
4 The institutional environment for international trade and investment

Bilateral and regional trade agreements are just one mechanism by which trade and investment between countries is governed and by which rules can be changed. To understand the impacts of such trade agreements, it is first useful to consider the other institutional arrangements with which they interact.

Although international trade and investment are often described as occurring between countries, in practice, it is predominantly businesses, and increasingly consumers, that actually undertake trade and investment across borders, to take advantage of higher prices or profits for businesses, and lower prices or wider product choice for consumers.

Some of the more enduring country-specific factors that influence choices about whether and where to trade and invest are a country's:

- natural and inherent characteristics, such as its distance from trading partners (which may impact on transport costs), a shared language (which may improve communication between businesses), and shared historical ties and culture (including via colonisation);
- macroeconomic features, such as whether it has currency and price stability, and a well-regulated financial system; both of which enhance confidence and facilitate trade and investment; and
- broader political environment, including whether it has a stable political system, internal security and an effective legal system, that provides businesses and consumers the assurance that they will be safe and not be subject to capricious or corrupt official activity.

In addition, a country's domestic regulatory and policy settings — both 'at-the-border' and 'behind-the-border' — and the implementation of its international commitments and regulations alter that country's economic conditions, and will affect its attractiveness as a source or destination of trade and investment.

This chapter provides an overview of these various rules, policies and institutions, as well as the mechanisms by which such rules and policies can be varied.

4.1 The World Trade Organization

The World Trade Organization (WTO) is a forum for sovereign nations to negotiate and enforce agreements on the conduct of international trade and related matters. It evolved out of the General Agreement on Tariffs and Trade (GATT), which had been established after World War II by 23 governments — mainly from developed countries including Australia — to foster a stable, rules-based trading system. Since the GATT's inception, industrial country tariffs on industrial products have declined significantly, while over the period since 1950, world merchandise trade has increased 27-fold (in volume terms), or three times faster than world output growth.

The WTO was established in 1994 by the *Marrakesh Agreement Establishing the World Trade Organization*, following member countries' agreement to create the organisation as part of the Uruguay Round negotiations. Membership of the GATT, and the WTO since 1995, has steadily increased. There are now 153 members, the majority of which are developing nations. Governments can apply to join or withdraw from the WTO at any time.

The WTO's coverage was also extended in the Uruguay Round with the formation of agreements covering trade in services, investment, and intellectual property.

Trading principles and the WTO agreements

The WTO oversees approximately 60 agreements, although member countries' commitments focus on around 10 of these (box 4.1). In broad terms, the agreements require all member governments to apply their trade rules in a consistent, transparent and, with some important exceptions, non-discriminatory way. The key features of the agreements that give rise to these outcomes are:

- Non-discrimination clauses: principally via the most-favoured-nation (MFN) rule and the national treatment rule. The MFN rule requires that each WTO member must grant to all its trading partners the conditions it grants to its 'most favoured' trading partner. The national treatment rule requires that countries should set conditions for imported goods and services no less favourable than those for domestically produced products.
- Binding and enforceable commitments: Member countries are required to establish a schedule of enforceable maximum tariff levels and other barriers they can impose on imports. In the case of tariffs, member countries are then 'bound' by these scheduled rates, although they are free to apply a lower rate than specified in the bindings. Members are also bound by other commitments, including those relating to services trade and intellectual property as well as any non-tariff barriers to goods trade.

- Transparency requirements: Member countries are required to make their trade laws and regulations available publically, and to notify the WTO of changes to their trade laws and policies. Each member's trade policies are also given some exposure via the WTO Trade Policy Review Mechanism.

Box 4.1 **The WTO agreements**

The WTO oversees approximately 60 agreements. The coverage of selected key agreements is outlined below.

Agreements concerning trade in goods

A number of agreements codify the commitments made by member countries concerning barriers to trade in goods:

- The *General Agreement on Tariffs and Trade 1994* (GATT) regulates merchandise trade barriers, with member countries agreeing to be 'bound' to the liberalisation commitments they have made. The agreement establishes the MFN and national treatment rules, and requires a member country's trade laws to be publicly available. The agreement also requires the elimination of quantitative restrictions (except for some limited circumstances), and provides some general exceptions to the WTO rules (such as for customs unions and free trade areas, and for environmental protection reasons).
- The *Agreement on Agriculture* contains member countries' commitments regarding trade in agricultural goods. Firstly, member countries were required to convert quantitative restrictions on agricultural products to tariff-equivalent levels of protection, and then reduce these tariffs over time. Secondly, trade-distorting agricultural support programs were to be phased down (with some allowance for generalised assistance such as for research and development, or pest control). The agreement also required negotiated reductions in export subsidies for agricultural trade.
- The *Agreement on Sanitary and Phytosanitary Measures* (SPS) requires members' quarantine systems to be the minimum necessary to achieve food safety and plant and animal health outcomes. Similarly, the *Agreement on Technical Barriers to Trade* (TBT) requires members to avoid using product safety standards or certification/testing regimes as barriers to trade. Both agreements encourage members to base their domestic regulations on other internationally agreed standards and procedures, reducing the likelihood that a country will be in breach of the agreements.

The *Safeguards Agreement*, the *Anti-dumping Agreement* and the *Agreement on Subsidies and Countervailing Measures* permit member countries to take remedial actions against imports that cause material injury to a domestic industry. Each agreement deals with a different cause of serious or material injury (including a 'surge' in imports, goods that have been 'dumped', and subsidised goods), and each establishes procedures for investigating complaints by local industries, the thresholds and evidentiary requirements that must be met for injury and causation to be proven, and the processes and permissible timeframes for imposing remedies.

(Continued next page)

Box 4.1 (continued)

Agreements concerning trade in services, investment and intellectual property

As part of the formation of the WTO, the Uruguay Round negotiations saw member countries making binding commitments regarding trade in services, investment rules and minimum standards of intellectual property protection a requirement for membership of the WTO and participation in the GATT. A number of agreements now cover these subject areas.

- The *General Agreement on Trade in Services* (GATS) binds member countries to the principle of MFN in regard to barriers to trade in services. The agreement includes similar transparency requirements as the GATT. WTO members commit themselves to reductions or elimination of market access barriers and national treatment through ‘Schedules of Specific Commitments’.
- The *Agreement on Trade-Related Investment Measures* (TRIMS) requires members to remove domestic investment regulations that distort trade in goods. Member countries must not apply investment measures that are inconsistent with the national treatment principle, or Article XI (quantitative restrictions) of the GATT.
- The *Trade Related aspects of Intellectual Property* (TRIPS) agreement establishes a set of global minimum intellectual property standards, agreement to which is a condition of WTO membership. It covers five substantive areas; namely, the basic principles of intellectual property protection and their interaction with the other multilateral agreements; levels of protection for intellectual property; enforcement rights; dispute settlement at the WTO level; and transitional matters. The agreement continues the principles of national treatment and MFN provision, and sets minimum periods and/or scope of protection in the areas of copyright, patents, industrial designs, trademarks, geographical indicators, integrated circuit layouts and undisclosed trade secrets.

Source: WTO (2008a).

Multilateral trade negotiation rounds

Changes to the trade rules governed by the WTO occur principally through ‘rounds’ of multilateral negotiations, involving all members of the WTO. The negotiation and bargaining process involves members making ‘concessions’ — a commitment to reduce a trade barrier in their domestic market — in exchange for concessions made by other members. Decisions are made on a consensus basis, with a requirement that all members agree to proposals before they are adopted. Further, the separate agreements and commitments negotiated as part of a round are considered jointly as an (‘all or nothing’) ‘single undertaking’.

From the establishment of the GATT in 1947 to the WTO in 1995, there have been eight concluded rounds of negotiations (table 4.1). As noted above, the Uruguay Round of negotiations involved an expansion in the matters agreed in the GATT, including the formation of the WTO.

Table 4.1 Coverage of multilateral trade rounds

<i>Year</i>	<i>Place/Round name</i>	<i>Subjects covered^a</i>	<i>No. of countries</i>
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960–61	Dillon Round	Tariffs	26
1964–67	Kennedy Round	Tariffs and anti-dumping measures	62
1973–79	Tokyo Round	Tariffs and non-tariff measures, ‘framework agreements’	102
1986–94	Uruguay Round	Tariffs and non-tariff measures (for services as well as agriculture and non-agricultural products), anti-dumping measures, services, intellectual property, dispute settlement, textiles, agriculture, creation of the WTO.	123
2001–	Doha Round	Tariff and non-tariff measures (for services as well as agriculture and non-agricultural products), intellectual property, investment rules, competition policy, transparency in government procurement, trade facilitation, anti-dumping, regional trade agreements, dispute settlement understanding, environment, e-commerce, small economies, debt & finance, technology transfer, capacity building, least-developed countries, special and different treatment.	153

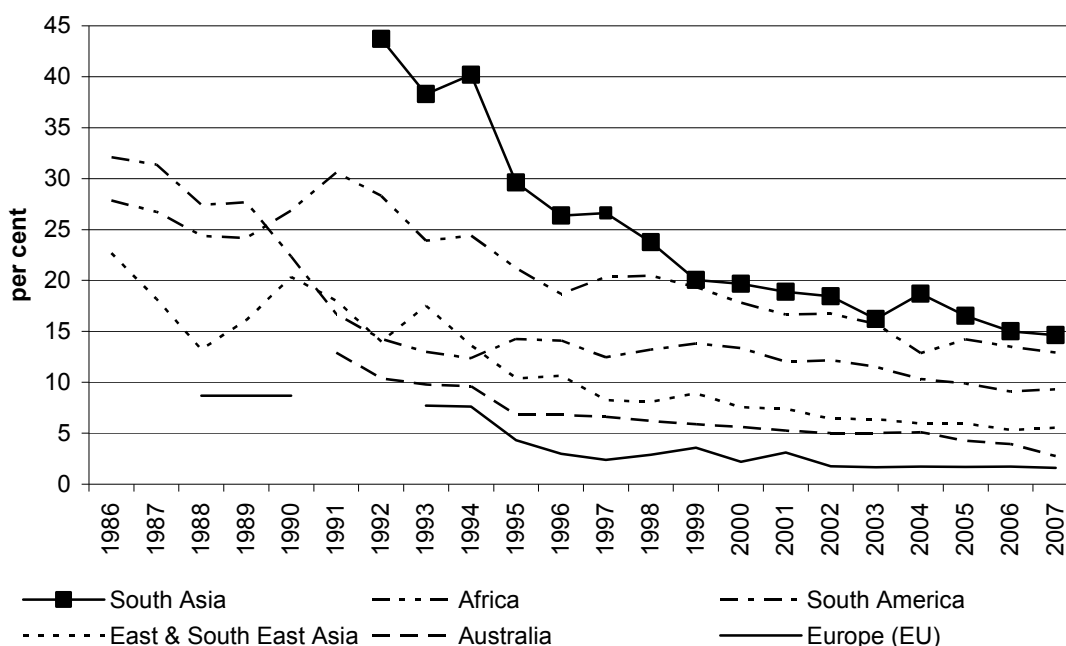
^a Not all subjects covered are necessarily included in the final agreement.

Sources: WTO (2001, 2008a).

Up until the recent rounds, the GATT multilateral negotiations have focussed on reducing tariff rates between member countries. From an average global tariff rate of approximately 40 per cent at the time of the GATT formation, average global tariffs were reduced to approximately 5 per cent by the mid-1990s (PC 2010).

Since the conclusion of the Uruguay Round in 1994, average applied tariff rates (the rate faced by importers in a country, which may be below the tariff rate a country is ‘bound’ to in the WTO) have continued to decline across the world (figure 4.1).

Figure 4.1 Average applied tariffs in selected geographic regions



^a South Asia includes India, Pakistan, Sri Lanka, Bangladesh, Nepal, Bhutan and the Maldives.

^b Average applied tariff rates are unweighted.

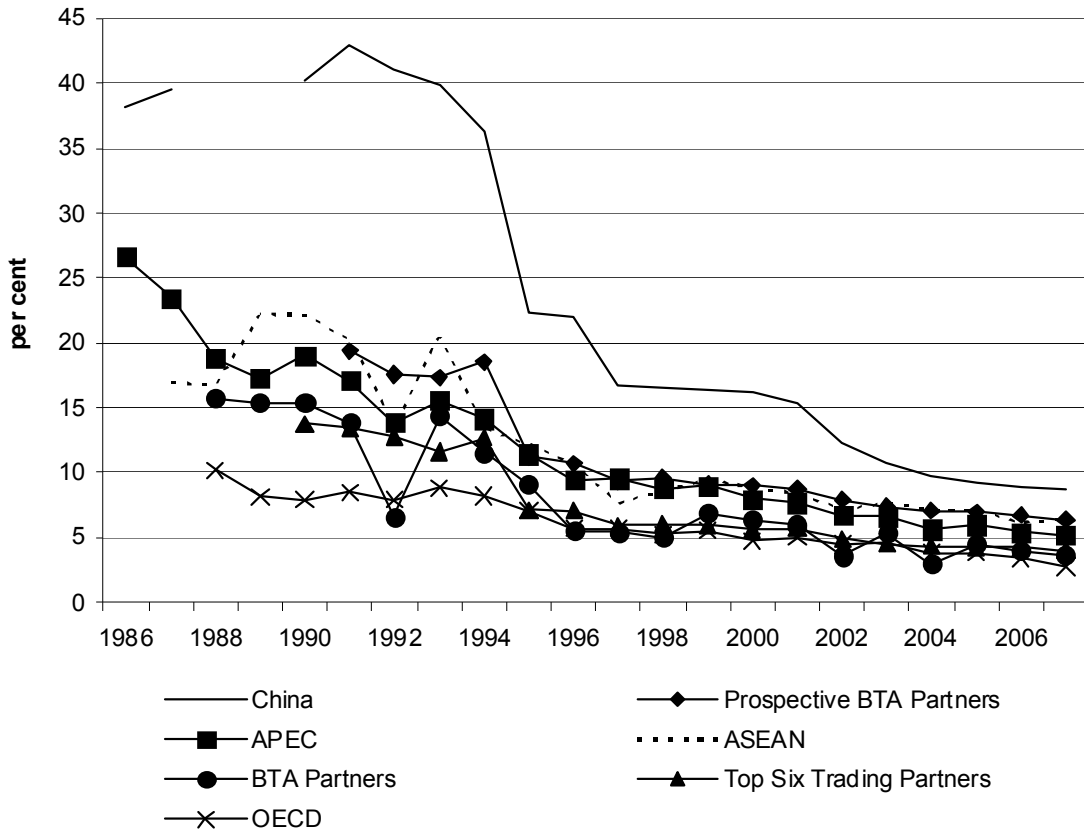
Source: World Bank (2010b).

Applied tariffs in Australia's key trading partners — particularly in China (Australia's main trading partner) — have fallen substantially since the early 1990s. Across APEC economies, tariffs have declined from an average of around 25 per cent to under 10 per cent (figure 4.2).

There has also been a steady, albeit less substantial, decline in tariffs amongst Australia's other large trading partners, and in those countries with which Australia has BRTAs, or with which it is currently negotiating such agreements. Average rates across APEC countries as a whole have fallen from an average of over 15 per cent in the late 1980s and early 1990s to under 10 per cent today.

Commencing in 2001, the Doha Development Agenda is the first round of multilateral negotiations to be held since the formation of the WTO. Although initially intended to run for three years, after nearly a decade the round is yet to be concluded. In July 2008, agreement was reached on a number of topics, but the meeting collapsed due to a disagreement over agriculture (WTO 2008b). Since 2008, while there have been some negotiations on technical aspects of the agricultural commitments, no formal agreements or commitments have emerged and, despite efforts, little progress was made during 2009 and for most of 2010. At this stage, there is also no formal agenda for further ministerial meetings.

Figure 4.2 **Average applied tariffs in Australia's key trading partners and selected international groupings**



a Top six trading partners are China, Japan, USA, Korea, United Kingdom and Singapore.

b Average applied tariff rates are unweighted.

Source: World Bank (2010b).

Other forms of non-discriminatory agreement

In addition to multilateral trade negotiation rounds, WTO member countries may engage in (near) multilateral reform of trade restrictions. Coalitions of member governments can form separate agreements to reform trade restrictions on an MFN basis. While such separate agreements are not a prominent feature of the WTO, some agreements of this nature have been established. For example, in 1996, 29 countries signed the Information Technology Agreement, agreeing to eliminate their tariffs on information technology products if the agreement were to attract enough signatories to cover 90 percent of global trade in the designated products. This coverage threshold was met by the following year, binding all of the signatories to those commitments under WTO rules.

4.2 Other multilateral institutions

While the WTO is the primary global institution governing international trade, other multilateral institutions have roles that either directly or indirectly influence trade and investment.

The International Organization for Standardization (ISO) develops and promulgates standards across numerous merchandise and service sectors, including in health, manufacturing, electronics, clothing, agriculture, food, construction, business organisation and services. It produces standards, technical reports and specifications upon application by member countries, and provides a means for businesses to demonstrate that their products or services conform to an agreed standard of quality or process. This facilitates trade by reducing transaction costs and providing confidence amongst businesses and consumers that products and services meet widely accepted standards. Australia participates in the ISO through the domestic body, Standards Australia.

In addition, specialist United Nations agencies develop and promulgate international standards and agreements in particular fields, some of which are referenced in WTO agreements and/or reflected in the national standards adopted by particular countries:

- The World Intellectual Property Organization (WIPO) oversees a range of international treaties dealing with the protection and enforcement of various forms of intellectual property, including copyright, patents, and the protection of geographical indicators, trade secrets, integrated circuit layouts and plant breeders' rights.¹
- The *Codex Alimentarius* Commission sets internationally recognised standards, codes of practice and other guidelines concerning food safety and food production. The WTO recognises the role of the *Codex* in providing agreed standards for the purposes of the *Sanitary and Phytosanitary Agreement*.
- The International Labour Organization (ILO) develops and promotes international labour standards. An ILO standard, once adopted by the organisation and ratified by a member country, has the force of international law. However, ratification is voluntary, and the ILO has no mechanism for enforcing compliance with its standards.

¹ Concern by less developed countries (which typically did not favour strengthening intellectual property protection) in the 1980s over WIPO processes, led to a push by developed countries to bring intellectual property within the ambit of the WTO (Trebilcock and Howse 1999, p.320). The TRIPS agreement was part of the foundation agreements to the WTO in 1994. Respective roles of the WTO and WIPO in setting global intellectual property rights and levels are yet to be settled.

-
- The International Telecommunications Union (ITU) administers a binding global framework for international telecommunications regulation, covering radio and telecommunications standards. In addition to its basic agreements, the ITU also administers a dispute settlement process.

Another multilateral institution, which influences financial regulation and investment, is the Bank for International Settlements (BIS). Although not established by a formal treaty, the BIS — through the *Basel Capital Accords* — specifies voluntary capital adequacy requirements for banks, as well as best practice guidelines for financial and banking supervision and regulation. These guidelines are intended to foster a stable global financial system, and impact directly on investment flows, as well as indirectly on a member country's financial stability.

A number of multilateral environmental protection treaties also influence trade and investment. Most directly, the *Convention on International Trade in Endangered Species of Wild Fauna and Flora* (CITES) entails bans on trade in some species, and a permit system for trade in others. Similarly, the *Basel Convention on the Control of Transboundary Movements of Hazardous Waste and their Disposal* bans the shipment of waste from member countries to non-member countries. Most multilateral environmental agreements do not entail trade restrictions, but do influence the domestic environmental standards of signatories, with trade and investment influenced by the application of those standards.

4.3 Bilateral and regional agreements and institutions

Three sets of WTO rules allow member countries to form bilateral and regional trade agreements, which are one permissible departure from the MFN principle embedded in the WTO agreements (box 4.2). Today, such agreements are widespread — for example, about half of world merchandise trade occurs between agreement partners. At present, some 278 such agreements have been notified to the WTO (chapter 5).

Aside from 'trade' agreements formed under WTO rules, countries are able to negotiate and conclude between themselves other treaties of mutual interest, covering issues of economic cooperation, investment, security or other matters. For instance, many countries have reached Bilateral Investment Treaties (BITs) and Trade and Investment Framework Agreements (TIFAs), also known in Australia as Investment Promotion and Protection Agreements (IPPAs). These agreements deal with investment flows from one country to another, and may establish such conditions as the treatment of investment funds in the importing country, dispute resolution processes and other matters.

Box 4.2 **WTO rules for bilateral and regional trade agreements**

Article XXIV of the GATT allows member countries to form preferential trade agreements with respect to trade in goods. The article covers:

- customs unions, where barriers between the members of the union are removed, and a common external tariff is imposed by each member country; and
- free-trade areas, where barriers between the members of the agreement are removed, but each member country is permitted to set their own external tariffs.

The rules require that the actions to reduce the trade barriers between member countries should lead to the elimination of duties and other restrictive regulations of commerce on ‘substantially all the trade between the constituent territories in products originating in such territories’. However, what is meant by ‘substantially all the trade’ is not defined within the GATT.

In the case of free-trade areas, the GATT rules require that the parties to an agreement maintain duties and other regulations of commerce applicable to trade with third parties at levels not higher or more restrictive than those applied prior to its creation. Because the formation of a customs union requires a common external tariff, the GATT rules provide that post-customs union duties and other regulations of commerce applied to non-members must not be ‘on the whole’ higher or more restrictive than those applicable prior to the formation of the customs union. Where customs union members are not able to achieve this balance to the satisfaction of their external trading partners, they must negotiate compensation or potentially face retaliatory actions.

A rule for agreements similar to that of the GATT exists in the GATS, and likewise requires agreements to have substantial sectoral coverage, and provides for the reduction of substantially all discrimination between foreign and domestic service providers.

Additional to the GATT and GATS provisions, in 1979, member countries agreed to allow developing country members to form agreements that lowered barriers to trade amongst themselves — now known as the ‘Enabling clause’. This clause has been continued in subsequent WTO agreements.

The general WTO principle of transparency also applies to the formation of customs unions and free-trade areas. In 1996, the WTO formed a Committee on Regional Trade Agreements. The role of this committee is to examine a proposed agreement to ensure that the outcomes are transparent and comply with the WTO rules. Information is provided to the committee by the member countries entering an agreement, and by written responses to questions posed by the committee members.

However, no examination report has been finalised so far by the committee in the intervening 14 years, in part because of disputes between members of the committee over the interpretation of the WTO agreements (WTO 2010a). However, the committee does report regularly on the agreements that have been notified to the WTO.

The WTO Dispute Settlement Panel has jurisdiction over disputes as to whether a customs union or free-trade area agreement complies with the requirements of Article XXIV of the GATT.

There are approximately 2500 BITs currently in force. Several countries have also reached ‘mutual recognition agreements’ (MRAs), under which the businesses, services or products that conform to domestic requirements in one country are deemed to meet the equivalent requirements in the partner country. Rather than being negotiated separately, such arrangements are sometimes included as provisions in bilateral and regional trade agreements.

A number of regional forums have also been formed by way of treaty between member countries and between participants through mutual cooperation. Such forums usually bring together countries geographically proximate to one another, often discussing issues beyond trade although they may also initiate trade agreements. Australia is a member of a number of such forums, including the Pacific Islands Forum (responsible for the formation of the Pacific Island Countries Trade Agreement), the Asia-Pacific Economic Cooperation (APEC) grouping and the East Asia Summit grouping, as well as the G20 group of advanced economies.

4.4 Domestic policies and programs

Domestic policy settings will have a pervasive influence over a nation’s competitiveness, and the level and pattern of its trade and investment. This section outlines key rules and institutions in Australia that have a significant influence on trade and investment.

Border regulation

The key types of border regulation maintained by the Australian Government include:²

- **Import tariffs:** Tariffs increase the returns earned by Australian producers, and in general are paid for by domestic consumers (or other local businesses) in the form of higher prices. Most imports to Australia face a tariff of 5 per cent or zero, but there are also pockets of higher tariffs in the textiles, clothing and footwear sector. The Commission has estimated that the gross dollar value of tariff assistance to domestic producers in 2008-09 was \$9.5 billion (PC 2010).
- **Quarantine:** Through the Australian Quarantine and Inspection Service, a range of regulatory and co-regulatory arrangements apply to the importation of plants, animals and food. Biosecurity Australia is responsible for undertaking science-based import risk assessments for plant and animal importation, and establishes quarantine policies for those goods deemed permissible for importation.

² Australia phased out most of its tariff quotas in the 1980s and 1990s

-
- Movement of people: Australia operates a visa system that allows foreigners to come to Australia for short periods of time as visitors or tourists. Australia also grants visas for business purposes, including an employer-sponsored worker migration system, as well as migration visas for professionals and those with skills in a range of defined employment areas.
 - Foreign investment: Australia regulates inward foreign direct investment via the *Foreign Acquisitions and Takeovers Act 1975* and associated regulations. The Act sets a range of minimum thresholds under which smaller scale investment proposals do not have to seek permission. As a result of the AUSFTA, different screening thresholds apply to US citizens and corporations than to other foreign entities.³ The Act also provides that certain inward investment proposals must be in the ‘national interest’ and requires the express permission of the Australian Government before they can proceed. The Foreign Investment Review Board (FIRB) reviews such proposals.
 - Trade ‘remedies’: As a WTO member, Australia has the right (but not the obligation) to implement Safeguards, Anti-dumping and Countervailing systems. Australia’s system is provided by the *Customs Act 1901*. While historically Australian industry has been a large user of the anti-dumping and countervailing system, in recent years this has steadily declined. This reduction has been associated with the decline in border protection afforded to Australian industries, and the increase in importance of imports as an input into production — factors that have reduced the likelihood that imports will injure Australian industries.

Behind-the-border measures

While not targeting international trade directly, many of Australia’s regulations and policies have a significant impact on the international competitiveness of Australian industry, a key factor in trade. In addition, such behind-the-border measures can act as a de facto trade barrier, restricting the flow of goods and services across borders. Some of the more prominent behind-the-border barriers in Australian include:

- Sectoral and product regulation: Regulation covers almost all areas of economic activity in Australia, including health, professional services, construction, mining and education. Some regulation bans or limits the sale of particular products or services, while other regulation limits the participation in activities to qualifying businesses or individuals. The Australian Competition and Consumer Commission (along with State and Territory governments) also has a

³ New Zealand citizens holding a special category visa are exempt from FIRB requirements if purchasing residential real estate in Australia. The Australian Government has announced its intention to extend the US FIRB concessions to New Zealand citizens (Rudd and Key 2009).

role in product safety standards (including labelling requirements, statutory warranties and information disclosures).

- **Industry assistance:** In addition to tariff assistance, Australian industry receives support through budgetary and other non-budget measures, including financial grants for activities such as research and development, as well as grants for restructuring or retraining staff, or drought support. Assistance can be granted by way of tax concessions, such as company, payroll or land tax concessions.
- **Export facilitation and financing:** The Australian Government provides assistance to business for the development or expansion of export markets, and business advice on exporting and financial grants through the Export Market Development Grants scheme and the activities of Austrade. The Export Finance and Investment Corporation provides export financing assistance to Australian businesses and, in some cases, overseas buyers.

Domestic reform

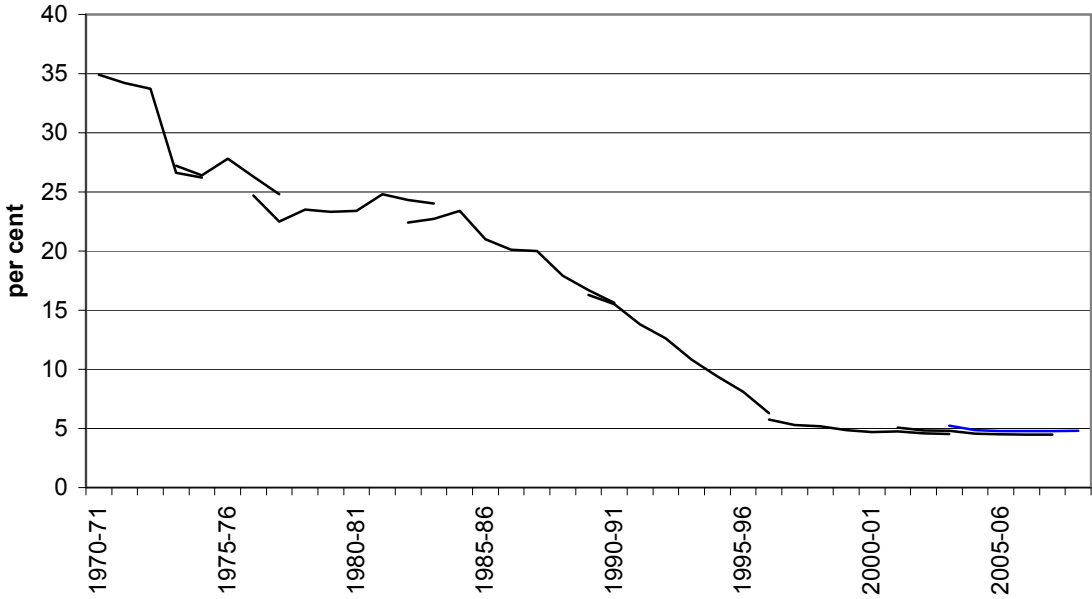
Reform within a country can be undertaken unilaterally, in response to a wholly domestic concern, or to implement a bilateral or multilateral obligation. Australia has a long history of domestic trade reform, as successive governments have reduced trade barriers below the levels bound in GATT and WTO negotiations.

Significant domestic trade liberalisation began in the 1970s, with an across-the-board cut in tariff rates of 25 per cent in 1973. Reform picked up speed again in the 1980s and 1990s, with the abolition of import quotas and the phasing down of tariffs to today's generally low levels. Reflecting these other changes, the Commission has estimated that the effective rate of assistance for manufacturing industries has fallen from in excess of 30 per cent in 1970 to around 5 per cent at present (figure 4.3).

In addition to reducing border protection, the Australian government has undertaken significant behind-the-border reform to regulations and practices that impact on the competitiveness of Australian industry. In particular, the National Competition Policy program, spanning 1995 to 2005, involved extensions in the anti-competitive conduct provisions of the *Trade Practices Act 1974* to previously excluded businesses; reforms of government businesses and improved regulatory arrangements to provide third-party access to essential infrastructure services and guard against the possibility of overcharging by monopoly service providers. It also incorporated previously agreed reform programs and subsequently agreed extensions to these programs for the electricity, gas, water and road transport sectors. A further round of reform, the National Reform Agenda (and now the

COAG Reform Agenda) aims to continue this work, with further efforts to harmonise regulation throughout Australia and, among other things, to reduce red-tape (COAG 2008, Australian Government 2009).

Figure 4.3 Effective rates of assistance to manufacturing, 1970-71 to 2008-09^a



^a Effective rates of assistance do not take into account preferences under BRTAs.
 Source: Commission estimates.

Many other countries have also undertaken unilateral tariff and related reform. For example, most developed and developing countries continue to reduce their MFN tariff rates — while some reduction is the result of commitments made by countries in the WTO, much of the reform has come without reciprocal outcomes. As reported by Martin and Ng (2004), two-thirds of the reductions in tariffs undertaken by developing countries since 1983 occurred unilaterally — giving emphasis to the view that countries primarily reform their trade regimes for domestic reasons, such as to improve the efficiency of their domestic industries and economic structures.