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## 14 Some specific provisions in BRTAs

As noted in chapter 5, in addition to the coverage of trade in goods and services, BRTAs can include provisions in areas such as investment, government procurement, e-commerce, intellectual property, competition policy, trade facilitation, economic cooperation, and labour and environment. While some of these topics are covered by multilateral trade agreements, others are not included or the commitments made in the WTO are of limited scope.

A number of participants commented favourably on the inclusion of some of these matters — often referred to as being ‘WTO-plus’ — in BRTAs (see box 14.1). DFAT noted that Australia’s agreements are comprehensive in coverage and argued that the inclusion of WTO-plus provisions had brought benefits for Australia. Examples of specific benefits provided by business participants included the facilitation of the trans-Tasman movement of business people, and improvements in regulatory independence and transparency in the telecommunications field. As well as any benefits that might accrue directly from such provisions, DFAT argued that the inclusion of WTO-plus provisions within BRTAs can generate longer-term benefits by helping to multilateralise the provisions in the WTO:

The development in FTAs of rules in newer areas has also paved the way for agreement in the WTO. Services, intellectual property, investment, government procurement and competition policy are all issues where progress in FTA negotiations has contributed to work on them in the WTO. (DFAT, sub. DR98, p. 3)

However, some academics have challenged the merits of this process in relation to some WTO-plus matters. Bhagwati (2008) argues that the inclusion in BRTAs of strengthened intellectual property rights and labour standards is often inimical to people’s living standards in developing countries, and that the spread of such provisions through individually-negotiated trade deals affords leverage to the inclusion of the same provisions in multilateral settings. Some participants in this study also warned that efforts to include some WTO-plus matters in Australia’s BRTAs could adversely affect the cause of trade liberalisation or entail other risks (box 14.1).

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**Box 14.1 Some participants' views on 'WTO-plus' issues**

The Commission received a number of positive comments from participants about the inclusion of WTO-plus provisions in Australia's BRTAs. The Department of Foreign Affairs and Trade stated:

Australia's FTAs are high quality agreements that are comprehensive in scope and reduce trade and investment barriers by securing enhanced market access for our goods and services exports ... our FTAs have been designed to address issues that are lightly covered in the WTO, such as government procurement, investment, and competition policy, and to varying degrees have ensured gains for Australia in these areas. (sub. 53, p. 10)

The Law Council of Australia noted the scope for agreements to extend to broader areas:

Bilateral preferential trade agreements provide greater opportunity to achieve wider and deeper trade liberalisation than regional preferential trade agreements as well as greater opportunity to address 'WTO-plus' issues such as trade related environmental issues. (sub. 47, p. 4)

From a business viewpoint, Telstra said:

Some of Australia's concluded bilateral agreements have included telecommunication services chapters ... An example of the WTO plus approach of these chapters are the commitments in relation to independence and transparency of regulatory decisions. (sub. 31, p. 2)

And commenting on trans-Tasman services trade, the NZ Employers and Manufacturers' Association Northern Inc. noted:

The establishment of this beyond GATS commitment has made the movement of professional people across the Tasman in both directions far easier ... (sub. 11, p. 6)

Other participants expressed a cautious view towards the value of some WTO-plus provisions in BRTAs. Ken Heydon argued that WTO-plus does not necessarily mean 'better' and added:

... there is the additional danger that the inclusion in PTAs of provisions dealing with controversial issues such as core labour standards will have a dampening effect on multilateral efforts at trade liberalisation should it be feared by developing countries that such inclusion will spread to the multilateral agenda. (sub. DR65, p. 2)

The National Farmers' Federation cautioned that:

... the Australian Government should be extremely careful to keep to trade-related matters only and to avoid 'new protectionism' in bilateral and regional trade agreements. (sub. DR85, p. 4)

On the other hand, some participants raised concerns about the inclusion of provisions addressing the movement of people across borders:

The ACTU does not believe that it is appropriate or desirable for BRTAs — directed at the regulation of goods and services — to regulate the movement of temporary workers. Workers are not commodities and should not be treated as such. (sub. DR80, p. 11)

And others commented that some commitments in BRTAs may unduly constrain Australia at a later time. AFTINET argued that:

The Global Financial Crisis is an important example of a global economic development which required immediate government action at national and international levels. Bilateral agreements which include "WTO-plus" financial liberalisation measures may limit the flexibility of governments to respond to the crisis. (sub. 33, p. 8)

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In the Commission's view, there is a range of WTO-plus matters on which agreement between Australia and a partner country will typically generate benefits for one or both parties. For example, measures that work to strengthen economic cooperation and improve competition policy frameworks, customs procedures and other trade facilitation measures may all add to efficiency with little downside risk.

In relation to other matters, the value of including provisions in a BRTA will depend much more on the specifics of the provisions and the circumstances of the partner economies. For example, it is plausible that commitments on government procurement in BRTAs could provide benefits to the parties. However, as discussed in chapter 7, the government procurement provisions included in AUSFTA have increased administrative costs and the complexity of tenders in Australia, and it is unclear whether there have been net benefits. Likewise, as discussed in chapter 10, while measures to facilitate the movement of natural persons can lower barriers to trade and facilitate international commerce, beyond some point concerns may arise as to the effects on local labour markets.

This highlights the need for careful assessments before provisions on such WTO-plus matters are included in BRTAs. Assessments first need to establish whether there is a market failure or other economic concern that provisions in BRTAs could effectively address. They also need to consider the balance of benefits and costs that might flow from the provision, and whether other mechanisms or settings would be better placed to address the issues identified. Of course, in some instances it may be appropriate to accept in an agreement a provision that is not ideal if it is part of a package that overall is in Australia's economic interests. Overall though, in the Commission's view, there should be no automatic presumption that a BRTA that is broader in the range of matters covered is necessarily superior to a narrower one.

Against this background, this chapter examines some of the more contentious WTO-plus areas and considers in broad terms whether and how Australia should seek to incorporate them in its BRTAs.

## **14.1 Intellectual property**

Intellectual property (IP) laws give creators of certain works a monopoly right over the authorised creation and sale of copies of their work. From an economic efficiency viewpoint, finding the appropriate degree of IP protection involves balancing:

- the incentives for creators to produce new works that stronger IP rights and protections provide; against

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- the costs to users that stronger IP rights and protections cause, by extending the monopoly pricing and restricting supply of those works.

Thus, IP protections that are either too strong or too weak can have adverse economic effects. For individual countries, the optimum design and level of IP rights also depends on the extent to which they are net importers or exporters of different forms of IP material and other considerations, such as their level of economic development and the nature of their legal system.

While IP protections have traditionally been the province of domestic legislation and dedicated multilateral treaties, in recent years they have also increasingly been included in trade agreements. In setting out Australia's current approach on this issue, DFAT stated:

There has been increasing recognition that the issue of adequate protection and enforcement of intellectual property has an international trade dimension. This is reflected in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Australia's approach to pursuing appropriate coverage of intellectual property issues in its FTAs. ...

While the WTO TRIPS Agreement sets minimum standards, many members are yet to fully implement those standards. Similarly, many World Intellectual Property Organization (WIPO) members are yet to implement many of the WIPO agreements to which Australia adheres, particularly those addressing pressing issues around copyright in a digital age.

All of Australia's recent FTAs reaffirm the commitments in the WTO TRIPS Agreement – with the exception of the CER which was negotiated before TRIPS. AUSFTA and the ACI-FTA are more comprehensive in their coverage of intellectual property rights and the type of protective measures to be provided than SAFTA, TAFTA or AANZFTA. With respect to copyright and related rights, for example, the term of protection for works increased under AUSFTA to the life of the author plus 70 years.

The potential of FTAs to strengthen regional economic integration is evident in such agreements' treatment of intellectual property where common approaches can promote foreign investment, technology transfer and trade between the parties. (sub. 53, pp. 36-7)

A number of industry bodies (for example, the Australian Publishers' Association (sub. 12), APRA and AMCOS (sub. 27) and Music Industry Piracy Investigations (MIPI) (sub. 28)) commented on the benefits to them from strengthening IP protections in BRTA partner countries. Illustratively, MIPI stated:

... trade agreements provide a unique opportunity for Australia to assist our key trading partners in addressing some of the challenges they face in respect of IP protection. Augmented protection of IP in Australia's trading partners will afford greater business confidence and consequently improve trade for Australian companies and organisations. (sub. 28, p. 7)

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While there can clearly be benefits from international cooperation on IP matters and from the common adoption of appropriate protections, the Copyright Agency Limited (CAL) stated:

CAL's view is that, ideally, improvements to intellectual property regimes should be achieved through multilateral treaties and the international organisations that administer them, such as the treaties administered by the World Intellectual Property Organization and the World Trade Organization. (sub. 34, p. 1)

CAL went on to acknowledge, however, that due to difficulties in developing new standards for IP protection and administration through those organisations, many countries, including Australia, have sought to address issues surrounding IP through BRTAs (as well as plurilateral agreements).

Meanwhile, IP Australia — which is the government body that oversees Australia's IP rights system — emphasised the need for a cautious approach to the inclusion of IP provisions in BRTAs:

IP Australia does not seek provisions that:

- are mere reproductions of provisions from previous FTAs that are of no particular interest to Australia and would simply advance the interests of other countries;
- inappropriately reduce flexibility to amend or change Australia's legislation or practices;
- require legislative change; or
- add unnecessary complexity to negotiations. (sub. 24, p. 1)

### **Considerations relevant to promulgating IP 'rule expanding' provisions**

Against this background, one question is whether Australia should push for provisions in future BRTAs that expand on existing IP rights and, in particular, that extend the term of copyright.

As discussed in chapter 10, analysis indicates that the extension in the duration of copyright required by AUSFTA imposed a net cost on Australia. This partly reflects Australia's status as a net importer of IP. However, even in the case of the United States, which is a significant net exporter of IP, the earlier, equivalent extension in the term of copyright is also likely to have entailed a net cost, reflecting adverse

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impacts on consumer welfare (Akerlof et al. 2002).<sup>1</sup> In turn, it is probable that further extensions in the term of copyright would add further net costs.

Given, however, that the copyright term extension provisions in AUSFTA cannot readily be unwound, it could be argued that Australia, in future BRTAs it might negotiate, should seek to have the same provisions adopted by partner countries. This would generate benefits for those Australian IP rights holders who export to the partner country, while having no new adverse effect on the price and consumption of IP material purchased in Australia.

On the other hand, just as was for case of Australia under the AUSFTA, a BRTA requirement for partner countries to extend copyright terms would likely impose a net cost on their economies. Moreover, while copyright holders in Australia who export would benefit, Australia as a whole would be unlikely to get value for the ‘bargaining coin’ it would need to expend to compensate the partner country for incurring those costs. Rather, the main beneficiaries would be rights holders in other countries, particularly the United States. The note of caution issued by IP Australia (above) — about avoiding provisions that are mainly of interest to other countries — is pertinent in this context. One view is that Australia would be far better to spend its limited bargaining coin in negotiations with partner countries on securing genuine trade liberalising reforms of potential benefit to both parties.

Given that previous extensions in other IP rights have also been found to have generated net costs on Australia (Gruen, Bruce and Prior 1996; see footnote 3, p. 263) — and thus would likely have similar effects on other countries — similar considerations would apply in relation to proposals to include other rule expanding provisions in future Australian BRTAs.

### **Considerations relevant to promulgating IP ‘rule enforcing’ provisions**

Another set of issues arise when considering the approach Australia should take to incorporating provisions in BRTAs that seek to ensure the enforcement of existing IP rights. As noted by DFAT above, some of Australia’s existing BRTAs seek to encourage partner countries to join or reaffirm commitments to multilateral IP

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<sup>1</sup> An amicus curiae brief was made by seventeen economists, including five Nobel Laureates, in the US case of *Eldred v Ashcroft*, which concerned the 1998 United States extension of copyright protection by 20 years. The authors calculated that the marginal increase in future compensation for authors would not be offset by an increased incentive to create new works; and that the extension would increase the impacts that stem from the monopoly protection for works and continue to preclude the benefits that come from works entering the public domain (including the creation of new derivative works).

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treaties. IP Australia (sub. 24, p. 3) also suggested that Australia's BRTAs encourage improvements in cooperation, information sharing, enforcement and prosecution activities.

Participants pointed to a range of benefits that could eventuate from such activities. In addition to increases in the value of IP rights held by Australians who engage in exporting, these include:

- reducing transactions costs by encouraging partner countries to increase their use of online facilities for registration of IP rights, and the promulgation of laws and other information;
- legal certainty through greater transparency in the application of IP laws, accession to widely accepted multilateral treaties and greater participation in multilateral forums; and
- greater technology transfer through strengthening enforcement mechanisms and improving investor confidence. (IP Australia, sub. 24)

While encouraging partner countries to join or reaffirm commitments to multilateral IP treaties can therefore potentially bring a range of benefits, there are two other sets of issues that need to be considered in assessing the merits of pushing for such terms in BRTAs.

First, as with efforts to expand IP rules, most of the benefits to IP rights holders from measures to promote adherence to existing rules in partner countries can be expected to accrue to third parties, such as rights holders in the United States. Again, the question would arise as to whether Australia should 'carry the water' for others, when doing so would diminish the bargaining coin available to negotiate for other reforms by the partner country of potentially more benefit to both it and Australia. Different views can be adopted on this issue:

- Some would argue that there is intrinsic value in efforts to encourage countries to comply with international standards and to adhere to agreements they have previously made but may not be vigorously observing, and that Australia as a good global citizen should contribute to such efforts, even where there is little direct benefit to Australia.
- Others would argue that Australia should support negotiations to promote adherence to sound international IP standards, but generally only in multilateral settings, in which all countries that stand to benefit from such measures could participate and contribute.

A second albeit related set of considerations is whether BRTAs are a cost-effective means of pursuing the Australia Government's IP objectives internationally.

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Negotiations around BRTAs provide an opportunity to raise IP issues with countries and, as noted above, Australia has successfully negotiated IP provisions in a number of its recent BRTAs. However, IP Australia (sub. 24, p. 4) stated that ‘there is not always a complete match between those countries of interest to the government in the FTA process and those of interest to IP Australia’. It continued:

While supportive of the positive outcomes that may eventuate from any FTA negotiation, IP Australia considers that FTA negotiations are just one of the avenues to achieve international reforms. It is a costly exercise for our organisation. Without empirical evidence, it is hard to accurately quantify the benefits for the investment made to support the FTA process as opposed to other international activities IP Australia undertakes to support the IP system. (sub. 24, p. 4)

### **Implications for future policy?**

In its draft report, the Commission noted that determining the approach Australia should take to IP issues in future BRTA negotiations entails balancing a range of factors. On the one hand, Australian IP rights holders who export their output stand to gain some benefits from promulgating existing international IP protections more widely, and from encouraging trading partners to adhere to their commitments. There is also an argument that Australia, as a good global citizen, should pursue such measures in BRTAs on ‘rule of law’ grounds. On the other hand, many IP measures are likely to result in net costs to the partner country and most of the benefits will flow to third parties. This is in contrast to preferential tariff reductions, for instance, and raises the issue of whether Australia’s bargaining coin would be more productively spent on negotiating reforms of potentially more benefit to both Australia and the partner country.

The Commission concluded that these complexities point to the need for Australia to adopt a cautious approach to negotiating IP protections in BRTAs and to avoid an automatic template. Rather, where the Australian Government is likely to pursue a BRTA, it should consider, prior to commencing negotiations, the value of seeking to have different IP provisions included in the agreement and whether alternative avenues may prove more cost-effective for pursuing its IP objectives.

In response to the Draft Report, DFAT submitted that:

The final report should acknowledge that Australia already takes a cautious approach to IP in FTAs ... IP is a complex area and the costs and benefits of FTA obligations relating to IP are carefully considered. Australia has sought to negotiate provisions that are consistent with current and emerging international standards, and our existing laws and policy settings. We have tailored our approach to reflect the different interests in each partnerships, taking into account the adequacy of IP protection in FTA partners

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compared to Australia's appropriate standards of IP protection and recognised international standards. (sub. DR98, p. 11-12).

The Commission is not convinced, however, that the approach adopted by Australia in relation to IP in trade agreements has always been in the best interests of either Australia or (most of) its trading partners.

Among other things, there does not appear to have been any economic analysis of the specific provisions in AUSFTA undertaken prior to the finalisation of negotiations, nor incorporated in the government's supporting documentation to the parliament.<sup>2</sup> As noted above, the AUSFTA changes to copyright imposed net costs on Australia, and extending these changes to other countries would be expected to impose net costs on them, principally to the benefit of third parties.

Concerns have also been raised about the effects of IP provisions in some other trade agreements that Australia has supported. For example, Australia supported the 1994 TRIPS agreement — which was included in the Uruguay Round single undertaking — and saw Australia extend the term of protection for patents from 16 years to 20 years. Subsequent analysis by Commission staff found that the extension of rights to existing patents could result in a large net cost to Australia.<sup>3</sup> Some economists have also argued that implementation of TRIPS by developing countries would result in significant net costs to them, costs not offset by the other provisions in the Uruguay agreement (Panagariya 1999, Finger 2002). To the extent that 'emerging international standards' would extend IP rights further, requiring developing countries to adhere to these standards could do them further harm, again principally to the benefit of business interests in the United States and Europe.

In responding to the Draft Report, DFAT also stated:

The final report should also make clear that Australian industry has real commercial interests in comprehensive IP commitments that promote appropriate standards of IP protection in our major trading partners, as the draft report does not appear to acknowledge this point. ... The draft report focuses on the so called "net costs" of

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<sup>2</sup> None of the three economic modelling exercises undertaken prior to signing AUSFTA attempted to quantify the proposed changes to Australia's IPR laws, and neither the National Impact Analysis nor the Regulation Impact Statement (both of which are prepared by the government and tabled with the agreement in parliament) discussed the likely implication for Australian consumers from the changes.

<sup>3</sup> Gruen, Bruce and Prior (1996) calculated that Australian users of patents and patented products could pay between \$1.5 billion and \$7.4 billion more, although this cost will be offset by gains of between \$1.1 billion and \$3.6 billion to Australian producers of patents and patented products. Calculations were based on range estimates of patent content of imports and exports. The study did not quantify the impact of any additional R&D induced by the extension in patent life: the authors argued that any additional incentive for new R&D would likely be small.

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extending protection through FTAs, without adequately reflecting the broader benefits of IP protection, including increased incentives for creation, innovation and investment, additional value added to exported goods and services, and access to cultural products and goods and services incorporating IP. (sub. DR98, p. 12)

Under its Act, the Commission is required to consider the benefits and costs of policies to the community as a whole, rather than focussing on the effects on particular sectors. While there is no doubt that some business interests in Australia would benefit from a further strengthening of IP provisions abroad, this is not a sufficient condition for seeking such a strengthening through BRTAs. In the Commission's assessment, in the context of trade negotiations, greater gains to both Australia and its BRTA partners generally could be obtained by spending bargain coin on reforms more likely to be of more benefit to the partners. Nor is it clear that extending provisions that would likely harm the economies of developing countries, principally to the benefit of businesses in third party developed nations, could readily be justified on good global citizenship grounds. In this context, the Commission is also cognisant of risks that incorporating 'emerging international standards' on IP into more BRTAs may raise expectations about the starting point for future multilateral IP negotiations further beyond the optimum level, potentially to the detriment of Australia and other countries.

Against this background, the Commission's view is that Australia's participation in international negotiations in relation to IP laws should focus on plurilateral or multilateral settings, and that its support for any measures to alter the extent and enforcement of IP rights should be informed by a robust economic analysis of size and distribution of the resultant benefits and costs.

The Commission considers that Australia should not generally seek to include IP provisions in further BRTAs, and that any IP provisions that are proposed for a particular agreement should only be included after an economic assessment of the impacts, including on consumers, in Australia and partner countries. To safeguard against the prospect that acceptance of 'negative sum game' proposals, the assessment would need to find that implementing the provisions would likely generate overall net benefits for members of the agreement.

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## 14.2 Investor-state dispute settlement

Investor-state dispute settlement (ISDS) provisions are mechanisms agreed between partner countries for the investors of one country to solve investment-related disputes with the partner government.

ISDS provisions are often included in BRTAs, and were the subject of significant commentary during this study. Following release of the Draft Report, the Commission convened a roundtable to further explore the issues surrounding ISDS. Roundtable participants are listed in appendix B. This section draws on information from the roundtable, supplementary submissions and further research and deliberation by the Commission.

ISDS provisions are intended to reduce the political risks to foreign investors of government actions, but are distinct from commercial arbitration, which is intended to provide an alternative mechanism for resolving business-to-businesses disputes outside of any country's formal judicial system. ISDS provisions are also additional to a country's regular legal system for settling disputes, and other mechanisms available to business to reduce their foreign risks, such as insurance and specific company-to-government agreements.

ISDS provisions have been included in trade agreements between developed and developing countries, as a way of providing additional protection to foreign investors in the developing country, given investor concerns about the state of developing countries' legal systems to solve investment disputes between investors and governments. However, the inclusion of ISDS provisions in agreements between developed countries is becoming increasingly common. By the end of 2009, 357 known treaty-based cases had been brought for international arbitration, more than half of which were initiated between 2005 and 2009 (UNCTAD 2010b).

Australia is a party to numerous Investment Promotion and Protection Agreements (IPPAs), which are concerned solely with investment rules between Australia and a partner country. Most of Australia's current BRTAs also contain investment chapters, which are similar in form to IPPAs. As discussed in chapter 6, investment chapters and the IPPAs (collectively known as International Investment Agreements, or IIAs) generally provide a range of investment protections to investors in a partner country to an agreement. Some of Australia's BRTAs and all of its IPPAs also contain ISDS provisions (box 14.2).

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### Box 14.2 Investor-state dispute settlement in Australia's agreements

Investor-state dispute settlement relates to the mechanisms agreed between countries for settling disputes that arise between an investor of one party to an agreement and the other government.

Australia's approach to date has been to include ISDS with third-party arbitration in agreements with some countries, while not including it with others (such as the United States and New Zealand). This reflects the fact that where Australia and the partner country operate stable and well-functioning legal systems. Australia's trade agreements traditionally offer parties a range of dispute settlement options, which may include:

- formation of an ad-hoc tribunal, the rules of which are established by the trade agreement;
- formation of an ad-hoc tribunal in accordance with the rules of the United Nations Commission on International Trade Law (UNCITRAL); or
- arbitration through the International Centre for Settlement of Investment Disputes (ICSID).

Arbitration of a dispute by the ICSID requires both countries to an agreement to have ratified the centre's Convention; thus, Australia's agreements often offer disputing parties a choice of dispute settlement mechanism. In addition, agreements generally encourage parties to attempt to first rectify disputes via consultation. However, third-party arbitration under ICSID is a popular form of resolving ISDS cases.

Both the UNCITRAL and ICSID rules also allow foreign investors to seek arbitration for investment disputes against a member country, even if no trade agreement exists between the investor's home country and the host government. However, this process requires the host government to consent to arbitration.

Currently, four of Australia's BRTAs (AANZFTA, ACI-FTA, SAFTA and TAFTA) allow third-party arbitration as part of the investment chapter (third-party arbitration was excluded from AUSFTA).

*Source:* Aisbett and Bonnitca, sub. 45, p. 2.

Australia's IIAs bind the agreement partners to the 'national treatment' of foreign investors (that is, treating foreign investors no less favourably than domestic investors), and often also require the provision of 'fair and equitable treatment' to foreign investors. Agreements generally also provide a legal entitlement to foreign investors to be paid compensation by the host country for direct acts of expropriation of foreign investments and, in some cases, indirect acts that amount to expropriation. However, these commitments often allow governments to undertake some actions that would otherwise breach the agreement, provided certain conditions are met (box 14.3).

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**Box 14.3 Protection against expropriation under AUSFTA**

AUSFTA provides protection to Australian and US investors against direct and indirect expropriation, for investments made in the corresponding territory. Article 11.7(1) states that:

1. Neither Party may expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (“expropriation”), except:
  - (a) for a public purpose;
  - (b) in a non-discriminatory manner;
  - (c) on payment of prompt, adequate, and effective compensation; and
  - (d) in accordance with due process of law.

Annex 11-B(4) of AUSFTA goes on to provide some guidance as to how indirect expropriation will be handled in dispute resolution under that agreement, stating:

4. The second situation addressed by Article 11.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
  - (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
    - (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
    - (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
    - (iii) the character of the government action.
  - (b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.

The requirements that stem from ‘fair and equitable treatment’ obligations are not always clear. As far as the Commission is aware, no ISDS arbitration case has been brought — either by an Australian company against a foreign government or by a foreign investor against the Australian Government — under any of Australia’s IIAs. However, numerous cases have been brought under the equivalent ‘indirect expropriation’ and ‘fair and equitable treatment’ provisions contained within other BRTAs, such as NAFTA. Box 14.4 outlines some of these cases, which show that in some circumstances, otherwise routine actions of government have been held to breach specific rights granted to foreign investors under a trade agreement.

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#### Box 14.4 What is ‘indirect expropriation’ and ‘fair and equitable treatment’?

In theory, clauses guaranteeing investors ‘fair and equitable treatment’ attempt to codify an existing right to fair treatment under customary international law. However, customary international law often lacks definition, leading some to question the helpfulness of the clarification. Problems have arisen where arbitral tribunals have imposed a stringent standard of treatment on host governments, particularly where an agreement does not reference the existing minimum standard requirements under international law (sub. DR67, Attachment 1, p. 10). In 2001 the NAFTA governments issued a clarification on the meaning of ‘fair and equitable treatment’, intending for it to be restricted to the standard of treatment required under customary international law.

While Australia has not yet been subject to an arbitration claim under any of its IIAs, a number of cases concerning indirect expropriation and ‘fair and equitable treatment’ have been brought under the NAFTA investment clauses. Such cases illustrate the types of government actions that could be in breach of international obligations.

- In *Ethyl Corporation v Canadian Government*, a US company challenged a Canadian Government ban on the importation and inter-provincial transport of the fuel additive MMT, on a number of investor-protection grounds in NAFTA, including that such a ban ‘amounted to an expropriation’ by reducing the value of Ethyl’s manufacturing plant, harming future sales and damaging its corporate reputation. The Canadian Government chose to settle the case prior to arbitration, overturned its ban and paid Ethyl’s legal fees and an amount of damages.
- In *Metalclad v Mexico*, a Mexican company with a right to operate a hazardous waste transfer station was purchased by a US company. The US company wished to expand the waste facility to process toxic waste and obtained the necessary federal and state permits, but not a local construction permit. The local government ordered Metalclad to cease construction, which went ahead regardless. Following construction, the local government continued to deny a permit. Metalclad eventually brought a claim that the denial of the permit was an indirect expropriation without compensation. An arbitration panel found that Mexico had breached its obligations under NAFTA, and ordered compensation be paid. The tribunal ruled that indirect expropriation included “covert or incidental interference” with the use of property.
- In *Pope & Talbot v Canada*, a US-based timber company operating sawmills in Canada under the *US-Canada Agreement on Trade in Softwood Lumber* sought arbitration that Canada’s treatment of the company, including the requirement to provide information on their operations under the agreement in Canada itself, breached their rights under NAFTA. Although the company was treated similarly to other timber companies in British Columbia, it was not treated similarly to other logging companies in Canada not subject to the agreement. A tribunal found that ‘market access’ was an investment for the purposes of NAFTA, and found that the Canadian Government had acted unreasonably in its dealings with the company. Damages and costs were awarded.

Source: UNCTAD (2010b).

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## **What are the benefits of ISDS, and how significant are they?**

The principal economic rationale for granting ISDS protections to foreign investors would be to overcome some form of market failure associated with investment. Foreign investment can improve a country's capacity to increase its output and production, which in turn can enhance living standards through higher national income, and the provision of social services. The economic literature (for example, Kerner 2009, Neumayer and Spess 2005) discusses two potential problems that might in theory justify ISDS provisions:

1. Governments may have an incentive to offer favourable conditions to foreign investors in the period prior to them making an investment, and then to expropriate that investment after it has been made.
2. Foreign businesses might face systemic biases against them, such as when tendering for government procurement contracts, or might face more onerous requirements in meeting regulatory or planning approvals.

While either problem could in theory necessitate higher returns to foreign investors to attract them to invest and/or result in lower levels of investment than would otherwise have occurred, there are reasons to doubt that such problems are significant in practice. Given the desire of most countries to remain attractive to foreign investment on an ongoing basis, the risks of expropriation, especially direct expropriation, are likely to be limited due to 'reputational effects'. Even a single instance of expropriation could harm a country's reputation as a location for inward investment. There is also evidence that, in practice, host governments are not systemically biased against foreign investors. In fact, a 2005 study analysing results of the World Business Environment Survey (10 000 business responses from 80 countries) found that foreign firms enjoyed regulatory advantages not shared by their domestic equivalents, as reported by those firms themselves (Huang 2005). Further, foreign firms surveyed in 48 developing countries self-reported that they considered their political influence allowed them to achieve fiscal and regulatory advantages that domestic firms could not (Desbordes and Vauday 2007).

There is also evidence that committing to ISDS provisions does not influence foreign investment flows into a country. In a recent study, Berger et al. (2010) examined the impacts of IIAs — both with and without ISDS provisions — on foreign direct investment flows. The authors concluded that while the inclusion of national treatment provisions within treaties had a positive effect on investment flows, the agreement by a country to ISDS provisions had no statistically significant impact on foreign investment into that country. This suggests that even if a country believes it is attracting an insufficient level of foreign investment, introducing ISDS provisions are unlikely to change the situation, once other factors influencing investment are taken into account.

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These considerations and studies cast doubt on the existence of any significant economic problems that might be effectively addressed by ISDS provisions.

Of course, such provisions could still benefit particular investors to the extent that they shift political risks associated with investments to host governments and/or provide an avenue for compensation ‘after the event’. In consultations following the Draft Report, it was also suggested that ISDS could provide additional leverage to businesses when negotiating with foreign governments prior to undertaking (or during the life of) foreign investments, were the businesses willing to threaten to pursue an arbitration case against a foreign government.

However, as noted in chapter 7, the Commission received no feedback from Australian businesses or industry associations indicating that ISDS provisions were of much value or importance to them. Indeed, as far as the Commission is aware, no Australian business has made use of ISDS provisions in Australian IIAs, including in its BRTAs.

One possible reason for this, and for the results of the studies indicating that ISDS has little impact on investment flows, could be the existence and relative attractiveness of other private and government options for addressing such political risk. For example, the World Bank Multilateral Investment Guarantee Agency, of which the Australian Government is a signatory, provides insurance to those investing in developing countries against expropriation (including indirect expropriation), as well as acts of war and terrorism. Similarly, the Australian Government’s Export Finance and Insurance Corporation offers Political Risk Insurance to Australian businesses, with coverage similar to the World Bank. Private insurance markets also offer investment insurance coverage for the same class of risks. Such market-based solutions can serve to mitigate risks faced by investors, allowing investment to be based on underlying market conditions. In addition, some prospective investors may be able to negotiate specific agreements that contain dispute resolution mechanisms with foreign governments, prior to undertaking any investment (although it would be expected that this particular alternative is more feasible for large businesses rather than small and medium businesses).<sup>4</sup>

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<sup>4</sup> For example, the government of Western Australia struck an agreement with foreign investors over the Gorgon gas project that included a provision that refers disputes to arbitration (WA *Barrow Island Act (2003), Schedule 1*). Similarly, Rio Tinto’s agreements with the Canadian Government (such as regarding the environmental treatment of the Diavik diamond mines) also contain clauses referring disputes to arbitration (Rio Tinto 2000), as do agreements between the Liberian Government and Chinese mining investors (Liberian Government 2009).

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In sum, while a range of potential benefits have been posited to accrue from ISDS provisions, there is little evidence that such provisions are necessary to address potential problems faced by investors or that they generate significant benefits in practice.

FINDING 14.1

*There does not appear to be an underlying economic problem that necessitates the inclusion of ISDS provisions within agreements. Available evidence does not suggest that ISDS provisions have a significant impact on investment flows.*

### **What are the risks of ISDS?**

A number of participants raised concerns about the inclusion of ISDS in IIAs, including the issue of ‘regulatory chill’, inefficiently biasing in favour of foreign investment, the granting of substantive and procedural rights to foreign investors that are not shared by domestic investors, and concerns with the processes of arbitration.

First, as discussed in chapter 6, IIAs and their investment provisions are intended to bind the actions of the governments that are party to an agreement from undertaking actions that might otherwise be prejudicial to foreign investors. However, ISDS provisions can further restrict a government’s ability to undertake welfare-enhancing reforms at a later date, a problem known as ‘regulatory chill’. Such ‘chilling’ occurs because the investment clauses that provide protection against ‘indirect expropriation’ and ‘fair and equitable treatment’ (example cases are discussed in box 14.4 above). These protections and minimum standards of treatment are extended to foreign investors but often not afforded to domestic investors, and can involve such government actions as changes to environmental legislation, taxation arrangements or licencing schemes. ‘Chilling’ occurs when governments choose not to undertake regulatory action (as opposed to directly expropriating property) for fear of triggering arbitration claims or paying compensation.

A number of submissions raised the prospect of ‘regulatory chill’ as a risk brought about by ISDS, not just for developing countries seeking to improve their standards of regulation, but also developed countries. For example, Professor Van Harten (sub. DR99, p. 5) noted the documented withdrawal by Canada of a proposal to impose cigarette plain-packaging regulations following the threat of ISDS arbitration. AFTINET (sub. DR68, p. 10) highlighted the arbitration case against Uruguay over the same proposal. Although Australia has not been subject to any ISDS claim to date, the prospect of such a claim in the future increases the possibility that regulatory chill will influence government decisions and regulatory outcomes.

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Second, some participants argued that investment protection provisions within IIAs grant rights to foreign investors that are not available to domestic citizens and investors. As noted by DFAT (sub. DR98, p. 14), ISDS grants new procedural rights to foreign investors that are not afforded to domestic investors, who are unable to seek third-party arbitration against the Australian Government. AFTINET submitted that the granting of such rights through ISDS provisions are:

... an unacceptable expansion of the rights of corporate investors at the expense of democratic government ... To enable corporate investors to sue governments for damages before tribunals which can challenge laws or policies and award damages undermines the democratic process and gives disproportionate additional legal powers to investors. (sub. DR68, p. 11)

The Commission recognises some domestic legislation will necessarily be concerned solely with foreign investors or citizens; for example certain Customs or immigration matters. However, the general granting of additional substantive and procedural rights to foreign investors through ISDS can disadvantage domestic relative to foreign investment and thereby distort investment flows. In reviewing the economic literature on the matter, Aisbett and Bonnitcha noted that if:

... foreign investors do not face greater political risk than domestic firms in the absence of a treaty, then the pre-treaty level of foreign investment is not inefficiently low [compared with] domestic investment. In so far as treaty protection further reduces the political risk faced by foreign firms, it may do so inefficiently. In this case, productivity may fall as a result of the investment agreement as efficient domestic producers are displaced by less efficient but better politically-insured foreign firms. (sub. 45, p. 4)

A third concern related to the awarding of damages in ISDS cases, including the degree of freedom arbitral tribunals have in determining the amount of compensation to be paid. Highlighting the potential for large claims for compensation, Dr Kyla Tienhaara noted:

While it is a rather extreme case, by 2006, Argentina was facing more than thirty claims for an estimated US\$17 billion in compensation ... The Czech Republic was obliged to pay more than US\$350 million in compensation to a Dutch investor, which according to one report meant a near doubling of the country's public sector deficit. A 2009 survey found 33 cases involving claims of more than \$1 billion, the highest being a claim for \$50 billion, and more than 100 additional cases where claims were between \$100 and \$900 million. (sub. DR67, p. 8)

Finally, a number of participants raised concerns with the international rules of third-party arbitration, including institutional biases and conflicts of interest, inconsistency and matters of jurisdiction, a lack of transparency and the costs incurred by participants (box 14.5). Further, arbitration cases are generally not

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**Box 14.5 Concerns with the process of arbitration**

Some participants highlighted a range of concerns with the process of ISDS and arbitration that are commonly identified in the policy literature.

- Institutional bias and conflicts of interest: It has been suggested that there is a ‘pro-investor’ bias in ISDS, resulting from the fact that only investors can bring arbitration claims, and the arbitration system relies on investor claims to continue. Further, conflicts of interest can arise in cases where the arbitrator in one case acts as legal counsel in other cases involving the investor.
- Inconsistency and jurisdiction: Unlike court systems where decisions of the court are binding on future cases, the rulings of an arbitral panel are binding only on the participants. As such, cases with similar or identical facts can reach different conclusions. Compounded by the lack of consistency in the rights afforded investors under different IIAs, ISDS is surrounded by a lack of certainty. The Law Council of Australia (sub. 47, p. 8) also commented on the lack of consistency in the jurisdiction of arbitration panels, noting that:

... some ICSID arbitration panels have decided that the jurisdiction of ICSID is a matter for the institution itself to decide following the provisions of its constituent convention. Other have argued that what is arbitrable is a dispute concerning an investment as defined in the underlying treaty between the relevant States, following the interpretative rules for *lex specialis* in international law.
- Lack of transparency: ISDS is modelled on a firm-to-firm commercial arbitration approach to dispute resolution, which has traditionally been confidential. ISDS arbitration generally does not contain a requirement for cases to be made public, or public access to documentation or awards made in a case. As such, it can be difficult or impossible for citizens to get access to information concerning elected governments.
- Costs: Far from being a cheaper form of dispute resolution than traditional litigation, investors in the ISDS system must pay for the right to seek arbitration, ensuring only the largest investors can afford to do so. Further, arbitral panels are rarely guided on the principles for awarding costs or damages, with some cases seeking damages well in excess of the losses incurred.

*Source:* Law Council of Australia (sub. 47, p. 8), Dr Kyla Tienhaara (sub. DR67, Attachment 1, pp. 3–8).

appellable, and arbitration panels are often able to solely determine what cases fall within their remit. AFTINET drew attention to a recent UNCTAD assessment that:

... the financial amounts at stake in investor–State disputes are often very high. Resulting from these unique attributes, the disadvantages of international investment arbitration are found to be the large costs involved, the increase in the time frame for claims to be settled, the fact that ISDS cases are increasingly difficult to manage, the fears about frivolous and vexatious claims, the general concerns about the legitimacy of the system of investment arbitration as it affects measures of a sovereign State, and the fact that arbitration is focused entirely on the payment of compensation and not on

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maintaining a working relationship between the parties. (UNCTAD, quoted in AFTINET, sub. DR68, p. 9)

Reflecting its assessment of the drawbacks to arbitration, AFTINET suggested that prevention of disputes and other alternatives could be preferable to ISDS provisions.

In the Commission's assessment, ISDS provisions can impose a range of potential problems on sovereign countries, the nature and extent of which are very difficult to calculate and may not be known at the time an agreement is made.

FINDING 14.2

*Experience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions.*

*Reducing the risks of ISDS*

There are several mechanisms that governments can use to seek to minimise or ameliorate the risks associated with ISDS.

Regarding the risk of 'regulatory chill' and vexatious arbitration claims, careful drafting of IIAs that precisely define 'investment', 'indirect expropriation' and 'equitable and fair treatment' can partially ameliorate the risk. Definitions that insufficiently constrain the scope of ISDS claims may give rise to future cases that partner countries cannot reasonably foresee at the time an agreement is made. To date, the Australian Government has largely avoided such problems in its agreements, as noted by Aisbett and Bonnitcha:

In general, post-establishment protections in Australia's FTAs are thoughtfully drafted. Investor-state arbitrations, to which Australia was not a party, have revealed a number of potential issues with similar wording contained in Australia's IPPAs. The Australian government has dealt with many of these issues through modifications to the most-favoured nation clause, by tying the fair and equitable treatment to the customary international law minimum standard, by adding an interpretative annex on expropriation and by setting out the procedure for investor-state arbitration in more detail. (sub. 45, p. 9)<sup>5</sup>

Nonetheless, it may be difficult (if not impossible) to precisely define the nature of an 'indirect expropriation' or what constitutes 'fair and equitable treatment', leaving government decisions potentially subject to the interpretations of third-party arbitral

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<sup>5</sup> For example, although the AUSFTA does not provide for ISDS, in that agreement the definition of investment makes clear that a 'covered asset' must have 'the characteristics of an investment' — that is, the commitment of capital or other resources, an expectation of gain or profit, or the assumption of risk.

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panels.<sup>6</sup> Moreover, provisions agreed by parties that reduce the risks to governments, by carefully defining ‘investment’ or other terms in the agreement, or otherwise narrow the scope of claims that could be brought to arbitration, will also reduce any prospective benefits to investors from the provisions.

The Commission also received feedback on how the risks that arise through the operation of arbitration panels can be reduced. Dr Luke Nottage (sub. DR63) noted that such arbitration concerns can be reduced by the Australian Government through the inclusion of clauses in IIAs that change the default rules of the ICSID or UNCITRAL. These changes could include requiring foreign investors to exhaust domestic legal channels prior to initiating arbitration, requiring that the existence of arbitration cases, documentation and awards be transparent and publically available; and providing for arbitration appeals. One way to do so could be for Australia to develop a ‘Model International Investment Agreement’ that includes more tailored arbitration rules (sub. DR63, p. 1).

Indeed, Australia followed this course in its agreement with Chile, which contains considerably more detailed procedural requirements than for Australia’s other agreements, including the requirement that investors attempt to consult with the host government prior to arbitration, the selection of arbitrators and the conduct of arbitration, as well as requiring transparency of arbitration documentation and any awards that are made.

The risks of ISDS can be further reduced by time-limiting agreements between countries, such that they cease to be binding after a period of years, unless countries agree to extend the agreement. This could occur where one partner country is rapidly developing, such that its legal system can eventually resolve investment-related disputes.

Another option for constraining the scope of ISDS claims, particularly where an agreement contains both developed and developing country partners, is to limit the application of ISDS to a subset of the member countries. This approach was taken by Australia and New Zealand under AANZFTA, which provides for ISDS between member countries except between Australia and New Zealand. Such an approach could be an option for Australia’s future agreements that involve similar issues; for

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<sup>6</sup> A further risk is that arbitral panels may expand the scope of narrowly-defined ISDS provisions, or incorporate them into agreements in their entirety, by virtue of MFN provisions. In a number of decisions, tribunals have held that even though a particular BIT did not include ISDS provisions, investors could still use the MFN clause to incorporate the ISDS provisions from another BIT. Although some agreements have subsequently attempted to preclude such ISDS extensions (for example, US-CAFTA), a number of subsequent tribunals have arrived at similar outcomes meaning that this remains a risk.

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example, the Trans-Pacific Partnership Agreement involves less developed countries, as well as more developed countries such as the United States and New Zealand (with both of whom Australia has previously excluded ISDS provisions).

### **Implications for future policy?**

The Commission received a range of feedback on its draft recommendation that Australia adopt a cautious approach in any future agreements considering the inclusion of ISDS provisions.

DFAT submitted that it already ‘advocates a careful, case by case approach to the inclusion of Investors State Dispute Settlement (ISDS) in Australia’s international agreements’, taking into account matters including the nature of the partner country’s legal system, stakeholder views, precedents and the promotion on bilateral investment flows (sub. DR98, p. 13).

However, a number of participants submitted that Australia should not include ISDS provisions in BRTAs. Aisbett and Bonnitcha stated:

Given that there are few benefits and potentially significant costs to offering post-establishment protection to foreign investment, we recommend that these provisions be omitted in future Australian FTAs. (sub. 45, p. 8)

On the other hand, Dr Nottage argued that the international arbitration system ‘probably offers net benefits overall and Australia should promote it more extensively’ (sub. 63, p. 6), while the Law Council of Australia stated that:

Future preferential trade agreements should, where appropriate, include more broad regimes for dispute resolution, encompassing not just state party dispute resolution but investor-state regimes, especially where Australia is dealing with a country that does not have a developed and predictable legal system. (sub. 47, p. 9)

It is the Commission’s assessment that although some of the risks and problems associated with ISDS can be ameliorated through the design of relevant provisions, significant risks would remain. Meanwhile, it seems doubtful that the inclusion of ISDS provisions within IIAs (including the relevant chapters of BRTAs) affords material benefits to Australia or partner countries. The Commission has also not received evidence to suggest that Australia’s systems for recognising and resolving investor disputes have significant shortcomings that should be rectified through the inclusion of ISDS in agreements with trading partners.

Against this background, the Commission considers that Australia should seek to avoid accepting ISDS provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already

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provided by the Australian legal system. Nor, in the Commission's assessment, is it advisable in trade negotiations for Australia to expend bargaining coin to seek such rights over foreign governments, as a means of managing investment risks inherent in investing in foreign countries. Other options are available to investors.

The Commission notes that, if perceptions of problems with a foreign country's legal system are sufficient to discourage investment in that country, a bilateral arrangement with Australia to provide a 'preferential legal system' for Australian investors is unlikely to generate the same benefits for that country than if its legal system was developed on a domestic non-preferential basis. To the extent that secure legal systems facilitate investment in a similar way that customs and port procedures facilitate goods trade, there may be a role for developed nations to assist through legal capacity building to develop stable and transparent legal and judicial frameworks. While not an immediate solution, over time such capacity building goes towards addressing the underlying problem, and provides benefits not only for foreign investors (including Australian investors), but all participants in the domestic economy.

### **14.3 Labour standards**

Labour standards vary from country to country depending on each country's stage of development, per capita income and political, social and cultural conditions and institutions. They can cover an array of matters, including hours of work, leave allowances, remuneration levels, pension rights, hiring and firing procedures, rights to union representation, workplace discrimination and workplace health and safety matters. At present, the enforcement of labour standards within each country is a matter for that country's government.

Most countries are also members of the International Labour Organization (ILO). Based on a tripartite structure, with representation from employers, unions and governments from member countries, the ILO promulgates various 'international' labour standards. However, the ILO currently has no means, beyond moral suasion, of enforcing its standards.

Since the ILO's formation in 1919, there have been numerous attempts to link labour standards to trade agreements, such that failure to observe certain standards would be justification for trade sanctions. In supporting such moves, some groups in developed countries have contended that 'labour linkage' is necessary to counter the suppression of workers' rights and the exploitation of labour in developing countries. However, others have argued that efforts to bring about such linkages are disguised protectionism and/or that linkage could undermine the comparative

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advantage of developing nations, retard economic development and delay the realisation of the very conditions that labour standards seek to protect.

Although WTO members — and its developing country members in particular — have resisted efforts to link labour standards to the multilateral trading system, labour standards have increasingly found their way into BRTAs. DFAT indicated that the Australian Government currently takes a case-by-case approach to the inclusion of labour standards in trade agreements and labour provisions have been included only in its agreements with the United States and Chile (sub. 53, p.38).

In submissions to this study, a number of participants argued for enforceable commitments to the ‘core’ labour standards promulgated by the ILO — which relate to union rights, child labour, discrimination and slavery — and some other matters to be included in all of Australia’s BRTAs. The AMWU submitted:

Core labour standards and environmental sustainability are universal human rights and immutable minimum standards ... We recognise that it is the sovereign right of states to establish and regulate higher standards than the minimum, but derogation below recognised minimum standards to gain an advantage in attracting investment or promoting trade is inconsistent with the international consensus and the objective of improving living standards through sustainable development. (sub. 21, pp. 12–13)

The Australian Fair Trade and Investment Network argued:

It should be a prerequisite [for] trade agreements that parties to the agreement abide by international standards on human rights, labour rights, Indigenous rights and environmental sustainability, as defined by the United Nations and the ILO. Trade agreements should not undermine these standards. Australia must ensure that it does not give preferential access to goods and services from countries where labour rights and human rights are being violated. (sub. 33, p. 14)

The Australian Council of Trade Unions pointed out that there are strong precedents for including labour clauses or chapters in BRTAs, with models promoted by the United States, Canada, the European Union, Chile and New Zealand, some of which extend beyond the core standards (sub. 19, pp. 7-8). The Council argued that the labour provisions included in AUSFTA had been inadequate, pointing to the labour standards in the US-Peru FTA as a better model:

The commitment to labour standards is strongest, however, in the US-Peru FTA. Both parties are obliged to ‘adopt and maintain’ in their laws and regulations the core labour standards. This is far stronger than previous agreements which commonly articulate an commitment to ‘attempt to ensure’ incorporation of labour rights. This stricter obligation is supported by dispute settlement procedures.

In the proposed Trans-Pacific Partnership Agreement, the ACTU would expect a commitment consistent with (and no less) that the standards of the US-Peru FTA, given

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that the agreement will be negotiated between Australia, Brunei Darussalam, Chile, NZ, Singapore, Vietnam, *and* the US and Peru. (sub. 19, p. 8)

The Commission examined whether core labour standards should be linked to trade agreements in the context of advising on Australia's approach to the Doha Round negotiations and in associated research (PC 2001, pp. 33-6 and Nankivell 2002). It noted that, in contrast to issues with predominantly cross-border ramifications, the impacts of a country's labour standards mainly fall on its own citizens. This may help explain why efforts by developed countries to link labour standards to trade agreements are sometimes seen as raising national sovereignty issues by developing countries. Moreover, while adherence to core labour standards can generate social and economic benefits in many cases, the net effects may not always be positive. In any case, attempts to enforce compliance with labour standards *through trade agreements* have limited prospects of affecting the wellbeing of the workforce in developing countries, not least because the vast bulk of workers operate in the informal and domestic sectors of developing economies. Overall, the Commission considered that other measures, such as trade liberalisation and appropriate technical and financial assistance to developing countries, are more likely to alleviate poverty and lift living standards in such countries. Financial assistance, for instance, can be used to help address the educational opportunities and health needs of children.

Similar issues apply in the context of whether labour standards should be included in BRTAs. It should also be noted that, in recent years, alternative mechanisms have emerged for encouraging compliance with core labour standards. For instance, World Bank loans are now contingent on the recipient country observing the core standards, and the Joint Standing Committee on Foreign Affairs, Defence and Trade recently proposed that Australia use its influence to have the same preconditions extended to Asian Development Bank loans to ASEAN countries (CPSU-SPSF, sub. 22, p. 5).

While the same committee also recommended that Australia seek to have core labour standards incorporated in all of its BRTAs, the Commission's assessment in the Draft Report was that government should adopt a cautious approach to this matter. It noted that there are generally likely to be more direct and appropriate means of alleviating poverty and lifting living standards in developing countries than through Australia seeking to include enforceable provisions on labour standards in BRTAs.

In response to the Draft Report, a number of participants reiterated their concern that core labour standards be incorporated in Australia's BRTAs. The CFMEU

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argued:

... this reasoning by the PC misses the key point about core labour standards. As the PC report itself notes, the ILO core labour standards relate to freedom of association, the right to organise and bargain collectively, abolition of child labour, discrimination and slavery. They are universal rights, not simply a means of alleviating poverty and lifting living standards. They should be recognised as such, vigorously pursued for inclusion in BRTAs, and in the strongest possible form. (sub. DR90, p. 5)

Others, however, have argued that:

The reality is that diversity of labour practices and standards is widespread in practice and for the most part reflects, not necessarily venality and wickedness, but rather diversity of cultural values, economic conditions, and analytical beliefs and theories concerning the economic (and therefore moral) consequences of specific labour standards. The notion that labour standards can be universalized, like human rights such as liberty and habeas corpus, simply by calling them ‘labour rights’ ignores the fact that this easy equation between culture-specific labour standards and universal human rights will have a difficult time surviving deeper scrutiny (Bhagwati 1999).

The Commission considers that efforts to encourage compliance with core labour standards should focus on mechanisms that are likely to be effective in enhancing living standards in developing countries, and that entail as few risks of adverse side-effects as possible. As noted above, attempting to incorporate core labour standards in BRTAs is a very indirect means of achieving this goal, and the effects may not always be positive. Accordingly, the Commission remains of the view set out in the Draft Report.

## **14.4 Restrictions on trade in cultural goods and services**

While many items, from clothes to cars, can be seen as embodying an element of the culture in which they were produced (or at least designed), some goods and services are seen as more strongly ‘cultural’ than others. The outputs of the publishing, music, the arts and audiovisual industries are often characterised in this way.

Trade in such ‘cultural’ goods and services is treated in a variety of ways under Australia’s existing BRTAs (box 14.6). Several participants in this study expressed concerns that BRTAs are tending to cover, and lock-in policy approaches to, cultural matters (as well as some other ‘public interest’ matters) that they consider should remain the domain of national governments. For example, AFTINET contended that:

... governments need to retain the right to legislate in the public interest, such as environmental standards, health issues like affordable access to medicines, cultural matters, and in response to crises such as the Global Financial Crisis and climate change. (sub. 33, p. 4)

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**Box 14.6 Coverage of some cultural matters in Australia's BRTAs**

The treatment of cultural regulation and the degree to which Australia has agreed to liberalise trade in 'cultural' goods and services vary between Australia's existing BRTAs. In some cases, the sole mention of culture in BRTAs is to explicitly exclude it from coverage. However, some agreements include provisions that may restrict a national government's ability to regulate cultural goods and services:

- *ANZCERTA (New Zealand)* – under the ANZCERTA Protocol on Trade in Services, Australia and New Zealand agreed to, among other things, market access and national treatment provisions for services. Article 18 of the protocol provides for exceptions such as measures aimed at national security or human, animal or plant life or health. No exception was made for audiovisual services or cultural matters.
- *Australia-ASEAN-New Zealand FTA* – under the general exceptions to the agreement, the parties agreed that — provided that they are not a disguised restriction on trade or unjustifiably discriminatory — measures necessary to protect objects or sites of historical value, or measures to support creative arts of national value would not be covered by the agreement.
- *Australia-Chile FTA* – Australia explicitly reserved the right to adopt or maintain any measures with respect to creative arts, broadcasting and audiovisual services, and other cultural industries.
- *Australia-United States FTA* – for broadcasting and audiovisual services, Australia agreed to a 'standstill' in relation to its quotas for local content, stipulated as a percentage of Australian content on Australian television and radio. As such, while Australia can still regulate the level of content (including on new media), it cannot require Australian content of levels higher than those recorded in the AUSFTA. Australia preserved the ability to introduce subsidies for cultural purposes.
- *Singapore-Australia FTA* – Australia explicitly reserved the right to adopt or maintain any measures in relation to the broadcasting and audiovisual services and cultural industries.
- *Thailand-Australia FTA* – Australia did not make any commitments in relation to broadcasting and audiovisual services or cultural industries under the positive list approach taken to services in this agreement.

Commenting on changes to the regulatory environment following the implementation of AUSFTA, the Music Council of Australia argued that:

Existing measures in respect of regulating content on Australian analogue television and radio services have been frozen and subjected to ratchet provisions. The extent to which Australia is able to regulate these services in the digital environment is severely constrained and in respect of its capacity to regulate new media is subject to tests that must secure US agreement that there is a demonstrable lack of access to Australian content. (sub. 35, p. 4)

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These concerns stem in part from a fear that application of national treatment or other provisions within BRTAs may limit a domestic government's ability to protect local providers of cultural goods and services, or regulate to advance cultural objectives.

Concerns are also expressed by some groups that 'free trade' would not necessarily result in satisfactory levels of the expression of Australian culture through, for example, local production of film and television content. On the latter point, the Music Council of Australia contended that:

... for various reasons including the size of its domestic market, the USA is the world's largest producer and exporter of films for cinema or television showing. ... [However,] Peoples of all countries are attached to particular values, ways of life, identities that are given form through their cultural activities and artefacts. Australians cannot contract with the US, however "efficient" its cultural production, to produce expressions of Australian culture. It is intrinsic to our expression of culture that it is we who do the expressing. (sub. 35, p. 2)

The Music Council went on to note a potential inconsistency between open trade in cultural matters and other international agreements:

The principle of comparative advantage is very much opposed to the desire for cultural sovereignty, as reinforced by the new UNESCO Convention for the Protection and Promotion of the Diversity of Cultural Expressions, to which Australia is a recent signatory. Signatories claim a right to support their own cultures. (sub. 35, p. 2)

AFTINET reiterated this point, noting that the Australian Government had:

... acceded to the UNESCO Convention for the Protection and Promotion of the Diversity of Cultural Expressions. The motivation for the development of this Convention was to offer governments an instrument for use in trade negotiations in which they were being pressured to surrender their cultural sovereignty.<sup>7</sup> (sub. DR68, p. 13)

Some participants were particularly concerned about the potential impacts on culture that might arise as a result of removing protection for Australian cultural services when a negative list approach is adopted for the treatment of services under a BRTA:

Both the CER and the AUSFTA have set precedents that require on-going vigilance by Australia's trade negotiators entering into negative list agreements to ensure that the concessions made in these agreements are not multi-lateralised. (Music Council of Australia, sub. 35, p. 4)

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<sup>7</sup> Specifically, the Commission notes that one of the Convention's main objectives, expressed in Article 1(h), is 'to reaffirm the sovereign rights of States to maintain, adopt, and implement policies and measures that they deem appropriate for the protection and promotion of the diversity of cultural expressions on their territory'.

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Others argued that to more clearly avoid such risks, Australia should adopt a positive list approach to services liberalisation:

*A positive list* agreement would enable Australia to determine precisely which sectors to include thus protecting the government's rights and responsibilities to regulate. (CPSU-SPSF, sub. 22, p. 4)

In examining the case for the inclusion of special restrictions or provisions in Australia's trade agreements on cultural grounds, it should first be recognised that, at least up to some point, Australians typically do enjoy and value — and indeed are willing to pay for — representations of their own culture or the presentation of material or stories from an Australian perspective or 'through Australian eyes'. While market forces will accordingly go some way towards ensuring an optimum supply of culturally-valuable Australian output, the Commission has previously identified forms of market failure that may arise in relation to some cultural goods and services, causing an underprovision of such material. These provide an economic rationale to consider government actions to off-set these effects.

For example, in evidence to the Commission's recent study on the parallel importation of books, a number of Australian authors indicated that the 'Australianess' of their writing was a key reason why many local consumers purchased their works. However, in that study the Commission found that measures to support some Australian-authored books may be warranted as such books can generate cultural 'externalities' through impacts on social capital and the transmission of ideas and social norms necessary for the efficiency functioning of a modern democratic society (PC 2009c, chapter 6).

While some public support for 'cultural' goods and services may thus be warranted, restrictive trade measures will not necessarily be the best mechanism for supporting the production of cultural goods and services, or pursuing cultural objectives. As the Music Council alluded, cultural objectives may be more directly addressed by preserving a satisfactory level of Australian culture and need not necessarily entail restrictions on cultural imports:

For the Australian cultural sector, this [a right to support Australian culture] does not translate as a desire for the government to exclude cultural imports but rather to ensure that there is sufficient room in Australian cultural life for the expression of local culture. (sub. 35, p. 2)

Given the costs to consumers associated with trade restrictions, including potentially higher prices and restrictions on availability of material from other cultures, it is likely that mechanisms such as transparent and appropriately focussed government financial support programs could in many cases achieve legitimate cultural objectives more cost-effectively.

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It should also be noted that commitments made in the context of a BRTA can lead to unintended consequences. This happened in the case of the ANZCERTA agreement with New Zealand when, following the High Court's decision in *Project Blue Sky v Australian Broadcasting Authority*,<sup>8</sup> New Zealand television programs were included with Australian programs for the purposes of the Australian content standard for broadcasting.

Overall, in determining the coverage of cultural goods and services within a BRTA (be it explicitly, or implicitly through the use of a negative list), the Commission considers that the impact of their inclusion, and consideration of available alternatives, should be carefully examined as part of a transparent benefit-cost analysis. This process would help ensure that any restrictions imposed in the name of culture are genuine and effective, and not a mechanism for simply affording protection to local producers.

Where it is deemed that cultural goods and services should be quarantined from provisions in a BRTA, the Commission considers that there would be merit in adopting the approach taken in AANZFTA (box 14.6). The agreement provides an exception for cultural measures provided that the measures are not unjustifiably discriminatory or a disguised restriction on trade (in a similar manner to exceptions provided in the GATT). In doing so, it aims to preserve the sovereign rights for nations to regulate in such areas of legitimate national interest, but also guards against the introduction of unnecessarily protectionist measures.

## 14.5 The proposed approach

In summary, a complex array of considerations are relevant in relation to whether, and how, many WTO-plus issues are incorporated in BRTAs.

The Commission has examined four specific issues in this chapter — intellectual property rights, investor-state dispute settlement, core labour standards and cultural matters — and found that, in relation to some of these, a different approach is warranted to the one taken by Australia to date.

As noted earlier, many other matters are sometimes included in BRTAs, a number of which concern areas that are normally seen as primarily the province of domestic policy. While in some cases it may be appropriate to include provisions on these matters in a particular BRTA, the Commission considers that such decisions should be based on a broader analysis of the implications of a change to national policy

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<sup>8</sup> [1998] HCA 28.

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settings. Such analyses should consider the likely economy-wide effects of the proposed provisions and the relative merits of other options or avenues for addressing the issues.

RECOMMENDATION 4

***The Australian Government should not include matters in bilateral and regional trade agreements that would serve to increase barriers to trade, raise costs or affect established social policies without a transparent review of the implications and other options for change. On specific matters, the Australian Government should:***

- a) adopt a cautious approach to referencing core labour standards in trade agreements; and to exclusions from BRTAs for trade in cultural goods and services;***
- b) avoid the inclusion of IP matters as an ordinary matter of course in future BRTAs. IP provisions should only be included in cases where a rigorous economic analysis shows that the provisions would likely generate overall net benefits for the agreement partners; and***
- c) seek to avoid the inclusion of investor-state dispute settlement provisions in BRTAs that grant foreign investors in Australia substantive or procedural rights greater than those enjoyed by Australian investors.***