and examining three multiple levels of law-making in both the investment and trade sectors, this Article illustrates that the kind of conflicts arising between regional and multilateral commitments are qualitatively different from that arising between regional and bilateral instruments. On the one hand, in the multilateral context regionalism has arisen as largely an exception to WTO rules that under MFN rules would ordinarily require a member to share the same benefits to all other members. And as an exception, regionalism is still at least legally permitted under the rules of the global trade system. On the other hand, bilateral rules may be found from both a legal and policy perspective to be incompatible with regional laws or member states. In this way, the friction between bilateral and regional systems is very unlike that between regional and WTO multilateralism, and has potentially more sweeping implications. Insofar as RIAs may merely make multilateral through it may attain a bad reputation, states may still engage the country in a subsequent iteration in order to effectuate group objectives. In any case, even here, the power or greatness of a state is key: the bigger the state, the more the reputational consequences will be offset by the practicalities of its participation.

154 See supra note 17 and accompanying text.
commitments a “floor” for liberalization, they may also act as a “ceiling” against further liberalization efforts of member states.

The at times disruptive role played by RIAs in both contexts highlights the need to more fully explore the extent to which treaty negotiators consciously tailor RIAs to leverage power imbalances in the group. Institutional design theory suggests that states and other international actors design institutions purposefully to advance their joint interests. Still, as this article demonstrates, states are generally as much beholden to their own interests as they are to maximizing joint welfare, if not more so. Thus presumably, states expound upon these self-interests when crafting regional arrangements—not only in terms of members’ substantive commitments and policies, but also in negotiating the sectoral coverage (e.g. trade, investment, services, etc.), group decisionmaking mechanisms, and membership. Indeed, the case studies show that power configurations and interests inform some of the legal frameworks undergirding RIAs. To more fully explore how this works in practice, however, an empirical study of how regional organizations develop over time and distribute economic and political gains is needed. Besides further accounting for the variety of different specie of regional integration, an interdisciplinary account tying evolving strategic considerations to existing institutional and legal mechanisms would greatly advance prevailing theories of multi-level, international rule-making. It would also, critically, serve as a platform for more precisely assessing the actual group welfare implications for regional agreements.

The dramatic proliferation of not only regional instruments, but also bilateral agreements, points to additional areas of investigation. As with regionalism, the utility of bilateral instruments has been examined almost entirely in the context of open multilateralism. Structural inconsistency of course frustrates such simple dichotomies—notably by not only positing a multi-tiered view of international commitments, but also by highlighting the complexity of economic integration. Indeed, some state responses to structural inconsistency suggests that just as some regional organizations may be more amenable to bilateral agreements, some bilateral agreements may be more amenable to regional organizations. For example, just five days after caving in to heavy domestic and regional pressure militating against a U.S.-backed BFTA, Uruguay announced plans to sign a non-binding “trade and investment framework agreement” in its place. In terms of implementation, the country’s president suggested tacking trade-related measures to a recently

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completed BIT with the United States—which has escaped scrutiny from Mercosur—in an attempt to advance liberalization. 157

The very notion of treaty substitution implies that perhaps some bilateral agreements are more palatable than others, a point which deserves significant analytical and theoretical analysis. Any explanation for bilateral substitution would be necessarily sectoral in nature, as the EC’s ultimate amendments of accession candidate BITs suggest. Yet even here, in the details of sectoral scope and the evolution of bilateral agreements, intriguing possibilities persist—including the evolution of the global economy to encompass emerging points of contention like services and intellectual property, as well as potential path dependency models highlighting the importance of pre-existing institutional frameworks. Furthermore, evolving legal technologies may account for sources of strategic friction, whether it be the (increasingly) greater commitments implied by MFN as countries enter into increasing numbers of commercial treaties or novel innovations such as investor-state arbitration and non-binding liberalization instruments. Ultimately, interdisciplinary study could forward the literature greatly by providing a more complete picture of the potentially varying textures of bilateral cooperation and tie the sectoral scope and legal technologies of select bilateral instruments to the strategic concerns of countries negotiating them (and particularly GDP or market imbalances). This kind of investigation could then be used for a larger comparative study incorporating the new insights from regionalism described in the program above.

Of course, some responses to structural inconsistency suggest that in choosing economic alliances, states do not necessarily act in an economically efficient manner. Indeed, many countries may adhere to regional frameworks wholesale even where discrete bilateral initiatives or programs might proffer greater economic gains for both individuals and the group. Such institutional loyalty implies other non-economic factors informing the decisionmaking of many states. Perhaps most obvious, domestic political concerns may sway the decisionmaking of political elites. Where prevailing regional alliances are popular, a political leader may be punished for defecting and cooperating with an unpopular outsider, even if such cooperation is efficient. Institutional scope may also account for regional steadfastness. Regional organizations are increasingly not only economic institutions, but also forums of choice for the addressing a variety of common concerns including security, immigration, and the environment. Effective responses to such concerns are public goods and as such are unlikely to be provided efficiently in the absence of external intervention like an RIA. 158

As a result, the implications of defection in one area like trade could extend beyond that sector to inform the ability of a country to

157 See id.
158 Schiff & Winters, supra note 6 at 22.
resolve issues or disputes in other sectors like security or investment. The possibility of such spillovers warrant closer analysis of RIAs—and indeed international organizations generally—as they may challenge dominant IR theories minimizing the reputational consequences of defection outside of the context in which defection occurs.

CONCLUSION

International economic law has witnessed a profusion of regional and bilateral trade and investment treaties memorializing a complex web of economic alliances and commitments. At its best, this phenomenon breaks down unproductive tariff walls to lift the welfare of participants. However, decentralized integration also poses challenges, particularly where regional and bilateral instruments conflict with one another. Under such circumstances, participants in some regional organizations will be tied to political arrangements or legal commitments that politically or legally preclude other beneficial linkages. The potential incompatibility of overlapping bilateral and regional regimes carries substantial implications for contemporary debates concerning international economic integration and governance. Most notably, it shows that in undermining bilateral agreements regionalism poses challenges to global efficiency that are potentially as far reaching as regionalism’s repercussions for the WTO. It also shows that because the benefits of regional integration are not always distributed equitably, regionalism may at times comprise a sub-optimal framework for small and strategically disadvantaged member states. In presenting a broader picture of the kinds of inefficiencies and fairness effects regional legal regimes may impose, these insights more robustly account for the kinds of externalities generated by regional legal regimes, as well highlight what have been unnoticed trade-offs of economic integration.