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# 11 Policy objectives for trade agreements

The Terms of Reference invite the Commission to make recommendations in relation to bilateral and regional trade agreements (BRTAs). Assessing the policy merits of any government measure and identifying worthwhile changes requires firstly an understanding of the objectives the measure should aim to achieve. It also requires consideration of how the measure compares as a means of achieving those objectives against alternatives that might be used, either in place of, or in conjunction with, the measure under review.

This chapter discusses what constitutes appropriate policy objectives for agreements on trade, and having identified four relevant objectives, discusses how well-suited BRTAs are for achieving each objective compared to available alternatives.

The approach taken is to consider how BRTAs and their alternatives perform against each objective separately. It should be borne in mind that, even if a measure is not necessarily the best available for achieving any one objective, the measure may still be warranted if it proves to be an efficient means of simultaneously addressing multiple objectives. Drawing on the analysis in this chapter, the role or roles BRTAs should play within Australia's broader trade policy agenda is taken up further in chapter 12.

## 11.1 What are appropriate policy objectives?

### The Commission's assessment framework

In assessing the merits of government policies and programs and making recommendations for their reform, the Commission is required to have regard the policy guidelines set out in section 8 of the *Productivity Commission Act 1998 (Cwlth)*. Among other things, these call for policies that:

- improve productivity and economic performance in order to achieve higher living standards for the whole community;
- reduce unnecessary regulation;

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- encourage the development of efficient and internationally competitive Australian industries; and
  - have regard to Australia's international commitments and the trade policies of other countries.

Importantly, the Commission is also obliged to take a broad, economy- and community-wide view, rather than focussing on the interests of particular industries or groups in its analysis.

In relation to trade policy, the Commission's guidelines are generally consistent with policies that aim to reduce barriers to the free flow of goods and services, both domestically and internationally. Such policies are likely to benefit the economy as a whole by encouraging Australia's resources to flow to their most highly-valued uses, consistent with the relative economic efficiency and competitiveness of different activities, sectors, industries and businesses within Australia. This approach has underpinned the Commission's advice on trade policy for more than three decades.

While the merits of policies based on this approach are widely acknowledged, in the course of this study, as in past trade policy debates, several participants have suggested that BRTAs be used to pursue objectives that diverge from it. For example, some have suggested that the advancement of Australian exports should be one aim for trade agreements (and of economic policy more generally):

All levels of government have a critical role to play in supporting an internationally competitive and sustainable Australian export sector. Supporting the growth of Australian exports can be achieved by several mechanisms, but most importantly through improved market access conditions through multilateral, regional, plurilateral and bilateral trade agreements. (Australian Industry Group, sub. 7, p. i)

Exporting can of course bring benefits to Australians and Australian businesses, but as the Commission has noted previously, this does not mean that exporting should, of itself, be a policy objective. This is because:

... the production, marketing and delivery of goods and services for export also uses Australian resources. For Australia to gain from any particular exporting activity, the benefit received needs to exceed the value that could have [been] obtained by using the embodied resources to supply the domestic market ... Thus, while most current exporting activity may well generate net benefits for Australia, it cannot be presumed that addition to exports ... will automatically do so too. (PC 2008, p. 6.9)

Indeed, it is possible that, in some cases, an increase in exports could lead to a fall in overall welfare. For example, if a policy were to drive increased exports in an industry already receiving government support, this could, in time, draw further

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resources into that industry from other, more efficient, industries, at a net cost to the economy as a whole.

Thus, while appropriate economic policies may well *result* in increases in activities such as exporting, the policies themselves should not seek ‘exports for exports’ sake’.

Similarly, others argue that rectifying or preventing trade imbalances in particular sectors or products should be an objective for assessing Australia’s trade agreements:

... where the benefits to the Australian automotive industry are less clear, Ford has advocated a very cautious approach be adopted in negotiations. ... Japan and Korea, for example, are automotive powerhouse economies with very low levels of import penetration. Automotive producers from both countries already have dominant positions in the Australian market. (Ford Motor Company of Australia Limited, sub. 51, p. 2)

While potential imbalances may be seen as undesirable from the viewpoint of businesses in a particular sector, it does not follow that they are necessarily ‘bad’ for the economy as a whole. Indeed, it is the exploitation of such imbalances that allows economies to gain from trade, by specialising in products at which each is relatively efficient, exporting their surpluses and importing products which can be produced at a lower cost in other countries.

### **Appropriate policy objectives for BRTAs**

DFAT depicts multilateral, regional and bilateral approaches to trade liberalisation as working together in a ‘cascade effect’ (sub. 53, p. 3). As such, in determining what may be appropriate policy objectives for BRTAs, it is relevant to examine Australia’s overall trade policy. This has been described by the DFAT in the following terms:

Australia maintains an active and diverse international trade policy agenda which combines multilateral, regional and bilateral strategies to break down world barriers to trade, maintain its export competitiveness and gain new market opportunities. ...

As well as supporting WTO multilateral trade negotiations, Australia seeks to build bilateral and regional strategic partnerships through free trade agreements ... or other mutual agreements for trade facilitation and cooperation with important trading partners. (DFAT 2008b, p. 1)

The Terms of Reference also state:

Australia has been pursuing bilateral and regional agreements intended to support the multilateral trading system while also enhancing commercial opportunities for Australian businesses and businesses in partner countries and enhancing Australia’s broader economic, foreign and security policy interests.

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In considering these broad statements together with the policy guidelines in the Commission's Act, the Commission has identified four policy objectives (or groups of objectives) that BRTAs potentially could be used to advance. Subsequent sections of this chapter discuss each of those objectives and assess the suitability of using BRTAs to achieve them. They are: reducing trade and investment barriers in our trading partners and in Australia (sections 11.2 and 11.3), economic cooperation and integration (11.4), and 'non-trade' objectives such as poverty alleviation, regional security and strategic relationships (11.5).

## 11.2 Reducing barriers in our trading partners

Reductions in trade and investment barriers in partner countries can increase the commercial opportunities for Australian producers, and are often expressed in terms of improved 'market access'. BRTAs offer an alternative to multilateral negotiations as a means of reducing barriers in other countries, and as such their relative advantages and disadvantages against this objective must be assessed in comparison to the multilateral process. There are several factors that need to be considered in such a comparison.

### *Achievability and outcomes*

Given the current lack of progress on the Doha Round, some view BRTAs as a more fruitful path to achieving international trade liberalisation than the WTO system. BRTAs may generate greater reductions in trade and investment barriers, at least in selected markets, because they can be negotiated in substantially less time and allow for more substantial reform. In contrast to BRTAs, tariff reductions in the multilateral system of the WTO normally result in a gradual reduction in bound rates, without necessarily bringing about substantive increases in market access, particularly in sensitive areas such as agriculture. In addition, many subjects that are treated in BRTAs, like investment, competition policy, government procurement and labour standards, are effectively 'off the table' in the WTO.<sup>1</sup>

Several participants commented on the relative pace and coverage of reform available through BRTAs. The Government of South Australia commented:

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<sup>1</sup> Chapter 14 discusses further the impacts from including 'WTO-Plus' matters within BRTAs. In brief, the Commission considers that the inclusion in BRTAs of some such matters, *including* measures that work to strengthen economic cooperation, competition policy frameworks, customs procedures and other trade facilitation measures, may all add to efficiency with little downside risk. However, for some other matters, inclusion of provisions risks resulting in greater costs than benefits.

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... in the absence of meaningful progress in the WTO given the political realities of global trade, FTAs do present a good opportunity for substantial market access gains in a relatively shorter period of time. (sub. 56, p. 9)

In a similar vein, the Australian Industry Group said:

FTAs can promote stronger trade and commercial ties between nations which are party to the agreement and can, in light of setbacks in the current multilateral trade negotiations, also speed up trade liberalisation by delivering gains faster than through multilateral or broader regional processes. (sub. 7, p. 4)

DFAT also submitted that:

... FTAs can support the WTO's multilateral trading system by providing momentum toward the completion of the Doha Round. FTAs can deliver economic benefits to participating countries more quickly than might be possible through a WTO round. They can tackle specific issues in more depth and often with a higher level of ambition than is possible in the WTO. They can be more comprehensive, covering issues not fully addressed in the WTO, such as investment. (sub. 53, p. 4)

Indeed, as discussed in chapters 6 and 7, Australia's BRTAs — most of which have been negotiated and finalised during the Doha Round — have reduced barriers to Australian trade in several areas, which has led to some benefits for businesses.

On the other hand, there are some subjects that are covered by WTO agreements that are not often features of BRTAs. As several participants in this study pointed out, the most prominent of these are export subsidies, particularly those on agricultural products:

Of particular concern to Australia is the issue of agricultural export subsidies which, because they are direct payments to producers and are not tariffs, can only be reduced by multilateral negotiations. Through bilateral agreements the USA and the EU have been able to maintain their subsidies at the same time as they also gain access to other markets. Because there is thus no incentive for the USA or the EU to remove their subsidies, the bilateral system is actively undermining multilateral negotiations. (CPSU-SPSF, sub. 22, p. 6)

Comprehensive multilateral agreements (pursued through the WTO negotiating round process) are the only way to consecutively address all 'three pillars' of agricultural support that currently distort world food trade — restrictions on market access, export subsidies and domestic supports and subsidies. (Australian Dairy Industry Council, sub. 38, p. 3)

Some participants doubted Australia's ability to gain significant access to markets through BRTAs, given our negotiating position as a relatively small country that has begun unilateral reform:

Australia is not in a strong negotiating position, having previously reduced and minimised trade barriers such as tariffs on a unilateral basis. This means Australia's

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ability to influence change on a bi-lateral or regional basis is severely restricted. (Australian Fair Trade and Investment Network, sub. 33, p. 11)

In this context, it was noted that Australia's BRTAs have been subject to the carve out of some sensitive sectors, as well as extended phase-in periods before substantial tariff reduction is achieved. Even so, some areas in which these carve outs and delays have occurred have proven to date to be largely immune to substantive reform via the multilateral system.

Nonetheless, whatever the potential outcomes from BRTAs, the stagnation of the Doha Round also casts significant doubt on the ability of multilateral negotiations to deliver international trade liberalisation, particularly in the short term.

### *'Defensive' considerations*

As well as gaining additional market access, several participants argued that BRTAs can be used to 'level the playing field' for Australian producers when other countries gain an advantage in markets through their own trade agreements:

... third parties (i.e. parties not subject to a trade agreement) can be detrimentally affected by the preferential access given to a competitor in an export market. ... For example, Victorian automotive exporters are at risk of losing markets in the Middle East should the Gulf Cooperation Council States finalise agreements with competitor countries that lower the existing 5 per cent tariff on passenger motor vehicles. Other examples include the potential effect on Victoria's agricultural exports (meat in particular) to South Korea should the US and South Korea bilateral trade agreement enter into force. (Victorian Government, sub. 40, p. 6)

In response to such third party action, Australia could seek to negotiate a BRTA with the target country (for example, Korea) with the aim of securing preferences of at least the magnitude of the third party, effectively granting Australia access to that market on at least the same basis as its main competitors and countering any existing trade diversion. Following the Draft Report, several participants supported the use of agreements for such 'defensive' reasons (box 11.1).

Of course, Australia's negotiation of a defensive BRTA with the target country could in turn provoke a reaction from other third-party countries who also have yet to negotiate with the target country. This would diminish any benefits the sector in question had gained from any BRTA preferences by again 're-levelling' the field and could result in disadvantages in other sectors, depending on the terms of the third party agreement. (As discussed in chapter 13, the inclusion of 'MFN' clauses in BRTAs can reduce this problem, by effectively automating the 'defensive' reaction.)

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### **Box 11.1 Participants' comments on defensive agreements**

Office of Horticultural Market Access, sub. DR70, p. 2

... if competitors achieve highly concessional or zero tariffs into export markets, Australian BRTAs could protect an existing export position by achieving parity with concessional or zero tariff outcomes achieved by others. 'Substantial commercial benefits' in this context could be protection of existing trade levels rather than achievement of additional trade growth.

NFF, sub. DR85, p. 6

The NFF highlighted the example of South Korea in our original submission, where [CIE] modelling revealed that Australian agricultural and food exports to Korea could be slashed – in real terms, down 12.4% (\$162 million) by 2030 – should Korea and the United States (US) ratify their Free Trade Agreement.

Australian Pork Limited, sub. DR91, p. 3

It concerns our industry that its competitors are in the process of finalising FTAs with these same high value markets, like Korea. ... To remain competitive in high value markets the government's priority for the pork industry should be to negotiate FTAs that deliver international pork export market competitiveness.

Australian Sugar Industry Alliance, sub. DR93, p. 1

Australia's trading partners are pursuing similar agreements with their other suppliers, our competitors. It is important that Australia is not left behind. As the world's only developed country exporter of raw sugar, Australia faces discriminatory trade barriers in the form of developing country tariff differentials, quota restrictions and other measures that favour our competitors in many of our export markets. This discrimination increases as our competitors conclude bilateral or regional trade agreements. A recent example is agreement in the Korea - ASEAN FTA to remove the tariff on Thai raw sugar sales to Korea.

Department of Agriculture, Forestry and Fisheries, sub. DR95, p. 2

While BRTA outcomes may not be quantifiable in dollar terms immediately, the cost of not pursuing BRTAs can be very high if our competitive position is eroded. Other countries are working hard to secure their own agreements and it remains imperative that Australia not lose market access in favour of other preferential arrangements which may only become apparent in the longer term. There are indications that this scenario is occurring as competitors such as New Zealand (dairy, meat, wool, wine), the United States (meat, dairy, horticulture) and Chile (horticulture, wine) have secured agreements with some of Australia's major export markets.

Multilateral reform avoids such concerns by securing reductions in barriers that apply equally to all WTO members. If successful, multilateral negotiations or other non-preferential reform would also be a more effective way of avoiding any issues

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from a potential web of trade rules made under a series of BRTAs. Nonetheless, in the short term and in the absence of progress at the WTO, negotiation of BRTAs represents a prospective means of protecting defensive interests.

This does not mean that BRTAs designed to protect defensive interests should automatically be pursued, as — like all trade agreements — they should first be subject to an assessment of the likely national benefits that could be obtained by pursuing them (see chapter 15). This would help to guard against cases where the gain from securing access for one or a few sectors could be outweighed by losses in others.

Further, as noted in chapter 8, the potential negative impacts upon Australia from not being involved in BRTAs with major trading partners, where they have multiple BRTAs, can be ameliorated if Australia undertakes unilateral (trade and broader domestic) reform to improve the competitiveness of the Australian economy.

#### *Negotiation, compliance and administration costs*

The process of negotiating BRTAs comes at a material cost for the Australian government. Taking part in multilateral negotiations also entails material costs, and it is difficult to ascertain if one form of negotiation is significantly more costly than the other (chapter 7). Even if the costs of negotiation are not substantially different, some participants argued that the outcomes achieved for similar costs favoured a multilateral approach:

... one important advantage of negotiating through the WTO is the high reward-to-effort ratio of the multilateral approach; for much the same effort that would have been expended in negotiating a major FTA, a similar effort could yield much greater market access benefit and global reach through the WTO. (Government of South Australia, sub. 56, p. 8)

Where the two forms of trade liberalisation may differ more clearly is in terms of the compliance and administration costs. Even where similar sorts of rules (such as rules of origin) are present in both multilateral agreements and BRTAs, the implementation of those in Australia's BRTAs can be more 'demanding' than the equivalent multilateral rules, because, for example, Customs does not apply rules of origin to determine eligibility for MFN treatment. Further, the preferential rules differ between each agreement, depending on the preferences or sensitivities of the negotiating parties, which can add to costs.

While it is possible, and desirable, to pursue a standard set of trading rules in BRTAs to reduce any potential inconsistencies, the priorities of partner countries during negotiation could limit the ability to secure standardised outcomes. To date,

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significant differences persist between the preferences and rules across many BRTAs, notwithstanding recent moves towards the more standardised use of rules among some agreements.

### *Other policy options*

In noting the limited ‘on the ground’ outcomes obtained through BRTAs alone, some participants advocated the use of other government programs, focussed on exporting, to secure better outcomes for Australian businesses:

Under-funding of the export-oriented industry support programs, such as the EMDG [Export Market Development Grants] Scheme, places jobs at risk and threatens the ability of exporters to undertake the activities which are so critical to the protection of market share. It also undermines Australian industry’s ability to maximise the potential of the market access gains afforded by free trade agreements. ... In light of their strong return on investment, Ai Group believes more can be done to support businesses in their export development activities to maximise the potential benefit to Australian industry from existing and future FTAs. (Australian Industry Group, sub. 7, p. 13)

In consultations, some participants indicated that they saw increased funding to EMDG or to Austrade’s export facilitation services as preferable to further spending on the negotiation of PTAs.

Such schemes do not lower barriers *per se*, but rather assist businesses that export to do so, and in this way can be seen as helping to counteract the effects of barriers to overseas markets. However, as noted above, although such programs may be seen to be successful in terms of increasing exports, the Commission does not consider this a valid objective for trade policy. (There are, however, other rationales that might be considered in assessing schemes such as the EMDG scheme (see PC 2009b)).

In terms of lowering barriers in other countries, the Commission’s current view is that the primary policy options are either multilateral agreements or bilateral and regional agreements (which, in their wider sense, can include efforts to improve market access beyond tariff reductions such as through cooperation agreements, trade facilitation mechanisms and mutual recognition of standards and regulations and should not necessarily be limited to preferential arrangements).

## **Conclusion**

Against the backdrop of limited progress in multilateral negotiations, BRTAs are a feasible option for seeking the reduction of trade and investment barriers in other countries. The exact outcome will vary between BRTAs, depending on the particular form and coverage of the agreement, and the choice of partner country.

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As such, it is important that each BRTA is assessed, to determine its ability to effectively reduce barriers in partner countries (as well as its overall impact on Australia).

FINDING 11.1

*The extent to which a BRTA reduces trade and investment barriers depends on the particular form and coverage of the agreement, and the priorities of the partner countries.*

### **11.3 Reducing our own trade and investment barriers**

As noted in chapter 8, while a country benefits from reductions in the trade barriers of its trading partners, the majority of the benefits from trade liberalisation in fact arise through domestic reform. Reducing domestic barriers to trade and investment leads to benefits to countries by improving resource allocation and efficiency within the economy, through reduced import prices and increased availability of capital, labour and knowledge, which in turn can improve the competitiveness and productivity of domestic businesses.

#### **Advantages of using trade agreements**

While bringing about domestic reform is not typically governments' central motivation for engaging in BRTAs, negotiating, agreeing to and then implementing a trade agreement may facilitate liberalisation of a country's own trade and investment barriers. Participants mentioned three ways in which this may occur.

First, the perceived 'trade-offs' undertaken throughout the negotiation process of a trade agreement could assist in managing the perceptions of domestic stakeholders and ease the passage of reforms:<sup>2</sup>

[PTAs] can also provide a path through which public support for trade and trade liberalisation can be garnered. PTAs provide a much easier sell to the public than unilateral reform, even if that reform is in Australia's own best interest. The well cited problem of trade reform — concentrated negative impacts, dispersed benefits — can make unilateral liberalisation politically difficult; whereas at least under a PTA Australian exporters get improved market access elsewhere. (RIRDC, sub. 10, pp. 13–14)

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<sup>2</sup> On the other hand, contentious reforms undertaken through trade agreements can attract substantial opposition as well. See, for example, the debate surrounding the pharmaceutical benefits scheme during the AUSFTA negotiations, discussed in chapter 10.

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Second, some have also argued that liberalisation through BRTAs can be a complement to unilateral reform, essentially representing the first step on the road to broader reforms as competition from partner country businesses is introduced. An example of this noted by RIRDC is reform within the dairy industry following the ANZCERTA:

Bilateral liberalisation generated through this agreement was one of adjustment for the Australian dairy industry. As the Australian dairy industry became more competitive it became easier to shift towards unilateral liberalisation. (sub. 10, p. 12)

Third, where beneficial policy settings (including reforms such as lowering bound tariffs) are agreed to in a BRTA, they become subject to a binding international obligation. This represents a benefit in addition to the policy itself, as it adds certainty by preventing later policy reversals or the introduction of new adverse policies.

Fourth, DFAT argued that the process of negotiation with other countries affords domestic policy makers and regulators the opportunity to gain familiarity with the regulatory regimes of partner countries, which might give rise to opportunities for beneficial changes in our own regimes:

One consequence of such intensive engagement at official level is the deeper understanding that each side gains of their counterpart organisations and administrative arrangements, institutionalising close working relationships and creating strong people-to-people networks in government across the breadth of economic policy issues. (sub. 53, p. 5)

## **Drawbacks to the use of trade agreements**

While BRTAs represent one way to effect domestic reforms, relying on them to achieve this objective would have several drawbacks.

### *Reliance on the competitiveness of businesses in partner countries*

As noted in chapter 8, where an agreement involves preferential arrangements, there may be some ‘trade diversion’ unless the country’s BRTA partners are effectively world price setters in the areas covered by the agreement(s). In such cases, it may be possible to replicate the effects of unilateral liberalisation through preferential agreements, at least in the short term.

Even where this is the case, however, there remains some risk that the businesses in the partners countries will not pass on the full benefit of barrier reductions to Australian consumers (and Australian businesses sourcing inputs from overseas), only adjusting their prices into the Australian market to the degree necessary to gain an advantage over other suppliers.

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There is also no guarantee that businesses in the partner countries will remain the most efficient producers over time. As such, the negotiation of preferences carries the risk of ‘locking in’ particular patterns of trade over time, creating a buffer against innovations from businesses in non-partner countries.

In contrast, reform on an MFN basis allows Australian businesses and consumers to adjust their demand to the most efficient businesses from around the world. In this respect, unilateral reform has an advantage over BRTAs:

... moving from traditional unilateral liberalisation to a bilateral agreement opens up the possibility that domestic gains from our own liberalisation may be eroded by imports being diverted to a higher-cost source. Australia’s traditional non-discriminatory approach to protection and its (unilateral) liberalisation has to date largely ensured that we used the lowest-cost sources of imports — as well as having the benefits of administrative simplicity and avoidance of international frictions. (Banks 2010, pp. 26–27)

### *Changing assistance arrangements midstream*

Assistance regimes for particular sectors are typically established by government with particular settings and timeframes built in. Businesses in the affected sector adjust their forward plans to take into account these settings. However, these settings could be changed during the life of the package as part of ‘concessions’ made to partner countries during the course of negotiations. The Commission was informed during its consultations that this problem befell businesses in the TCF industry, when concessions were provided under the AANZFTA agreement which were not envisaged when a sectoral adjustment package was announced the year before.

While effective consultations with industry as part of the BRTA process could go some way to ameliorating such concerns, the involvement of another government through the negotiation process entails inherent uncertainties.

### *Constrained policy options*

The finalisation of a trade agreement necessarily binds the parties to undertake, or refrain from, certain policy options. Some participants to this study argued that such binding activity, in particular policy areas, constituted an undesirable constraint on the government’s sovereignty:

... the AMWU has consistently argued that it was not in Australia’s national interest to compromise the nation’s sovereignty by including issues such as procurement and liberalisation of foreign investment in the Australia-US FTA. ... Firmly identifying what elements of Australia’s sovereignty are not negotiable in bilateral and regional FTAs is important. (AMWU, sub. 21, pp. 9–10)

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Further, such policy constraints can arise in ways that may not be fully appreciated at the time of negotiation due to, for example, new technologies that emerge long after an agreement is finalised.

Alternatively, it may be regarded that such constraints can act as a discipline on policy makers, to prevent the undoing of beneficial reforms (or ‘backsliding’ into protectionist measures as noted in chapter 6). Therefore the desirability of locking in reform through the use of trade agreements necessarily depends on the desirability of the underlying policy in question. As such, some of the potential downsides of the inflexibility of trade agreements could be overcome by careful analysis of the policies to be entered into. For a given policy, however, the flexibility afforded by unilateral reform can be beneficial in allowing adjustment should unforeseen outcomes arise.

A further concern with the use of BRTAs is that they constrain not only the *level* of barriers, but they can also constrain the *form* that barriers take. One example of this is in relation to investment regulation which, under the AUSFTA, was bound so that United States investors are not required to notify the Foreign Investment Review Board (FIRB) if their investments are below particular monetary thresholds (currently at \$231 million for ‘sensitive sectors’ and \$1004 million for ‘non-sensitive’ sectors).<sup>3</sup> This not only binds Australia to not decrease the threshold below current levels, but also necessarily restrains the *form* of the policy to involve a monetary threshold, even when other forms of criteria (and liberalisation) may later be desirable.

For example, the Australian Government could consider removing the monetary threshold and replacing it with mandatory notification of only those investments in one particular sector. While this may represent further liberalisation for many investments, for those United States investors that currently benefit from either the \$231 million or \$1004 million thresholds, such a change could be more restrictive, and as such they may oppose any renegotiation of the AUSFTA that may be required to allow it, potentially constraining the Australian Government’s ability to introduce a different form of investment policy that may be less restrictive overall.

### *Other drawbacks*

Other drawbacks to the use of BRTAs to achieve domestic reform have been noted elsewhere in this report. Briefly, they include:

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<sup>3</sup> The threshold levels were originally \$50 million and \$800 million respectively, as set out in Australia’s schedule in Annex 1 (Non-conforming measures) of the AUSFTA. For current indexed levels, see: [www.firb.gov.au/content/monetary\\_thresholds/monetary\\_thresholds.asp](http://www.firb.gov.au/content/monetary_thresholds/monetary_thresholds.asp).

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- *negotiation costs*: Negotiating BRTAs, like pursuing trade reform through the WTO, comes at a material cost to the Australian government. Undertaking reform unilaterally entails similar implementation costs, but avoids these negotiation costs.
  - *bargaining coin and delayed reform*: Pursuing domestic reforms through BRTAs creates the incentive to delay reforms for use as ‘bargaining coin’ during negotiation with other countries. While this may have some impact on the outcomes obtained from negotiations, unilateral reform can secure benefits sooner and with greater certainty (this issue is discussed further in chapter 12).

## Conclusion

While the use of BRTAs to reduce Australia’s own trade and investment barriers has some advantages, on balance, the Commission considers that unilateral reform remains the most direct means for pursuing such reductions, as it is not subject to the negotiating priorities and timelines of partner countries, but rather can be undertaken once beneficial reforms have been identified. Unilateral reform also avoids incurring some of the drawbacks entailed in the use of BRTAs.

### FINDING 11.2

*Unilateral reform is the most direct means for reducing Australia’s trade and investment barriers. Pursuit of BRTAs can create incentives to delay unilateral reforms as well as entailing administrative and compliance costs.*

## 11.4 Economic cooperation and integration

Beyond reductions in tariffs and services barriers, BRTAs may also play a role in furthering economic cooperation and integration (chapter 10). While the distinction is not clear cut, economic integration can be seen as distinct from liberalisation or openness in that both at- and behind-the-border barriers are eliminated, and cross-border measures are harmonised, leading to conditions approaching a ‘single market’. Such integration is seen by some as potentially leading to benefits for the integrated economies including a larger pool of capital and labour, greater economies of scale for producers, improvements in productivity through knowledge and technology transfers and dynamic gains through investment and productivity.

Many of the ‘larger pool’ benefits to Australia could be achieved through unilateral (or, in the longer term, multilateral) reform to remove our own barriers. In terms of

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domestic benefits, this approach seems preferable to the pursuit of BRTAs (as discussed in section 11.3).

However, beyond such measures to improve openness, there remains a valid role for agreements between governments to further integrate economies by establishing like standards, institutional frameworks and trade facilitation measures that improve certainty for business.

### **The potential for BRTAs to achieve integration**

The effective flow of trade and commerce between countries requires not only physical infrastructure, but also institutional frameworks to exist between nations to allow, in the broadest sense, ownership and exchange of goods, and systems for dispute resolution between parties. Although many multilateral agreements exist to set broad rules between countries (and to establish international institutions), there remains substantial scope for governments to agree on matters that establish institutional frameworks and facilitate trade between nations.

Common, transparent, stable and comprehensible frameworks assist foreign businesses entering into new markets, as they improve the certainty and confidence for the businesses unused to local conditions. By encouraging the entry of businesses, such aligned frameworks also help to realise the benefits attributed to integration noted above. Further, trade facilitation can improve processing times and lead to overall reductions in transport and distribution costs. It is important to note, however, that much trade already occurs without a BRTA between trading partners, as evidenced, for example, by the existing levels of trade between Australia and China, Japan and Korea (countries that Australia has yet to conclude a BRTA with).

Some commentators have questioned the role of small BRTAs (as opposed to multilateral, or even large regional agreements) in achieving such economic integration, as larger parties to agreements may skew the negotiations in their favour:

... in regional arrangements between countries with uneven bargaining power, smaller, developing countries fear that deep integration can become an instrument for extracting concessions of all kinds not just in trade but in other 'non-trade' matters by their larger, more powerful counterparts. The agenda for deep integration is likely to be determined by rich, developed countries. And it is the smaller, developing countries who will have to adjust their standards to those of developed countries, regardless of whether these are appropriate to their conditions. (Panagariya 1999, p. 47)

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However, several other commentators have suggested that BRTAs, particularly those that focus on regional groupings, have a potential role to play in improving economic integration in the future:

... plurilateral agreements have the potential to build shared approaches to trade and investment, including through the adoption of a single approach to important administrative and implementation aspects of FTAs ...

Australia's participation in the range of regional negotiations demonstrates our ability to engage in multiple processes in support of free trade in our region. These initiatives are important features of the evolving regional economic architecture. It is important that Australia participates in each of these initiatives to seek to guide and influence their development. (DFAT, sub. 53, p. 51)

There is a staggering array of regional arrangements being discussed or negotiated: ASEAN "Plus 3", ASEAN "Plus 6", the EAS, the TPP, the FTAAP and Asia-Pacific Community. This is in addition to the patchwork of bilateral and regional agreements already in place.

... [the TPP] gives Australia an opportunity to drive greater consistency and coherence among the FTAs in the region. This will help reduce the scope for complexity and trade diversion arising from the existing patchwork of FTA arrangements. (Business Council of Australia, sub. 41, Attachment 1, p. 21)

In this context, the Australian Government is currently participating in existing forums which aim to develop a regional economic architecture. These include APEC and the East Asia Summit (EAS), which consists of ASEAN members, plus China, Japan, Korea, India, Australia and New Zealand. Further, there are presently two proposals under consideration by the EAS for regional trade agreements, namely the East Asia Free Trade Area (encompassing ASEAN, China, Japan and Korea), and the Comprehensive Economic Partnership in East Asia (CEPEA), which would include all EAS participants.

## **Integration under existing BRTAs**

While some saw potential for BRTAs to achieve future integration, other commentators argued that, based on the effects to date, preferential agreements are not well suited to this goal as they may not address substantial issues (by excluding sensitive sectors such as agriculture) and could introduce further complications through the introduction of new, fragmented trading rules within a region:

... trade policy in Asia is currently very unbalanced, relying too much on weak and partial FTAs which will not liberalise where it matters and thus not be a driving force for regional or global integration. In fact, [Sally] warns that emerging "hubs-and-spokes" made up of dirty FTAs, threaten disintegration, especially if the multilateral trading system weakens further. (Bosworth and Trewin, sub 32, Attachment 2, p. 72)

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However, some trade agreements have been seen to further economic integration for the member countries. Regarding Australian agreements, participants including Peter Lloyd (sub. 3) and the Business Council of Australia (sub. 41) highlighted the steps made towards economic integration as the ANZCERTA agreement with New Zealand has evolved over time.

As concluded in chapter 10, overall, BRTAs to date are likely to have achieved limited, though positive, benefits in terms of economic integration. Given the potential for integration, such a result highlights that the simple presence of a trade agreement between economies is not sufficient to guarantee that this objective is fully met. Rather, the extent of integration will depend on the form and coverage of the agreement in question. In particular, potentially inconsistent preferences and rules established under bilateral PTAs can actually undermine economic integration.

The Commission also notes that, during consultations for this study, several participants commended the collaborative, non-adversarial approach to reaching agreement on technical matters through bodies such as APEC (or other technical working groups). They regarded this as a more effective means of agreement on matters that were important frameworks for trade between countries than the adversarial, ‘tit-for-tat’ approach adopted as part of the negotiation of some trade agreements:

APEC is a process designed to promote regional economic cooperation, including by lowering all impediments to all international commerce. APEC is not a PTA and should not become one.

... Accordingly, APEC economies are reducing impediments to international commerce in ways which do not seek to divert economic activity away from any economy. That is the essence of open regionalism. (Elek, sub. 44, p. 5)

## **Alternatives for achieving integration**

While BRTAs can go some way to obtaining the benefits for Australia from economic integration, they are not the only way to access them:

... even if we are able to identify dimensions along which deep integration is desirable, it does not follow that a PTA is [a] necessary complement to it. In principle, much of deep integration agenda can be pursued independently of a PTA. To justify [a] PTA, one must identify extra gains resulting from a simultaneous pursuit of PTA and other deep integration agenda. Short of that, the two policies must be justified on their own merit. (Panagariya 1999, p. 45)

Indeed, the agreements between governments required to establish the frameworks for trade that can improve economic integration do not necessarily have to occur as part of a preferential trade agreement. For example, governments may enter mutual

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recognition agreements, exchange improvements in visa arrangements or simply encourage knowledge sharing and cooperation between regulatory authorities. Further, there are some aspects of trade that are better suited to such agreements. For example, the view that services liberalisation is achieved through reform to behind-the-border barriers, and thus better handled through alternative mechanisms (rather than formal trade agreements), was supported by the Law Council of Australia:

... it has been the Law Council's experience that greater opportunities for the export of services to other jurisdictions has been achieved through direct negotiation with relevant stakeholders overseas (e.g. bar associations, courts and government) rather than through preferential trade agreements ... (sub. 47, p. 3)

That said, there may be some benefits for achieving deeper integration if a range of related matters are negotiated at once, as part of a wider trade agreement. The overall benefits of an economic integration agreement will vary according to the parties involved, the form and coverage of the agreement, the extent of liberalisation agreed to, and the compatibility of rules set under the agreement with pre-existing multilateral and regional trade rules, including whether the rules and preferences are granted on a preferential basis or not (design principles for trade agreements are discussed further in chapter 13).

#### FINDING 11.3

*There is a continuing role for arrangements between governments to facilitate trade and investment; for example, by establishing consistent standards, institutional frameworks and measures to improve market openness. BRTAs are one means by which such arrangements can be established.*

## 11.5 Non-trade objectives

In addition to trade and investment barriers and cooperation on economic matters, there are some 'non-trade' objectives that can be pursued through, or affected by, the negotiation of a BRTA. These objectives include poverty alleviation and development, and fostering regional security and strategic relationships.

### Poverty alleviation and development

A substantial body of economic literature suggests that trade liberalisation — by both developing and developed countries — can help to improve the living standards of both the rich and poor around the world, contributing to a decrease in the proportion of people in absolute poverty.

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... most agree that developing countries can gain real benefits from opening up their economies. Indeed, the weight of evidence is that greater openness is important for growth and has been a central feature of successful development. No country has developed successfully by closing itself off from the rest of the world, very few countries have grown over long periods of time without experiencing a large expansion of their trade, and most developing countries with rapid poverty reduction also enjoy high economic growth ... (OECD 2010a, p. 58)

To the extent that they promote trade liberalisation, BRTAs can also have a role in alleviating poverty in developing countries by this means. However, as with all countries, the effect of BRTAs on developing countries can vary by agreement. For example, analysis undertaken as part of this study (box 8.6) raises doubts as to whether benefits resulted from two of Australia's previous non-reciprocal agreements, the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) of 1981 and the Australia-Papua New Guinea trade agreement of 1977.<sup>4</sup> Of course, differently designed agreements could have different development outcomes.

While reductions in barriers to trade and investment can be beneficial, when seeking to assist development, the approach taken to encouraging trade liberalisation with developing countries (and the assumptions made about their domestic institutional frameworks) should not simply replicate that taken with developed countries. That is, the agreements should not focus solely on the reduction of barriers:

Trade and investment liberalisation of course is not enough. It must be accompanied by wide-ranging domestic economic reform and strong institutions. Developing countries need assistance to achieve these. (AusAID, sub. 46, p. 5)

Access to a larger market, as a means to achieving scale economies and diversifying production has been a long-standing rationale for regional arrangements among developing countries. ... However, in developing countries with low levels of income and large rural populations, more is involved than choosing the right trade policy. Effective regional integration may accelerate growth and structural change ... but there is little reason to assume that trade liberalisation alone will achieve this. (UNCTAD 2007, p. 44)

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<sup>4</sup> Broadly, the results indicate that the Australia-Papua New Guinea agreement led to an increase in imports into the two countries, which was more than offset by a decrease in exports from the two to other countries, resulting in a net decrease in global trade. There was also a net decrease in relation to SPARTECA, where the estimated increase in trade between members was more than offset by a decrease in trade with non-members. These results may be driven by a lack of reform of barriers in the developing countries, given the one-sided nature of the agreements. Further, to the extent that they resulted in preferential access beyond Australia's relatively low MFN rates, the agreements may have focussed heavily resource constrained nations on exporting to Australia (and New Zealand), perhaps away from markets that otherwise would have represented higher value for them.

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Indeed, the economic literature has previously identified a need for reforms aimed at assisting development to be broad based:

... [Commentators note] that the critical elements in translating economic growth into poverty reduction seem to be complementary and multidimensional public policies. Work by the University of Adelaide exploring the links between trade, growth and poverty reduction lists five prerequisites for a positive relationship between trade and poverty reduction: *i)* trade openness; *ii)* domestic reform; *iii)* a robust and responsible private sector; *iv)* institutional reforms; and *v)* political will and co-operation ... (OECD 2010a, p. 58)

While BRTAs alone are unable to address all these requirements, they may be able to assist positively in relation to some, depending on their design. Moreover, in undertaking the negotiations for the recent AANZFTA, and the upcoming PACER-Plus negotiations (with Pacific Island Forum countries), Australia's approach to negotiation has involved its aid agency, AusAID, in capacity building and economic cooperation activities with partner countries, including in the training of negotiators and hosting of workshops on trade issues (box 11.2). The Australian Government has recently reaffirmed its support for PACER Plus, describing it as 'a new way to approach trade by supporting capacity building' (Elliot 2010).

The Commission supports such capacity building and economic cooperation actions to assist developing countries. While such actions may be contained within a BRTA they may also be pursued in the absence of a trade agreement with the relevant developing country. This would avoid complicating or delaying negotiations through the incorporation of contentious trade provisions, and could engender future cooperation between the parties by avoiding any perceptions of the use of bargaining power.

Overall, if a developing country considers that it would be in its national interests to pursue a trade agreement with Australia, the Commission believes that, in aiming to ensure that the negotiated outcomes do assist in alleviating poverty and realising development objectives, the Australian government should continue to take into account the circumstances of partner countries and measures to achieve successful engagement in such negotiations (for a summary of some relevant considerations, see, for example, ACFID 2009a, 2009b and UNCTAD 2007).

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### **Box 11.2 Capacity building as part of PACER Plus negotiations**

The Australian Agency for International Development (AusAID) has been involved since the scoping stage of the ongoing negotiations for the Pacific Agreement on Closer Economic Relations Plus (PACER Plus). This included assessing the capacity of the Forum Island Countries (FICs) to engage in negotiations, as well as any support needed for them before and during negotiations (this was informed by feedback from AusAID Posts in the Pacific).

AusAID established the Pacer Plus Support Initiative in 2007-08 to support the FICs. The objectives of the program are to build their capacity to negotiate; develop analysis and policy research on Pacific trade; engage stakeholders in the Pacific; and facilitate trade (including through building institutional capacity). Some key activities undertaken in the 'scoping' stage, as a result of this support include:

- completion of a series of five trade policy papers from the Vanuatu-based Pacific Institute for Public Policy;
- a report on the benefits and costs of PACER Plus that contributed to discussion amongst the FICs of the costs and benefits of various negotiation options; and
- provision of WTO Trade Facilitation Needs Assessment workshops in the four WTO member countries (PNG, Solomon Islands, Fiji and Tonga) and two accession countries (Samoa and Vanuatu). AusAID engaged the Oceania Customs Organisation to lead the workshops, which were aimed at identifying trade facilitation measures under PACER Plus.

The Support Initiative was continued in the 'initiation' stage of PACER Plus, with some key activities including:

- a training program for one trade officer from each of the FICs to prepare for negotiations. The training consists of ten modules of one week's duration each;
- establishing a Trade Research Initiative to provides \$65 000 to each FIC to commission independent trade research. To date, one study has been completed (Samoa), four are underway (Niue, Nauru, Tonga and the Cook Islands) and one is being negotiated (Tuvalu) ;
- support (with New Zealand) of FIC participation in PACER Plus meetings, including funding for ministers' and officials' meetings in Brisbane in October 2009, and funding for the following officials' meeting in April 2010 in Port Vila, Vanuatu; and
- support for the establishment and operation of the Office of the Chief Trade Adviser to provide advice and technical assistance to the FICs during negotiations.

AusAID indicated that future assistance is likely to continue and evolve as the negotiations move into a more substantive phase.

*Source:* AusAID (sub. 46).

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## Security and strategic relationships

Beyond the terms contained within a trade agreement, it has been argued that the process of negotiating and signing an agreement between two (or more) countries potentially improves the strategic relationship between the parties (both formally and through general goodwill and awareness of the partner country), leading to cooperation in other policy areas, such as defence. This cooperation, combined with the potentially improved economic growth and stability in partner countries, could result in an overall improvement in security:

Australia's interest in the stability and development of the Pacific is based on greater regional prosperity and reducing the growing threat from transnational crime (including money laundering, terrorism, drug trafficking and people smuggling) (AusAID 2004, p. 11)

... the economic and security spheres are interdependent. Economic and human development cannot be achieved in an environment where there is poor governance and political instability. Conversely, a faltering or struggling economy that is unable to provide essential services for its people may create social inequalities, personal grievances or community unrest that become a security problem. (SFADTC 2010, vol. 2, p. 6)

Although trade by itself cannot represent a developmental panacea, we cannot secure prosperity without trade and Australia's objective is to see our immediate region as prosperous, trading and stable. A properly considered, comprehensive PACER Plus free trade agreement comprising a carefully crafted trade capacity building or 'Plus' component provides a key platform to deliver this outcome. (DFAT 2008c, pp. 25–26)

While these benefits can be seen as an *outcome* of trade agreements, they have also been cited as a potential objective and a key part of the Government's assessment:

Needless to say, FTAs are a product of negotiations between countries and not all of Australia's identified objectives are met in all circumstances. It is the role of governments to weigh and assess the overall balance of benefits in deciding how and when to conclude any particular FTA negotiation. These assessments will necessarily have regard to a broad range of considerations, including commercial and strategic considerations. (DFAT, sub. 53, p. 8)

... governments are also using PTAs as instruments to secure wider foreign policy and strategic objectives that are often unrelated to trade and commerce. The most obvious contemporary example of this can be found in the United States where bilateral and regional trade agreements are increasingly being used to reinforce strategic relationships. ... The AUSFTA was a good example of this phenomenon: this was a deal driven by politics, not economics, hence Australia's willingness to accept such a poor outcome on areas of major interest such as agriculture. (Capling 2008, pp. 28, 36)

Sometimes such strategic linkages are part of the public justifications for entering a trade agreement, but at other times governments have justified a proposed agreement on economic grounds alone. For example, in announcing that Cabinet

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had approved the AUSFTA, the then Prime Minister focussed entirely on the economic relationship between the countries (see Howard 2004).

Indeed, the characterisation of security and strategic relationships as a central justification for a trade agreement is a cause of some concern, as the practical value of any contribution made by BRTAs to such relationships is often not clear and yet such considerations can seem to dominate other considerations. Thus, in its submission, the Australian Fair Trade and Investment Network was critical of ‘The linking of strategic issues such as security alliances to Trade Agreements, at the expense of consideration of the actual economic and social impacts of the agreements’ (sub. 33, p. 4).

The Commission is not well placed to assess the strategic value of any particular agreement. Indeed, the difficulty in assigning an objective economic value to a strategic goal (related to, say, diplomatic, sporting or defence interests) introduces difficulties into the benefit-cost analysis for agreements generally.

A key uncertainty relates to the effectiveness of BRTAs in pursuing strategic goals. For example, while intended to improve the prosperity of developing country partners, as noted above, it is questionable if past Australian trade agreements such as the (non-reciprocal) SPARTECA have done so. In turn, the contribution of these past BRTAs to regional security through this pathway is also questionable (though differently designed BRTAs might be more effective in this respect). Likewise, while the act of the negotiating and signing an agreement can improve the strategic relationship between the parties, this may not always be the case if negotiations become difficult and agreement is viewed as a costly compromise.

However, even where (well-designed) BRTAs are able to indirectly advance security and strategic interests, it seems unlikely that they would be the most appropriate or cost-effective means to do so. In this context, the Commission notes that Australia has negotiated a range of specific defence and security treaties, such as the ANZUS treaty (with New Zealand and the United States), an agreement with the Indonesia on the framework for security cooperation, and a memorandum of understanding on defence cooperation and joint declaration on security cooperation with India. These are just some examples of the range of agreements and actions available to government (ranging from formal treaties, memoranda of understanding and cooperation agreements through to meetings between officials and ministers) to highlight relationships between countries. In addition to this range of agreements, the Commission also notes that the Australian Government pursues many direct programs aimed at improving security in partner countries (examples of such programs in the context of the Pacific Islands are presented in box 11.3).

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### Box 11.3 Australian security-related programs in the Pacific

In addition to strong trade and development ties with the Pacific Islands, the Australian Government also undertakes several programs aimed at improving regional security. One of the most visible examples of such programs is the Regional Assistance Mission to the Solomon Islands (RAMSI), led by Australia but involving personnel from several other countries in the region. In operation since 2003, RAMSI's initial focus was to restore law and order in the Solomon Islands, and as such required substantial police and military involvement. As stability has improved, greater focus has been placed on long term issues such as capacity building, governance and improved judicial and correctional institutions. From 2003 to 2008-09, the Australian Government's total financial commitment to RAMSI was \$1.4 billion.

Other programs include those aimed at combating transnational crime, such as:

- the Pacific Transnational Crime Network, established by the Australian Federal Police to foster cooperation on criminal intelligence and investigative capacity in the Pacific;
- training provided both to police forces (by the AFP) and to the police and military in maritime surveillance (by the Department of Defence);
- legal assistance, provided by the Attorney-General's Department to improve policing and criminal justice legislation;
- cooperation under a number of agreements, including the Honiara Declaration on Mutual Assistance in Criminal Matters, Proceeds of Crime and Extradition, the Nasonini Declaration (covering a range of issues including counter-terrorism, terrorist financing, money laundering, drug trafficking and people smuggling), and Counter-Terrorism Memoranda of Understanding with both Papua New Guinea and Fiji;
- assistance to develop anti-money laundering and counter financing of terrorism systems, delivered by the Anti-Money Laundering Assistance Team in the Attorney-General's Department; and
- strengthened border protection and counter terrorism capability, including technical assistance for border assessments, identity verification and forensic document examination, delivered through the Department of Immigration and Citizenship.

Australia also pursues several defence programs in the Pacific, including:

- the Defence Cooperation Program which involves approximately 60 military and civilian advisers providing training and support (covering, for example, strategic planning, maritime security, communications and disaster relief) to defence and police forces in the Pacific; and
- the Pacific Patrol Boat program which has provided 22 patrol boats to 12 Pacific Island nations for law enforcement (including areas of transnational crime, illegal fishing and search and rescue). The program also provides advisers, training and equipment for the recipient nations.

*Source:* DFAT (2008c).

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Of course, in the case where a proposed BRTA is justified on economic grounds, the formation of an agreement may have the effect of enhancing relationships.

However, were a proposed BRTA not justified on economic grounds, the Commission does not consider it desirable for non-economic interests to be used as the justification to enter an agreement, as there are potentially more appropriate methods for achieving security and strategic objectives available. In such cases, it is preferable to use other arrangements to further the non-economic objectives in question, and avoid incurring the net economic cost of entering a BRTA.

## **11.6 Summing up**

The Commission's assessment is that BRTAs are a feasible policy option for the pursuit of some of the objectives discussed in this chapter. A well designed BRTA could be used to seek reductions in trade barriers in partner countries, and to establish arrangements to facilitate trade and investment between partners that may be required to operationalise or enhance available multilateral frameworks. Of course, such agreements would still need to be subject to a realistic assessment of their economy-wide impact, and the need to avoid unnecessary duplication or overlap with Australia's other trade measures.

The Commission also considers that several of the objectives mentioned above (particularly those of reducing Australia's own trade barriers, and non-trade considerations) are not well-suited and/or should not be confined to achievement through BRTAs, particularly those involving concessional arrangements between members.

Were BRTA negotiations to be used with the aim of advancing a wide array of non-economic policy objectives, it would be difficult for the Government and negotiators to assess the costs and benefits of proposals and concessions. Non-economic objectives can typically be addressed more effectively through other means. Government should only use BTRAs for non-economic purposes if they know the alternatives would be more costly, and with a clear notion of what is an unacceptable price to pay for these non-economic goals. In sum, BRTAs are generally not the ideal means for advancing non-economic interests in their own right, although clearly a BRTA, if successfully negotiated, can strengthen relationships that over time will enhance the achievement of other goals.