



**Australian Government**  
**Productivity Commission**

# Bilateral and Regional Trade Agreements

Productivity Commission  
Research Report

November 2010

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# Foreword

In recent years, Australian governments have entered a range of bilateral and regional trade agreements, and negotiations are presently underway for more. These agreements typically seek to reduce trade barriers between partner countries on a preferential basis, and some also contain provisions affecting broader areas of policy.

The Commission was asked by the Government to examine the effects of such agreements on a range of matters, including trade and investment barriers, prospects for multilateral reform, regional integration and Australia's economy generally.

In preparing this report, the Commission has drawn on a range of information and evidence, including material put forward in submissions and during consultations with interested parties, studies in the academic literature, and research and quantitative analysis undertaken within the Commission.

Preparation of the report was overseen by Commissioner Patricia Scott and Associate Commissioner Andrew L. Stoler. Mr Stoler was appointed by the Government on a part-time basis specifically for the purposes of this study. He has extensive experience as a United States trade negotiator in Geneva and then as a Deputy Director-General at the WTO, and his views and knowledge have contributed to the report in various ways. Mr Stoler does not agree with a number of the recommendations in this final report, as well as some of the supporting analysis and findings. His views are set out in appendix A. The Commission considered these carefully in reaching its conclusions.

The Commission is grateful to all those businesses, organisations, individuals and officials who participated in the study through submissions, consultations, workshops and surveys. The research team for the study was led by Paul Gretton and Tom Nankivell and located in the Commission's Canberra Office.

Gary Banks AO  
Chairman

November 2010

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# Terms of reference

## **REVIEW OF BILATERAL AND REGIONAL TRADE AGREEMENTS**

The Productivity Commission is requested to undertake a study on the impact of bilateral and regional trade agreements on trade and investment barriers and on Australia's trade and economic performance.

### **Context**

It is widely acknowledged that the benefits of trade liberalisation are greatest if the liberalisation is undertaken multilaterally. Nevertheless, conclusion of the current round of multilateral trade negotiations has proven elusive and many countries have sought more quickly realisable outcomes through bilateral and regional free trade agreements. Free trade agreements have also been seen by many as promoting broader economic integration and serving foreign policy and strategic interests.

Globally, bilateral and regional trade arrangements have thus emerged as part of the policy landscape. The World Trade Organization estimates that close to 400 free trade agreements will be in force globally by 2010. The proliferation of free trade agreements poses many challenges for Australia and for the global trading system. Depending on the nature of the agreements they can carry the risk of trade diversion. Countries not party to agreements can be disadvantaged by the preferences offered to others under the agreements.

The Australian Government is committed to reinforcing the primacy of the multilateral trading system and resisting any rise in global protectionist measures. Australia has been pursuing bilateral and regional agreements intended to support the multilateral trading system while also enhancing commercial opportunities between Australian businesses and businesses in partner countries and enhancing Australia's broader economic, foreign and security policy interests. Australia has therefore signed a number of trade agreements and is in the process of negotiating, or considering, several others.

Against this background, the Commission is requested to provide advice on the effectiveness of trade agreements in responding to national and global economic and trade developments and in contributing to efforts to boost Australia's engagement in the region and evolving regional economic architecture.

### **Scope of the Study**

The Commission is requested to:

- examine the evidence that bilateral and regional trade agreements have contributed to a reduction in trade and investment barriers. Consider also to what extent such

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agreements are suited to tackling such barriers, including in the context of the proliferation of such agreements between other countries;

- examine the evidence that bilateral and regional trade agreements have safeguarded against the introduction of new barriers. Consider also the potential for trade discrimination against Australian businesses without full engagement in the evolving network of bilateral and regional agreements;
- consider the role of bilateral and regional trade agreements in lending support to the international trading system and the World Trade Organization;
- analyse the potential for trade agreements to facilitate adjustment to global economic developments and to promote regional integration;
- assess the impact of bilateral and regional agreements on Australia's trade and economic performance, in particular any impact on trade flows, unilateral reform, behind-the-border barriers, investment returns and productivity growth;
- assess the scope for Australia's trade agreements to reduce trade and investment barriers of trading partners or to promote structural reform and productivity growth in partner countries. Consider alternative options for promoting productivity improving reform in partner countries; and
- assess the scope for agreements to evolve over time to deliver further benefits, including through review provisions and built-in agenda.

### **Key Considerations**

In conducting the study and making recommendations the Commission shall:

- seek public submissions and consult widely with the business sector, government agencies and other interested parties;
- draw on available, credible evidence both nationally and internationally and take into account the changed international trade, economic and strategic environment;
- have regard for the Government's commitment to uphold Australia's international treaty obligations and to play a constructive role in any global response to the economic challenge of rekindling sustained growth; and
- have regard to the report of the independent Review of Export Policies and Programs undertaken by Mr David Mortimer AO and Dr John Edwards and the work undertaken by the associated FTA Reference Panel.

The Commission is to produce and publish a final report within twelve months of commencement.

NICK SHERRY

Assistant Treasurer

[received 27 November 2009]

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# Disclosure of interests

The *Productivity Commission Act 1998* specifies that where Commissioners have or acquire interests, pecuniary or otherwise, that could conflict with the proper performance of their functions during an inquiry they must disclose the interests.

Andrew L. Stoler has advised that he holds the position of Executive Director with the Institute for International Trade at the University of Adelaide. The Institute undertakes projects related to bilateral and regional trade agreements (as well as other trade matters) for a range of clients in both the private and public sectors, including the Department of Foreign Affairs and Trade.

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# Abbreviations and explanations

## Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ABS	Australian Bureau of Statistics
ACCI	Australian Chamber of Commerce and Industry
ACBPS	Australian Customs and Border Protection Service
ACFID	Australian Council for International Development
ACI-FTA	Australia-Chile Free Trade Agreement
ACP	African, Caribbean and Pacific Group of States
ADB	Asian Development Bank
AFP	Australian Federal Police
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
ASR	Australian Services Roundtable
ATIGA	ASEAN Trade in Goods Agreement
AUSFTA	Australia-United States Free Trade Agreement
BCA	Business Council of Australia
BIS	Bank for International Settlements
BITs	Bilateral Investment Treaties
BRTAs	Bilateral and Regional Trade Agreements
CACM	Central American Common Market
CAL	Copyright Agency Limited
CEPEA	Comprehensive Economic Partnership in East Asia
CEPT	Common Effective Preferential Tariff

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CER	Closer Economic Relations
CGE	computable general equilibrium
CIE	Centre for International Economics
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CMAs	Critical Mass Agreements
COAG	Council of Australian Governments
CPG	Commonwealth Procurement Guideline
CRTA	Committee on Regional Trade Agreements
CTC	Change in Tariff Classification
DAFF	Department of Agriculture, Fisheries and Forestry
DFAT	Department of Foreign Affairs and Trade
DoFA	Department of Finance and Administration
EAS	East Asia Summit
EC	European Community
EEC	European Economic Community
EFTA	European Free Trade Association
EMDG	Export Market Development Grants
FDI	Foreign Direct Investment
FIC	Forum Island Countries
FIRB	Foreign Investment Review Board
FMA	Financial Management and Accountability
FTAs	Free Trade Agreements
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GNP	Gross National Product
GTAP	Global Trade Analysis Project
IAC	Industries Assistance Commission
IC	Industry Commission
ICSID	International Centre for Settlement of Investment Disputes

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ILO	International Labour Organization
IMF	International Monetary Fund
IP	Intellectual Property
IPPA	Investment Promotion and Protection Agreement
ISDS	Investor-State Dispute Settlement
ISO	International Organization for Standardization
ISPs	Internet Service Providers
ITA	Information Technology Agreement
ITU	International Telecommunications Union
JSCOT	Joint Standing Committee on Treaties
LAFTA	Latin American Free Trade Area
MERCOSUR	Acuerdo Comercial–Mercado Común del Sur (Southern Common Market Agreement)
MFN	Most Favoured Nation
MFAT	New Zealand Ministry of Foreign Affairs and Trade
MIPI	Music Industry Piracy Investigations
MOU	Memorandum of Understanding
MPPs	Mandatory Procurement Procedures
MRAs	Mutual Recognition Agreements
NAFTA	North American Free Trade Area
NFF	National Farmers’ Federation
NIA	National Institute of Accountants
NIA	National Interest Analyses
NZ	New Zealand
OECD	Organisation for Economic Co-operation and Development
PACER	Pacific Agreement on Closer Economic Relations
PATCRA	Papua New Guinea-Australia Trade and Commercial Relations Agreement
PBAC	Pharmaceutical Benefits Advisory Committee
PBS	Pharmaceutical Benefits Scheme
PC	Productivity Commission



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PSR	Product Specific Rules
PTA	Preferential Trade Agreement
R&D	Research and Development
RAMSI	Regional Assistance Mission to the Solomon Islands
RIRDC	Rural Industries Research and Development Corporation
RoO	Rule(s) of Origin
RVC	Regional Value Content
SAFTA	Singapore-Australia Free Trade Agreement
SCFTAAUSA	Select Committee on the Free Trade Agreement between Australia and the United States of America
SFADTC	Senate Foreign Affairs, Defence and Trade Committee
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
SPS	Sanitary and Phytosanitary Measures
TAFTA	Thailand-Australia Free Trade Agreement
TBT	Technical Barriers to Trade
TCF	Textiles, Clothing and Footwear
TIFAs	Trade and Investment Framework Agreements
TPMs	Technological Protection Measures
TPP	Trans-Pacific Partnership
TRIMS	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property
UNCTAD	United Nations Conference on Trade and Development
US	United States
WIPO	World Intellectual Property Organization
WITS	World Integrated Trade Solution
WTO	World Trade Organization

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## Explanations

Billion	The convention used for a billion is a thousand million ( $10^9$ ).
Findings	<i>Findings in the body of the report are paragraphs highlighted using italics, as this is.</i>
Recommendations	<b><i>Recommendations in the body of the report are highlighted using bold italics.</i></b>

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# OVERVIEW

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## Key points

- In line with global trends, Australia has recently entered a number of new bilateral and regional trade agreements (BRTAs) and is negotiating several more.
- The Australian Government's approach has been to negotiate comprehensive agreements that seek substantial reductions in trade barriers.
  - For merchandise trade, recent BRTAs have resulted in some significant bilateral tariff reductions both in Australia and in partner countries.
  - For services and investment trade, BRTAs typically limit discrimination between suppliers.
  - Australia's agreements have often also included provisions on matters such as intellectual property, competition policy and trade facilitation.
- Theoretical and quantitative analysis suggests that tariff preferences in BRTAs, if fully utilised, can significantly increase trade flows between partner countries, although some of this increase is typically offset by trade diversion from other countries.
  - The increase in national income from preferential agreements is likely to be modest.
- The Commission has received little evidence from business to indicate that bilateral agreements to date have provided substantial commercial benefits.
  - This may be because the main factors that influence decisions to do business in other countries lie outside the scope of BRTAs.
- Domestic economic reform offers relatively large economic benefits and should not be delayed to retain 'bargaining coin'.
- In the international arena, the Australian Government should continue to pursue progress in the Doha Round. Building the case for substantive reductions in trade barriers internationally requires improvements in domestic transparency and policy analysis *within* each country.
- While BRTAs can reduce trade barriers and help meet other objectives, their potential impact is limited and other options often may be more cost-effective.
- Current processes for assessing and prioritising BRTAs lack transparency and tend to oversell the likely benefits.
- To help ensure that any further BRTAs entered into are in Australia's interests:
  - Pre-negotiation modelling should include realistic scenarios and be overseen by an independent body. Alternative liberalisation options should also be considered.
  - A full and public assessment of a proposed agreement should be made after negotiations have concluded — covering all of the actual negotiated provisions.
- The Government should also develop and publish an overarching trade policy strategy, to better coordinate and track the progress of trade policy initiatives, and to ensure that efforts are devoted to areas of greatest likely return.

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# Overview

It is widely acknowledged that the benefits of trade liberalisation are greatest if the liberalisation is undertaken on a non-discriminatory or ‘most favoured nation’ (MFN) basis. Australia has long been involved in trade liberalisation on this basis, having unilaterally reduced its own trade barriers and supported multilateral efforts through the World Trade Organization (WTO) and its predecessor. However, the current WTO ‘Doha’ Round appears to have stalled, and some now question the effectiveness of the multilateral framework for delivering further reductions in trade barriers.

At the same time, there has been rapid growth in bilateral and regional trade agreements (BRTAs — defined in box 1), the bulk of which are often termed ‘Free Trade Agreements’. These latter agreements, more accurately labelled preferential trade agreements (PTAs), entail the exchange of ‘concessions’ (or preferences) between the partner economies to the agreement, advantaging trade between the partners although potentially at the expense of trade from other sources. BRTAs often cover other matters too, including investment protections, intellectual property provisions, trade facilitation, government procurement, e-commerce, and labour and environmental standards. In this context, BRTAs can cover matters that are effectively not within scope in the WTO setting.

Until recently, Australia had largely eschewed BRTAs. The key exception was the 1983 ‘Closer Economic Relations’ agreement with New Zealand. Australia was also a signatory to the non-binding 1994 APEC Bogor Declaration. Over the last seven years, however, Australia has concluded several new PTAs and is currently negotiating or exploring several others (box 1).

For the PTAs recently entered into by Australia or that are in prospect, the formal decision to commence negotiations has typically followed the preparation of a feasibility study, containing quantitative modelling of the potential benefits of an agreement with the prospective partner country. PTAs are typically promoted on economic grounds, although they may also serve foreign policy and strategic interests.

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## Box 1 **Bilateral and regional trade agreements**

### **What are bilateral and regional trade agreements?**

For the purposes of this study, the Commission has interpreted the term ‘bilateral and regional trade agreements’ broadly to cover:

- agreements concluded between two parties in which at least one of the parties, whilst maintaining their own tariffs, obtain concessional entry to the market of the partner, such as in the Australia-New Zealand Closer Economic Relations Trade Agreement — such agreements are variously referred to as preferential or free trade agreements;
- similar agreements between multiple parties, such as Australia’s recent regional agreement with ASEAN and New Zealand and the North American Free Trade Agreement — also referred to as preferential or free trade agreements;
- agreements (termed ‘customs unions’) between two or more countries in which members adopt a common external tariff while allowing concessional trade between partners, such as the customs union of the European Union; and
- agreements between trading partners to lower their own trade barriers with respect to all parties (including those outside the agreement) either according to arrangements bound under the agreement or on a voluntary basis, such as the APEC Bogor Declaration.

### **Australia’s agreements**

Australia has a range of relatively long-standing BRTAs. Apart from its agreements with New Zealand, which have been extended in scope over time, these older preferential agreements are confined to duty concessions on merchandise trade. Australia has had a non-reciprocal agreement with the South Pacific Islands Forum since 1981, and a specific agreement with Papua New Guinea since 1977. It also has a long standing reciprocal PTA with Canada, although most of its provisions have been superseded by reductions in the partners’ MFN tariffs. In addition, Australia is a party to the Bogor Declaration, under which APEC members agreed to progressively lower trade barriers to all trading partners.

More recently, Australia has entered into five new preferential trade agreements:

- Singapore-Australia FTA (commenced 28 July 2003);
- Thailand-Australia FTA (commenced 1 January 2005);
- Australia-United States FTA (commenced 1 January 2005);
- Australia-Chile FTA (commenced 6 March 2009); and
- ASEAN-Australia-New Zealand FTA (commenced 1 January 2010).

Australia is also negotiating bilateral PTAs with China, Malaysia, Japan and Korea. And it is negotiating three regional deals: with the Gulf Cooperation Council; the PACER Plus agreement with Pacific Island Forum countries; and the Trans-Pacific Partnership with Brunei Darussalam, Chile, New Zealand, Singapore, Peru, Vietnam and the United States.

Australia has also completed feasibility studies recently with Indonesia and India, and has now agreed to negotiate an economic partnership agreement with the former.

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## **The study**

Following a recommendation in the 2008 Review of Export Policies and Programs (Mortimer 2008), the Government asked the Commission ‘... to undertake a study of the impact of bilateral and regional trade agreements on trade and investment barriers and on Australia’s trade and economic performance.’ Among other things, the Commission was asked to examine:

- the contribution and suitability of BRTAs to reducing or limiting trade and investment barriers;
- the role of BRTAs in supporting the international trading system, and in facilitating adjustment to global economic developments and promoting regional integration;
- the impact of BRTAs on trade flows, unilateral reform, behind-the-border barriers, investment returns and productivity growth;
- the scope for Australia’s BRTAs to reduce trade and investment barriers or to promote structural reform and productivity growth in partner countries; and
- the scope for BRTAs to evolve over time to deliver further benefits.

In undertaking the study, the Commission consulted widely. It held meetings with interested parties, invited submissions, of which around one hundred were received, engaged with major business associations to ascertain the views of business, and contacted Commonwealth departments to obtain information on the costs to government agencies of negotiating and administering BRTAs. However, the information received from businesses and a key government department has not been as extensive as expected.

In preparing the report, the Commission drew on information received together with existing literature, including the analysis in the earlier Mortimer review, as well as quantitative analysis undertaken by the Commission. This report sets out the Commission’s findings and recommendations.

## **The economic effects of bilateral and regional trade agreements**

While the scope and ambition of different BRTAs varies, the Australian Government’s policy has been to negotiate comprehensive agreements that seek to liberalise substantially all the trade between the partner countries and which cover a range of other matters. Prima facie, these aims have largely been met, particularly in relation to barriers to trade in merchandise.

- For merchandise exports, Australia’s PTAs have resulted in some appreciable reductions in tariff barriers faced by Australian suppliers in partner countries,

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notwithstanding some carve outs or long phase-in periods for tariff reductions (or quota increases) in ‘sensitive sectors’ in some cases. For merchandise imports into Australia, tariffs have been eliminated for complying imports from partner countries.

- In relation to services trade, PTAs typically contain provisions aimed at reducing (or preventing increases in) discrimination between domestic service providers and those of partner countries. Australia’s PTAs also tend to include arrangements for developing mutual recognition of standards and professional qualifications, and can provide for the temporary movement of employees and business people to work in the partner country.
- In relation to investment, the operation of Australia’s PTAs is broadly similar to that for services, with a key objective being to bind current commitments and improve regulatory certainty. Notably, the AUSFTA contains presently unique provisions that reduce the scrutiny of US investments in Australia by the Foreign Investment Review Board.

The barrier reductions negotiated through BRTAs have clearly had practical benefits for some businesses. For example, some agricultural industries believe that negotiated improvements in market access have allowed them to obtain pricing benefits from the partner market, and some manufacturing businesses have attributed their ability to expand in a foreign market to tariff concessions and other provisions afforded by a particular agreement. Even where provisions have not significantly reduced barriers from prevailing levels, some aspects of BRTAs have served to ‘lock in’ existing levels of domestic protection, preventing parties from introducing more restrictive measures in the future.

However, while the Commission has obtained insufficient evidence to be definitive, it appears that businesses generally have made limited use of the opportunities available from Australia’s existing BRTAs.

This may be because the main factors that influence decisions to trade or invest abroad are not directly influenced by BRTAs. In this context, some agricultural bodies noted that notional improvements in market access from negotiated reductions in tariff and quota barriers could remain largely unrealisable without concomitant reforms to quarantine requirements in partner countries. In the services area, some industry groups indicated that businesses intent on supplying services to foreign countries typically already ‘work around’ many formal barriers in those countries. The Commission was also told that, even where the mutual recognition of qualifications or testing procedures are agreed in a BRTA, additional requirements in the partner country can sometimes hamper their use. More generally, the Commission has received little evidence from business that would demonstrate that



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the viability of exports and investments in a particular market is significantly influenced by whether or not Australia has a BRTA with the particular country.

To further explore the economic effects of the reductions in trade and investment barriers through trade agreements, the Commission undertook a number of quantitative exercises. One involved ‘ex ante’ modelling of the potential effects of bilateral tariff reductions between Australia and both a large country and a small country, and of the effects on Australia if it did not enter BRTAs with particular countries while its rivals did. The Commission also modelled the potential effects of a reduction in barriers to foreign direct investment). Another entailed an ‘ex post’ econometric examination of the effects on merchandise trade flows of actual agreements, utilising data for more than 140 countries dating back to 1970. While no quantitative study can hope to fully capture the precise impacts of trade agreements, the Commission considers that they are sufficient robust to draw some conclusions about the relative merits of different forms of liberalisation.

Overall, the analyses suggest that preferential BRTAs could have a significant impact on aggregate trade flows between partner countries, although some of the estimated increases in those trade flows are likely to be offset by trade diversion from other countries. Despite the overall increase in trade modelled, the results indicated that improvements in national income from bilateral preferential agreements are likely to be modest — especially where member nations have small economies. In the case of some larger regional agreements, particularly those with less emphasis on preferential arrangements, the analyses indicated that such arrangements were more likely to deliver more substantial benefits. Analysis also suggested that reductions in investment barriers could, under some circumstances, generate some benefits, but these would be more certain where reform is undertaken on a non-preferential basis.

While the provisions in BRTAs dealing directly with trade in goods, services and investment are likely to have generated some benefits for Australia, other provisions involve additional costs or risks. These include the AUSFTA-driven changes to Australia’s intellectual property regime and government procurement requirements. Australia has also signed up to investor-state dispute settlement provisions in some BRTAs for which there appear to be few benefits and considerable risks.

### **Future approach to trade liberalisation and the role of bilateral and regional trade agreements**

BRTAs are among a number of means available to governments to reduce trade and investment barriers in Australia and other countries and to promote regional

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integration. In considering any future role for BRTAs, the potential contribution of other mechanisms for achieving these goals also needs to be assessed.

### *Unilateral reform*

Over the last four decades, Australia has gained significant economic benefits as a result of programs of unilateral reform, which entailed reducing its own trade barriers without the need for any specific international engagement. Indeed, and contrary to mercantilist notions that focus on export promotion and market access and often cloud debates about trade policy, the main benefits that arise from trade liberalisation result from a country purchasing its inputs and final goods from the lowest cost sources of supply, and exposing its industries to greater import competition by reducing its own trade barriers. This creates a competitive environment that drives productivity and a more efficient utilisation of resources within the economy.

While Australia's previous unilateral reform efforts have reduced tariffs substantially, even at current (low) tariff levels the modelling conducted as part of this study suggests that much of the future economic gains available to Australia from tariff reductions could be achieved through unilateral reform.

So even while current tariffs in Australia are low, the application of tariffs continues to raise costs to industry and consumers and erode export competitiveness. Also, while Australian foreign investment review provisions have been enacted to meet national interest objectives, they entail compliance and administrative costs and may act as a deterrent to foreign investment. Both tariff and foreign investment concessions have been included in PTAs entered into by Australia and more are in prospect, discriminating against other trade and investment partners. This suggests a case for reviewing these measures with a view to extending these concessions to trade and investment from other sources.

While some might argue that further domestic reform should be stayed to retain 'bargaining coin' in international trade negotiations, this would delay and potentially forego the relatively much larger and more readily achieved gains available from domestic reform in favour of smaller and uncertain benefits.

### *Multilateral and plurilateral reform*

While Australia has already undertaken substantial liberalisation of its own trade barriers and should continue to do so, there are further benefits that could accrue from the reduction of barriers to trade and investment in the economies of its

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trading partners. The benefits of trade liberalisation are greatest if the liberalisation is undertaken on a multilateral basis, a result reflected in the modelling presented in this report. By lowering barriers to all countries, multilateral reform avoids the potential for trade diversion inherent in PTAs, and affords the liberalising economies with access to lowest-cost imported supplies.

However, for the present, the Doha Round appears to have stalled and it is not clear that the WTO, and the negotiation processes it administers, remain best placed to advance the international trade liberalisation agenda. Even so, the Australian Government has indicated that conclusion of the Round remains its highest trade policy priority. The Commission endorses worthwhile efforts to secure a meaningful outcome in the Doha Round.

Should real progress within the WTO continue to prove elusive, the Australian Government should weigh up with like-minded countries the costs and benefits of broadly based ‘critical mass agreements’ (CMAs) to push ahead on reform. These agreements (such as the Information Technology Agreement) come into effect once the signatories account for a designated percentage (90 per cent in the ITA) of world trade in the product in question. Once in effect, they impose obligations on signatories, with the resulting rights typically offered by signatories on an MFN basis to all trading partners. While it may be difficult to effectively advance a CMA agenda without leadership from significant trading nations, leading international groups of countries, such as the G20, could drive substantial progress through CMAs if none were forthcoming through the Doha Round.

Over the longer haul, getting substantive trade liberalisation (whether via unilateral, bilateral, regional, plurilateral or multilateral processes) is likely to also require reforms to the domestic policy processes of trading countries. In this context, it has been widely acknowledged that one obstacle to international trade reform is resistance raised in the domestic debate of each country. This is in part due to the concessions-based mindset in which ‘tit-for-tat’ negotiations are conducted, coupled with the mercantilist manner in which gains or losses are often assessed and publicly reported. This is exacerbated by the fact that typically there are concentrated groups of ‘losers’ from reductions in trade barriers, who are more vocal than the widely dispersed ‘winners’ — industries using imported inputs, exporters and consumers. Together, these factors result in a biased weighting of potential benefits and costs arising from trade liberalisation. As the Commission has previously noted and as Australia’s experience shows, this problem could be ameliorated in time through the use of transparent policy processes to shed light on the economy-wide impacts and benefits of lower barriers.

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### *Bilateral and regional trade agreements*

Determining whether BRTAs should be used to supplement other approaches to trade liberalisation needs to take into account the benefits and costs likely to flow from agreements that Australia might feasibly be able to negotiate.

To date, most economic modelling of the benefits and costs of Australia's preferential BRTAs has been undertaken as part of official feasibility studies, before the agreements are negotiated. A number of the studies have derived 'outer envelope' estimates of possible gains by assuming a full coverage of goods sectors, a full pass-on of tariff reductions and a full utilisation of concessions. Optimistic estimates of the potential gains from services and investment provisions have sometimes also been included. Use of the results of these modelling exercises — which typically yield estimates of benefits in the billions of dollars — has inflated expectations of the likely economic gains from Australia's BRTAs.

In practice, the actual agreements negotiated have sometimes entailed gaps in coverage and/or long phase-in periods, and the available evidence suggests that the anticipated benefits of their liberalising provisions have not been fully realised. Some BRTAs have also incorporated costly provisions that were not included in the estimates. Together, these points suggest that the economic value of Australia's preferential BRTAs has been oversold.

Nevertheless, the information and analysis presented in this report supports the view that BRTAs can generate net benefits for Australia, depending on the particulars of the agreement and the countries involved.

The case for BRTAs also needs to consider whether there are other options that could deliver similar or greater benefits at less cost. In this context, there is a range of trade-related matters, including trade facilitation, investor protections and the mutual recognition of standards and qualifications, that are increasingly covered by BRTAs and that could potentially be addressed more productively through other arrangements. For instance, the use of mutual recognition agreements and bilateral investment treaties could avoid the costs and complications involved with achieving a wider trade agreement involving trade-offs between various provisions associated with the negotiation of BRTAs.

While these considerations point to a need for caution before embarking on an expansive BRTA agenda, the Commission's assessment is that some further bilateral and, particularly, regional trade agreements, if designed appropriately, could be warranted on economic grounds. However, it is important that a realistic assessment of the gains and costs be made and that other options be considered.

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Beyond the economic considerations most frequently used to justify BRTAs, some have argued that BRTAs should also be pursued to achieve security and ‘strategic’ objectives. While the formation of an agreement can affect relationships between countries, the Commission considers that other, more targeted measures, such as direct development assistance, social and economic cooperation arrangements and joint defence training initiatives, are generally better suited to this task. Thus, were a proposed BRTA not justifiable on economic grounds, it would be appropriate to use other measures for security and strategic purposes. This would still allow those objectives to be obtained, but would avoid the additional economic costs entailed in such a BRTA.

In sum, the Commission’s assessment is that bilateral and regional trade agreements could potentially bring a number of benefits, but should only be pursued where they are likely to generate net economic benefits and be a cost-effective option for trade liberalisation.

### **Improving trade policy development processes**

Devising and implementing good trade policy is not straightforward. While many elements of the current approach appear sound, the Commission’s examination of the processes used for establishing trade agreements has also identified a range of concerns and deficiencies, including that:

- the selection of partner countries is not prioritised or coordinated strategically;
- there is inadequate assessment of other options for advancing trade policy objectives with partner countries before embarking on BRTAs;
- the results of modelling in feasibility studies are used to ‘oversell’ the benefits of agreements, while typically the actual text of agreements is not subject to assessment;
- consultation is inadequate in some respects, particularly once negotiations have begun; and
- Parliament is often not well placed to affect the outcome of negotiations.

More broadly, the Commission is concerned that, at least in some quarters, there tends to be a mindset of ‘agreements for agreement’s sake’, premised partly on the view that Australia must follow a trend in other countries. Some negotiations have run on for several years with few signs that a worthwhile outcome is close. The resources devoted to different negotiations are not made public, and it is not clear that other trade liberalisation options are given sufficient consideration before decisions to pursue BRTAs are taken.

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In the Commission's view, while there are many strengths to Australia's approach to trade policy, a more transparent and strategic process is required to ensure an appropriate focus on policies that are most in Australia's interests.

### *Trade policy strategy*

Under the Commission's proposed approach, the government would formally develop and publish a comprehensive trade policy strategy. The strategy would consider trade policy developments and opportunities in the broad, and, where they are identified, key issues with priority partner countries or regional groupings. The strategy document would provide an overarching view of Australia's actual and potential trade policy initiatives, and the governmental efforts devoted to them, including options for multilateral, plurilateral, bilateral and unilateral reductions in trade barriers. It would also report on progress with actions in train. The strategy would be considered by Cabinet annually, with a version then released publicly.

Development of such a strategy, with clearly prioritised trade policy objectives, opportunities and associated actions, should contribute to the more effective use of limited resources in government, industry and the community. The periodic reviews would provide a transparent, structured forum to guard against particular initiatives continuing inordinately without success, and to manage pressures for resources to be devoted to ad hoc opportunities of limited value relative to other options. A requirement for Cabinet consideration of the strategy should formally ensure that trade policy matters (which affect a broad range of government portfolios) receive appropriate input and consideration on a whole-of-government basis.

### *Pre-negotiation options assessments*

If, as part of the strategy, it were decided to pursue trade liberalisation opportunities in conjunction with particular partners, this would lead to a pre-negotiation analysis of policy options for furthering trade liberalisation objectives with the partner(s).

While many elements of the current feasibility study process would be retained, improvements are proposed in three areas.

First, the assessment would explicitly canvass the spectrum of possible approaches for furthering Australia's trade objectives with the selected partner, including cooperation frameworks, technical exchanges, capacity building initiatives and mutual recognition arrangements as well as comprehensive trade agreements. Drawing on assessments of the relative costs and benefits likely to be achievable under the key options, the assessment would advise on the most effective option or

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combination of options. As part of this, the assessment should also consider the possibility that no further specific action is warranted.

Second, to enhance the realism and credibility of any estimates, quantitative analysis undertaken as part of the options assessment should be overseen by an independent body and include a range of possible liberalisation scenarios. The public report would not specify which combination of scenarios is regarded as the most likely, but such advice would be provided to Cabinet, including warnings of particularly inadvisable approaches and unachievable objectives.

Third, were it decided to pursue a trade agreement with the partner country, Cabinet would need to determine (but not publish) ‘minimum acceptable outcomes’, as well as exit strategies and/or fallback outcomes that may be achieved should progress with negotiations become frustrated.

### *Negotiation processes*

If negotiations are agreed to, the proposed approach would also entail little change to the current process of negotiation of Australia’s agreements.

However, to respond to industry concerns of limited consultation during negotiations, the Commission considers that further use of confidentiality deeds, where appropriate, could be explored. Wider concerns that negotiations can be left open without meaningful progress for substantial periods would be addressed through the annual trade policy review process.

It is also important that negotiators seek to include only those provisions in BRTAs that are likely to generate benefits for Australia or are necessary to secure a worthwhile deal. The Commission has considered and made recommendations on a number of specific topics that are often included in agreements (box 2).

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## Box 2      **Some BRTA design elements**

The Commission has considered the appropriate treatment of a range of specific issues within BRTAs.

Based on the evidence and analysis in this study, greater gains are available to all parties from trade liberalisation if agreements are struck on a non-preferential basis. This suggests that Australia should give weight, in prioritising and negotiating agreements, to non-preferential arrangements such as APEC, and to non-preferential provisions within other agreements. At the same time, Australian negotiators should not be precluded from accepting preferential conditions where they are necessary to secure a beneficial agreement.

Where BRTAs do contain preferential provisions, ‘rules of origin’ (RoO) may be required to avoid the transshipment of products from non-member countries through the partner with the lowest tariff. While the use of product specific ‘change of tariff classification’ (CTC)-based rules has become the norm for Australian agreements, the composite approach recently adopted in the AANZFTA — which offers the choice of CTC rules or Regional Value of Content rules — offers clear advantages.

Many BRTAs cover matters beyond normal goods and services trade barrier issues. The inclusion of some of these matters, such as 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. The inclusions of some other provisions, however, could be costly.

In relation specifically to investor-state dispute settlement provisions, the government should seek to avoid accepting provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already provided by the Australian legal system. Nor 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.

Similarly, given the risk of ‘negative sum game’ outcomes, the Australian Government should not seek to include intellectual property provisions in Australia’s BRTAs as an ordinary matter of course, and should only include such provisions after an economic assessment of the impacts, including on consumers, in Australia and partner countries. The Commission considers that Australia’s participation in international negotiations in relation to IP laws should focus on plurilateral or multilateral settings.

Further, the government should adopt a cautious approach to the inclusion of matters such as labour standards and exclusions for cultural matters in Australian BRTAs.

More generally, the Australian Government should not include matters in BRTAs that increase barriers to trade, raise industry costs or affect established social policies without separate review of the implications and available options for change.

In the draft report, the Commission also canvassed moving away from comprehensive agreements and considering the negotiation of, for example, goods-only agreements and services-only agreements. Based on participant feedback and further deliberation, the Commission has not proceeded with this recommendation.



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### *Post-negotiation analysis*

Following the completion of negotiations and prior to the signing of an agreement, the economic implications of the actual text of a proposed BRTA should be analysed. Such analysis should be commissioned and overseen by an independent body, with scope for public input.

Such a process would provide more realistic information about the likely benefits and costs Australia may realise from entering into an agreement and illuminate any potential aspects which could have particularly adverse impacts. This would provide a better basis for the government to decide whether to enter the agreement.

Some government agencies expressed concerns about subjecting agreements to such post-negotiation scrutiny, suggesting among other things that it could damage Australia's credibility as a negotiating partner and provide an opportunity for interest groups, both here and in the partner country, to lobby to 'unpick' the agreement.

The Commission accepts that this process would add an additional element to the process, but considers that the transparency entailed is appropriate given the sometimes broad ranging nature of the issues subject to negotiations, without the need for enhanced parliamentary involvement advocated by some participants. Moreover, such assessment are also likely to provide incentives for negotiators from partner countries to be mindful that whatever is offered to Australia within an agreement will be subject to public analysis. In the Commission's view, trade agreements that would deliver significant net benefits should be sufficiently robust to be able to withstand such scrutiny.

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# Findings and recommendations

The Commission has included formal findings on a number of factual and normative matters for which the Commission's examination has enabled it to reach a sufficiently firm conclusion. These, and the Commission's recommendations on matters relevant to the reference, are set out below.

## Findings

### *Chapter 6*

- 1 Australia's preferential trade agreements contain commitments to reduce and bind at zero tariffs on most items of merchandise trade between agreement partners, although sensitive sectors are sometimes excluded or subject to lengthy phase-in periods.
- 2 APEC members have unilaterally reduced general tariffs on merchandise trade beyond their Uruguay Round commitments and have made substantial progress towards Bogor Declaration trade liberalisation goals.
- 3 Australia's BRTAs typically contain provisions addressing aspects of trade in services, but these do not necessarily lead to significant reductions to services barriers in partner countries. In a number of areas, the main impediments to effective competition by Australian services providers in partners' services markets are related to regulatory and institutional issues that lie outside the scope of BRTAs.
- 4 In most agreements, investment provisions in Australia's BRTAs have bound current arrangements and provided protections against future policy changes rather than reducing existing investment barriers.
- 5 While the incidence of preferential agreements has increased, their overall impact on multilateral liberalisation is not clear from available evidence.

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## *Chapter 7*

- 1 Businesses have provided little evidence that Australia's BRTAs have generated significant commercial benefits. The information available suggests that, where benefits accrue, they are mainly to existing exporters.
- 2 Although a major departmental activity, no useful information is publicly available regarding the staffing and other costs incurred by the Department of Foreign Affairs and Trade in pursuing BRTAs.

## *Chapter 8*

- 1 Based principally on various quantitative studies on the effects of BRTAs and other trade liberalisation scenarios:
  - a) While bilateral tariff preferences between the members of a trade agreement can yield economic benefits to those countries, the net benefits are likely to be small. Greater net benefits are available through countries lowering their own trade barriers on a non-discriminatory, most-favoured-nation basis.
  - b) The potential impacts on Australia of being excluded from, or choosing not to engage in, preferential trading agreements among its trading partners depend partly on Australia's own policy actions and the market responsiveness of its exporters.
  - c) The application of rules of origin in preferential trade agreements can lead to additional administrative costs for importers and exporters of merchandise goods.
  - d) Non-discriminatory trade agreements are more likely to result in net trade creation and associated economic benefits than agreements with restrictive preference structures.

## *Chapter 9*

- 1 The evidence available to the Commission indicates that the direct economic impacts from services and investment provisions in Australia's BRTAs to date have been modest. More significant gains may be achieved in the future through some of the processes established under Australia's agreements. However, their realisation will require concerted efforts from Australia and its BRTA partners over many years.

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## *Chapter 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.
- 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.
- 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.

## *Chapter 13*

- 1 No preferential trade agreements have been entered into between major trading blocs. While accession clauses are often seen as a means to multilateralise preferential agreements, little use has been made of them to date by either large or small countries.
- 2 Trade facilitation measures are an effective means of enhancing trade. Such measures can be included in a BRTA, but are most beneficial if undertaken on a non-preferential basis.

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

## *Chapter 15*

- 1 The approach to conducting feasibility studies used for most previous Australian BRTAs has produced overly optimistic expectations of the likely economic effects of BRTAs. Such an approach does not provide an adequate basis for assessing their merits.

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## Recommendations

### *Recommendation 1 (chapter 12)*

The Australian Government should only pursue bilateral and regional trade agreements where they are likely to:

- afford significant net economic benefits; and
- be more cost-effective than other options for reducing trade and investment barriers, including alternative forms of bilateral and regional action.

### *Recommendation 2 (chapter 12)*

The Australian Government should ensure that any bilateral and regional trade agreement it negotiates:

- as far as practicable, avoids discriminatory terms and conditions in favour of arrangements based on non-discriminatory (most-favoured-nation) provisions;
- does not preclude or prejudice similar arrangements with other trading partners; and
- does not establish treaty obligations that could inhibit or delay unilateral, plurilateral or multilateral reform.

### *Recommendation 3 (chapter 13)*

The Australian Government should adopt the composite model for rules to determine origin in merchandise trade, as in AANZFTA, as the basis for rules of origin in any future preferential trade agreement. In adopting this model:

- a choice of Regional Value Content and Change in Tariff Classification rules for determining origin should be afforded for each item of merchandise;
- the least restrictive variant of each test should be adopted, consistent with preventing trade deflection; and
- Australia should seek a waiver to rules of origin requirements where the difference between the MFN tariff rates in the partner countries is 5 percentage points or less.

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*Recommendation 4 (chapter 14)*

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 comprehensive review of the implications and available 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.

*Recommendation 5 (chapter 15)*

The Australian Government should improve the scrutiny of the potential impacts of prospective trade agreements, and opportunities to reduce barriers to trade and investment more generally.

- a) It should prepare a trade policy strategy which identifies impediments to trade and investment and available opportunities for liberalisation, and includes a priority list of trading partners. This trade policy strategy should be reviewed by Cabinet on an annual basis, and be prepared before the pursuit of any further BRTAs. A public version of the Cabinet determined strategy should be released.
- b) Before entering negotiations with any particular prospective partner, it should undertake a transparent analysis of the potential impacts of the options for advancing trade policy objectives with the partner. All quantitative analysis and modelling should be overseen by an independent body.
- c) It should commission and publish an independent and transparent assessment of the final text of the agreement, at the conclusion of negotiations, but before an agreement is signed.

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*Recommendation 6 (chapter 13)*

If it is deemed that capacity building should be part of a trade agreement development process, the Australian Government should fund and deliver capacity-building programs in a manner that minimises potential (or perceived) conflicts of interest. Any such programs should not impose an obligation to negotiate a trade agreement.

*Recommendation 7 (chapter 7)*

To enhance transparency and public accountability and enable better decision making regarding the negotiation of trade agreements, the Department of Foreign Affairs and Trade should publish estimates of the expenditure incurred in negotiating bilateral and regional trade agreements and multilateral trade agreements. These should include estimates for the costs of negotiating recent agreements.

*Recommendation 8 (chapter 12)*

The Australian Government should examine the potential to further reduce existing Australian barriers to trade and investment through unilateral action as a priority over pursuing liberalisation in the context of bilateral and regional trade agreements. The Government should not delay beneficial domestic trade liberalisation and reform in order to retain ‘negotiating coin’.

*Recommendation 9 (chapter 12)*

The Australian Government should support worthwhile efforts to achieve multilateral liberalisation. Should meaningful progress within the WTO prove elusive, the Government should weigh up with like-minded countries the feasibility of appropriate broadly based agreements to advance reform.

*Recommendation 10 (chapter 12)*

The Australian Government should lend support to initiatives directed at the establishment of domestic institutions in key trading countries to provide transparent information and advice on the community-wide impacts of trade, investment and associated policies.





PART A

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# INTRODUCTION



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# 1 About the study

While Australian governments have a long record of pursuing trade liberalisation on a non-discriminatory basis, including in multilateral forums, in recent years they have also increasingly entered a range of preferential bilateral and regional trade agreements. Since 2003, Australia has entered into such agreements with Singapore, the United States, Thailand, Chile and ASEAN (together with New Zealand), and it is negotiating and exploring several others (chapter 2). Previously, Australia's only major preferential trade agreement was the 1983 'Closer Economic Relations' trade agreement with New Zealand.

Australia's rapid take-up of preferential trade agreements, struck on a bilateral or regional basis, mirrors an international trend. The growth of these agreements worldwide means that around half of global trade is potentially covered by preferential arrangements.

The increasing prevalence of such trade agreements has resulted in debate about their implications for the global trading system. Are they 'building blocks' that are making genuine progress in reducing trade barriers, more rapidly and deeply than could be achieved through multilateral means alone? Or are they 'stumbling blocks' that distort trade patterns and have the effect of undermining multilateral trade negotiations and impeding domestic reform? There are also questions about the trade and economic effects of such agreements on participating countries and their trading partners, as well as the role such agreements might play in advancing regional integration and related strategic objectives.

## 1.1 The reference

On 27 November 2009, the Australian Government asked the Commission to undertake a study of bilateral and regional trade agreements (BRTAs). The study is to examine the effectiveness of such trade agreements in responding to national and global economic and trade developments, and in contributing to efforts to boost Australia's engagement in the region and evolving regional economic architecture. Among other things, the Commission must examine:

- the contribution of such trade agreements to reducing trade and investment barriers and safeguarding against the introduction of new barriers;

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- the role of such trade agreements in lending support to the international trading system and the World Trade Organization (WTO);
  - the potential for such agreements to facilitate adjustment to global economic developments and to promote regional integration;
  - the impact of trade agreements on Australia's trade and economic performance, in particular any impact on trade flows, unilateral reform, behind-the-border barriers, investment returns and productivity growth; and
  - the scope for Australia's trade agreements to reduce trade and investment barriers of trading partners or to promote structural reform and productivity growth in partner countries.

The terms of reference — which are reproduced in full at the front of this report — ask the Commission to examine evidence available both nationally and internationally, and to take into account the changing international economic and strategic environment. The study is to have regard to the Government's commitment to uphold Australia's international treaty obligations and to play a constructive role in any global response to the economic challenge of rekindling sustained growth, following the global financial crisis and associated economic downturn. It is also required to have regard to recent reports which have covered preferential trade agreements, including the 2008 Review of Export Policies and Programs chaired by David Mortimer AO (hereafter the Mortimer review). The Commission has also been invited to make recommendations in this study.

In reporting on matters referred to it, the Commission is also required, under the *Productivity Commission Act 1998*, to provide a variety of viewpoints and options representing alternative means of addressing the issues in the report. The Act also provides that, in performing its functions, the Commission may inform itself on any matter as it thinks appropriate.

## 1.2 Conduct of the study

After receiving the terms of reference, the Commission sought input from a range of interested parties:

- It met informally with a broad cross-section of stakeholders, including: business people (including David Mortimer AO who, as noted, headed up the 2008 review), industry bodies, union representatives, non-government organisations, academics, and Commonwealth and State government officials (listed in appendix B).
- The Commission released an Issues Paper on 21 December 2009 outlining a range of matters on which it was seeking information and advice. In response to that paper, 61 submissions were received (also listed in appendix B).

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- As the submissions received by the end of March contained only limited information on the specific effects of Australia's BRTAs on businesses, in April the Commission distributed a further request for such information via a number of business groups. (One group, the Australian Chamber of Commerce and Industry, surveyed its members and provided a response following the draft report.) The Commission also surveyed Commonwealth government agencies to obtain estimates of the costs associated with the negotiation of trade agreements.

The Commission also undertook two major quantitative analyses for the study:

- 'ex ante' modelling of the potential effects of a range of hypothetical trade liberalisation strategies, including multilateral, unilateral and bilateral tariff reductions, and various investment liberalisation scenarios; and
- an 'ex post' econometric examination of the effects of a range of existing BRTAs on merchandise trade flows, utilising data for more than 140 countries dating back to 1970.

The preliminary results of the Commission's modelling and econometric analysis were made available for scrutiny and comment at a workshop held in Canberra on 17 May 2010. Feedback from that workshop was taken into account in the versions of the modelling and econometrics presented in the report. Technical supplements to the draft report, documenting the quantitative exercises, were made available on the Commission's website on 24 September 2010.

### *The draft report process*

As well as information from participants and its quantitative analyses, in preparing the draft report the Commission drew on previous Commission research, submissions to the Mortimer review and the report of the review itself, and the academic literature on trade agreements, including previous quantitative studies on the effects of trade agreements.

The draft report was released on 16 July 2010. The draft report set out the Commission's preliminary views on the matters under reference. It included seven draft recommendations as well as requests for further information on matters where the information received prior to the draft had been less than expected.

The draft was released to provide participants an opportunity to provide additional information on areas covered by the report, point out areas in which the Commission may have overlooked or misconstrued evidence, and to provide feedback on the Commission's conclusions and draft recommendations.

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The Commission received 40 submissions following release of the draft report. It also received feedback at a policy forum on the draft (hosted by the Crawford School of Economics and Government, Australian National University) attended by a range of academics and invited stakeholders, including from business, unions and government. The Commission also met separately with selected government departments and interested parties, held a roundtable to discuss matters relating to investor-state dispute settlement issues, and made follow-up inquiries on particular issues to a number of participants. Appendix B lists the participants that attended the roundtable and policy forum and/or made submissions following the draft.

### *The final report*

This report sets out the Commission's completed analysis, findings and recommendations in relation to the matters under reference.

Reflecting feedback on the draft report and further analysis and deliberation by the Commission, the final report varies from the draft in some important respects. In particular, the Commission has included formal findings on a number of factual and normative matters for which the Commission's examination has enabled it to reach a sufficiently firm conclusion. The Commission has also revised its recommendations. Most notably, it has not retained the proposal in the draft report that the government consider pursuing services-only or goods-only agreements (see section 13.2). On the other hand, it has strengthened or reformulated a number of recommendations from the draft, including in relation to:

- the basis on which future BRTAs should be pursued (recommendation 1);
- the approach to intellectual property and investor-state dispute settlement provisions in BRTAs (recommendations 4b and 4c); and
- the approach to trade policy development and the future role of BRTAs (recommendation 5).

Recommendations have also been added regarding the approach to capacity building in the context of BRTAs (recommendation 6) and broader approaches to the achievement of trade and investment liberalisation (recommendations 7-9).

While in agreement with some aspects of this study, the Associate Commissioner does not agree with a number of the recommendations and some underlying analysis and findings in this final report. The Associate Commissioner's views on these matters are reported in appendix A.

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## 2 What are bilateral and regional trade agreements?

The terms of reference ask the Commission to examine the impacts of ‘bilateral and regional trade agreements’ (BRTAs). This chapter starts by considering what types of arrangements are covered by this term. It then provides a brief outline of Australia’s past, present and prospective BRTAs, and also identifies some key agreements around the globe.

### 2.1 Types of trade agreements

The terms bilateral trade agreement, regional trade agreement, free trade agreement, reciprocal trade agreement and preferential trade agreement are used at different times and in different ways. The term ‘customs union’ is also used to describe a particular form of trade agreement.

For the purposes of the study, the Commission has interpreted the term BRTA broadly to cover:

- agreements concluded between two parties in which one or, more usually, both the parties, whilst maintaining their own tariffs, obtain concessional entry to the market of the partner, such as in the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) — such bilateral arrangements are referred to in the WTO as Free Trade Agreements/Areas;
- similar agreements between multiple parties, such as Australia’s recent regional agreement with ASEAN and New Zealand and the North American Free Trade Agreement — also referred to as Free Trade Agreements/Areas in the WTO;
- agreements between two or more countries in which members adopt a common external tariff while allowing concessional trade between partners, called Customs Unions in the WTO — the customs union of the European Union is an example; and
- agreements between trading partners to lower their own trade barriers with respect to all parties (including those outside the agreement) either according to arrangements bound under the agreement or on a voluntary basis, such as between APEC members as enunciated in the 1994 Bogor Declaration.

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## **Preferential BRTAs**

The first three forms of agreement above all involve the provision of concessional access to the markets of other agreement members.

While most of these are commonly referred to as Free Trade Agreements (FTAs), it is important to distinguish the effects of these agreements from ‘free trade’. Free trade would require the removal of all tariffs, quotas, subsidies and other government measures that distort trade flows. FTAs involve preferential arrangements under which tariffs and some other barriers to trade are lowered (although not always eliminated), but only for those countries party to the agreement. The barriers for other countries are not reduced by the agreement.

As such, FTAs can potentially distort trade flows as between members and non-members and are termed ‘preferential trade agreements’ (PTAs) in this report. PTAs have been the main focus of participants’ comments, and in practice virtually all BRTAs to date have been PTAs.

## **Non-preferential BRTAs**

Indeed, there is a legitimate question as to whether other arrangements such as the APEC Bogor Declaration, which while struck on a regional basis provides for reductions in members’ trade barriers to extend not only to members but also to those outside the region, should be included within the definition of ‘BRTAs’. In the case of the Bogor Declaration, an additional consideration is that the ‘agreement’ is not legally binding. While some have therefore questioned whether the Bogor Declaration could have much if any impact, others have argued that the non-legalistic and collegiate nature of APEC has in fact been instrumental in achieving reductions in trade and investment barriers by member countries in the years since the declaration (box 2.1).

An analytical requirement for this study is to examine the relative efficacy of alternative approaches to BRTAs for achieving trade liberalisation. Thus, whether or not the Bogor Declaration is included within the definition of BRTAs, the Commission would need to consider to what extent, if any, pursuing such agreements would be likely to bring about further and meaningful reductions in trade and investment barriers. While recognising that alternative classifications are possible, for practical purposes the Commission has included the Bogor Declaration within the study’s definition of BRTAs. At the same time, in analysing BRTAs, it has been conscious to recognise the differences between arrangements of this type and binding, preferential BRTAs.



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### **Box 2.1 The APEC Bogor Declaration and its inclusion as a BRTA**

Formed in 1989, the objectives of APEC are to promote free and open trade and investment, accelerate regional economic integration, encourage economic and technical cooperation, enhance human security and facilitate a favourable and sustainable business environment (APEC 2010).

As part of the 1994 Bogor Declaration, APEC members have committed to progressively lowering trade barriers to all trading partners by no later than 2010 for developed members and 2020 for developing members.

APEC and the Bogor Declaration differ substantially from most BRTAs, which are preferential arrangements between a pair or group of countries that bind members via international treaties, and are meant to be notified to the WTO. Meanwhile, the APEC Bogor Declaration is non-preferential and makes no binding commitment on members. However, the text of the Bogor Declaration uses language that in common parlance would be interpreted as an agreement — ‘we agree to adopt the long-term goal of free and open trade and investment in the Asia-Pacific’ — and, as noted, included timeframes for implementation (APEC 1994).

In commenting on the inclusion of the APEC arrangements within the definition of BRTAs adopted in the Issues Paper, Professor Peter Lloyd (sub. 3, pp. 6-7) cautioned:

APEC is quite different in nature from all other regionals and bilaterals already concluded or under negotiation. It is a forum whose agreements are non-binding and non-reciprocal, unlike other agreements, and it has not negotiated any opening of trade in goods and services. It is not listed in the WTO RTA Database and for the very good reason that it is not notifiable under WTO rules, not being either a free trade area or a customs union. If APEC is included in any Productivity Commission analysis, it should be treated as distinct from all binding reciprocal bilaterals and regionals.

While APEC members have to date fallen short of the full ambition expressed in the Bogor Declaration, there is nonetheless evidence consistent with the view that the Bogor process contributed to lowering trade and investment barriers. As discussed in chapter 6, APEC members made notable reductions in their trade barriers following the Declaration; reductions that were deeper than those required under their WTO Uruguay Round commitments. Further, at the Commission’s modelling workshop, Peter Drysdale — head of the East Asian Integration Project at the Australian National University — argued that in fact the non-legalistic, collegiate nature of APEC and the Bogor process had been influential in developing a consensus among member countries in moving ahead with non-discriminatory trade liberalisation, and had, for example, provided a critical platform for progress by China on the way towards accession to the WTO where it committed to large scale unilateral liberalisation in 1995. More recently, the then Australian Minister for Trade noted that ‘The work of APEC continues to boost trade and investment flows at, behind and across regional borders’ (Crean 2010, p. 3).

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## **Distinguishing BRTAs from other trade agreements**

BRTAs are distinguished from multilateral (or general) trade agreements concluded between a broad community of countries to provide a rules-based system for international trade and investment between members. The General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), administered by the WTO, are the principal agreements of this type currently governing global trade.

BRTAs can also be distinguished from ‘critical mass agreements’ — such as the 1996 WTO Information Technology Agreement — which come into effect once the signatories account for a designated percentage (90 per cent under the Information Technology Agreement) of world trade in the product in question. Once in effect, they impose obligations on signatories, with the resulting concessions typically offered on a most-favoured-nation (MFN) basis by signatories.

## **2.2 Australia’s bilateral and regional trade agreements**

Since the formation of the GATT in 1947, development of Australia’s international trading relations has mainly been undertaken on MFN basis within the multilateral GATT/WTO framework. Australia, as a member of APEC, is also a party to the 1994 Bogor Declaration, discussed earlier. Australia has also negotiated and maintained PTAs with a relatively small number of countries. Some of these agreements are long-standing, while, more recently, Australia has entered in to a number of new agreements.

### **Early PTAs**

Australia has a number of long-standing PTAs. Apart from its agreements with New Zealand, which have been extended in scope over time, these older agreements are confined to duty concessions on merchandise trade.

There has been a series of agreements with New Zealand, the first being signed in 1922. This was followed by the New Zealand–Australia FTA in 1965. Limitations with this agreement led to the establishment of a new, major agreement with built-in provisions for review and amendment, ANZCERTA, which commenced in 1983. The agreement initially only covered trade in goods, however, services provisions were added in 1988.

A non-reciprocal agreement with the South Pacific Forum Island Countries (SPARTECA) entered into force in 1981. This agreement provides for duty

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concessions into both Australia and New Zealand from the Cook Islands, Fiji, Kiribati, the Republic of the Marshall Islands, the Federated States of Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.

In addition to this agreement, Australia has a specific bilateral agreement with Papua New Guinea. The first agreement between the two countries (PATCRA) came into force in 1977. This was followed by a subsequent agreement (PATCRA II), which came into force in 1991.

Australia also has a long standing agreement with Canada. The first agreement was established in 1931, replaced with a new agreement in 1960 and amended in 1973. This agreement granted each of the countries preferential tariff rates on a limited range of goods. However, most of its provisions have been superseded by reductions in Australian and Canadian MFN tariffs.

## **Recent PTAs**

More recently, Australia has entered into a number of new BRTAs. These are mostly bilateral, apart from the most recent regional agreement with ASEAN and New Zealand. Australia's recent agreements include:

- Singapore-Australia FTA (SAFTA), which commenced 28 July 2003;
- Thailand-Australia FTA (TAFTA), which commenced 1 January 2005;
- Australia-United States FTA (AUSFTA), which commenced 1 January 2005;
- Australia-Chile FTA (ACI-FTA), which commenced 6 March 2009; and
- ASEAN-Australia-New Zealand FTA (AANZFTA), which commenced 1 January 2010.

These agreements all cover a broadly similar range of topics. In addition to affording preferential access for goods trade between partners, these agreements all contain provisions, to differing extents, relating to trade in services, investment, intellectual property, electronic commerce, government procurement and competition policy. Some agreements cover additional issues. For instance, AUSFTA covers environmental and labour issues, while AANZFTA contains a dedicated chapter on economic cooperation.

While many of the chapter headings are common to all agreements, the content of each chapter varies between agreements, reflecting different sensitivities and priorities. For example, the US agreement contains a separate chapter on agriculture reflecting particular sensitivities with respect to some agricultural products.

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The operation of PTAs is also affected by side letters to the agreements, which can extend, alter or clarify application of the agreement text. For example, letters between Australia and New Zealand, inter alia, omit the application of chapters on safeguards, investment, and consultation and dispute settlement of the AANZFTA between the two countries. More detail on the matters covered in Australia's recent PTAs is provided in parts B and C of the report.

## **Current PTA negotiations**

In addition to existing agreements, negotiations for further bilateral and regional agreements are also under way — with negotiations on a number of prospective agreements being in train for some time. Negotiations towards bilateral agreements are proceeding with:

- China (negotiations commenced 2005);
- Malaysia (negotiations commenced 2005);
- Japan (negotiations commenced 2007); and
- Korea (negotiations commenced 2009).

The negotiations for regional agreements in which Australia is participating are:

- the Gulf Cooperation Council, which comprises Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (negotiations commenced 2007);
- the Pacific Agreement on Closer Economic Relations (PACER) Plus negotiations within the Pacific Islands Forum, which comprises Australia, the Cook Islands, the Federated States of Micronesia, Kiribati, Nauru, New Zealand, Niue, Palau, Papua New Guinea, the Republic of the Marshall Islands, Samoa, the Solomon Islands, Tonga, Tuvalu and Vanuatu (negotiations commenced 2009); and
- the Trans-Pacific Partnership (TPP) Agreement which is intended to expand on the current Trans-Pacific Strategic Economic Partnership Agreement between Brunei Darussalam, Chile, New Zealand and Singapore, that entered into force in 2006. The United States, Peru, Vietnam and Malaysia have also joined the TPP negotiations (negotiations commenced in March 2010).

Feasibility studies have also been conducted on possible bilateral agreements with India and Indonesia. On 2 November, the Indonesian and Australian Governments agreed to enter negotiations for a 'comprehensive economic partnership agreement' between the countries. The Australia–India Feasibility Study remains under consideration and no announcement has yet been made over the commencement of negotiations or the scope and form that any agreement might take.

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## 2.3 Other countries' agreements

With most countries now engaged in at least one bilateral or regional trade agreement (chapter 5), effects on international trade are likely to be pervasive. Bilateral and regional agreements are also likely to impinge on Australia's trading relations with parties to agreements of which Australia is not a member, as trade and investment flows of members are influenced by preferences negotiated under those agreements. Some key preferential trade agreements involving global economies include:

- The European Union. The European Economic Community (predecessor of the European Union), which entered into force in 1958, was the first major PTA. Since then, it has been expanded a number of times and now includes 27 members. Intra-EU trade now accounts for 18 per cent of total global goods trade. The European Union has also pursued trade agreements with a strong focus on traditional trading partners in Africa, the Caribbean and Pacific islands, often former colonies of EU members.
- US agreements. The United States entered its first PTA with Israel in 1985. This was followed by an agreement with Canada in 1987, while the North American Free Trade Area (NAFTA) was formed with the inclusion of Mexico in 1994. Trade between NAFTA members accounts for 6 per cent of global merchandise trade. The United States now has PTAs with 17 countries, including Australia. It has also negotiated agreements with Colombia, Panama and Korea, although these are yet to be approved by the US Congress.
- Japanese agreements. Japan entered into its first PTA with Singapore in 2002. It is now party to 11 notified<sup>1</sup> trade agreements, mostly with other Asian economies, including an agreement with ASEAN. Trade between Japan and its trade agreement partners amounts to almost 2 per cent of global trade.
- Chinese agreements. Like Japan, China has been a relatively late adopter of PTAs, with most of those focused within Asia. Outside of Asia, partners include Chile, New Zealand and Peru. Trade between China and its trade agreement partners amounts to 5 per cent of global trade.
- The ASEAN trade agreement between members of the ASEAN community. Trade between members of the ASEAN regional trade agreement amounts to over 1 per cent of global trade.
- Agreements between economies of South America, including the regional agreements of the Andean Community (entered into force 1988), the Latin American Integration Association (entered into force 1981) and MERCOSUR

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<sup>1</sup> Notified agreements cover those notified to the WTO excluding the Generalised System of Preferences and Protocol on Trade Negotiations.

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(commenced 1991) and many bilateral agreements between members of those regional agreements. Bilateral trade between members of those regional agreements amounts to about 1 per cent of global trade.

- New Zealand Agreements. New Zealand is involved in a number of agreements with Australia, namely ANZCERTA, AANZFTA and SPARTECA, and is also a member of Trans-Pacific Partnership agreement that Australia is currently in negotiations to join. It also has agreements with Singapore, Thailand and China.

Other countries that are notable for the number of BRTAs that they have undertaken include: Chile, which is currently a signatory to 16 notified agreements; Singapore, which has 18 notified agreements; and Mexico, which has 13 notified agreements.

PART B

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BRTAS WITHIN THE BROADER  
POLICY LANDSCAPE





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## 3 International trade and investment flows

This chapter examines international trade and investment flows to provide some context for the assessment of the impacts BRTAs have on trade, investment and economic performance.

It mainly draws on data from the systems of national accounts, balance of payments and related statistics. Under these frameworks, distinctions are made between merchandise trade, services trade, income and investment flows. Official data collections distinguish between trade and investment flows between countries. In addition to this distinction, the WTO General Agreement on Trade in Services (GATS) delineates categories which highlight the commercial relations between businesses in different countries (box 3.1).

Section 3.1 provides an overview of the global economy, the composition of the global balance of payments and trends in trade and investment. Section 3.2 then provides a similar overview of the Australian economy.

### 3.1 Global trends

#### Overview of the global economy

The level and distribution of economic activity has important implications for international trade and investment. Generally, as countries grow and per capita incomes rise, so do the number and complexity of international trade and investment linkages. With this, the importance of the rules that effectively govern those relationships and facilitate trade and investment between countries also increases.

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### Box 3.1 Trade and investment data collection

Official national balance of payments statistics are divided into the current account and the capital account. The current account records the value of exports and imports of goods and services, and the value of earnings and payments from investments and loans. The capital account records the value of all foreign direct investment, portfolio investment, other investment and central bank transactions. Depending on the direction of the flow, that is, into a country or out of a country, transactions are recorded as credits or debits.

Services are generally regarded as being intangible, typically requiring direct interaction between the producer and the consumer (Mattoo, Stern and Zanini 2008). The General Agreement on Trade in Services (GATS), however, adopts a somewhat different nomenclature for services from that used in balance of payments statistics. The GATS system classifies trade in services into four modes:

- cross-border supply, such as providing a service through email, phone or fax (mode 1);
- consumption abroad, such as when a consumer travels abroad for tourism, education or medical services (mode 2);
- commercial presence, for example when a company establishes an office in another country to provide services in that country (mode 3); and
- presence of natural persons abroad, for example when an employee travels abroad to provide a service directly (mode 4).

Broadly, trade in services covered by modes 1 and 2 is included in the balance of payments as imports or exports of services, while the presence of natural persons abroad (mode 4) is represented as remittances by individuals or as other service income payments.

Commercial presence is represented in the balance of payments though foreign direct investment (FDI). This concept is related to GATS mode 3 in that it covers the investment flows related to the establishment of a company office in another country. The scope of the balance of payments, however, does not extend to delineating the operations of foreign-owned businesses in a host country, which is relevant to an examination of restrictions on trade and investment and the application of national treatment — matters that are relevant to GATS. There are other differences between FDI and GATS mode 3; for example, in defining FDI, the International Monetary Fund's Balance of Payments Manual (IMF 1993) specifies that the foreign investor own a minimum of 10 per cent of the relevant foreign enterprise, whereas the GATS does not specify an ownership threshold in its definition of commercial presence; rather, as indicated above, it refers to the establishment of offices.

There are questions regarding the accuracy and reliability of some aspects of services trade data — a number of problems in the Australian context were catalogued in a report by ACIL Tasman (2010). While such concerns mean caution should be applied in interpreting such data in some contexts, the discussion in this chapter addresses broad trends in services trade and comparisons with merchandise trade at the aggregate level, where any such issues are less likely to be significant.

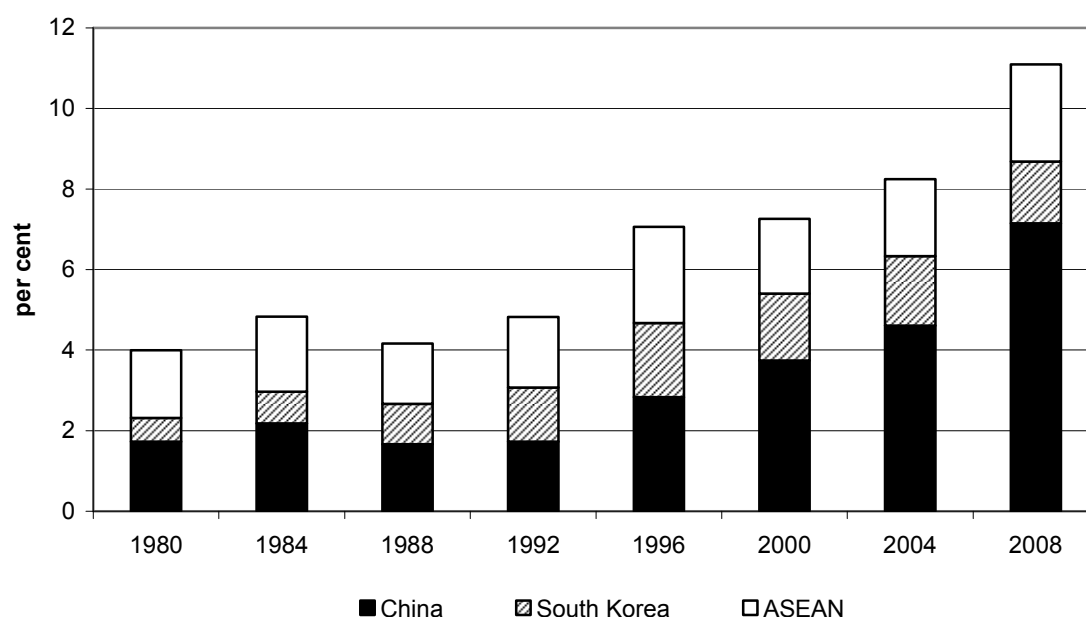
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### *The rise of Asia in relative and absolute terms*

The rapid economic development of East and South Asia over recent decades has seen measured output increase more than sevenfold since 1980 and the relative contribution of the economies in the region to the global economy grow substantially — from 16 per cent of global production in 1980 to around 22 per cent by 2008. Over the same period, while the level of production by the developed economies of Europe and North America increased fivefold, their share declined. The relatively slow growth of the Japanese economy over the last two decades has seen its share fall too, particularly after 1990.

The economic performance of some East Asian economies has been particularly pronounced. For example, the share of global production of China, South Korea and ASEAN combined has almost trebled since 1980, with most of the increase occurring since the early 1990s (figure 3.1).

**Figure 3.1 Contribution to global production — China, South Korea and ASEAN, 1980 to 2008<sup>a</sup>**



<sup>a</sup> Formed in 1967, ASEAN originally comprised Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei subsequently joined in 1984, Vietnam in 1995, Laos and Burma (Myanmar) in 1997 and Cambodia in 1999.

Source: World Bank (2010a).

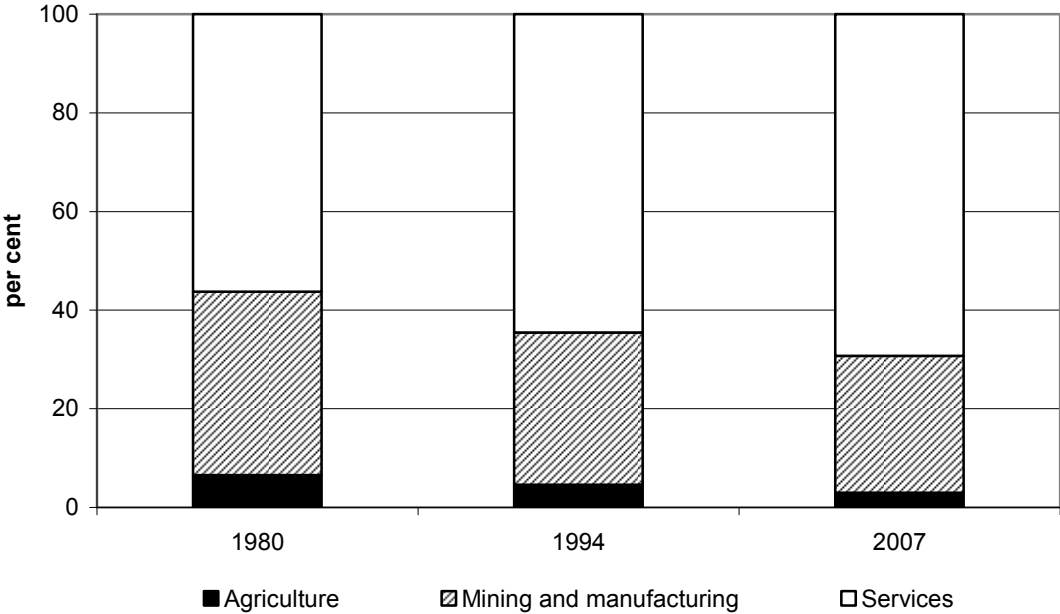
Accompanying this economic growth has been an increase in gross domestic product (GDP) per capita. Data from the World Bank show that per capita incomes

in the East Asia and Pacific region have increased more than sixfold in constant US dollar terms since 1980 (World Bank 2010a).

*The growing importance of services*

Along with the increased tendency for countries to trade as their economies grow and develop, the economic structure of countries also changes. The demand for services tends to increase faster than per capita incomes. Accordingly, the share of services in global production has increased over the last few decades, with a corresponding decline in the relative shares of agriculture and manufacturing (figure 3.2).

**Figure 3.2 Value added by broad sector as a proportion of global production, 1980, 1994 and 2007**



Source: World Bank (2010a).

The propensity for services to expand in relative importance has, nevertheless, varied across economies. For example, in ‘high income’ countries, the percentage of value added by the services sector grew from an average of 59 per cent in 1980 to 73 per cent in 2007. In the fast growing East Asia and Pacific region, the contribution of services to value added increased from an average of 27 per cent to 41 per cent over the same period.

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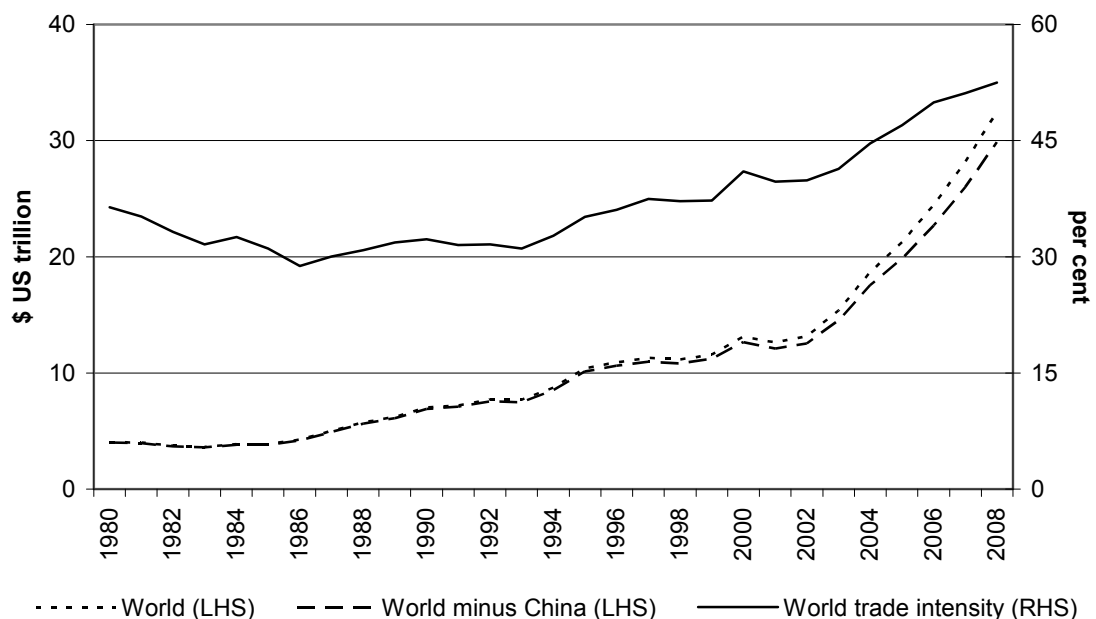
## Trends in merchandise and services trade

With economic growth being accompanied by changes in the structure of economies, trade patterns have also changed in response to shifts in comparative advantage between countries.

### *Merchandise trade*

Over the period from 1980 to 2008, the value of global merchandise trade increased eightfold from US\$4 trillion to over US\$32 trillion. More than two thirds of this growth occurred after the year 2000 with the emergence of China as a major trading nation (figure 3.3). As a result of global merchandise trade growing faster than global production, global merchandise trade intensity (measured as global merchandise exports plus imports as a proportion of global production) increased from around 36 per cent in 1980 to 52 per cent in 2008.

Figure 3.3 **Trends in global merchandise trade (exports plus imports), 1980 to 2008**

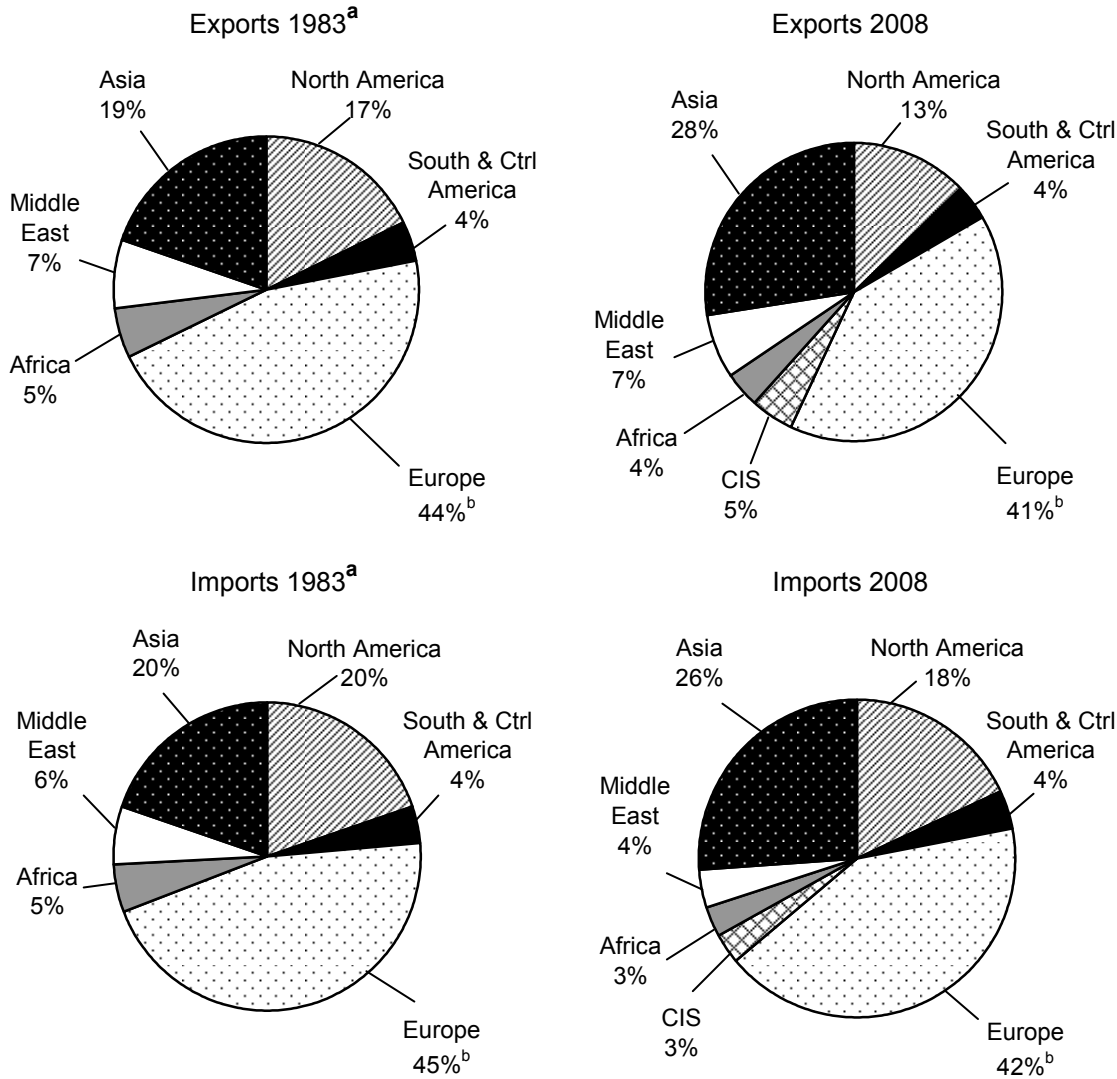


Source: World Bank (2010a).

Within the overall increase in global trade, there has been significant variation in regional contributions. While the nations of Europe account for the largest share of global trade, mainly comprising trade between the economies of the European Union, their relative share of global trade has steadily declined since the early 1980s, as has that of the North American economies (figure 3.4). With the rapid

growth of the Asian economies over the last three decades, the relative magnitude of trade by Asian nations has increased substantially.

**Figure 3.4 Merchandise exports and imports by region as a proportion of global trade, 1983 and 2008**



<sup>a</sup> Data for Commonwealth of Independent States (CIS) are not available for 1980. Official membership of CIS comprises Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Uzbekistan, with Turkmenistan an unofficial associate member. <sup>b</sup> Data for Europe includes intra-European Union trade.

Source: WTO (2009).

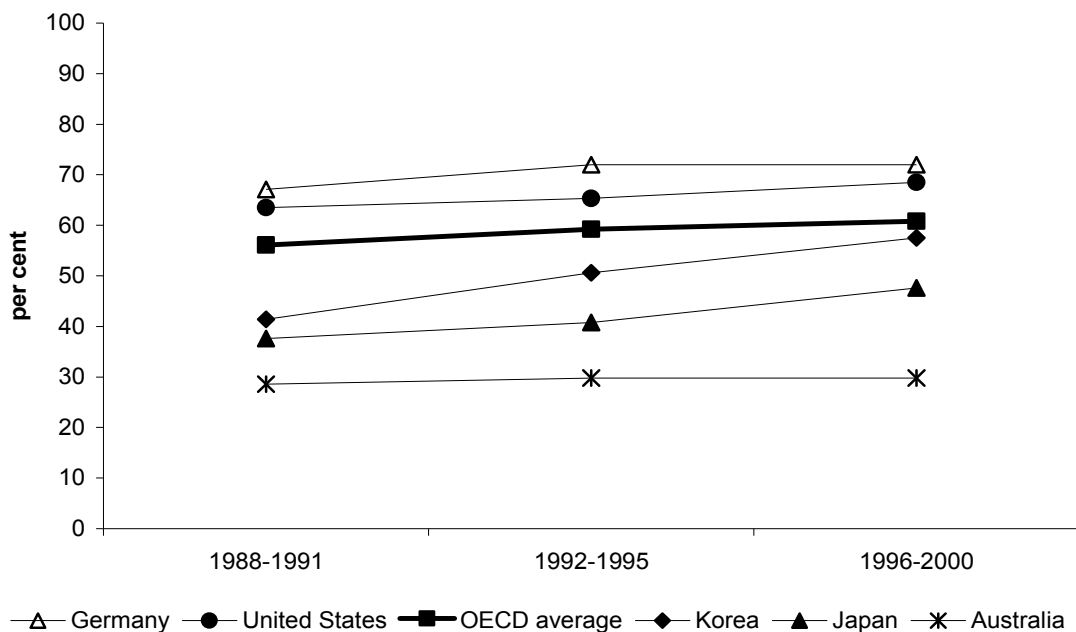
**Intra-industry trade**

Increased specialisation has resulted in production processes becoming more globally integrated, with final products often being comprised of inputs and

components sourced from a number of countries. As a result, components and partly-finished manufactures cross borders more often than in the past and world trade flows are now marked by greater vertical specialisation and more intra-industry trade.

The growing importance of intra-industry trade was examined by the OECD (2002). According to this study, manufacturing intra-industry trade between OECD economies, measured as the two-way exchange between countries of goods within standard industrial classifications, has risen from an average of 56 per cent of total manufacturing trade in the period 1988 to 1991 to around 61 per cent almost a decade later (figure 3.5), continuing a trend that has extended across OECD countries since at least 1970.

**Figure 3.5 Manufacturing intra-industry trade as a percentage of total manufacturing trade, OECD and selected OECD countries, 1988-91 to 1996-2000<sup>a</sup>**



<sup>a</sup> Estimated by the OECD using Grubel-Lloyd indexes based on commodity group transactions.

Source: OECD (2002).

With the growth in intra-industry trade of OECD economies, the share of manufacturing output made up of imported inputs increased from an average of 38 per cent in 1995 to 44 per cent in 2005 (OECD 2009). In this environment, attempts to protect domestic industries, or selected bilateral trade flows, through the imposition of border measures, are likely to impose higher domestic costs than before.

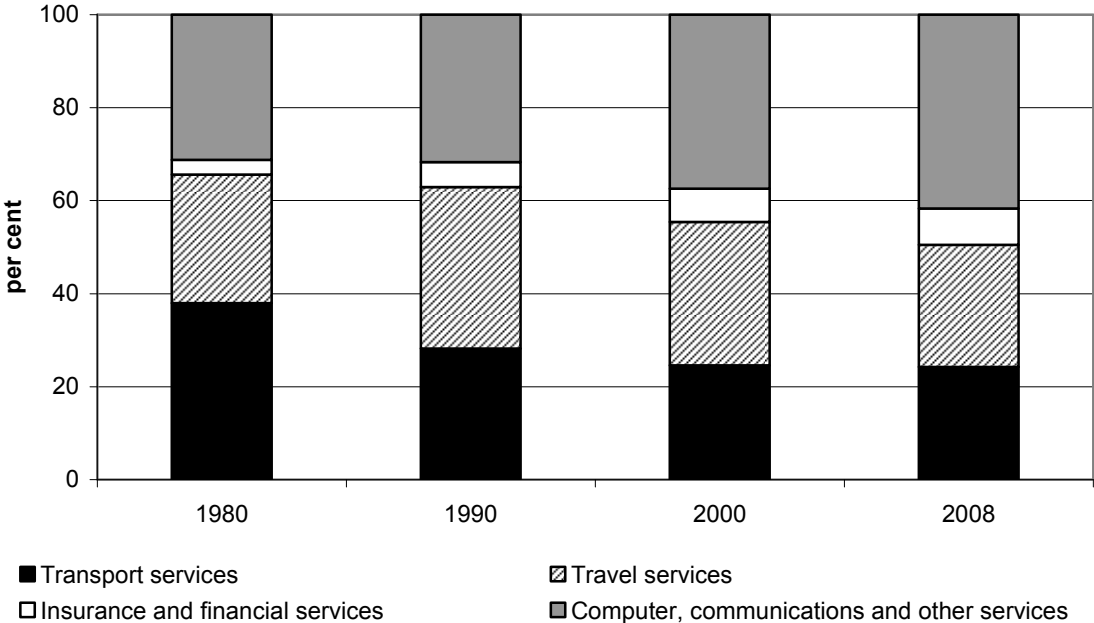
Reflecting the concentration of primary products in Australia’s merchandise exports, Australia’s intra-industry trade has been relatively low by international standards; at around 30 per cent over the period 1988 to 2000 (less than half the OECD average).

**Services trade**

As noted earlier, the share of services in global production has been increasing relative to manufacturing and primary production. However, despite this trend, and notwithstanding advances in information and telecommunication technologies that have led to an expansion in the range of services that can be traded across international borders, the share of services in global trade remains small compared to their share of global production. Nonetheless, the trade intensity of services (measured by the ratio of services imports plus exports to global production) has increased from around 7 per cent in 1980 to 12 per cent in 2008 (World Bank 2010a).

There have been changes in the composition of services trade, with communications and computer services and banking and insurance services increasing their share of total services trade, while the share of traditional transport services, associated with the movement of merchandise, has declined (figure 3.6).

**Figure 3.6 The changing composition of services trade, 1980 to 2008<sup>a</sup>**



<sup>a</sup> Percentage of commercial services exports (total services exports minus exports of government services).

Source: World Bank (2010a).



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## Trends in foreign investment

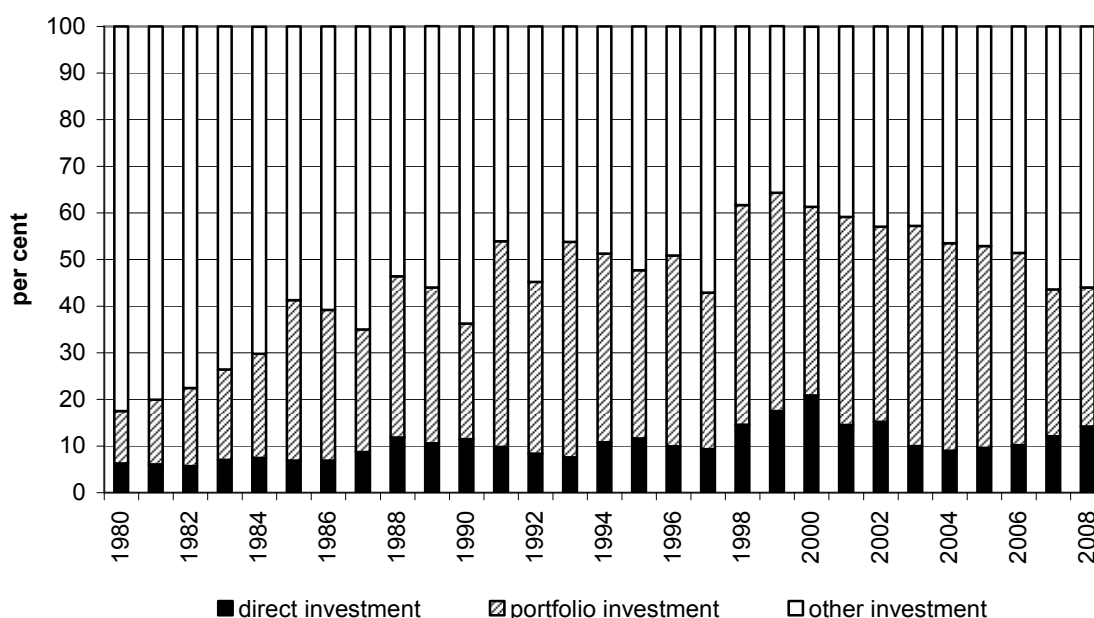
Investors have increasingly been looking beyond national borders for investment opportunities and, with economic growth tending to lift the aggregate level of savings and thus the availability of investment funds within economies, cross-border capital and investment flows have been rising. In such an environment, the rules governing such flows have become more important.

### *Global capital flows*

With the increasing globalisation of businesses and financial markets, global capital flows increased more than 17-fold over the period 1980 to 2008, considerably faster than global production. By 2008, measured global financial flows (inflows plus outflows) were around 54 per cent of global production, up from 17 per cent in 1980.

There have also been marked changes in the relative prevalence of different forms of investment (figure 3.7). In particular, international portfolio investment abroad through bonds, equities, debt securities and derivatives increased 45-fold and

**Figure 3.7 Composition of global capital flows, 1980 to 2008<sup>a</sup>**



<sup>a</sup> Direct investment includes equity capital, reinvested earnings, other capital and financial derivatives between affiliated enterprises. Portfolio investment covers investment in equity and debt securities, excluding any such instruments that are classified as direct investment. Other investments include currency and deposits and trade credits.

Source: IMF (2010).

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expanded its share of total investment abroad from 11 per cent in 1980 to 30 per cent in 2008. Foreign direct investment, which includes the establishment of branches and subsidiaries abroad as well as equity holdings that enable foreign investors to participate in or influence management, also increased significantly — more than 35-fold over the 28 year period to 2008. By 2008, foreign direct investment flows were 14 per cent of total investment flows, up from just 6 per cent in 1980.

### *Trends in foreign direct investment*

Along with the substantial increase in foreign direct investment over recent decades, there has also been considerable change in the distribution of investment across regions (figure 3.8, on p. 25). In particular, the share of foreign direct investment flowing into Asia and, to a lesser extent, Africa and the Commonwealth of Independent States, has increased markedly, while the share flowing into Europe and North America has declined. This trend parallels the relative growth of international trade across these economies and reflects the growing integration of many developing and transition economies into the global economy.

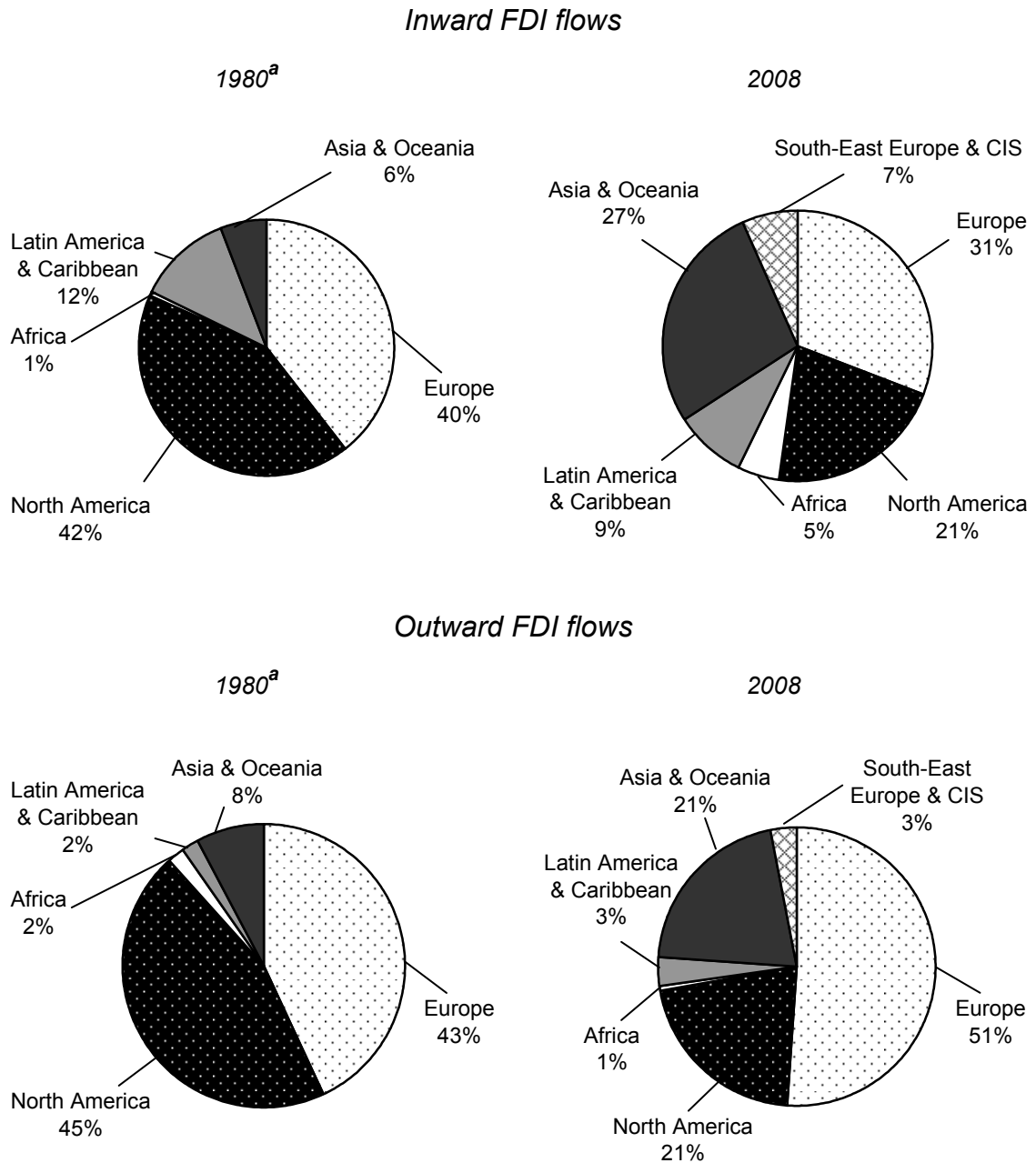
The source of foreign direct investment has also changed, with Asia providing a much larger proportion of direct investment outflows, while the share supplied by North America has declined.

### **Global balance of payments**

Despite considerable growth in investment and, to a lesser extent, services, merchandise trade remains the single most important component of global payments (figure 3.9 on p. 26). Historically, merchandise trade and cross-border trade in services defined the economic relationships between countries. In recent years, however, these relationships have become increasingly dominated by investment and income transactions (including investment income and the remittances of natural persons), the growth of which has outstripped merchandise and services trade — even after allowance for some reversal of past trends in 2008 associated with the global financial crisis.

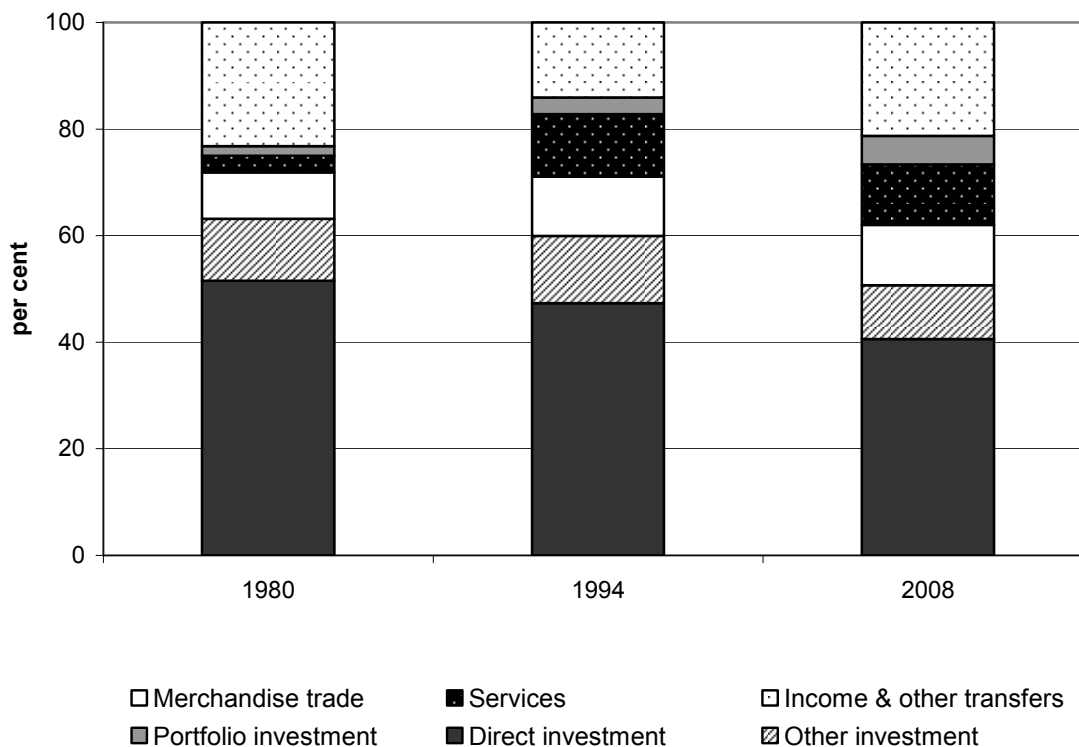
From a very small share in the early 1980s, foreign direct investment and portfolio investment now comprise a significant proportion of payments within global balance of payments accounts.

Figure 3.8 **Distribution of global foreign direct investment, 1980 and 2008**



<sup>a</sup> Data for South-East Europe and the Commonwealth of Independent States (CIS) for 1980 are not available.  
 Source: UNCTAD (2010a).

**Figure 3.9 Composition of payments within global balance of payments accounts, 1980, 1994 and 2008<sup>a</sup>**



<sup>a</sup> Direct investment includes equity capital, reinvested earnings, other capital and financial derivatives between affiliated enterprises. Portfolio investment covers investment in equity and debt securities, excluding any such instruments that are classified as direct investment. Other investments include currency and deposits and trade credits.

Source: IMF (2010).

## 3.2 Australian trends

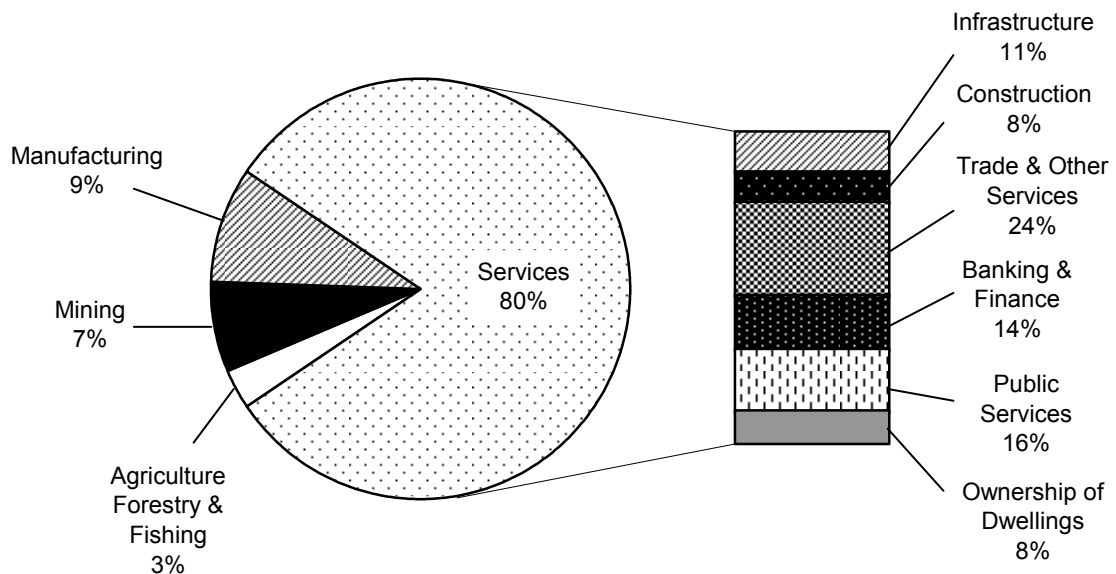
Shifts in the composition of Australia's economy and its patterns of trade with the rest of the world provide an important backdrop to any potential impacts that may arise from changes to Australian, world or partner country trading rules.

### *Overview of the Australian economy*

In common with other developed economies, Australia's GDP is oriented towards the services sector, which accounts for around 80 per cent of GDP (figure 3.10). Of the goods-producing sectors, manufacturing accounts for around 9 per cent of GDP and the primary industries of mining, agriculture, forestry and fishing activities collectively account for around 10 per cent of GDP.

The services sector comprises a diverse range of activities including utilities and transport, construction, trade, business and personal services, banking and finance, and public services (including health and education), with each group contributing substantially to aggregate production.

**Figure 3.10 Composition of the Australian economy, 2008-09<sup>a</sup>**



<sup>a</sup> Percentages may not add to 100 due to rounding.

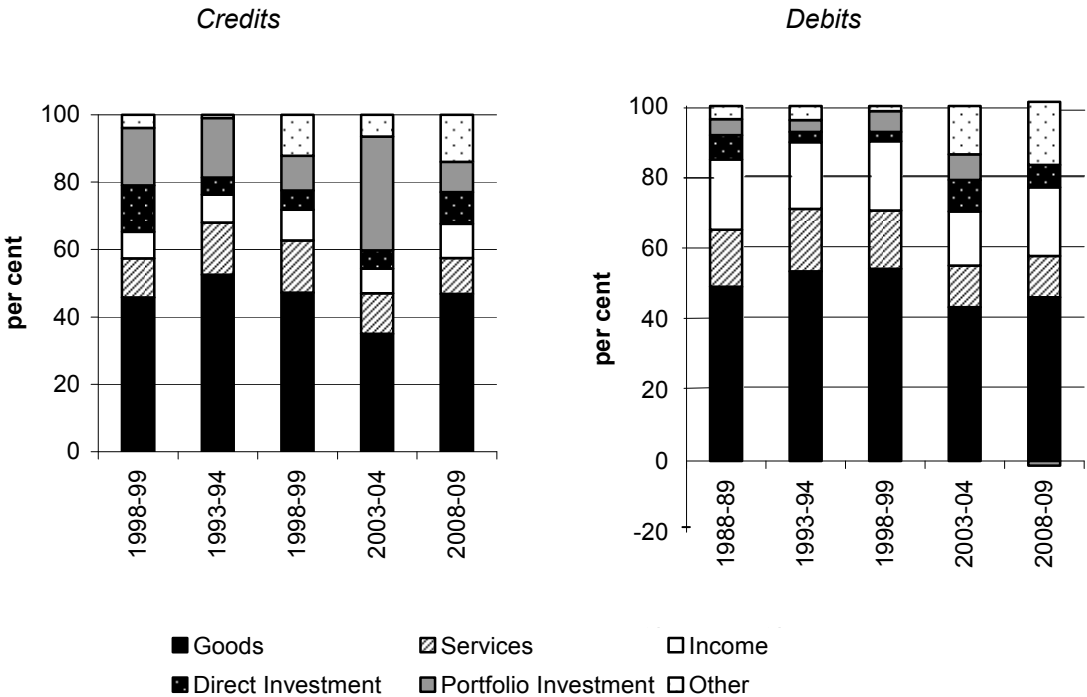
Source: ABS (*Australian National Accounts: National Income, Expenditure and Product, March 2010*, Cat. no. 5206.0).

While production activity is oriented towards services, the main focus of Australia's balance of payments transactions remains on merchandise imports and exports, which accounted for just under half of balance of payments transactions (both credits and debits) in 1988-89 and remained above 40 per cent in 2008-09 (figure 3.11). The share of services trade relating to 'direct services', such as transport, tourism, cross-border supply of business services and the provision of education services, has remained fairly steady over this period.

There has, however, been an increase in the relative importance of Australia's international capital flows abroad. The decision to invest offshore is driven by a number of factors, not least of which is the commercial incentive to gain access to global markets. In the 1980s, a range of reforms both domestically and overseas, including the deregulation of Australia's financial markets and the floating of the Australian dollar, helped create a more open and outward-looking environment for Australian businesses.

As a result, portfolio investment increased from around 5 per cent of balance of payments outflows in 1988-89 to an average of around 10 per cent of outflows over the last decade, notwithstanding a sharp turnaround in 2008-09 as a result of the global financial crisis. Australian direct investment abroad has also increased in importance, particularly since the mid 1980s, with the greater global integration of Australia’s capital markets.

**Figure 3.11 Australia’s Balance of Payments, 1988-89 to 2008-09**



Source: ABS (*Balance of Payments and International Investment Position, Australia, March 2010*, Cat. no. 5302.0).

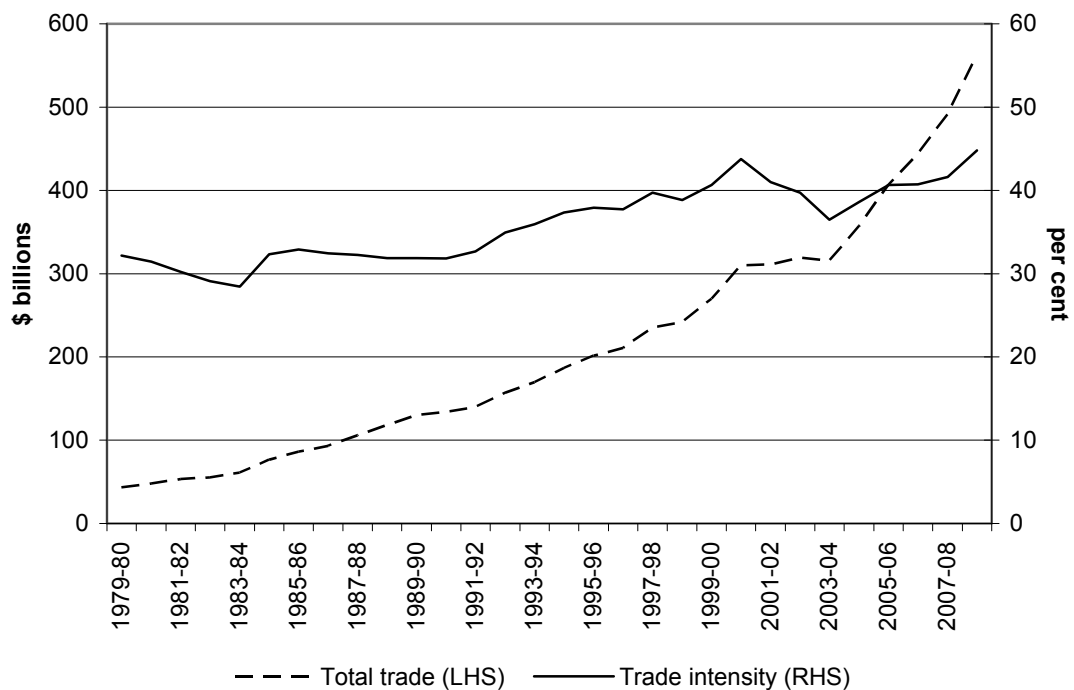
Reflecting Australia’s traditional role as a net capital importer, income payments overseas (mainly dividends and interest, as well as reinvested earnings of direct investment enterprises) have been relatively more important than income receipts from abroad. Nevertheless, with the growth in Australian investment offshore, the value of income receipts is rising.

**Trends in Australian trade**

While the level of financial transactions has been increasing relative to merchandise and services trade, the trade intensity of the Australian economy, in line with global trends, has also been increasing. By 2008-09, the trade intensity (measured by the ratio of imports plus exports to GDP) is estimated to be around 45 per cent (figure 3.12).

This is 13 percentage points above the level prevailing in Australia in 1979-80 — before Australia’s general reductions in tariff protection, liberalisation of financial markets, floating of the Australian dollar, and economy-wide program of national economic reform. While trending upward, there have been substantial year-to-year variations in the estimated trade intensity due to changes in Australia’s terms of trade, that is, the price in Australian dollar terms of Australia’s exports relative to its imports.

**Figure 3.12 Trends in Australian (merchandise and services) trade, 1979-80 to 2008-09**

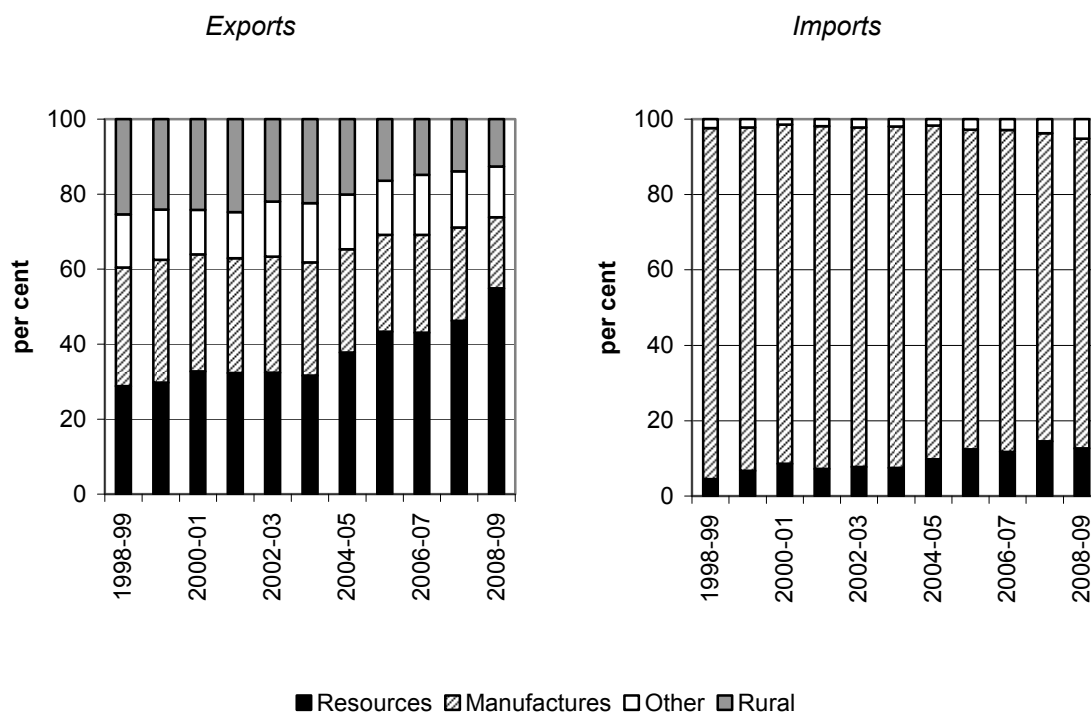


Source: ABS (*Australian National Accounts: National Income, Expenditure and Product, March 2010*, Cat. no. 5206.0).

### *Composition of Australia’s merchandise trade*

Historically, Australia’s merchandise exports have been dominated by agricultural and resources products, while imports have largely comprised manufactured goods (figure 3.13). With higher prices for key mining products, particularly coal and iron ore, and the effects of drought on agriculture, the share of mineral resources exports in Australia’s total exports has increased substantially over the last decade.

**Figure 3.13 Composition of Australia's merchandise trade, 1998-99 to 2008-09**



Source: ABS (*Balance of Payments and International Investment Position, Australia, March 2010*, Cat. no. 5302.0).

The strong global demand for mineral and energy products has resulted in Australia's terms of trade climbing to the highest level since the 'wool boom' of the early 1950s (figure 3.14).

### *Composition of Australia's services trade*

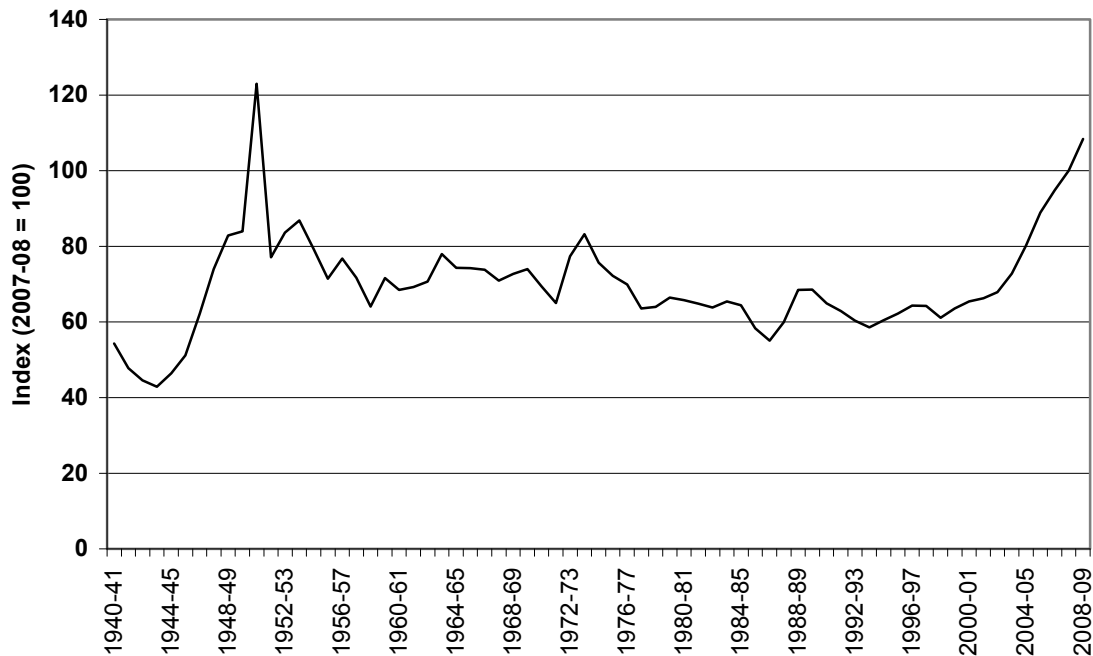
Within the services sector, Australia's main imports relate to personal travel by Australian residents travelling overseas. Imports of these services have grown to 32 per cent of services imports by 2008-09, up 9 percentage points from 1998-99.

From the early 1990s, exports of education and training related services have expanded significantly relative to other services exports. By 2008-09, exports of education services contributed 32 per cent of services exports, displacing other personal travel as the main services export.

In line with global trends, the relative importance of both imports and exports of transport services (including international air travel) has declined steadily since the early 1990s.



Figure 3.14 Australia's terms of trade, 1940-41 to 2008-09



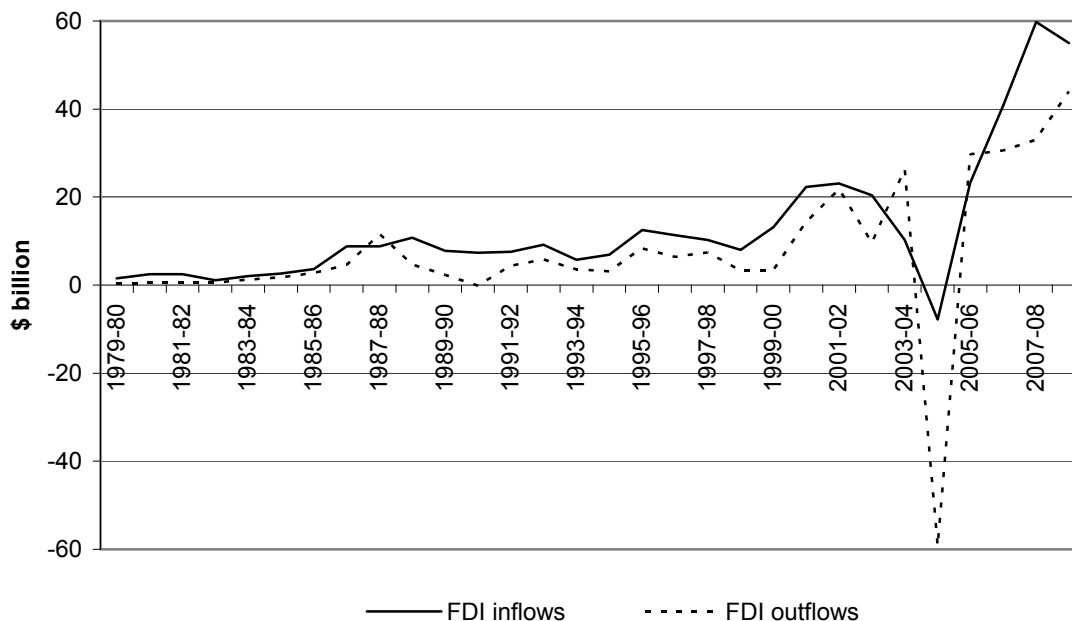
Source: ABS (*Australian National Accounts: National Income, Expenditure and Product, March 2010*, Cat. no. 5206.0) and Gillitzer and Kearns (2005).

### Trends in Australia's direct investment

As noted, the economic reforms of the 1980s helped create a more open and outward-looking environment for Australian businesses. In the decade leading up to these reforms, direct investment inflows were typically some four to five times greater than outflows. Since that time, the value of direct investment abroad by Australian businesses has increased markedly. Direct investment inflows have continued to grow substantially, and inflows still exceed outflows in most years. There was a temporary reversal in both inflows and outflows in 2004-05, which coincided with the relocation of News Corporation from Australia to the United States (figure 3.15).

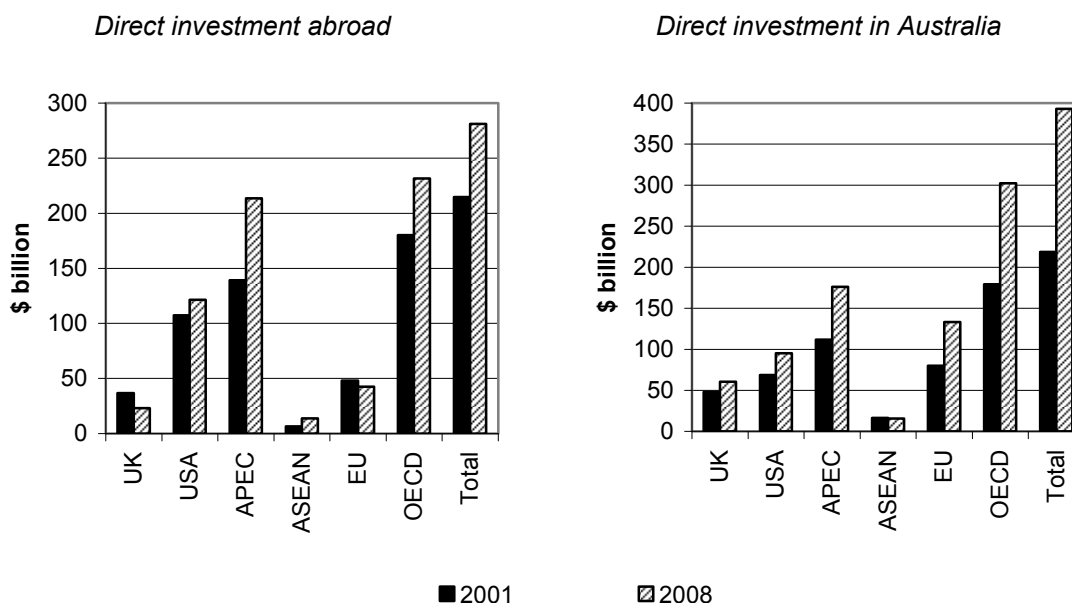
Historically, most overseas direct investment in Australia and Australian direct investment abroad has been with other developed countries, including New Zealand, the United States and countries within the European Union. Nevertheless, there has been an increasing tendency for direct investment links to be established with countries in other regions, particularly the Asia-Pacific region (figure 3.16).

**Figure 3.15 Australia's foreign direct investment – inflows and outflows, 1979-80 to 2008-09**



Source: ABS (*Balance of Payments and International Investment Position, Australia, March 2010*, Cat. no. 5302.0).

**Figure 3.16 Regional composition of the stock of Australia's foreign direct investment, 2001 and 2008**

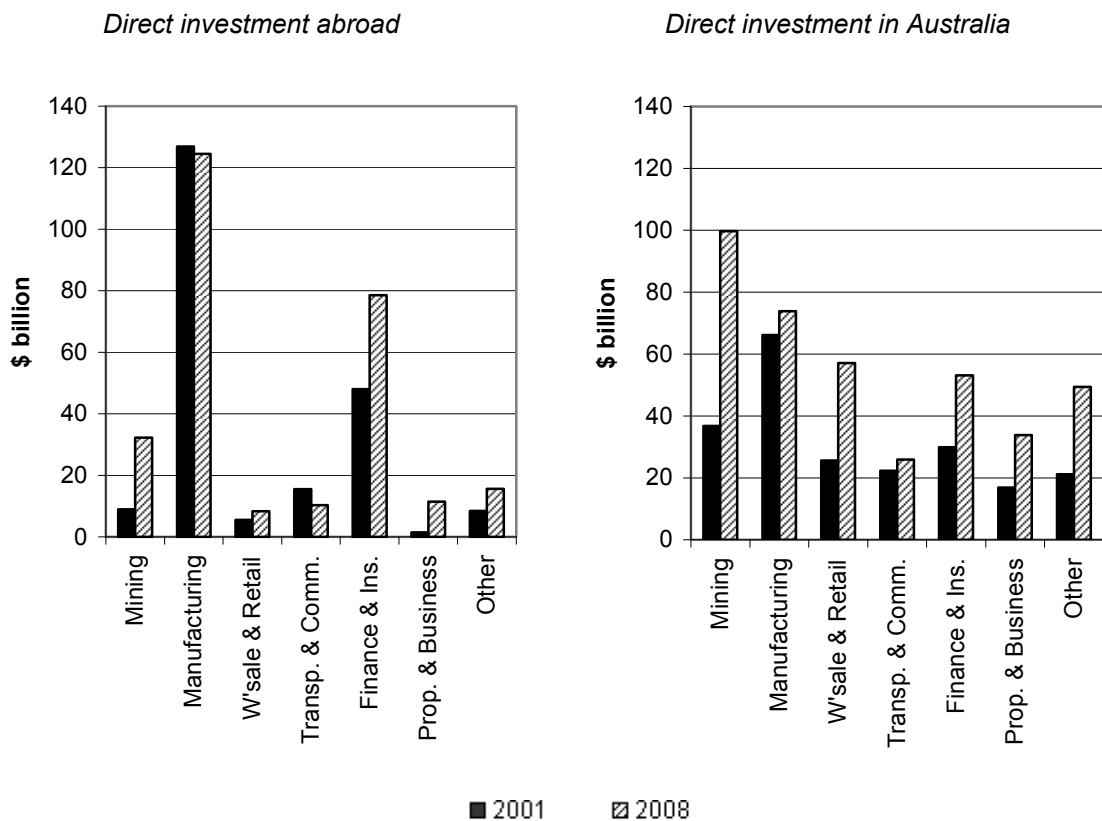


Source: ABS (*International Investment Position, Australia: Supplementary Statistics, 2008*, Cat. no. 5352.0).

Traditionally, direct investment in Australia and Australian direct investment abroad has been concentrated in the manufacturing sector (figure 3.17).<sup>1</sup> However, since the early 2000s, investment in other sectors has increased in importance. In particular, the level of inward investment in mining has more than doubled and now exceeds the estimated level of inward investment in manufacturing (figure 3.17, right hand panel). The level of inward investment in services activities, including wholesale and retail and finance, has also increased substantially.

With respect to Australian direct investment abroad, while manufacturing remained the sector with the largest level of outward investment, the importance of investment by the mining and finance sectors, in particular, has increased (figure 3.17, left hand panel).

**Figure 3.17 Industry composition of the stock of Australia's foreign direct investment, 2001 and 2008**



Source: ABS (*International Investment Position, Australia: Supplementary Statistics, 2008*, Cat. no. 5352.0).

<sup>1</sup> The 'stock' of FDI is a measure of all such investment at a point in time. It reflects the accumulated effects of all previous FDI activity and the effects of exchange rate changes and other revaluations on the value of FDI. Stock data abstract from the substantial year-to-year variation that occurs in annual 'flow' data.

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### 3.3 Summing up

The last few decades have seen the relative contribution of economies in Asia to global economic production and international trade increase substantially. The increasing involvement of China in the global economy has provided a substantial impetus to this trend. By contrast, and although they still account for well over half of global output, the relative contribution of the European and North American economies to global production has declined.

Consistent with the rise in global per capita incomes, the world's production of services has expanded considerably more rapidly than industrial and agricultural production.

Economic links between countries have also been increasing. These developments are particularly evident in the increased trade intensity of the global economy — with global trade in goods and services growing considerably faster than global production. They are also evident in the expansion of global capital flows relative to production and trade and the increasing importance of cross-border trade in information and communication technology services.

While merchandise trade and cross-border trade in services have traditionally defined the economic relationships between countries, these relationships have become increasingly influenced by investment and income transactions, the growth of which has outstripped merchandise and services trade. Nonetheless, merchandise trade remains the single most important component of global payments.

Australian trends have largely mirrored these international developments. Consistent with other developed economies, the contribution of services in Australia's GDP has increased and is now around 80 per cent of national production. With respect to international payments, merchandise trade has fallen in relative importance while international investment flows have increased, particularly since the deregulation of Australian financial markets and unilateral reduction in border protection in the 1980s. While direct investment links remain mainly with other developed economies, there is an increasing tendency for outward and inward direct investment to be linked with developing economies, particularly in the Asia-Pacific region.

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## 4 The institutional environment for international trade and investment

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

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

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

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

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

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

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## 4.1 The World Trade Organization

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

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

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

### Trading principles and the WTO agreements

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

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

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

#### Box 4.1     **The WTO agreements**

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

##### **Agreements concerning trade in goods**

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

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

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

(Continued next page)

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Box 4.1 (continued)

**Agreements concerning trade in services, investment and intellectual property**

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

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

Source: WTO (2008a).

## Multilateral trade negotiation rounds

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



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

**Table 4.1 Coverage of multilateral trade rounds**

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

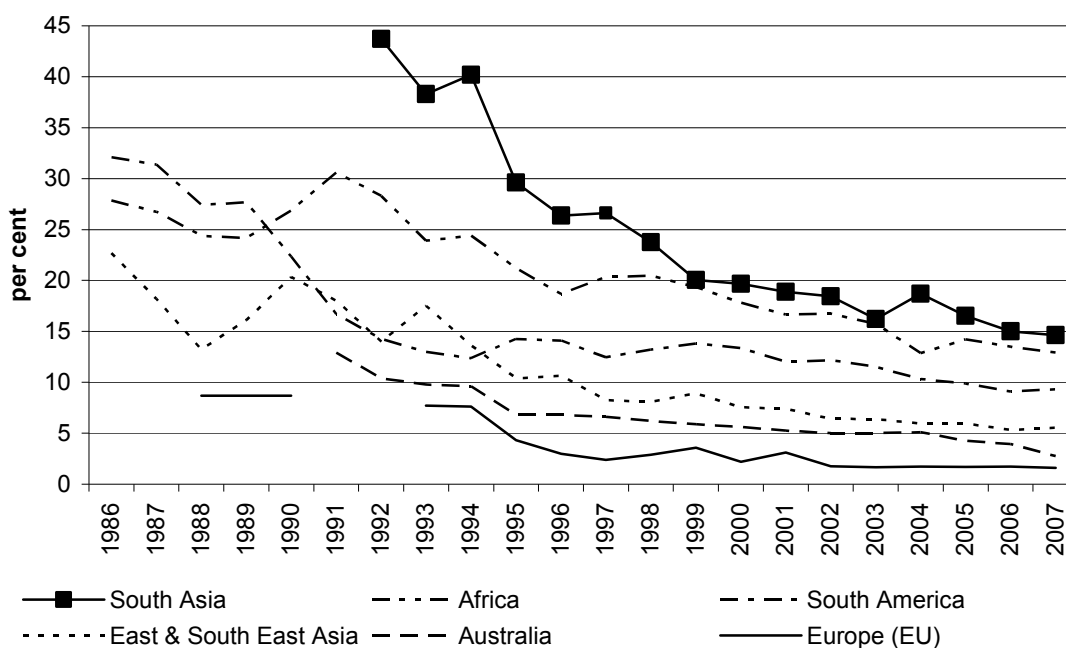
<sup>a</sup> Not all subjects covered are necessarily included in the final agreement.

Sources: WTO (2001, 2008a).

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

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

Figure 4.1 Average applied tariffs in selected geographic regions



<sup>a</sup> South Asia includes India, Pakistan, Sri Lanka, Bangladesh, Nepal, Bhutan and the Maldives.

<sup>b</sup> Average applied tariff rates are unweighted.

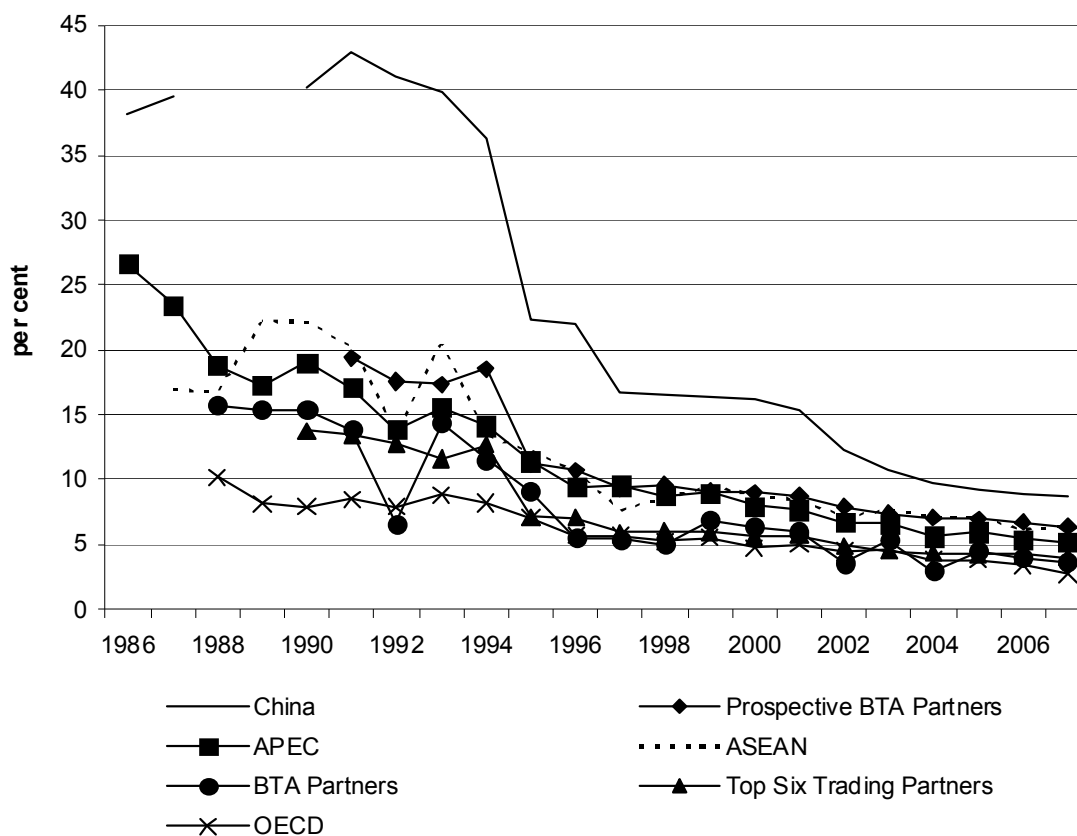
Source: World Bank (2010b).

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

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

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

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



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

**b** Average applied tariff rates are unweighted.

Source: World Bank (2010b).

### Other forms of non-discriminatory agreement

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

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## 4.2 Other multilateral institutions

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

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

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

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

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

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

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

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

### **4.3 Bilateral and regional agreements and institutions**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## **4.4 Domestic policies and programs**

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

### **Border regulation**

The key types of border regulation maintained by the Australian Government include:<sup>2</sup>

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

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<sup>2</sup> Australia phased out most of its tariff quotas in the 1980s and 1990s

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

## Behind-the-border measures

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

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

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



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

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

## **Domestic reform**

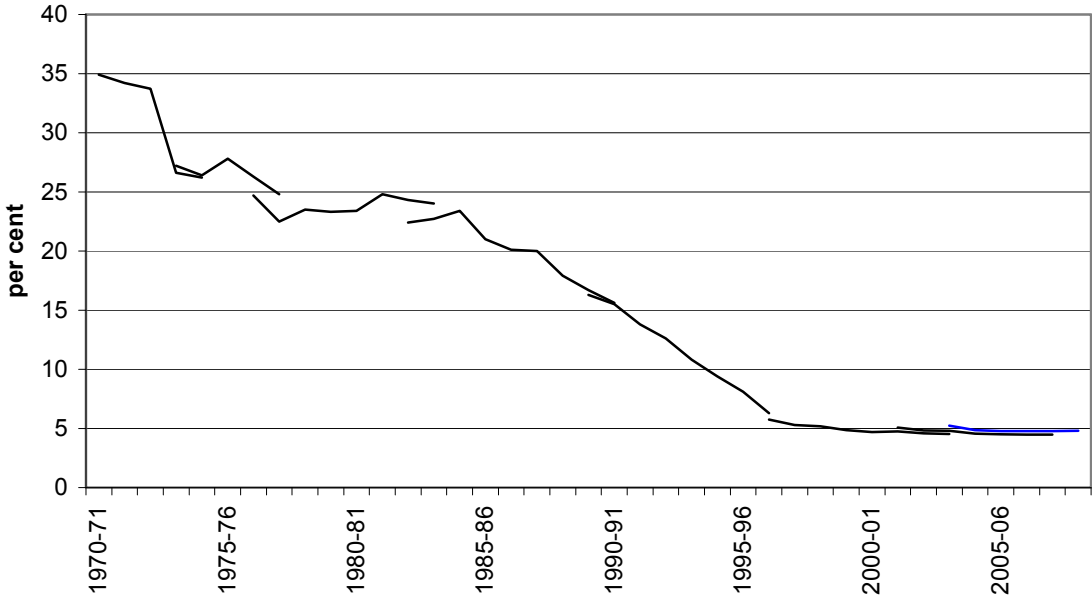
Reform within a country can be undertaken unilaterally, in response to a wholly domestic concern, or to implement a bilateral or multilateral obligation. Australia has a long history of domestic trade reform, as successive governments have reduced trade barriers below the levels bound in GATT and WTO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

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

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

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

**Figure 4.3 Effective rates of assistance to manufacturing, 1970-71 to 2008-09<sup>a</sup>**



<sup>a</sup> Effective rates of assistance do not take into account preferences under BRTAs.  
 Source: Commission estimates.

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

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## 5 The changing nature and reach of BRTAs

While a range of institutional arrangements affect international trade and investment (chapter 4), the potential influence of bilateral and regional trade agreements (BRTAs) has increased significantly in recent years. This chapter examines the changing nature and reach of BRTAs, and in particular preferential trade agreements (PTAs), both globally and in relation to the Australian economy.

Section 5.1 reports on the increase in the incidence of PTAs notified to the WTO. Section 5.2 outlines the nature and scope of PTAs and how this has changed over time while section 5.3 describes the nature and scope of PTAs currently in force with reference to agreements entered into by Australia and key trading partners. Section 5.4 reports on the extent to which international trade and commerce are influenced by bilateral and regional trade agreements.

### 5.1 Growth in preferential trade agreements

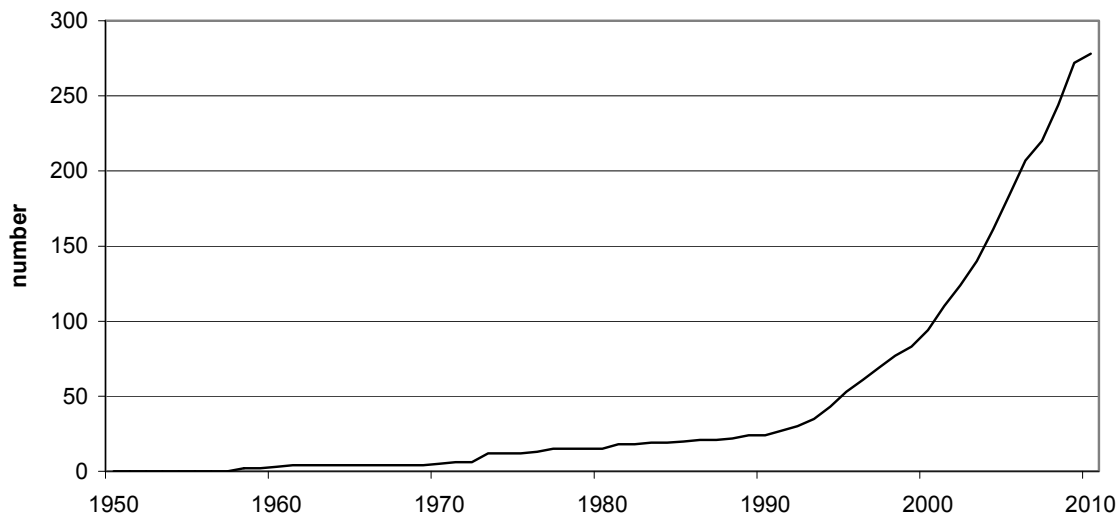
The number of PTAs has grown significantly over the last 50 years. In the early 1960s there were 9 agreements in force.<sup>1</sup> At present there are 288 agreements notified to the WTO and many more under negotiation (figure 5.1).<sup>2</sup>

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<sup>1</sup> The nine trade agreements in force in the early 1960s were the Central American Common Market (CACM), the European Free Trade Association (EFTA), the Treaty of Rome (from which the EU evolved), EFTA—Finland Association, the Latin American Free Trade Area (LAFTA), the Canada — Australia trade agreement, the Ghana — Upper Volta trade agreement, the EEC — Greece interim agreement and the Equatorial Customs Union (comprised of the Central African Republic, Chad, Congo and Gabon).

<sup>2</sup> The WTO data on notifications is not a precise measure of the number of agreements in place. This is partly because, on the one hand, notifications under both GATT Article XXIV (for the goods component of an agreement) and GATS Article V (for the services component of the agreement) are included in the tally. Similarly, accession agreements, such as where new members joined the European Union, can be counted as separate agreements in force. On the other hand, there is a substantial number of other regional and bilateral agreements that define trade relations between countries that are not notified to the WTO: for example, agreements between some members of the former Soviet Union.

**Figure 5.1 Number of trade agreements notified to the WTO<sup>a</sup>**  
 Number and date of entry into force

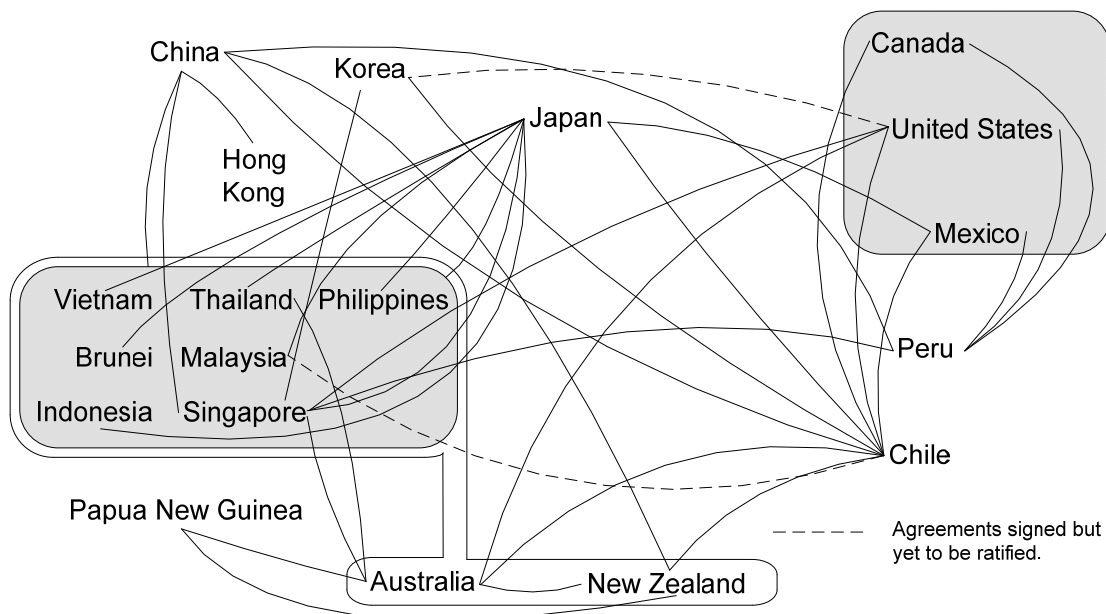


<sup>a</sup> Only includes agreements that are presently in force.

Source: WTO (2010b).

The growth in the number agreements has resulted in substantial overlap and inter-linkages between agreements. For instance, amongst APEC economies, there are numerous agreements that interlink members, as illustrated in figure 5.2.

**Figure 5.2 Inter-linkages between PTAs in the APEC economies, 2010**



Sources: Lloyd and Maclaren (2004); WTO (2010b).

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## 5.2 The evolving nature of PTAs

There has been a broad evolution in the nature of PTAs since the end of the Second World War, which can be thought of as having occurred in three relatively distinct ‘waves’. The first wave extended until the 1970s while the second wave centred on the 1980s and was associated with an increased incidence and broadening of scope of agreements. The third wave has been characterised by the dramatic expansion in the incidence of PTAs since the 1990s and a further expansion in the scope of some styles of agreement.

### First wave

Early, or ‘first wave’, trade agreements tended to be fairly limited in scope, with preferential liberalisation of merchandise trade a primary focus of the agreements. In part, this was in response to the prevailing high tariffs following the Great Depression.

Examples of first wave agreements include some of Australia’s early agreements, such as those with New Zealand and Canada. There were also attempts to develop agreements among developing countries, but these efforts had mostly collapsed by the 1960s. The most significant of the early agreements was the 1958 European Economic Community agreement, which was the predecessor of the European Union (which has expanded over time and now includes 27 member countries). However, this agreement was more comprehensive than other first wave agreements and had strong economic integration objectives.

### Second wave

The second wave of bilateral and regional trade agreements was characterised by the emergence of the United States into the PTA arena in the 1980s. The entry of the United States into PTAs has been attributed to the expansion of the European Union and uncertainty over prospects for the Uruguay Round. Prior to this time, the United States had only focused on the multilateral approach to trade liberalisation. The first US agreement was with Israel in 1985, followed by one with Canada in 1987 (which was subsequently expanded to include Mexico, forming NAFTA, which entered into force in 1994). For Australia, the second wave was marked by the 1983 Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

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The scope of second wave agreements was generally broader than earlier agreements, often including provisions on non-tariff barriers, competition policy and dispute resolution procedures. However, the focus primarily remained on merchandise trade (Adams et al. 2003).

### **Third wave**

The growth of agreements since the 1990s has seen almost all WTO member countries become involved in PTAs. Some of the key developments of PTAs during the period include:

- the development of bilateral trade agreements between the European Union and other European states, often as a precursor to EU membership;
- substantial development of bilateral agreements trading partners by the United States, along ‘hub and spoke’ lines (box 5.1);
- rapid growth in involvement in PTAs by Asian countries. The Asian Development Bank (ADB 2008) noted that there were less than 10 agreements involving Asian countries in 1990, but by 2007 there were over 200 agreements that had either been concluded, were under negotiation, or were being proposed; and
- Japan’s move towards PTAs. Like the United States, Japan had previously focused on multilateralism. Its first preferential trade agreement was with Singapore in 2002 and it now has 11 agreements in force notified to the WTO.

While large economies such as the United States, Japan, China and the European Union have pursued numerous agreements in recent years, there are no PTAs between any of these economies.

The coverage of third wave agreements has, as a rule, expanded considerably over that of earlier first and second wave agreements. Issues covered include services, investment, competition policy, government procurement, e-commerce and intellectual property. Labour and environmental provisions are also a feature of many third wave agreements and are a particular focus of US PTA negotiations. That said, merchandise trade remains an important focus of many third wave agreements. While globally, tariffs on merchandise trade have generally fallen, as a result of both multilateral and unilateral reform, some high tariffs remain (chapter 4). Hence, market access gains for traded goods remain a key objective (or source of sensitivity) for many industries.

As noted in chapter 4, agreements can be subject to review and modification, so that existing first or second wave agreements can be modified to reflect third wave issues. One example, ANZCERTA, is discussed in the following section.

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### Box 5.1 'Hub and spoke' agreements

The 'hub and spoke' characterisation refers to cases where major trading nations conduct a series of bilateral agreements with numerous smaller trading partners. The most obvious examples of hubs under this framework are large economies such as the European Union and the United States. ASEAN, China and Japan are also emerging hubs.

The drivers behind the formation of these types of relationships are varied, and the motivations can differ significantly between the 'hub' and the 'spoke' parties. Bhagwati (2008) identified a number of reasons why small or developing countries might seek agreements with hub countries:

- **Trade Preferences.** At its simplest, the appeal of a preferential trade deal is to improve market access opportunities and gain a competitive advantage over competing exporters. However, in response, competitors seek to negotiate their own bilateral agreement with the hub economy in an attempt to counter potential trade-diversion from existing agreements, leading to an increasing number of 'spokes'.
- **Security.** Smaller countries may undertake bilateral agreements to more closely align themselves with the economic and political fortunes of larger powers.
- **Economic reform and credibility.** Developing countries may engage in agreements with hubs either to lock in domestic reforms or as a means of improving credibility to attract new investment from abroad.

The motivations of hub economies can vary. Competitive expansion of bilateral and regional trade agreements in response to increased activity of other hub economies may be a source of motivation for increasing participation in PTAs. Another may be the ability to push for reforms in areas such as intellectual property, labour laws and environmental standards that may not be possible within a multilateral setting.

Baldwin (2009) has argued that the hub and spoke approach creates a web of bilateral agreements that raise transactions costs and can favour the development of industry in hub countries, rather than spoke countries. In the context of east Asia, Baldwin argued the development of two hubs within the region — China and Japan — risked potential regional divisiveness, rather than regional cooperation.

## 5.3 The scope of specific PTAs in force

Most BRTAs are based on preferential arrangements although, as noted above, many agreements entering into force tend to be quite comprehensive in their scope, with provisions covering a wide range of topics beyond preferential treatment with respect to tariffs. While coverage of the agreements is broadly similar, there are some differences between agreements reflecting the objectives and sensitivities of partner countries.

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## Australian agreements

The main current Australian bilateral and regional trade agreements are the relatively long-standing ANZCERTA with New Zealand and Australia's more recent agreements with Singapore, Thailand, the United States, Chile and New Zealand/ASEAN.

### *ANZCERTA*

The ANZCERTA came into effect in 1983. It has been modified over time, leading to increasing economic integration between the two countries. The agreement was preceded by the 1966 New Zealand-Australia Free Trade Agreement, which had led to the managed removal of trade barriers on between 60 and 80 per cent of merchandise trade, while having no mechanism for the removal of the remaining barriers (Brown 1999, DFAT 1997).

Initially, ANZCERTA only covered trade in goods, but was extended as a result of a series of reviews. Provisions for consultation and review are contained within the formal agreement and provide a mechanism for on-going adaptation. A 1988 review led to changes such as a protocol on harmonisation of quarantine procedures, as well as a protocol on trade in services. Subsequent reviews led to the inclusion of 'third wave' provisions including mutual recognition, harmonisation of standards and harmonisation of the business environment, including business law.

With respect to trade in goods, the ANZCERTA provides for the prohibition of tariffs and quantitative restrictions subject to rules of origin (RoO) and permitted exceptions. In addition, the agreement contains measures to minimise market distortions, such as through agreed limits on industry assistance, anti-dumping actions and bans on export subsidies. It also seeks to address non-tariff barriers through harmonisation of quarantine, customs and other standards.

The ANZCERTA Trade in Services Protocol provides for free trade in services, except for designated services subject to existing regulations, such as telecommunications, aviation, broadcasting and postal services. The Protocol contains a number of provisions that cover, amongst other things, national treatment, market access, most-favoured-nation (MFN) treatment, and commercial presence.

To date, investment is not explicitly covered within the agreement, although an Investment Protocol is currently under negotiation. As with AUSFTA, it is intended that the agreement will include an increase in investment thresholds above which proposals are subject to screening by the Foreign Investment Review Board (FIRB) (Rudd and Key 2009).<sup>3</sup>



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ANZCERTA has often been cited as a relatively good example of a preferential trade agreement. For example, Lloyd observed:

If we had wanted a model [for negotiating a preferential trade agreement], we could not have done better than the original CER agreement as extended in the 1990s. This is the cleanest and least bureaucratic agreement anywhere in the world and is more trade-liberalising and integrating than any other agreement in the world except the European Union. (sub. 3, p. 5)

While the economic integration agenda that surrounds the ANZCERTA gives it a broad scope of influence in trans-Tasman relations, it is notable that the agreement does not cover intellectual property rights, environmental concerns or, currently, investment.

### *More recent agreements*

The five PTAs signed by Australia in the last decade (with Singapore, Thailand, the United States, Chile and ASEAN/New Zealand) share a number of similarities. In addition to preferential tariff concessions on goods trade, these agreements contain provisions relating to trade in services, investment, intellectual property, electronic commerce, government procurement and competition policy. Table 5.1 illustrates the broad chapter coverage of each of Australia's recent agreements.<sup>4</sup>

While these third wave agreements cover a wide range of topics and seek to increase economic integration, preferential trade liberalisation with respect to merchandise trade remains a key objective. The importance of merchandise trade liberalisation will vary between agreements, depending on the prevailing market access barriers. For instance, tariffs and quantitative restrictions were of relatively low significance in the case of Australian trade with Singapore, as a result of the relatively low pre-existing barriers, whereas in cases such as Thailand and the United States, there were significant pre-existing market access barriers with respect to some products. For example, Thailand had high existing tariffs on automobiles and a range agricultural products. While the agreements contain preferential trade liberalisation between the agreement partners, they do not necessarily result in the complete or immediate removal of tariffs and quantitative restrictions. The actual tariff and quota commitments under recent agreements are discussed in chapter 6.

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<sup>3</sup> New Zealanders are already exempt from FIRB screening for residential real estate investment in Australia.

<sup>4</sup> It should be noted that in some cases, the text of a chapter may simply codify existing arrangements or, as noted by Cutbush (sub. DR89, p. 6) in relation to chapters dealing with quarantine provisions, may actually specify that the issue is excluded from more preferential treatment afforded to other issues covered by the agreement.

For trade in services, key features of recent agreements are similar and include items such as: provisions for national treatment to ensure that partner country service providers are treated no less favourably than domestic providers; mutual recognition of selected professional qualifications; and reductions in restrictions on commercial presence by foreign service providers. A key feature of services trade is that many of the barriers are behind-the-border measures. To this end, to varying degrees, agreements also include attempts to harmonise regulatory frameworks and impose regulatory disciplines on trade agreement partners.

**Table 5.1 Coverage of Australia's recent PTAs<sup>a</sup>**

	SAFTA	AUSFTA	TAFTA	ACI-FTA	AANZFTA
Goods	●	●	●	●	●
Agriculture		●			
Rules of Origin	●	●	●	●	●
Customs administration	●	●	●	●	●
Sanitary and phytosanitary measures	●	●	●	●	●
Technical barriers to trade	●	●	●	●	●
Trade remedies		●	●	●	●
Services	●	●	●	●	●
Investment	●	●	●	●	●
Telecommunications	●	●		●	*
Financial services	●	●		●	*
Movement of natural persons	●		●	●	●
Competition	●	●	●	●	●
Government procurement	●	●		●	
E-commerce	●	●	●	●	●
Intellectual property	●	●	●	●	●
Education	●				
Labour		●			
Environment		●			
Transparency		●	●	●	
Economic cooperation					●
Cooperation				●	
Institutional arrangements	●	●	●	●	●
Dispute settlement	●	●	●	●	●

<sup>a</sup> Dots represent chapter coverage of topic in agreement text. Asterisks indicate topic is covered in an annex to a chapter.

Source: adapted from Mortimer (2008).

Investment is one of the prominent third wave issues that was not explicitly addressed in the ANZCERTA agreement, but which is part of all recent agreements. Investment provisions seek to improve transparency and legal protections for

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investors, as well as address limits on foreign equity. One change that came about as a result of AUSFTA was an increase in the thresholds for US investors into Australia above which investments from the US are subject to screening by the Foreign Investment Review Board.

Intellectual property is another third wave issue that features in some of Australia's recent agreements. However, it is the provisions of AUSFTA that involved the most substantial changes to Australia's intellectual property regulations. Under the agreement, Australia adopted a range of provisions from the US intellectual property system, substantially strengthening protection for copyright owners. Australian obligations included:

- ratifying a range of international agreements;
- extending the term of copyright and patent protection; and
- increasing enforcement and protections for intellectual property holders.

Provisions on competition policy are also common to modern agreements. As with intellectual property, AUSFTA and ACl-FTA contain more extensive provisions than Australia's other agreements, which are limited to a principles-based chapter, intended to guide the development of competition policy in partner countries. In AUSFTA, the agreement provides for greater cooperation in detection, investigation and enforcement of breaches.

Government procurement provisions in BRTAs typically involve national treatment of foreign suppliers from other agreements, such that parties can not apply local content preferences. DFAT (sub. 53) note that government procurement can be a sensitive issue and it is not covered in all agreements. In the case of Australia's agreements, there are substantive government procurement provisions in ANZCERTA, SAFTA, AUSFTA and ACl-FTA, although the nature of the arrangements varies considerably. They are not part of either TAFTA or AANZFTA. In TAFTA, there is a chapter heading on the topic, establishing a working group to progress the issue.

A new feature of Australian PTAs is the economic cooperation chapter in the most recent agreement with ASEAN and New Zealand, which provides for trade and investment related cooperation. An Economic Cooperation Work Program, for which Australia provides funding assistance, has been established that provides technical assistance and capacity building to developing ASEAN countries.

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## International approaches to preferential agreements

### *New Zealand*

In addition to its agreements involving Australia, New Zealand has bilateral trade agreements with Singapore, Thailand, China and Malaysia. It is also a member of the ‘Trans-Pacific Strategic Economic Partnership Agreement’ (P4 Agreement). Negotiations are currently underway for the Trans-Pacific Partnership agreement which builds on the P4 Agreement and expands its membership to include the United States, Peru, Vietnam, Australia and Malaysia (MFAT 2010).

New Zealand’s approach to trade agreements has similarities to that of Australia. It pursues comprehensive agreements, with a similar chapter framework to the Australian agreements. Its trade partners are also similar. One case of interest, though, is New Zealand’s agreement with China. New Zealand is the first OECD country to negotiate an agreement with China. Australia’s negotiations with China have been quite protracted — commencing in 2005, they are yet to be concluded.

### *United States*

The United States has PTAs in force with 17 countries. It has also signed agreements with three additional countries, including Korea, but these are yet to be approved by Congress. The majority of US PTA partners are developing countries, particularly countries in Central and South America. The largest US agreement is NAFTA, with Canada and Mexico.

The United States has a quite rigid comprehensive approach to conducting trade agreement negotiations and adopts a ‘WTO-plus’ approach. That is, it pursues an agenda in its agreements that extends beyond the scope of multilateral negotiations under the WTO. The United States typically pursues a strong agenda for bilateral tariff reductions on merchandise trade, although within this approach significant exceptions are made, including in its agreements with Australia and Korea, where designated agricultural products are excluded. Similarly, RoO can restrict access to preferential tariff cuts, and the RoO for NAFTA are particularly complex.

In services, the United States has achieved measures resulting in greater transparency. It has also negotiated agreements prohibiting any ‘local presence’ requirements on PTA partners that require cross-border service providers to have a local base of operations and/or be resident in the importing country. However, Heydon and Woolcock (2009) suggest that the United States’ exclusion, from a number of its agreements, of services measures maintained at the sub-national level reduces the effective coverage of those agreements.

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In other areas, the United States has generally achieved comprehensive investment provisions and has pursued provisions to impose more stringent copyright protection. The United States also insists on provisions addressing labour and environmental standards in its agreements.

### *European Union*

The European Union operates the most prominent and long standing modern PTA which, as a customs union with common external tariffs, has a particularly strong economic integration focus. Since its entry into force (as the European Economic Community) in 1958, with six members, it has been progressively expanded to 27 members.<sup>5</sup>

While the European Union is itself a preferential trade agreement, as an integrated economy, it also strongly pursues PTAs with third parties (usually developing countries) and has almost 30 satellite agreements in force. Unlike the United States, the European Union adopts a more flexible approach, in keeping with the differing range of objectives it pursues with potential partners. Agreements with near neighbours (which potentially may accede to the European Union) tend to be comprehensive in nature. Other agreements with countries in Europe and the Mediterranean have a regional stability focus, while its agreements with African, Caribbean and Pacific countries incorporate flexibility with the stated aim of addressing development needs. Overall, however, its agreements tend to be more modest in terms of the commitments negotiated than those of the United States (Heydon and Woolcock 2009).

### *Asia*

Asian economies have generally been later than Europe and America in pursuing agreements on trade and investment. However, since the 1990s, the growth has been rapid and there are now over 200 agreements either in force or being negotiated or proposed that involve Asian countries. In Asia, there is a range of approaches that different countries have adopted in pursuing agreements, with countries pursuing both bilateral and regional variants. But unlike the United States, which pursues uniform style agreements, including with respect to bilateral tariff preferences, Asian agreements are often less trade focused. They are often labelled as ‘cooperation’ and ‘partnership’ agreements, and, while tariff cuts form part of these agreements, they are often only broad commitments, with details left for further

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<sup>5</sup> European Union member countries are signatories to a number of treaties. Trade commitments, which require members to form a customs union, are contained within the Treaty Establishing the European Community.

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negotiation over time. For instance, Singapore has pursued a network of agreements, despite its own very low tariffs, with agreements emphasising issues such as intellectual property and product standards. The China-ASEAN agreement provides only broad commitments to progressive bilateral tariff reductions (Whalley 2008). China and Japan are in the process of negotiating a significant number of agreements.

## **5.4 The global reach of trade agreements**

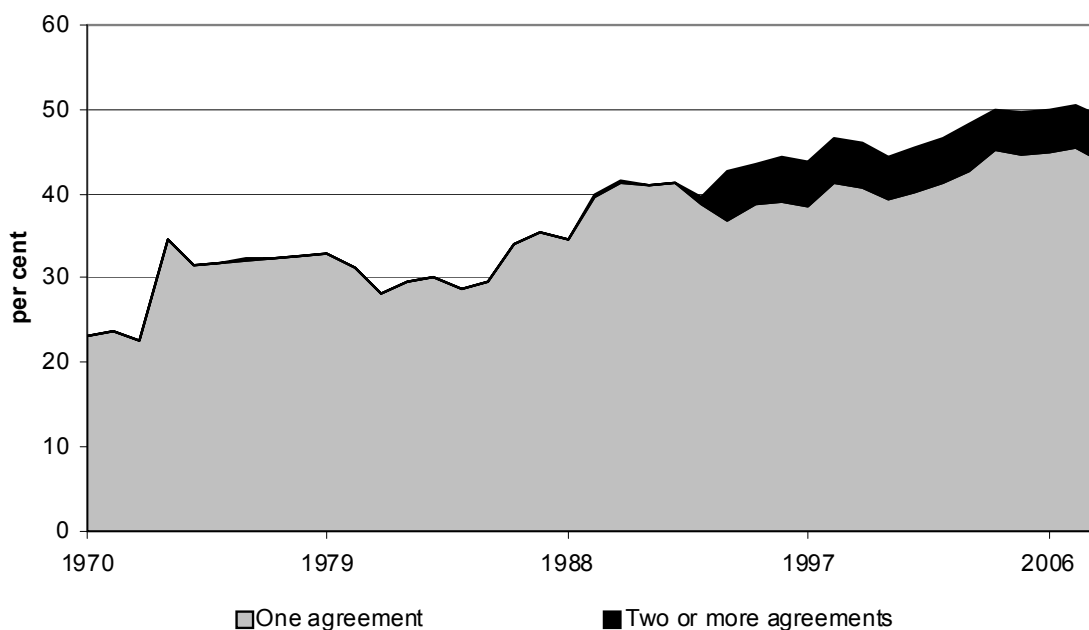
The recent growth in the number of agreements means global trade, including that of Australia, is being increasingly influenced by the formation of PTAs and other forms of bilateral and regional trading agreements.

### **Share of global trade between trade agreement partners**

The proportion of global trade between PTA partners has increased over time. Figure 5.3 illustrates the growth in the share of global merchandise trade between partners over the 38 years to 2008. Trade between parties to trade agreements has increased from around one quarter of total global merchandise trade in 1970 to about half in recent years. Available information also indicates that the proportion of trade, by value, that may be directly influenced by two or more agreements has steadily increased in recent years (darker shaded area, figure 5.3). However, it should be noted that the figure represents total trade between trade agreement members, rather than the share of that trade that is granted preferential treatment under PTAs. The share of merchandise trade that is granted preferences under an agreement will be lower because the MFN tariff will be zero in many cases, or, where MFN tariffs are non zero, exporters may not utilise preferences due, for example, to compliance requirements.

While the greatest growth in the number of new agreements occurred in the period since the mid-1990s, the change in the proportion of global trade between partners over the same period has been relatively small. Rather, the growth has been driven by the earlier formation of large agreements such as the European Union and NAFTA. The EU effect is quite distinct. Its formation in 1958, followed by a number of accessions, including that of the United Kingdom in 1973, drove much of the increase in the share of trade between agreement partners. In fact, intra-EU trade accounted for 18 per cent of total global goods trade in 2008. Similarly, trade within NAFTA, which came into force in 1994 as a successor to the earlier US-Canadian agreement, also comprises a significant share of global trade, accounting for 6 per cent of total goods trade in 2008.

Figure 5.3 Share of global merchandise trade between parties to PTAs<sup>a</sup>



<sup>a</sup> Based on value of merchandise trade in US dollars and covering 416 regional and bilateral trade agreements, comprising 311 notified to the WTO and 105 not notified to the WTO.

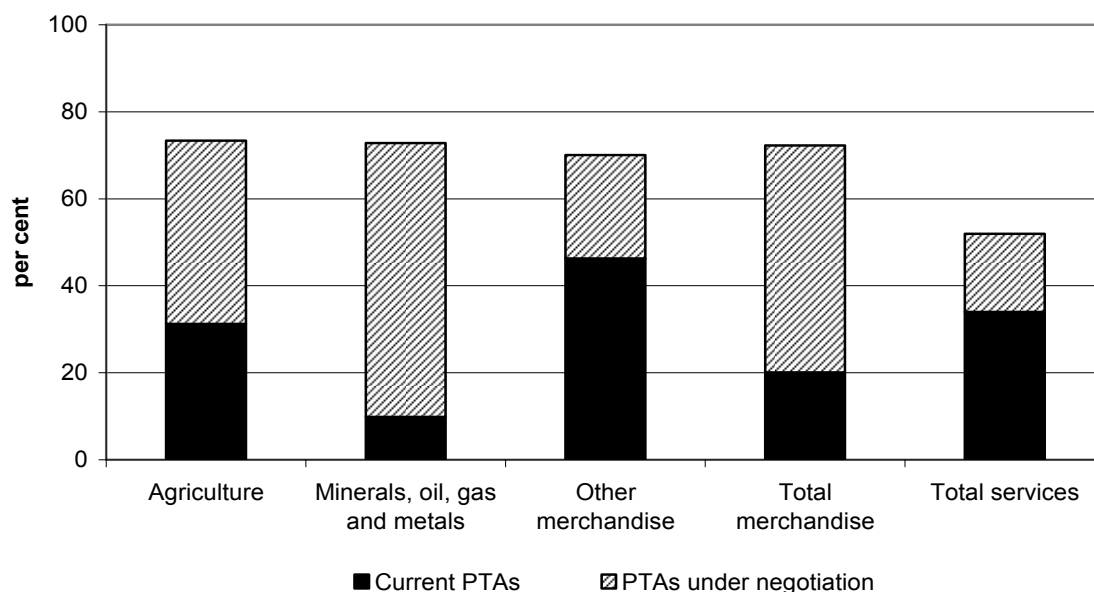
Source: Commission estimates using trade data from UN Comtrade database and trade agreements from the WTO (Renard, C., WTO, Geneva, pers. Comm., 14 November 2008) and Medvedev (2006).

### Share of Australian trade with PTA partners

Trade with PTA partner countries accounts for a substantial proportion of Australia's total trade. This share would increase substantially with the completion of PTAs under negotiation. In 2009, Australia's current PTA partners accounted for around a fifth of all merchandise exports and a third of services exports (figure 5.4). Also notable is that countries with which Australia is currently negotiating a PTA accounted for a further 52 per cent of merchandise exports, and 18 per cent of services exports, in 2009. Assuming current negotiations are concluded, this will mean that PTA partners account for the majority of Australian export markets – although, as noted above, not all of the trade between agreement partners receives preferential tariff concessions.

With respect to imports, in 2009, current PTA partners were the source of a substantial share of both merchandise (38 per cent) and more particularly, services (44 per cent) (figure 5.5). Again, countries with which negotiations are currently ongoing are the source of a substantial share of merchandise imports (33 per cent in 2009), although this is less so the case for services imports, with those countries only accounting for 7 per cent of services imports in 2009. As noted above however, not all trade between agreement partners receives preferential tariff concessions.

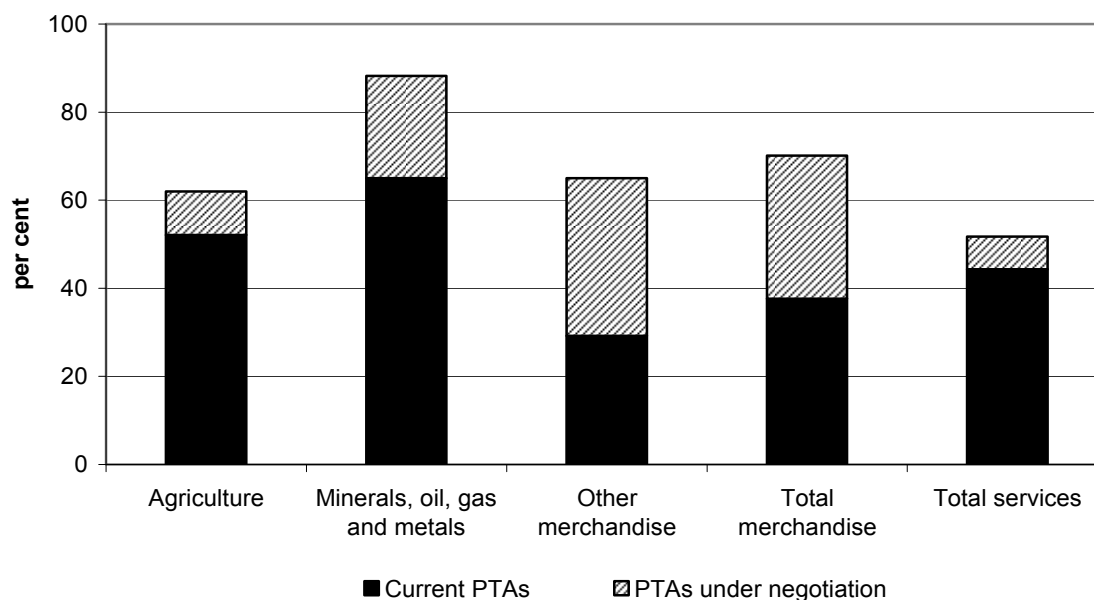
**Figure 5.4 Share of Australian exports to PTA partners, 2009<sup>a</sup>**



<sup>a</sup> Agriculture category is based on HS Chapters 1–20 and 50–52. Minerals, oil, gas and metals category is based on HS Chapters 26,27 and 71–81.

Source: Commission estimates using World Integrated Trade Solution (WITS) data and ABS (*International Trade in Goods and Services, Australia, Sep 2010, Cat. no. 5368.0*).

**Figure 5.5 Share of Australian imports from PTA partners, 2009<sup>a</sup>**



<sup>a</sup> Agriculture category is based on HS Chapters 1–20 and 50–52. Minerals, oil, gas and metals category is based on HS Chapters 26,27 and 71–81.

Source: Commission estimates using World Integrated Trade Solution (WITS) data and ABS (*International Trade in Goods and Services, Australia, Sep 2010, Cat. no. 5368.0*).



PART C

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EVALUATING THE ECONOMIC  
IMPACTS OF BRTAS



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## 6 Effects on barriers to trade and investment

This chapter assesses the potential impact that bilateral and regional trade agreements (BRTAs) have had on barriers to trade and investment. While the focus is on Australia's agreements, the impacts of other agreements, and the broader lessons, are also considered.

Section 6.1 examines the impact Australia's BRTAs have had on the barriers of member countries. Section 6.2 then examines whether BRTAs have been able to influence overall trade barriers and, in this context, how have they contributed to, or detracted from, global attempts to reduce barriers.

### 6.1 To what extent do BRTAs reduce barriers for members?

There are a number of ways in which agreements can reduce trade and investment barriers, including:

- reductions in tariffs on merchandise trade;
- reductions in non-tariff barriers on merchandise trade;
- reductions in barriers to services trade; and
- reductions in barriers to investment.

While many reductions in these areas operate 'at-the-border', there is an increasing tendency to also include behind-the-border measures in trade agreements — that is, measures focused at domestic policy issues, but which may indirectly restrict the ability of foreign competitors to operate in domestic markets. This section principally examines the impacts of Australia's BRTAs on 'at-the-border' barriers. Some specific behind-the-border provisions are discussed in chapter 10.

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## Reductions in tariffs on goods

### *Tariff concessions under preferential agreements*

One of the most readily identified outcomes of any trade agreement is its effect on tariffs on merchandise trade. In some cases, particularly in relation to certain agricultural products, agreements can also affect tariff quotas. Overall, preferential agreements tend to result in the reduction of tariffs between partners. Australia's agreements, excluding its early non-reciprocal agreements with Pacific Island countries, generally contain commitments by all members to reduce tariffs on at least 95 per cent of tariff lines — a threshold advocated as representing consistency with the 'substantially all trade' coverage provisions stipulated under GATT Article XXIV (box 4.2). Deviations from this level of commitment are restricted to a small number of countries in the AANZFTA. Commitments are also tempered by the use of phase-in periods and exemptions. All recent agreements, except SAFTA, use phase-in periods for tariff reductions, in some cases of up to 20 years. Exemptions, while representing a small number of tariff lines, tend to be in sensitive sectors with relatively high levels of protection.

The nature and timing of tariff reductions and changes in tariff quotas vary between agreements entered into by Australia.

### *ANZCERTA (New Zealand)*

Following its inception in 1983, ANZCERTA resulted in the complete reduction of tariffs to zero by both parties on merchandise trade complying with the agreement rules of origin (RoO) by 1990.

### *SAFTA (Singapore)*

Under SAFTA, both countries reduced all tariffs to zero upon entry into force in 2003. However, Singapore already had few existing tariff barriers, with only a small number of alcohol product tariff lines gaining any tariff concessions.

### *AUSFTA (United States)*

In regards to manufactured goods, both countries reduced most remaining tariffs to zero immediately upon entry into force in 2005, leading to approximately 97 per cent of tariff lines being duty free. Remaining non-zero tariff lines (clothing and textiles) will be phased to zero by 2015.

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For Australian agricultural exports to the United States, the tariffs on two thirds of line items were set to zero immediately, with some further reductions phased in over 18 years. There will be some expansion in the tariff quota for beef, while the out-of-quota tariff will be phased to zero (from 26.4 per cent) between years 9 and 18 of the agreement. Dairy tariff quotas were expanded but out-of-quota tariffs are retained. There were also no changes in market access for sugar.

There are some safeguard measures in the agreement that potentially erode the tariff reductions. For instance, either party can undertake emergency action on clothing and textile products, by increasing the duty to the most-favoured-nation (MFN) rate, if preferential tariff concessions lead to an increase in imports that are determined to threaten the domestic industry. Australian horticultural products exported to the United States face price-triggered safeguards for particular products or product groups and there are quantity-triggered safeguards on beef during the tariff phase-out period, with a price-triggered safeguard from year 19.

#### *TAFTA (Thailand)*

Thailand had relatively high tariff rates, with few duty free tariff lines and some relatively high tariff peaks. For example, automotive tariffs were up to 80 per cent, while beef tariffs were 51 per cent. Around half of Thailand's tariffs on complying Australian imports were reduced to zero upon entry into force in 2005. A substantial proportion of remaining tariffs were phased to zero by 1 January 2010, with most remaining tariffs to be phased to zero by 1 January 2015. Border restrictions on some agricultural products such as beef will not be phased out until 2020, while designated dairy tariff quotas will not be abolished until 2025.

Australia will reduce all tariffs on imports from Thailand to zero by 2015. Under the agreement, tariffs on motor vehicles were cut to zero upon its entry into force.

#### *ACI-FTA (Chile)*

Most tariffs on both sides were reduced to zero on the agreement entering into force in 2009, with most tariffs to be phased out by 2015 — Chile's sugar tariff is the exception.

#### *AANZFTA (ASEAN and New Zealand)*

Under this regional agreement, the extent of tariff reductions varies between members (table 6.1). In general, the less developed economies have longer phase-in periods and are subject to lesser reductions, or in some cases, the binding of tariffs

**Table 6.1 Percentage of zero HS6 tariff lines for AANZFTA members**

<i>Country</i>	<i>2005 (Base Tariffs)</i>	<i>2010</i>	<i>2013</i>	<i>Final tariff elimination</i>	<i>Year achieved</i>
	%	%	%	%	
Australia	47.6	96.4	96.5	100.0	2020
Brunei	68.0	75.7	90.0	98.9	2020
Burma	3.7	3.6	3.6	85.2	2024
Cambodia	4.7	4.7	4.7	88.0	2024
Indonesia	21.2	58.0	85.0	93.2	2025
Laos	0.0	0.0	0.0	88.0	2023
Malaysia	57.7	67.7	90.9	96.3	2020
New Zealand	58.6	84.7	90.3	100.0	2020
Philippines	3.9	60.3	91.0	94.6	2020
Singapore	99.9	100.0	100.0	100.0	2009
Thailand	7.1	73.0	87.2	99.0	2020
Vietnam	29.3	29.0	29.0	89.8	2020

Source: DFAT (2010a).

at 2005 applied levels. Only Australia, New Zealand and Singapore will eliminate tariffs on all qualifying goods from AANZFTA members. For some members of this agreement, tariffs will be eliminated on less than 95 per cent of tariff lines.

The entry of this agreement into force means that Australia now has two agreements with each of New Zealand, Singapore and Thailand that Australian exporters can potentially use to obtain tariff concessions. While tariff outcomes for Singapore are the same, reductions are generally phased in sooner under the pre-existing bilateral agreements, and in the case of Thailand, there are some tariffs that will be eliminated under TAFTA, but not AANZFTA.

Overall, while Australia's recent bilateral and regional trade agreements may not involve the complete removal of tariffs, these preferential agreements have nevertheless resulted in the negotiation of some appreciable reductions in tariff barriers faced by Australian suppliers in partner countries.

For imports into Australia, while starting from a base of generally very low tariffs, there have been widespread reductions to those tariffs for complying imports from agreement partners, potentially lowering costs for Australian firms.

The effect of tariff reduction commitments in preferential agreements is indicated by observed changes in the average tariffs between Australia and its trade agreement partners (table 6.2). Because agreements were only signed relatively

recently and agreed tariff reductions are often subject to phase-in periods, the full extent of reductions in tariff barriers is yet to be realised for all agreements.

**Table 6.2 Change in average applied tariffs on bilateral trade between Australia and trade agreement partners<sup>a</sup>**

	<i>Exports from Australia</i>			<i>Imports to Australia</i>		
	<i>Year</i>	<i>Simple average</i>	<i>Weighted average</i>	<i>Year</i>	<i>Simple average</i>	<i>Weighted average</i>
		<i>%</i>	<i>%</i>		<i>%</i>	<i>%</i>
Singapore	2001	0.0	0.0	2002	4.5	0.8
(SAFTA)	2008	0.0	0.0	2008	0.0	0.0
Thailand	2004	11.5	2.5	2002	6.2	4.8
(TAFTA)	2008	10.3	1.5	2008	1.6	0.4
United States	2002	3.8	2.1	2002	4.6	2.6
(AUSFTA)	2008	1.0	0.1	2008	1.2	0.1

<sup>a</sup> Data not available for certain agreements due to their relatively recent implementation. Simple average is the average tariff across all tariff lines. Weighted average is weighted by the share of imports from the partner country for each tariff line.

Source: Commission estimates using World Integrated Trade Solution (WITS) data.

FINDING 6.1

*Australia's preferential trade agreements contain commitments to reduce and bind at zero tariffs on most items of merchandise trade between agreement partners, although sensitive sectors are sometimes excluded or subject to lengthy phase-in periods.*

**Tariff reductions on a non-preferential basis**

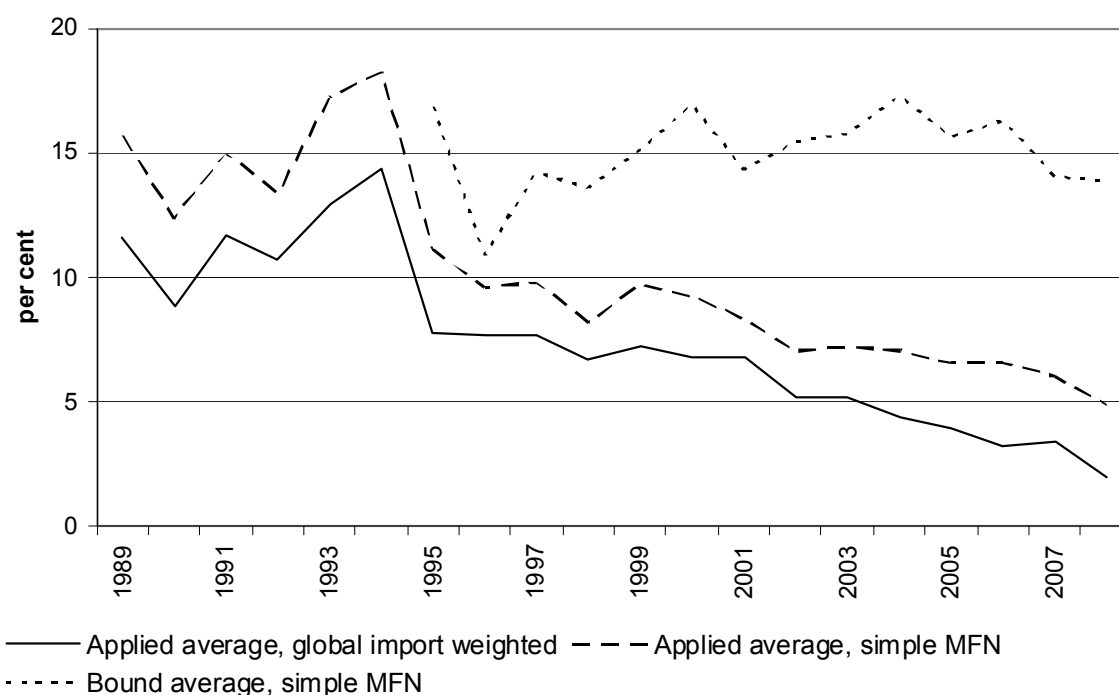
While the APEC Bogor declaration did not place binding obligations on members to reduce their trade barriers, it did involve the announced intention by APEC members to reduce tariffs and other barriers to trade on an MFN basis:

To strengthen the open multilateral trading system we decide to accelerate the implementation of our Uruguay Round commitments and to undertake work aimed at deepening and broadening the outcome of the Uruguay Round. We also commit ourselves to our continuing process of unilateral trade and investment liberalization. As evidence of our commitment to the open multilateral trading system we further agree to a standstill under which we will endeavour to refrain from using measures which would have the effect of increasing levels of protection. (APEC 1994, p. 1)

Following the declaration in 1994, and coinciding with the implementation of the WTO Uruguay Round commitments, there was a substantial fall in tariffs among APEC members (figure 6.1). In general, available information suggests that APEC

members have gone beyond their Uruguay commitments and towards the objectives announced in the Bogor Declaration. Applied tariffs are below rates bound under the Uruguay Agreement and have continued to trend down, leading to a significant difference between bound and applied rates. While showing a similar trend, there is some difference between simple and trade weighted average applied tariffs, with the latter being lower as a result of trade being concentrated in items attracting a lower duty.

Figure 6.1 **APEC members' average tariff rates<sup>a</sup>**



<sup>a</sup> Some of the variation between years in average tariff rates is caused by changes in the number of APEC countries reporting (including as a result of changes in APEC membership) and variation in tariff structures between countries. Because the trade weighted average tariff is calculated using trade data for each year as weights, some of the change in the trade weighted tariff is also due to changes in the composition of trade.

Source: Commission estimates using World Integrated Trade Solution (WITS) data.

FINDING 6.2

*APEC members have unilaterally reduced general tariffs on merchandise trade beyond their Uruguay Round commitments and have made substantial progress towards Bogor Declaration trade liberalisation goals.*



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## **Reductions in non-tariff barriers**

In addition to tariffs, BRTAs typically contain provisions relating to non-tariff barriers including sanitary and phytosanitary measures, technical barriers to trade and customs procedures. Coverage of these issues is generally similar between agreements and in some cases simply affirms existing commitments under the WTO. For example, under AANZFTA, members agree to determine the customs value of goods in accordance with the WTO Agreement on Customs Valuation.

Trade facilitation is also an important objective of regional agreements such as APEC. In support of the Bogor Declaration, in 2001, APEC members endorsed the APEC Principles on Trade Facilitation. The principles cover areas such as: transparency; consultation; simplification of rules and procedures; non-discrimination; consistency, harmonization and standardisation (including mutual recognition); modernisation; and cooperation (APEC 2001).

## **Reduction in barriers to trade in services**

Many of the barriers facing services trade are behind-the-border barriers, such as regulatory and institutional arrangements that restrict competition. As discussed in chapter 9, many of these barriers effectively lie beyond the reach of BRTAs. Nevertheless, there are a range of barriers to trade in services that countries might seek to address through BRTAs.

DFAT submitted that, in pursuing the services component of agreements, Australian negotiators have sought a number of objectives, including:

- securing the binding of existing levels of market access;
- negotiating new market access in sectors of priority commercial interest;
- most-favoured-nation (MFN) commitments to ensure we gain the benefits offered to future FTA partners of our FTA partners;
- improved transparency;
- disciplines on domestic regulation (standards, licensing, recognition of qualifications);
- commitments to treat services investors at least as well as investors in goods sectors;
- separate chapters on sectors of particular interest e.g. telecommunications, financial services, education and movement of natural persons; and
- a ratchet mechanism to ensure that future autonomous liberalisation by FTA partners is locked in. (sub. 53, p. 26)

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Reflecting this approach, recent agreements entered into by Australia typically contain some or all of a standard range of provisions such as:

- National treatment: this provision calls for foreign service providers to be afforded treatment no different to that afforded to domestic service providers.
- Market access: these provisions relate to restrictions on the operation of foreign service providers, such as restrictions on the number of foreign operators, number of employees or value of operations.
- Commercial or local presence: these provisions relate to restrictions on the ability of a foreign service provider to establish a commercial presence, or the need for foreign service providers to meet local presence requirements — such as a local office, or residency requirements — to supply a service.
- MFN treatment: under this principle, parties agree to afford to foreign service suppliers of a partner country, no less favourable treatment than that they afford to foreign service suppliers of another country.
- Ratchet mechanisms: these are used to bind any future concession that a party may make unilaterally.

In many cases, however, services chapters in BRTAs do not lead to preferential reductions to existing barriers in partner countries. As DFAT noted:

In contrast to tariff negotiations ... services negotiations in FTAs do not necessarily create new preferential market access opportunities for Australia's services exporters. The more likely FTA outcome is the binding of existing levels of openness ('standstill commitments') ... (sub. 53, p. 27)

The coverage of services within agreements is typically specified either through a positive list approach (only specified items are covered) or a negative list approach (only specified items are not covered) (box 6.1). Commitments on reductions in services barriers in Australian agreements vary, although those agreements that adopt the negative list approach contain larger overall reductions in barriers to trade in services. Key aspects of each agreement are summarised below.

- ANZCERTA (New Zealand) — the services protocol to ANZCERTA includes provisions such as national treatment, market access, rights of commercial presence and MFN treatment. It provides for free trade in services, except for those listed exceptions. The list of exemptions has been progressively reduced with the only exceptions remaining in the areas of air services, broadcasting, third party insurance, postal services and coastal shipping for Australia, and air services and coastal shipping in the case of New Zealand. The agreement adopts a negative list approach such that any new services are automatically subject to the provisions of the protocol.

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## Box 6.1 Negative and positive list approaches to services

There are two different approaches that are used in setting the coverage of service provisions within BRTAs:

- The negative list approach. Under this approach, all market access barriers and deviations from national treatment are eliminated with the exception of sectors that are scheduled as 'non-conforming exceptions'. This approach is applied in agreements such as NAFTA, AUSFTA and ANZCERTA.
- The positive list approach. Under this approach, market access and national treatment obligations only apply to scheduled services, with non-scheduled sectors remaining unaffected by the BRTA. This approach is specified in the GATS and is applied in agreements such as AANZFTA.

There are a number of advantages attributed to the negative list approach. First, its coverage is, by default, more extensive than that afforded by the positive list approach. Because everything is covered except for specifically listed exceptions, this approach may better comply with Article V of the GATS, which requires agreements to have substantial sectoral coverage. Another advantage is that it is more transparent, because it is clear what the regime of non-conforming exceptions is, whereas under the positive list approach, details of the restrictions or discriminatory rules that apply to non-scheduled sectors may not be readily available to foreign service providers.

While the positive list approach does not share these advantages, it is sometimes favoured because it provides countries with a clearer picture of the commitments being entered into and may be regarded as more manageable, given the development of a country's regulatory frameworks and institutions. Some participants voiced a preference for this approach. For instance, the Australian Council of Trade Unions submitted that:

The positive list approach is the best way to avoid unintended, unforeseen and excessive liberalisation by:

- Preventing the automatic application of liberalisation obligations to services that do not exist nor were contemplated at the time the agreement is negotiated
- Preventing inappropriate restrictions on the rights of government to regulate in the public interest
- Not limiting the regulatory options of future governments when, and after, the new services emerge
- Checking unidirectional policy movement (towards comprehensive liberalisation) because variances to the 'negative list' annex cannot be reversed to the status quo once variance to the existing arrangements are made (sub. 19, p. 4)

While the negative list approach is generally thought to be more liberalising, this may not always be the case if listed exemptions are extensive or complex. Moreover, while the sectoral coverage may be narrower under the positive list approach, there may be substantial reductions in barriers in those sectors that are covered. However, in practice, it is unlikely that agreements using a positive list approach would be more liberalising than those adopting the negative list approach. Where feasible, and provided that comprehensive information on the implications is available to the government and parliament, the Commission generally supports use of a negative list approach.

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- SAFTA (Singapore) — includes provisions on market access, national treatment and transparency. The agreement adopts the negative list approach, but there are considerably more exclusions than in the case of ANZCERTA. Outcomes on residency requirements for professionals, removal of some quantitative restrictions, such as the number of wholesale banking licences in Singapore available to Australian banks and provision of a framework for the development of mutual recognition agreements (MRAs) were the key outcomes for Australia from the agreement.
  - AUSFTA (United States) — under AUSFTA, each party must afford national treatment to the other, not impose local presence requirements and meet market access provisions. Parties are also bound to MFN treatment. The agreement adopts the negative list approach. While exclusions do not appear to be as extensive as under SAFTA, there are considerably more than in ANZCERTA. The agreement includes a framework for developing MRAs, including through the development of a Working Group on Professional Services.
  - TAFTA (Thailand) — commitments with regard to services are less comprehensive than those under the agreements already discussed. The agreement uses a positive list approach and hence only provides for specific concessions, rather than specific exemptions. The agreement called for the parties to enter into further negotiations within three years of entry into force, although this is yet to occur.
  - ACI-FTA (Chile) — as with the AUSFTA agreement, this agreement contains provisions on market access, national treatment, local presence and MFN treatment. It also uses the negative listing approach and has a ratchet mechanism to lock in future reductions in barriers to services trade.
  - AANZFTA (ASEAN and New Zealand) — this agreement uses the positive list approach, with national treatment and market access obligations applying only for sectors listed in the agreement and subject to listed conditions. There is no automatic MFN provision, but scope for consultation of more favourable treatment is extended to another party. The agreement stipulates that a review process will be commenced within three years with a view to progressively extending commitments.

#### FINDING 6.3

*Australia's BRTAs typically contain provisions addressing aspects of trade in services, but these do not necessarily lead to significant reductions to services barriers in partner countries. In a number of areas, the main impediments to effective competition by Australian services providers in partners' services markets are related to regulatory and institutional issues that lie outside the scope of BRTAs.*

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There have also been attempts to lower barriers to trade in services through forums such as APEC. One outcome of such attempts is the APEC Business Travel Card which is aimed at streamlining business migration by removing the need to individually apply for visas to participating APEC members. All APEC economies, except Russia, participate in the scheme, although Canada and the United States are only transitional members and retain additional requirements with respect to visas.

## **Reductions in investment barriers**

Traditionally, agreements on investment have been undertaken through specific bilateral investment treaties (BITs). Currently there are over 2000 BITs in operation and Australia is party to 20 of these treaties. Australia's BIT partners are all developing countries (ICSID 2010). In general, BITs focus on post-establishment issues. BRTAs typically include the same provisions as those found in BITs, covering topics such as: provisions on national treatment; MFN treatment; transfers; expropriation; and investor-state dispute settlement.

As for services, the extent of the reduction in barriers is difficult to quantify and examples of business benefiting from reductions in barriers to investment are less common than for reductions in tariff barriers on goods trade. Commitments on reductions in investment barriers are summarised below.

- ANZCERTA (New Zealand) — as yet, the agreement contains no specific provisions on investment.
- SAFTA (Singapore) — the agreement covers a range of investor protections, including provisions on national treatment, transparency, expropriation and nationalisation, compensation for losses and transfer of investors' funds. The agreement does provide for investor-state dispute settlement.
- AUSFTA (United States) — the agreement provides for national treatment, MFN treatment and a minimum standard of treatment in accordance with customary international law. The agreement does not include provision for investor-state dispute settlement. The most prominent change under the agreement is the change in Australia's screening thresholds for foreign investment from the United States.
- TAFTA (Thailand) — the agreement includes provisions on national treatment, MFN treatment, expropriation, compensation for losses and transfers. The agreement includes provision for investor-state dispute resolution. TAFTA also included some changes to foreign investment restrictions, allowing for majority Australian ownership — up to 60 per cent, or in some cases 100 per cent, up from 49.9 per cent — for various business types, including mining, and construction services.

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- ACI-FTA (Chile) — the agreement includes provisions on national treatment, MFN treatment, minimum standard of treatment in accordance with customary international law, transfers, treatment in case of strife and expropriation. The agreement also provides for investor-state dispute settlement.
  - AANZFTA (ASEAN and New Zealand) — the agreement covers post-establishment elements of investment and provides for protection of foreign investors through provisions covering: national treatment; fair and equitable treatment and full protection and security (in line with customary international law); non-discriminatory treatment for investors who suffer losses due to armed conflict, civil strife or states of emergency; free transfer of funds; and compensation for expropriation or nationalisation and transparency. The agreement also provides for investor-state dispute settlement, but not between Australia and New Zealand. The agreement also provides for a work program to attempt to include pre-establishment market access issues, such as foreign equity limits within five years of commencement.

One of the most prominent examples of foreign investment barriers being affected by BRTAs is that of the increase in the thresholds above which US investments in Australia are subject to screening by the Foreign Investment Review Board (FIRB). Under AUSFTA the threshold for investing in non-prescribed Australian businesses above which approval is required has been raised to \$1004 million for US investors, compared with \$231 million for all other foreign investors.<sup>1</sup>

The extent to which this represents a reduction in barriers to investment is not clear. On the one hand, there is a view that FIRB approvals are relatively routine and only impose a relatively minor transaction cost on foreign investors. For instance, in 2008-09, of the 5355 applications considered (of which over 90 per cent related to residential real estate), there were only three rejections (all in relation to residential real estate). For non-residential real estate approvals, only five were subject to conditions (FIRB 2010). Hence, the increase in the threshold may not represent a substantial reduction in investment barriers. On the other hand, there are arguments that the presence of FIRB creates a perception of increased sovereign risk and may deter some investment in Australia.

In its assessment of AUSFTA, the Centre for International Economics (CIE 2004a) argued, along these lines, that even where proposals were not rejected, the presence of the threshold could act as a deterrent and could contribute to an equity risk premium on investing in Australia, increasing the cost of capital. The restrictiveness index score for Australia calculated by the OECD (box 6.2), which gives a high

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<sup>1</sup> Other thresholds apply for other classes of investment.

weighting to the FIRB screening arrangements, adds to the impression that there is scope for material barrier reductions through reform of those arrangements.

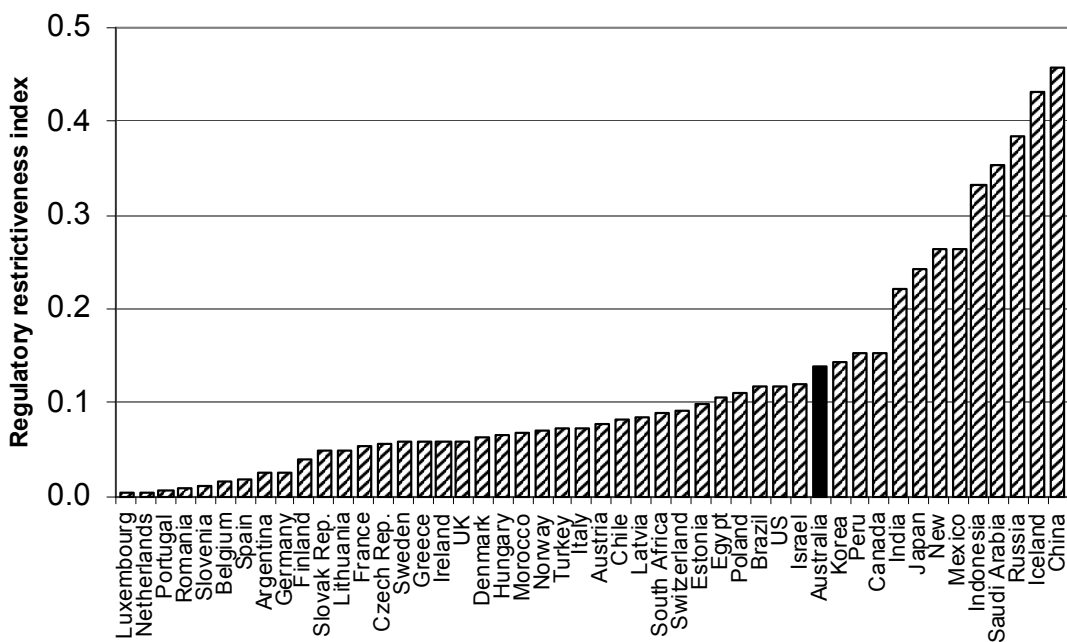
### Box 6.2 International comparison of FDI restrictions

Many of the barriers to investment are behind-the-border measures that affect the actual or perceived riskiness faced by foreign investors and are inherently difficult to quantify. One attempt to quantify and compare investment barriers is the foreign direct investment (FDI) regulatory restrictiveness index compiled by the OECD secretariat.

The index has been calculated for both OECD countries and a number of non-OECD members. The index attempts to measure the deviation from national treatment for foreign investors, where 0 represents full openness and 1 a prohibition on FDI.

While the index provides a heuristic approach by which FDI regimes can be compared on a common basis across countries, according to the compilers of the index, the approach has a number of limitations. In particular, the index has limited sectoral coverage — it is calculated at the industry level for 9 sectors and 11 sub-sectors, and then aggregated to provide a weighted national average. There are also some difficulties in ranking countries, and the authors caution that the index should not be used in isolation.

Having regard to these limitations, the index provides an indication of how Australian barriers compare with those of other countries. On an international scale, Australia's investment barriers are in the mid-range. Australia's score can, in large part (according to the measures contained in the index) be attributed to Australia's FIRB screening arrangements.



Source: Kalinova, Palerm and Thomsen (2010).

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Investment provisions in BRTAs can also address sovereign risk. Agreements that provide pre-establishment protections are one means of insulating investors against future changes to foreign investment policies in partner countries.

FINDING 6.4

*In most agreements, investment provisions in Australia's BRTAs have bound current arrangements and provided protections against future policy changes rather than reducing existing investment barriers.*

### **Limits on realising reductions in trade and investment barriers**

As noted in the above discussion, BRTAs can result in the reduction of trade and investment barriers, either preferentially or on an MFN basis, depending on the nature of the agreement and the provisions embodied in particular agreements. However, the extent to which reductions in barriers can be utilised in practice can vary. One potential source of limitation is the operation of RoO. In addition, other barriers, such as quarantine measures, limit the ability of businesses to respond to reductions in tariffs.

#### *Rules of origin*

RoO are incorporated in preferential trading agreements (PTAs) to determine whether goods entering from the partner country qualify for preferential tariff treatment. That is, they restrict the availability of preferential entry to goods deemed to originate from the partner countries. In the absence of RoO, there would be an incentive (tempered only by the costs of transshipment) to import goods from a third country into the PTA region through the member with the lowest MFN tariffs in order to take advantage of the duty concessions within the region. In seeking to limit the availability of preferences to goods originating from the partner country, one effect of RoO is that they can claw back some of the liberalising effects that would otherwise pertain from the tariff reductions contained in PTAs.

Assessing origin can be difficult because production processes for many goods are now typically fragmented and can use inputs sourced from several countries. Moreover, the nature and potential sources of inputs are continually changing, as is the technology and organisation of production itself. In these circumstances, governments are forced to rely on negotiated RoO that attempt to reconcile the goals of the particular trade agreement.



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There are three common tests for determining origin:

- The change in tariff classification (CTC) test — a good is transformed if there is a change in tariff classification, using the Harmonized Commodity Description and Coding System. The CTC method can be applied at the 8-digit, 6-digit, 4-digit or 2-digit level of classification.
- The specified process test — a good is transformed if it has undergone specified manufacturing or processing operations which confer origin of the country in which they were carried out.
- The regional value content (RVC) test — a good is transformed if a threshold percentage value of locally or regionally produced inputs is reached in the exporting country.

RoO are also often subject to considerable ‘fine print’ and special rules for particular tariff items are common.

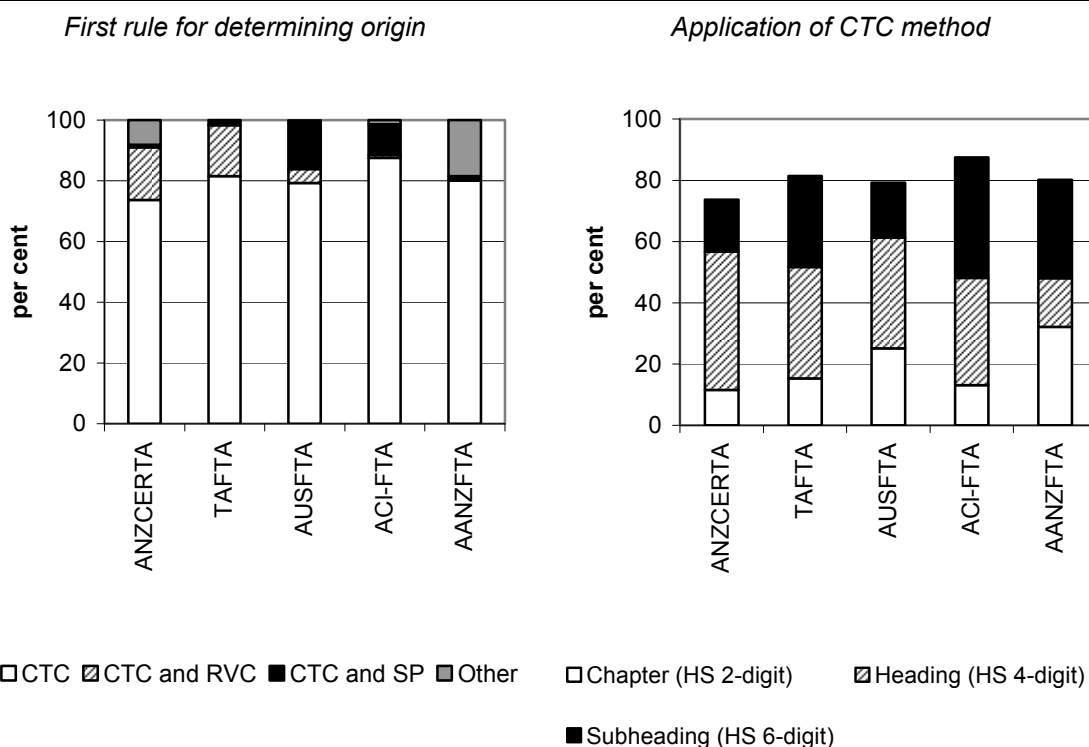
The composition of RoO vary across agreements. Analysis of some of Australia’s recent agreements demonstrates the diversity of approaches for conferring origin that businesses must consider when sourcing inputs to attain concessional access for their products (figure 6.2).

The most frequent rule of origin (in Australia’s most recent agreements) is the CTC test. However, agreements often, but not always, specify rules of origin which require application of more than one rule (for example, a combination of a CTC rule and a RVC rule) or a CTC rule with an exception, which narrows the scope of the CTC rule by carving out specific products. SAFTA (which is not included in figure 6.2) only applies a single two-tiered test of origin. The first tier requires that the product be ‘manufactured’ in the member countries. The second tier requires the application of a regional value content rule.

Examining the individual agreements shows that Australia’s agreements with the United States and Chile contain a relatively high proportion of CTC rules with specified process tests — approximately 16 and 10 per cent, respectively, of rules for items with a non-zero MFN rate in the Australian tariff. While the agreements with New Zealand and Thailand each contain less than 3 per cent of CTC rules with specified process tests, these agreements have higher proportions of CTC rules with regional value content tests — around 17 per cent, for both agreements, for items with a non-zero MFN rate in the Australian tariff.

**Figure 6.2 Summary of methods used to determine origin in recent preferential trade agreements entered into by Australia<sup>a</sup>**

Per cent of 6-digit HS items with non-zero MFN rates in the Australian tariff



<sup>a</sup> CTC refers to a change in tariff classification test. SP refers to specified process tests that require particular production methods to be used (within the territory of the PTA) to qualify for preferential entry. RVC refers to a regional value content rule. The CTC statistics for AANZFTA relate to the proportion of total rules where a CTC option is available (but not necessarily the first rule). The CTC rules for ANZCERTA came into effect in 2007, however, business can still elect to use the pre-existing RVC approach.

Source: Commission estimates.

The RoO for ANZCERTA are about to be changed again. Under changes tabled in parliament on 21 June 2010, rules will be brought closer into line with the RoO of Australia’s more recent agreements (Crean and Carr 2010). This will result in more CTC-only rules, although for some lines there will be a choice of CTC or RVC rules. Further, the option to use the original RVC approach that has been available since the agreement’s inception will be abolished from 1 January 2012. Until that time, producers can demonstrate origin either on the basis of the product specific (predominately CTC-based) rules or the old RVC rule.

The variation in composition of RoO across different agreements means that some products will be required to meet different RoO to utilise preferences across agreements.

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While RoO can be necessary to prevent transshipment where there is sufficient variation in tariffs amongst PTA members, RoO can be unnecessarily restrictive. One example of a restrictive RoO is the ‘yarn forward’ rule found in NAFTA, which requires that for clothing and textile products, all steps forward from the formation of the yarn used in the fabric be conducted within the trade agreement area.

Because of these different approaches to implementing RoO, it is likely that some BRTAs will have more trade-creating RoO regimes than others.

### *Non-tariff barriers*

As noted earlier, BRTAs often include provisions aimed at addressing non-tariff barriers to trade, such as quarantine and customs procedures. Nevertheless, the continued presence of non-tariff barriers can mean that some potential reductions in trade and investment barriers, such as tariff concessions, are not realized. In particular, in the case of agricultural products, access is subject to the establishment of quarantine protocols that are negotiated in line with the WTO Sanitary and Phytosanitary Agreement. The lack of protocols for particular products with trade agreement partners can prevent trade, despite reductions in tariff barriers, as noted by the Office of Horticultural Market Access:

Tariff and border access liberalisation under bilateral and regional agreements will, to a significant extent for horticulture, remain unrealisable unless improved phytosanitary access is also achieved. Liberalised border access is negotiated under bilateral and regional agreements whether or not phytosanitary access is in place. (sub. 39, p. 7)

Behind-the-border measures are also a common source of additional impediments that can restrict realisation of the benefits from tariff reductions. In some cases, changes to other policies can occur after agreements are signed, and can be perceived as attempts to cancel out agreement concessions. For example, the Australian Industry Group cited the case of Australian automotive exports to Thailand:

... Thailand has instituted measures relating to passenger motor vehicles which significantly reduced the potential for Australian vehicle exporters to benefit from TAFTA. Thailand’s restructuring of motor vehicle excise tax applies the new excise rates on a non-discriminatory basis to all exporters. However, the fact that the rates escalate according to engine size disadvantages Australia. (sub. 7, p. 6)

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## 6.2 Broader effects of BRTAs on trade and investment barriers

While some specific trade and investment barriers have been reduced — and trade facilitation measures introduced — under BRTAs, they can also have broader impacts on trade and investment barriers. BRTAs can potentially affect the capacity to reduce barriers multilaterally or unilaterally. Additionally, existing BRTAs can impact on the formation of future BRTAs.

### Reducing barriers multilaterally

While many of the issues addressed in BRTAs are ‘WTO-plus’ — that is, they are beyond the scope of issues considered within the multilateral WTO framework — there is a long-standing contention as to whether BRTAs, particularly those that reduce trade and investment barriers on a preferential basis, promote or inhibit global trade liberalisation. That is, are they ‘building blocks’ or ‘stumbling blocks’?

#### *Building blocks?*

The potential for agreements to act as building blocks towards further multilateral reform of trade and investment barriers will depend on the nature of particular agreements. Further, there are a multitude of ways in which these agreements can potentially influence broader efforts to achieve openness.

The first is that BRTAs can be used to pursue issues not currently within the scope of multilateral negotiations, that is, WTO-plus issues. For instance, Griswold (2003) argues that because of the difficulty in reaching a consensus amongst WTO members, BRTAs are useful for pairs or small groups of countries to reach agreements that are more ambitious in terms of tariff reductions (even if on a preferential basis), or in areas such as quarantine and technical barriers to trade, services, investment, electronic commerce, customs facilitation and labour and environmental standards. He further argues that such agreements can then provide a basis for either wider regional or multilateral negotiations. In a similar vein, DFAT, citing the WTO secretariat, suggested:

- FTAs have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally;
- in turn, some of these rules have paved the way for agreement in the WTO;
- services, intellectual property, environmental standards, investment and competition policy are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO. (sub. 53, p. 46)

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Similarly, some have argued that BRTAs could also be used by developing countries to start down the path to reform without having to realise the full adjustment costs that may arise from multilateral or unilateral reforms (Griswold 2003).

Another argument is that BRTAs can act in favour of multilateral reform though competitive pressures. Again, Griswold (2003) notes that the creation of an alternative approach may increase the impetus to reach a multilateral agreement. Similarly, Baldwin (1997, 2006) has argued that BRTAs can foster further multilateral reform because they advantage exporters, the natural proponents of free trade while simultaneously weakening key opponents of free trade, the import-competing industries. As such, he argues that such agreements can foster reform more generally. Similarly, he has argued that the multilateralisation of BRTAs can be stylised as a ‘domino theory of regionalism’. Under this approach, if an additional country decides to join a trade bloc this can, in turn, induce other non-members to join the trade bloc, as the enlargement of the PTA increases the benefits of joining. Baldwin has used this idea to explain the development of BRTAs in Europe.

### *Stumbling blocks?*

There are also several arguments that BRTAs can be stumbling blocks to further multilateral reforms. For instance, Bhagwati (2008) listed the following concerns on how preferential agreements could have a malign effect on multilateral negotiations.

- Those lobbying for specific lower barriers in a particular market could lobby for a preferential, rather than multilateral, agreement so that benefits are not diluted by ‘free riders’.
- Countries may maintain higher MFN tariffs as bargaining chips for negotiating preferential agreements.
- There is a limited number of skilled trade negotiators, so that bilateral and regional negotiations divert attention from multilateral negotiations.
- Multiple bilateral and regional agreements can exhaust trade reform goodwill, creating trade reform fatigue.

Some of these points have been included in submissions to this study. For instance, Lloyd submitted that:

The incentive effects which bilateral/regional agreements have must generally be towards weakening the incentives to multilateral liberalisation ... when bilateral/regionals do succeed in opening up significantly important overseas markets, they create an incentive to preserve the preferences gained; witness the opposition of ACP countries in the current Doha Development Round to “preference erosion”. (sub. 3, pp. 2–3)

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Another issue is that the BRTAs are subject to carve-outs for sensitive sectors, as with multilateral negotiations, as Elek submitted:

Unfortunately, there are very few comprehensive PTAs. The same products which are proving hard to liberalise in the WTO or APEC, are proving just as hard to tackle among smaller groups of economies. As Findlay et al. (2003) explain, it is harder to deal with sensitive sectors in PTAs among pairs, or small groups, of economies. Compared to multilateral negotiations, it is more difficult to overcome vested interests against reform. (sub. 44, p. 25)

Further, Ravenhill, following his examination of agreements in the Asia-Pacific region, argues that Baldwin's domino theory may have some explanatory power in the context of Europe, but that in the context of the Asia-Pacific, it does not:

The low utilization rates [among analysed agreements in the Asia-Pacific] suggest a great deal of indifference on the part of business to these agreements: they simply do not provide sufficient advantages for business to take the trouble to complete the documentation required for compliance with the rules of origin.

If the agreements do not create significant advantages for exporters in the partner economies, the corollary is that they do not generate significant disadvantages for exporting interests based in countries that are not parties to an agreement. Such a conclusion substantially undermines the logic of the "domino" effect. In reality, we see little evidence around the region of business clamouring for PTAs to "level the playing field". The character of PTAs in the region is not such, therefore, that they are likely to generate any automatic, self-sustaining momentum towards consolidation/multilateralization. (sub. 36, pp. 3–4)

Ravenhill also argues that because agreements have been tailored to accommodate domestic protectionist interests, there is substantial variation across agreements, further reducing the scope for multilateralisation.

Overall, the effects of BRTAs on multilateral trade liberalisation are unclear but, in any case, from an Australian point of view the issue is moot. The involvement or otherwise of Australia in BRTAs will have little effect on the extent of the global proliferation of bilateral and regional agreements, and hence Australian involvement in BRTAs is unlikely to have any effect on the multilateral trade liberalisation process.

#### FINDING 6.5

*While the incidence of preferential agreements has increased, their overall impact on multilateral liberalisation is not clear from available evidence.*

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## Reducing barriers unilaterally

There are a number of potential impacts of BRTAs on unilateral reductions of trade and investment barriers. On one hand, there is the building block argument that, as for the case of multilateral liberalisation, BRTAs, appropriately designed, can provide an option for countries to start down the path to reducing trade and investment barriers prior to undertaking more extensive unilateral (or multilateral) actions. On the other hand, there is a concern that BRTAs can inhibit unilateral reform as countries retain barriers to use as bargaining coin in BRTA negotiations.

In Australia's case, since the mid-1970s, there has been a strong history of liberalisation. For example, the effective rate of assistance for manufacturing has fallen significantly over the last 40 years (figure 4.3). While trade and investment barriers erected for domestic reasons are thus now relatively low, this has largely been the result of unilateral reform, rather than from multilateral reform or the entry into force of BRTAs.

As the Commission has commented previously (PC 2007), a concern with the effect of trade agreements is that the nature of negotiations, which operate on a 'give and take' basis, demand that a negotiating party be able to offer concessions to other parties in return for the concessions that they offer. This demand for negotiating 'coin' can create perverse perceptions of a country's trade barriers. There is the risk that the success of negotiations is judged with respect to the quantum of concessions offered by the other party, relative to those that are conceded. With this mindset, unilateral reforms are seen as a 'waste' of negotiating coin and support for unilateral reform is reduced.

In the context of Australia, trade barriers are already low. This lack of negotiating coin has been cited as a source of difficulty in conducting recent negotiations. For example, the Australian Fair Trade and Investment Network submitted that:

... 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 ability to influence change on a bi-lateral or regional basis is severely restricted. ... Australia is not in a position to be able to apply the required negotiating coin to obtain further benefits through the evolution of bi-lateral or regional free trade agreements. (sub. 33, p. 11)

While Australia has relatively few trade and investment barriers remaining, there is a possibility that these may be retained for the purposes of negotiating coin, hence impeding reductions in tariffs and other barriers to trade and investment, postponing economic gains that would otherwise be available to Australia.

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Agreements that confer preferences on other countries can also create external stakeholders in domestic policy settings. For instance, exporters in countries that receive preferential trade concessions have an interest in barriers not being lowered on an MFN basis to preserve the margin of preference negotiated under an agreement. By creating a third party stakeholder, reforms may be harder to enact. In fact, BRTA provisions may constrain the nature of future unilateral changes, including reductions in barriers, and may require renegotiating elements of existing agreements.

### **Flow-on effects on other bilateral and regional agreements**

Existing BRTAs can impact on the formation of later bilateral or regional trade agreements as a countervailing measure. For example, the National Farmers' Federation stated:

... the key driver of bilateral and regional trade agreements is the risk of being left behind. ... Australian farmers now face a raft of examples where, due to the vast number of bilateral and regional trade agreements now in place, they face a situation where they are or will be discriminated against due to trade agreements of which they are not a participant. (sub. 13, p. 9)

Existing agreements can also affect the scope of new agreements. For example, since negotiating an extensive agreement with the United States, subsequent negotiations by Australia have often incorporated similar provisions. While consistency in agreements has the potential to reduce the transactions costs of negotiating successive agreements and to multilateralise key elements, some argue that this will only be the case when the interests of the parties in successive negotiations are closely aligned. It would appear to be the case that, for Australia, its successive PTAs have not been entirely effective in achieving this goal. For instance, in the case of the recent AANZFTA, there are variations in commitments between members, such as the variation in tariff commitments illustrated in table 6.1, and there are variations between the commitments in AANZFTA and those negotiated bilaterally. Further, in some instances, the commitments have been greater under the earlier bilateral agreement than those agreed in the subsequent regional one.

### **Preventing backsliding**

As the Commission noted in its 2008-09 Annual Report, there has been a global trend towards more trade restricting policies in the wake of the global financial crisis (PC 2009a). There have been some increases in tariffs, although these typically have been either within bound levels, or by countries who are not WTO



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members. However, most of the increases in trade barriers have not been through increases in tariffs, but rather have been concentrated in areas where temporary measures are permitted. This includes measures such as anti-dumping duties, non-tariff barriers (for example, licensing conditions), domestic subsidies and domestic government procurement subsidies.

A potential function of BRTAs is the prevention of this ‘backsliding’ on reforms. That is, that even where agreements do not result in a reduction in existing barriers, they can be used to lock in current policies, restricting countries from increasing barriers in the future.

For instance, in the case of MFN tariffs, in many instances applied tariffs may be low, or even zero, but bound tariff levels might be quite high, and there is a risk that applied tariffs could be increased up to bound levels. Even where BRTAs do not reduce tariffs, or at least not immediately, they typically bind rates at the pre-existing applied levels (some of the commitments under AANZFTA are an example of this). In Australia’s case, its involvement in six BRTAs in which it has committed to eliminate its tariffs on imports from partner countries reduces the scope for a future Australian government to reverse the tariff reductions undertaken over the last three or so decades.

BRTAs can potentially also address some of the other forms of trade restricting measures. Some agreements, such as ANZCERTA, include restrictions on the use of anti-dumping measures. Further, provisions in agreements on non-tariff measures can reduce the scope for them to be used to restrict trade.

Participants to this study have cited a number of examples where BRTAs have locked in current arrangements, reducing uncertainty. For example, Telstra submitted that BRTAs:

... ‘lock in’ existing levels of domestic liberalisation, preventing parties from introducing more restrictive measures in the future. This increases certainty and reduces foreign investment risk. (sub. 31, p. 1)

Similarly, the Australian Dairy Industry Council noted that AUSFTA contained protections for Australian dairy exporters against potential new trade barriers:

Against this, AUSFTA does appear to provide Australian dairy exporters with some ongoing protection against the imposition of new trade barriers.

US dairy producers have, with variable degrees of commitment, advocated for quota limits to be imposed on imports of milk proteins for much of the past decade. These quotas would be additional to the restrictions already imposed on trade in skim milk powder. The USA is the world’s largest importer of milk protein concentrate, casein and caseinates. If the advocated quotas were imposed it would lead to a significant

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diversion of product into third country markets with an attendant depressing impact on world prices.

However, industry and government understand that the provisions of AUSFTA will require that Australian exports be excluded from any such action. (sub. 38, p. 6)

However, the scope of BRTAs to restrict the introduction of new trade restricting measures is still limited. Production and export subsidies typically<sup>2</sup> remain outside the scope of BRTAs and there has been an increase in these in response to the recent crisis, for example the United States has reintroduced export subsidies and increased price support for its dairy producers (PC 2009a).

In the case of government procurement, which is explicitly covered in many BRTAs, their effectiveness in stopping backsliding can be mixed. For instance, under the pretext of the global financial crisis, there have been moves to implement preferences for local suppliers by numerous countries including the United States and Australia (by the New South Wales Government). Under AUSFTA, Australian suppliers are granted a waiver from the domestic preferences under the ‘Buy American Act’. As an example, AUSFTA has countered attempts to mandate US state and federal governments purchase only US manufactured steel. However, there are still some restrictions, including sub-federal regulations that grant preferences to local suppliers (DFAT, sub. 53). Similarly, the agreement has not prevented local purchasing preferences being offered by the New South Wales Government through their ‘Local Jobs First Plan’.

Even where BRTAs are able to effectively ‘lock in’ policy changes, whether the effects are positive or negative will depend on whether the policy change agreed in the BRTA is beneficial. Lower tariffs are generally consistent with improved economic efficiency, but as discussed in chapters 10 and 14, some policy changes agreed to in Australia’s trade agreements are likely to entail net costs for Australia — extensions to patent life and copyright terms are an example. The binding of such changes through trade agreements makes what may, on further analysis, be desirable policy reversals more difficult to achieve.

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<sup>2</sup> An exception arises in the case of ANZCERTA, where the 1988 ‘Agreed Minute on Industry Assistance’ between Australia and New Zealand specified that both countries would avoid the use of measures that would have ‘adverse effects on competition between industries in the Free Trade Area’ such as export incentives, production bounties or other industry specific measures.

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## 6.3 Summing up

Australia's BRTAs have led to some clear reductions in trade and investment barriers between agreement partners.

While tariffs between partners on qualifying merchandise in PTAs have typically reduced to zero, long phase-in periods are not uncommon and there can be carve-outs of sensitive sectors. Further, some significant barriers that limit the ability to utilise reductions in barriers can remain, such as quarantine requirements and behind-the-border measures.

While it is widely recognised that there is a wide range of barriers to services trade and investment, immediate reductions in barriers under BRTAs can be limited. One exception is AUSFTA, which has resulted in much more substantive changes to investment barriers than those of the other agreements. While immediate reductions in services trade and investment barriers may be limited, agreements can create certainty by binding existing arrangements and can provide scope for future reductions in barriers, including through the use of MFN and ratchet clauses.

BRTAs can also have broader impacts on the liberalisation of trade and investment barriers, potentially influencing multilateral and unilateral reform, although these impacts are likely to vary significantly, depending on the nature of the agreements. Any effects on multilateral reform are largely a moot point for determining whether Australia should engage in BRTAs. However, given that unilateral actions have consistently been demonstrated to represent a substantial share of the gains available from trade liberalisation, such impacts are a consideration when deciding whether to pursue more BRTAs and, if so, how they should be designed (Part D).



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## 7 Impacts on business and government

As discussed in the previous chapter, Australia's bilateral and regional trade agreements have resulted in some reductions in barriers to trade and investment above those achieved by unilateral liberalisation and multilateral agreements. While reforms of that nature should help to 'open the market', the benefits obtained depend in large measure on the subsequent uptake of opportunities by business.

In seeking evidence on the impact of BRTAs on businesses, the Commission met with industry associations and sought follow-up information from their members, and drew on submissions to the study, and those made to the 2008 Mortimer review and to other reviews. Following the release of the Draft Report, the Commission received the results from surveys undertaken by the Australian Chamber of Commerce and Industry (ACCI) and the AFG Venture Group, commenting on the impact of BRTAs on some of their member and client businesses, as well as other feedback from participants. While the evidence obtained from business is quite limited and focuses mainly on the preferential style of trade agreement, when brought together, the responses collectively give some indication of the nature and extent of the impacts as perceived by business of such agreements.

The Commission also approached Australian Government agencies engaged in negotiating and administering Australia's preferential trade agreements to gain an indication of the costs to government of such agreements. While all departments involved in BRTAs were able to provide indicative estimates of costs, such information was not provided by DFAT.

This chapter first presents some broad assessments of Australia's preferential bilateral and regional agreements provided by business organisations and interest groups. It then reports on some specific impacts that businesses have suggested flow from Australia's agreements. The chapter then provides, in section 7.2, an indication of the costs to government of preferential agreements. Where possible, these costs are quantified.

### 7.1 Views of business

The Commission received a range of submissions from industry associations as well as some businesses, commenting on Australia's current policy of pursuing BRTAs.

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While these submissions have generally been made with Australia's current preferential trade agreements in mind, some submissions make broad references to the potential future benefits that may arise from entering into such agreements. Submissions generally had an exporter perspective, focusing on issues of export market growth and market access, although broader impacts have sometimes been alluded to.

### **The potential for benefits**

A number of participants made 'in-principle' comments on Australia's policy of pursuing trade liberalisation including through BRTAs and referred to the potential for bilateral and regional agreements to afford benefits to themselves, their industry or Australia more broadly. Others adopted a more cautious view of the potential benefits of preferential agreements as a trade liberalising measure.

In commenting on the potential for benefit for Australian business, Horticulture Australia Ltd stated that:

Higher value and additional [export] markets can be accessed and returns improved ... access to export markets either through liberalised tariff and other border measures, or through new and improved phytosanitary access, is important. (sub. 39, p. 11)

Similarly, the Winemakers Federation of Australia noted that it:

... is a strong and public supporter of the Australian Government's initiatives in increasing market access and facilitating trade in multilateral and bilateral forums. Bilateral free trade agreements represent an important alternative mechanism for locking in meaningful market access gains for Australian wine exports. (sub. 1, p. 6)

And the National Farmers' Federation (NFF) stated:

The NFF believes that the Australian Government should continue to pursue bilateral and regional trade agreements under strict principles. The political reality of the important role that bilateral and regional trade agreements can play is ever increasing. This comes not only from a desire to open up new markets and improve economic welfare but also derives from defensive reasons. (sub. 13, p. 8)

The Business Council of Australia suggested that existing Australian agreements had a pervasive beneficial impact on the Australian economy:

The negotiation of FTAs has also been an important means of reducing barriers to trade and investment, resulting in tangible economic benefits for both Australia and the other nations that have been a party to concluded agreements. (sub. 41, p. 1)

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Observing the ‘slow moving nature and complexity of multilateral trade negotiations’, Ford Motor Company of Australia noted that comprehensive PTAs can:

... complement the WTO system, provided it makes good sense to do so ... [for example] Where there are genuine complementarities between negotiating countries with respect to their automotive manufacturing industries and fair potential trade opportunities ... (sub. 51, pp. 1–2)

Other participants gave more qualified views on Australia’s policy of pursuing preferential agreements or argued that Australia should only sign new agreements where they benefited Australia. For example, on the one hand the Australian Industry Group submitted:

The Australian Industry Group remains a strong advocate for both multilateral trade negotiations and free trade agreements which deliver real benefits to Australian industry. Ai Group supports the principles of expanding free trade and recognises the many potential benefits for companies including the reduction of import duties, reduced barriers to investment, improved market opportunities and increased labour mobility. (sub. 7, p. 1)

On the other hand, it went on to state that:

... the existence of trade agreements in, and of, themselves is not sufficient to fully realise the potential of Australia’s export growth. Further, while acknowledging that FTAs cannot alone resolve all the barriers which confront Australian companies in the international trading environment, the potential benefits of FTAs are not being fully realised by Australian exporters. (sub. 7, p. 1)

The Department of Agriculture, Fisheries and Forestry (DAFF) suggested that not all potential agreements offered the same level of benefits to Australia:

Despite the broad opportunities for Australian agriculture through FTAs, the potential benefits of some of Australia’s current and future negotiations are varied. For example, achieving comprehensive FTAs with Japan, China, the Republic of Korea and Malaysia would mean Australian agriculture has preferential access to the majority of its most valuable export destinations. In contrast, Australia’s agricultural exports to Pacific Island Countries (excluding New Zealand) are less of a focus in the negotiations towards a Pacific Agreement on Closer Economic Relations (PACER) Plus. (sub. 6, p. 2)

The Law Council of Australia voiced reservations about preferential agreements:

... the world trading system is best served through the World Trade Organisation Agreements. Preferential trade agreements have the potential to undermine the multilateral trading system ... Australia should enter into such agreements only where it is demonstrated that the agreement will deliver substantial economic benefits to Australia within a reasonable period of time ... (sub. 47, p. 3)

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The conditional nature of general comments on the liberalising potential of BRTAs amongst industry groups suggests that the delivery of benefits through BRTAs is not straight forward. Information to support the assessment of the extent of benefits actually accruing to businesses, however, is limited to small qualitative surveys of business experience with mixed results. A paradox seems to exist between the views of a number of industry associations, which have expressed policy support for Australia's approach to pursuing preferential agreements as well as their potential for delivering benefits and the lack of widespread evidence from businesses as to the size of benefits.

### **The extent of benefits for some business**

The primary purpose of bilateral and regional trade agreements is to reduce border — and behind-the-border — barriers to trade in Australia and its trading partners. One of the more visible barrier reductions of such agreements is the regulatory and tariff changes achieved in Australia's export markets, and the potential benefits these can provide to Australian exporters.

The ABS estimates that 43 259 Australian businesses exported goods in 2008–09 (ABS 2010). Of these only a small number have responded to surveys about the impact of trade agreements or their prospects, or made a submission to this study. Although the coverage of exporters is too small to draw general conclusions, the responses together with those of industry associations provide an indication of how agreements can affect some firms.

#### *Manufacturing exports*

In its submission, the Australian Industry Group (which represents a range of Australian manufacturing industries) provided the results of a survey it undertook in 2009 of its members about member perceptions of the effectiveness of Australia's recent preferential trade agreements. Fifty responses were received. In respect of those responses:

- Of the 22 businesses that exported to the United States prior to the signing of the AUSFTA, 55 per cent (12 businesses) reported that agreement was 'moderately or highly effective', while for businesses exporting to Chile, only 17 per cent (2 businesses) reported the same (sub. 7, p. 9).
- Twenty two per cent (5 businesses) said that the AUSFTA had been 'moderately or highly effective' in providing new export opportunities, although 59 per cent reported a 'moderate or highly effective' impact in relation to accessing markets in the United States (sub. 7, p. 9).



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The American Chamber of Commerce in Australia provided a series of qualitative responses (assembled by Austrade) by 62 businesses that had made use of, or hoped to use, various provisions under the AUSFTA, SAFTA and TAFTA (sub. 58, pp. 4–28). These remarks were mainly by small and medium enterprises — although some larger firms were also included in the survey.

Around half of the firms contacted indicated that a trade agreement had provided them with an advantage over competitors as a result of tariff reductions. For some of the businesses, this allowed them to enter a market for the first time, with around 20 firms indicating that they were a new exporter to a particular market as a result of an agreement. Roughly the same number of respondents were existing exporters into a market, most of whom believed that tariff reductions would allow them to increase their export sales in the future. For example, Dickins McLeod Engineering stated that:

Exports make up 20 per cent of our revenue, but we are confident we can make that 80 per cent in [the] next two to three years. This is all due to the zero tariff that our diggers benefit [from] in the US thanks to AUSFTA. (sub. 58, p. 13)

And Alcoa Australia commented on the benefit of tariff reductions in Thailand:

Elimination of the duty on aluminium ingot has provided Alcoa with a competitive advantage in Thailand ... any duty preference we can obtain that other competitors do not is an advantage (sub. 58, p. 27).

Some merchandise exporters contacted by Austrade reported benefiting from increased access to government procurement opportunities, particularly in the United States. For example, Sealite, an exporter of navigation equipment and lights stated:

We had no effective market access before AUSFTA because American government agencies couldn't buy directly from Australian companies. But that has all changed for us, thanks to AUSFTA. The US is becoming a major market for us. (sub. 58, p. 11)

A small survey of businesses was also undertaken for the Mortimer review in order to gauge the impacts of BRTAs. Of the 31 respondents to that survey, firms reported that agreements recently entered into by Australia's had improved access to export markets, increase export volumes and pricing, and had also had a 'head turning' effect (Mortimer 2008, pp. 97–99). For example, Powerdown Australia reported that tariffs eliminated as part of TAFTA had 'improved the competitiveness of their exports, and allowed them to hold and strengthen their position in the market, despite competition from large suppliers and Thailand's domestic automotive parts sector' (Mortimer 2008, p. 99).

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However, even when Australia has negotiated lower tariffs through an agreement, other factors can intervene to reduce the benefits achieved. In its submission, Ford Motor Company indicated that while it had good prospects for increasing exports of utility vehicles to Thailand under TAFTA when the agreement was made, a restructuring of excise taxes to favour small vehicles by the Thai Government just prior to the agreement coming into force had become a substantial behind-the-border barrier:

The effect of this new domestic taxation structure was to place the Ford Territory at a significant price disadvantage, seriously eroding its potential competitiveness. Consequently, the trade opportunity originally identified has evaporated and exports of the Ford Territory to Thailand remain inconsequential. (sub. 51, p. 2)

Other participants to this study noted that BRTAs could result in increased competition in the Australian market without delivering reciprocal market opening in overseas markets, to the detriment of their operations. For example, LyondellBasell Australia observed:

Some existing FTAs (eg NZ, US, Singapore) have delivered equal duty free status for polypropylene but other agreements with Thailand and now ASEAN have delivered very unequal market access arrangements. In the case of Thailand inbound duty free access was granted in 2008 whilst Australia has only just (from 1/1/2010) been granted duty free access outbound to Thailand. In the case of the most recent ASEAN FTA, the reciprocity of market access agreed is even less equitable for LyondellBasell. Whilst all ASEAN producers have been given duty free access into Australia from 1/1/2010, once ratified, Australia's improved access to ASEAN markets varies widely country to country both in terms of duty level and timing. The best illustration of this point is for our access to the Philippines and Malaysia, both key target export markets for LyondellBasell. Malaysian tariffs will not reduce to zero until 2016 and for the Philippines will reach a minimum of 12% by 2020. ASEAN producers have duty free access to these markets which makes it virtually impossible for LyondellBasell to compete.

... Consequently the unfortunate reality is that the current FTA regimes in place mean that we have even more disadvantaged access to especially ASEAN markets than before. (sub. 16, p. 1)

While both the surveys and responses prepared by the Australian Industry Group and Austrade, as well as the responses to the earlier survey conducted for the Mortimer review, focus on Australian exporters, the Commission has not received any feedback from businesses using imported intermediate goods indicating whether BRTAs have resulted in input price reductions.

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### *Agricultural exports*

Some agricultural industry groups provided examples to the Commission of benefits they had received from Australia's BRTAs. For example, the Australian Dairy Industry Council (sub. 38, p. 9) noted that 'for dairy, there has been some competitive advantage in the reduction or removal of tariff barriers through recent FTAs'. Similarly, the Office of Horticultural Market Access submitted that:

... tariff outcomes under bilateral and regional trade agreements are nearly always superior to Most Favoured Nation (MFN) tariff rates ... (sub. 39, p. 3)

The American Chamber of Commerce in Australia's submission of Austrade remarks provided a number of examples of benefits to Australian agricultural producers (sub. 58, pp. 4–28). For example, beef, dairy, citrus and olive producers all reported that the reduction in US tariffs under AUSFTA had been beneficial to their business.

The Winemakers Federation of Australia noted that its experience with preferential trade agreements was mixed:

Under the Thailand–Australia Free Trade Agreement, ... Australian wine faces an import duty of 28 per cent from 1 January 2008 compared with the MFN rate ranging from 54.6 to 60 per cent and as a result we have secured significant market gains ...

The benefits to the Australian wine industry [from the AANZFTA] were limited and restricted to tariff concessions from Vietnam and Philippines. (sub. 1, p. 6)

It also noted that in relation to liberalisation of non-tariff barriers to trade, 'relatively little benefit has been received by the wine sector' from the BRTAs negotiated so far.

DAFF also noted that barrier reductions had been achieved across a range of agricultural products:

For example, under the Australia–Thailand FTA the tariff on table grape exports to Thailand was immediately reduced from 33 per cent to 30 per cent, and will be phased to zero by 2015. Between 2003–04 and 2008–09 there has been an over four-fold increase in table grape exports, which are now valued at over \$24 million. Australian beef exports to Thailand have also benefitted. The tariff on beef was reduced from 51 per cent to 40 per cent on commencement, and will be reduced to zero by 2020. The value of beef exports to Thailand has more than doubled between 2003–04 and 2008–09.

Under the Australia–US FTA (AUSFTA) the immediate elimination of the in-quota tariff of US4.4 cents/kilogram on beef has been worth approximately \$45 million to the Australian industry between 2005 and 2008. Under AUSFTA Australia also gained new duty free access to tariff rate quotas for a range of cheeses and cheese exports to the US have risen from \$33.9 million in 2003–04 to \$59.7 million in 2008–09. (sub. 6, p. 2)

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However, the exclusion of particular industries from agreements will also reduce the benefits that are realised. In this regard, the Australian Sugar Industry Alliance, while supporting the negotiation of comprehensive bilateral PTAs ‘that include worthwhile improvements in market access’, noted that the AUSFTA totally excluded sugar and that:

In each of the FTAs Australia is negotiating, the agricultural aspects, especially for sensitive products such as sugar, are proving to be difficult. Almost without exception our counterparts, perceiving a threat from unrestrained Australian imports, are strongly supporting the exclusion of sugar from any agreement. (sub. 15, p. 5)

Further, the National Farmers’ Federation stated that:

Australia’s completed bilateral and regional trade agreements are far from being perfect outcomes for Australian farmers and indeed the Australian economy ... Furthermore, it is clear that there is increasing pressure on the Australian Government to lower its ambition in the ability for future trade agreements. The NFF encourages the Australian Government to resist this pressure.

... In saying this, the NFF acknowledges that for many agricultural commodities, commercial opportunities for trade have improved as a result of existing bilateral and regional trade agreements. (sub. 13, p. 15)

The NFF also highlighted the myriad other factors that can influence the level and value of Australian exports (not just agricultural exports), including exchange rate conditions and other supply and demand factors.

Market conditions must still be favourable (e.g. exchange rates and demand and supply factors) in order to realise these opportunities, but the reality is that in many cases, tariffs have been lowered and quotas have been increased. (sub. 13, p. 15)

In a similar vein, DAFF commented on various impediments to achieving benefits from Australia’s agreements:

Australia’s limited agricultural productive capacity and desire to maintain exports to historic markets do not make it easy to quickly increase or divert trade in response to new agreements. ... Agricultural outcomes in FTAs can be restricted by long phasing periods, safeguards mechanisms, limited technical (quarantine) market access or the fluctuating Australian dollar which can negate tariff reductions. (sub. 6, p. 3)

### *Services exports*

Services comprise the largest component of Australia’s economy (approximately 80 per cent in 2008–09) and are a growing component of Australia’s trade. Some businesses did report that Australia’s BRTAs had improved the trade in services and investment. For example, Telstra noted that the BRTAs concluded so far:

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... have had a positive impact on Telstra's investments in foreign telecommunication services markets and that opportunities exist for the Government to improve again on these outcomes. (sub. 31, p. 2)

Further, some of the 62 firms contacted by Austrade reported actual or prospective benefits to them from Australia's recent bilateral agreements (sub. 58, pp. 4–28). For example, a number of businesses indicated that they had benefited from an ability to send employees to Singapore and Thailand for short-term projects without the need to obtain work visas. A number of education service providers also indicated that under SAFTA, establishing partnerships with Singaporean institutions had become much easier.

However, some of Australia's larger service industry groups did not report that there had been evident benefits, despite the inclusion of a services chapter in most of Australia's BRTAs (chapter 6). For example, the National Institute of Accountants (NIA) stated that:

... while we believe the nation as a whole has benefitted in a macro sense, the NIA and our members have not enjoyed the benefits of such agreements. That is, while most current trade agreements have a [Mutual Recognition Framework] to support the recognition of professionals, including accountants in the other jurisdiction, it is our understanding that no framework for the recognition of accountants has yet been established. Therefore in spite of such trade agreements with a number of countries, the NIA has not seen any improvement in the ability of our members to work in such countries. (sub. 20, p. 4)

And while the Business Council of Australia pointed to AUSFTA and its reduction to barriers for the legal sector as an example of tangible benefits (sub. 41, Attachment 1, p. 18), the Law Council of Australia suggested that the benefits of any reduction in barriers were not the result of Australia's BRTAs:

... from a services perspective and, in particular, legal services perspective, 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)

While it did not make a submission to this study, in its submission to the 2008 Mortimer review, the Australian Services Roundtable suggested that BRTAs had not achieved much with regards to liberalising services trade. In that submission, the ASR noted:

The negotiating intention has been to obtain, and to the extent possible retain, a margin of preference for existing Australian exporting firms. Australia's negotiating mandates have been too narrowly focused on achieving small wins on market access, rather than on achieving deeper microeconomic reforms. Domestic regulatory issues have been largely off the agenda as not part and parcel of bilateral preferential negotiation ... As a

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consequence, Australia's FTA agenda has been of limited actual value in improving the business environment for enhanced trade and investment in services. (ASR 2008, pp. 20–21)

In part, the lack of evidence on the extent of gains to Australia's services industries may be explained by the nature of the barriers they face. Although chapter 6 reported a reduction in barriers to services trade in Australia's BRTAs, high-level agreements between national governments may be unable to achieve substantive liberalisation in practice because, for many service industries, the actual barriers to trade are administered outside government. For example, in most Australian professional services, the requirements for registration and professional practice are not regulated by the Australian or even state governments, but by professional associations. In the absence of a commitment to reduce barriers by the relevant professional bodies, effective liberalisation of services trade may not be achievable without supporting agreements between national standard setting and professional bodies. To this end, the ASR noted that 'the most constructive outcomes have been the establishment of ongoing working groups and committees to examine [the] possibility for regulatory harmonization or mutual recognition over time' (ASR 2008, p. 21).

### **Scope for other benefits**

In some cases, a BRTA may not immediately lead to increased trade between member countries. However, the reduction in trade barriers in a particular export destination can provide business with additional export 'options' in the future, given appropriate market conditions. One example provided to the Commission is the case of beef exporters to the United States. While beef producers may not have fully taken advantage of the more liberal market access arrangements to the United States following the signing of the AUSFTA because of more lucrative markets elsewhere (partly as a result of the mad-cow disease scare), the improved access arrangements to the US market nonetheless do represent a contingent benefit for the Australian industry. Such developments can give domestic producers a greater incentive to increase their productive capacity in the knowledge that an alternative — and relatively accessible — export destination exists.

The Australian Dairy Industry Council also commented on the potential for benefits of this type:

Our experience also shows that FTAs are beginning to have a 'head turning' effect on trade, ie. customers in FTA partner markets such as Thailand now look at opportunities for supply from Australia ahead of other suppliers as they see the commercial advantage of setting up long term business relationships linked with FTA preferences. (sub. 38, p. 5)

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Additionally, reduction in trade barriers can heighten competition between countries importing Australian products. For example, the Australian Dairy Industry Council observed:

Expanding market opportunities through FTAs can also have positive indirect effects on commercial trade. For example, the creation of new profitable market outlets in countries such as the US can have the effect of firming up Australia's negotiating position with buyers in third country markets. The increased flexibility in Australia's trading options can lead third country buyers to seek to lock in improved long term relationships with Australian suppliers. (sub. 38, p. 5)

By raising the profile of bilateral and/or regional relationships, trade agreements may also have a 'head turning' effect that is favourable to business. Such potential effects were noted by Universities Australia in relation to the Australia–Chile agreement:

The recently signed FTA includes a chapter on cooperation. This chapter along with the government to government Memorandum of Understanding on Education, were a key impetus in the Chilean government seeking the involvement of Universities Australia as their partner in the delivery of the Chilean Bicentennial Fund Scholarship program in Australia. Therefore while the FTA does not specifically cover education, its signing has raised the profile of Australia in Chile and provided the basis for substantial increased activity in Chile by Australian universities. (sub. 17, p. 3)

Similarly, Austrade indicated that there was a clear increase in client activity in the 12 months preceding — and 18 months following — the signing of the Singapore, United States and Thailand trade agreements (sub. 52, p. 10). This suggests that the promotional activity surrounding trade agreements can stimulate some businesses to consider export markets they might not otherwise have focussed on.

## **Responses to the Draft Report**

In its Draft Report, the Commission noted that the evidence of significant benefits to business was limited and sought further information from participants on the specific impacts that BRTAs have on businesses. While some further information was subsequently received, the response tends to reinforce the picture in the draft.

Some industry associations provided additional examples of the negotiated tariff reductions in Australia's agreements (for example, Australian Pork Ltd, sub. DR91, p. 7) and/or pointed to the ex ante economic modelling of the benefits that could flow from future agreements (for example, Cattle Council of Australia, sub. DR97, p. 4). The Australian Chamber of Commerce, Singapore, gave the examples of an Australian law firm, a brewery and universities being enabled to increase exports to Singapore following the introduction of SAFTA (sub. DR71, p.1–2).

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In relation to trade in services, the International Legal Services Advisory Committee (ILSAC) (sub. DR96, p. 4) noted that:

... Although it is difficult to quantify the economic impact of FTAs, ILSAC considers that bilateral and regional trade agreements have produced positive results for Australia's legal services sector ...

In discussing the type of foreign market access sought by the Australian legal profession, ILSAC noted that:

... the level and scope of access for lawyers engaged in providing business/commercial legal services internationally does not have to extend to becoming a local lawyer with all the rights that full admission provides a local lawyer. The country-specific nature of legal practice means it is unrealistic to expect total recognition of a right to practise. Corporations, financial institutions and other clients involved in cross-border commercial transactions seek legal *advisory* services covering the laws of jurisdictions in which the transaction spans. Australia, therefore, does not seek market access for Australian lawyers to provide *consumer* legal services, such as those relating to family law, wills and personal injury. Nor is a right to represent clients in local courts sought, other than a right to appear in international commercial arbitration. (sub. DR96, p. 5)

In practice, it appears to the Commission that for services liberalisation, the existence of a BRTA (either concluded or in negotiation) can be a catalyst for negotiations between sub-government service regulators (including professional services bodies). ILSAC noted that

In some cases FTAs have directly resulted in the alleviation of trade restrictions. In others they have provided a platform for the legal profession to address barriers through direct negotiation with overseas counterparts ... (sub. DR96, p. 6).

Along these lines, the Law Council of Australia indicated that during recent government-to-government negotiations for an Australia-India BRTA, it was engaged in 'parallel dealings with the Bar Council of India which ultimately resulted in the signing of a Memorandum of Understanding intending to promote further integration and cooperation between each body ...' (sub. 84, p. 6). This view supports the previous statements about services liberalisation made by the Australian Services Roundtable.

However, apart from the example of legal professional services, the Commission received no further specific evidence of benefits of BRTAs for services industries.

A more systematic attempt to provide data to the Commission on the benefits of BRTAs to business was undertaken by the Australian Chamber of Commerce and Industry, in response to a request by the Commission for information about member experiences (sub. DR87). In conjunction with its state chambers of commerce, bilateral business councils, the Australian Federation of Employers and Industries



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and the Australian Institute of Export, ACCI surveyed its exporting member businesses, asking about their experiences with Australia's current BRTAs, including the extent of benefits they had received. The details of this survey were sent to over 5000 of ACCI's member businesses, with approximately 600 accessing the survey questions on-line. However, only 51 respondents completed the survey (sub. DR87, Attachment 1, p. 1). In summarising the results of this work, ACCI noted in part that:

- A small number of companies believed that FTAs had positively benefited their business, although some companies remained sceptical and did not view BRTAs as of benefit to their business;
- At best, based on the survey results, FTAs are marginally beneficial to business. This is consistent with previous findings, the findings of other business surveys, and the views of a number of industry groups;
- The promotion of the bilateral FTA market as a good place to do business is benefiting business when choosing markets, but actual market access issues do not appear to have significantly improved. (sub. DR87, p. 8)

In particular, ACCI noted that businesses reported that 'practical trade facilitation measures' such as the Export Market Development Grant scheme were more beneficial to business than BRTAs (sub. DR87, p. 9).

The Commission also approached other business groups during the study for information about member experiences, but did not receive any further information.

On a different tack, the AFG Venture Group submitted the results of surveys of business views on the economic environment in various Asian countries<sup>1</sup>, which among other things allowed the tracking of respondents' BRTA expectations against eventual outcomes, particularly in relation to the Thai agreement. The surveys found that, in 2004, 70 per cent of respondents had a 'positive' perception of TAFTA, but by 2008 only 20 per cent responded positively, while 'negative' perceptions of the agreement grew over the same period, and increased substantially between 2008 and 2009 (sub. DR69, Attachment 1, p. 9). AFG noted that while '... expectations had been very high but the achievement had been low', most of the respondents supported the further development of FTAs (AFG Venture Group, sub. DR69, Attachment 1, pp. 8–9). (The surveys did not seek views on whether respondents would value other government support more highly than BRTAs).

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<sup>1</sup> AFG received responses from approximately 150 businesses to its 2004 and 2009 surveys, and responses from around 400 responses its 2008 survey.

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There are a number of possible reasons for this limited evidence of substantial benefits for business from Australia's BRTAs. In its response to the draft report, the Office of Horticultural Market Access stated:

Horticulture is not surprised at the finding of limited evidence of 'substantial commercial benefits' from BRTAs ... a range of other factors can impact on trade generation and outcomes. The attribution of trade outcomes to any particular influencing factor is quite often difficult where many factors are impacting.' (sub. DR70, p. 2)

Along the same lines, some also suggested that the main benefits are retention of existing market share, rather than new gains. For instance, the National Farmers' Federation noted that commercial benefits would include avoiding the 'commercial losses that accrue when we do not have a trade agreement with a country that has a preferential arrangement with a competitor to Australia' (sub. DR85, pp. 5–6). In essence, it was suggested that some businesses might not be conscious of the benefits they are receiving from BRTAs, or that the benefits they are receiving are resulting from BRTAs.

Another explanation for the limited evidence of business benefits from Australia's BRTAs is that, in practice, the benefits have generally been modest, either because the agreements have not effectively addressed many commercially significant barriers to trade and/or because businesses have been unable to avail themselves to the opportunities afforded. Along these lines, ACCI stated:

While BRTAs have had little effect in the eyes of business, the BRTA agenda remains stronger than other trade facilitations efforts. ... One reason for the over-emphasis on BRTAs in trade facilitation is that they are process driven, and can subsequently lack strategic direction and coordination across the spectrum of trade related issues. (sub. DR87, pp. 8–9)

## **Compliance and administration costs**

In addition to commenting on commercial benefits that BRTAs afforded businesses and industries, some participants also commented on the costs of accessing preferential access under a BRTA, including the costs of complying with rules of origin (RoO). There are also other costs that can result from changes in regulatory and administrative requirements following the signing of a trade agreement.

RoO have the potential to impose costs on businesses in two ways:

- For businesses producing a good for export that does not meet the prevailing rule of origin, there may be an incentive to shift to a less efficient input mix or production process in order to meet the rule (and thus qualify for the preferential tariff).

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- There is a range of administrative ‘paperwork burdens’ associated with meeting and proving compliance with rules of origin. These can include recording and keeping the necessary documentation proving that goods meet a particular rule, purchasing certificates of origin from certifying authorities and submitting those along with exports, and a variety of other administrative activities.

In its submission, DFAT suggested that:

As the number of FTAs has increased criticism has been levelled at ROO for the creation of a so called ‘spaghetti bowl’ or ‘noodle bowl’ effect. Critics argue that the multiplicity of rules in each agreement and between FTAs creates confusion and is an unnecessary barrier for business. These claims overstate the impact that multiple ROO have on an exporter. While an FTA may have a number of different ROO, an exporter only needs to be concerned with those ROO which relate to their products. In Australia’s case there is a great deal of harmonisation among our ROO. Most changes to Australia’s ROO in more recent FTAs – for example, in the PSRs [Product Specific Rules] in ANZCERTA, ACI-FTA and AANZFTA, compared to the PSRs used in AUSFTA and TAFTA – are due to refinement of the rules to remove unnecessary restrictions and to provide exporters with greater choice. Further, a regional FTA like AANZFTA – which links 12 countries – should significantly simplify trade arrangements for exporters. (sub. 53, pp. 18–19)

On the other hand, a number of participants suggested that additional costs to business and complexity arose with rules of origin. The Commission heard from participants that RoO are a cost on exporting businesses, and in particular that the ‘spaghetti bowl’ of overlapping BRTAs (and associated RoO) can increase these costs (box 7.1). In its response to the draft report, DFAT noted that a regional work program had just begun that was seeking to improve the ‘complementarity and coherence’ or RoO in the region. (sub. DR 98, p. 9).

### *Other costs*

There can be both increases and reductions in other administrative and compliance costs for business that arise in the context of BRTAs, including costs associated with the administrative procedures of overseas customs services or product standards and certification/accreditation requirements, or getting professional qualifications recognised by overseas registration boards. Similarly, there can be costs associated with meeting the process requirements for government procurement, and there are usually significant costs associated with addressing the criteria governing foreign investment, such as meeting minimum threshold requirements for domestic ownership.

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### Box 7.1 Participant views on rules of origin

A number of participants provided their views on the costs and complexity that arise in the context of rules of origin:

For merchandise trade, costs may vary depending on the nature of the rules of origin. In this regard, Australian businesses are largely satisfied and accustomed to provisions which prescribe 50 per cent Free-on-Board value to qualify for Australian origin. Although CTC provisions can assist some products to qualify more easily, Australia does not have an exporter community which is highly educated in Harmonised System codes or customs practices to a great degree. (Australian Industry Group, sub. 7, p. 7)

As the AMWU has noted in previous submissions, supporters of the benefits of bilateral and regional FTAs tend to underestimate or ignore some of the costs of such agreements. One additional layer of cost is found in the complexity of rules of origin required for preferential tariff treatment under such agreements...The bottom line appears to be that AUSFTA rules of origin using the CTC method have adopted certain administrative procedures that are less of a day-to-day burden for importers and exporters — until such an import or export company is audited, when that light-touch day-to-day record-keeping is often lacking in sufficient detail. The costs of differing and complex rules of origin are born by exporters, consumers and ultimately the entire world economy via the problems they create for a single properly functioning multilateral trading system. (sub. 21, p. 5)

... [I]t is critical that consistency of the respective rules be applied across all agreements as it makes both compliance easier and ensures that border authorities are familiar with the rules that apply for each country. (Employers and Manufacturers' Association (Northern), sub. 11, p. 6)

The most notorious example of the increased cost to business is the differences between preferential trade agreements in, and the complexity of, rules of origin. Rules of origin have the potential to render compliance costs which exceed the preferential duty rate to be obtained through compliance. (Law Council of Australia, sub. 47, p. 4)

Several submissions noted that BRTAs can lower such regulatory compliance and administrative costs. For example, at a broad level, the Australian Industry Group observed that:

The benefits of FTAs go beyond market access and tariff reductions. Comprehensive FTA provisions can also open opportunities by addressing behind the border non-tariff barriers. This can include reducing business costs and time from streamlined regulatory arrangements such as licensing and reciprocal recognition of standards and qualifications. (sub. 7, p. 4)

However, while the potential for gain exists, the mere complexity of BRTAs can make it difficult for businesses — particularly small businesses — to fully appreciate the requirements placed upon them. On this point, the Australian Industry Group added:

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FTAs are extremely detailed, complex agreements which are crafted in legalistic language. This can make FTAs particularly difficult for SMEs to decipher and comprehend exactly ‘what’s in it for them’ and how to best capitalise on provisions delivered by the specific agreements. (sub. 7, p. 11)

The Commission did not receive feedback from businesses that BRTAs had reduced their compliance or administrative costs.

While BRTAs can be perceived by business to achieve reductions in border and behind-the-border barriers, businesses also recognised that compliance and administrative costs, as well as the general complexity of such agreements, can hamper their ability to benefit from these lowered barriers.

#### FINDING 7.1

*Businesses have provided little evidence that Australia’s BRTAs have generated significant commercial benefits. The information available suggests that, where benefits accrue, they are mainly to existing exporters.*

## 7.2 Impacts on government

BRTAs also result in costs (and potentially benefits) for the Australian Government and, to a lesser extent, state and territory governments. In any assessment of the economic impacts of BRTAs, the costs incurred by governments (and ultimately borne by taxpayers) is relevant.

As the lead government responsible for negotiating and implementing trade agreements, the Australian Government incurs a range of administrative costs as part of its policy to pursue bilateral and regional trade agreements. Some of these costs are not attributable to particular agreements — for example, developing trade and related policies that have a whole-of-government focus. However, other costs, such as those incurred in the preparation of feasibility studies, and negotiation rounds, do relate to specific agreements.

This section examines some of these costs, as well as the projected reductions in tariff revenue as a result of Australia’s agreements.

### Pre-negotiation costs for BRTAs

Government departments undertake a range of activities prior to the commencement of formal negotiations for a BRTA. Traditionally undertaken or coordinated by DFAT, these activities can include bilateral meetings with government officials

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from the potential partner country to familiarise themselves with the trading and regulatory systems of the respective countries. At this time, DFAT will often consult with Australian businesses and industry bodies, as well as other government departments, in order to establish the ‘offensive’ and ‘defensive’ interests of various parties; that is, to garner views on the outcomes that should be sought and the concessions that could be made.

Prior to the negotiation of each of Australia’s six current BRTAs, as well as with each of the agreements currently under negotiation, the Australian Government has prepared a feasibility study to publically explore the potential costs and benefits to Australia. These feasibility studies give interested parties a chance to provide a public submission on their views of the proposed agreement. They often contain economic modelling of the potential impacts of an agreement. However, the extent to which these feasibility studies have accurately estimated the actual impacts of agreements — and perhaps conditioned unrealistic community expectations regarding the potential benefits of particular agreements — is not without debate. Some of the issues surrounding feasibility studies are considered further in Part D.

## **Negotiation costs**

While the familiarisation, research and consultation activities mentioned above consume some government resources, potentially the most significant cost incurred in the development of a BRTA, as in multilateral agreements, is that of negotiating an outcome with the countries concerned. Negotiation costs stem from the direct financial costs of staff time and other financial outlays, such as travel expenses, for DFAT and other participating government departments.

Negotiations generally involve ‘rounds’ of meetings between officials of Australia and the partner countries, with the hosting of such meetings usually alternating between countries. A range of factors makes comparing the negotiation costs of various agreements difficult (such as whether the countries involved share a language, and the distance between the countries), although as a general rule the more protracted the negotiations the more expensive they are to negotiate. While some of Australia’s previous negotiations have concluded reasonably quickly (for example, negotiations for AUSFTA commenced in 2003, and were concluded after five rounds in 2004), others have taken considerably longer. For instance, negotiations for the proposed Australia–China agreement commenced in 2005 and are yet to be concluded (DFAT 2010b), with nine negotiating rounds having been held in Beijing and six in Australia. This also applies, of course, to multilateral negotiations under the WTO, with the Doha Round now into its ninth year,

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compared to seven-and-a-half years in total for the earlier Uruguay Round, and just three years for the Kennedy Round (table 4.1).

In considering the overall costs and benefits of BRTAs, the costs of negotiating such agreements need to be taken into account. While in some cases they will be small relative to other costs and benefits, they may be important where agreements are more finely balanced (for example, with smaller countries). An understanding of the costs of negotiations is also important for determining to the extent to which disciplines should be placed on the negotiation process to bring about swifter outcomes. The provision of estimates of the costs incurred in developing the various trade agreements Australia is or has been pursuing could also help to establish the appropriateness of the balance of government resources directed towards the different negotiations, as well as between trade negotiations and other government priorities.

Some data on the cost of negotiations are available in recent budget papers. In the 2006–07 budget, supplementation funding of \$6 million was provided to a range of departments to participate in the negotiations for an Australia–China BRTA (Australian Government 2006). And in the 2007–08 budget, \$12.7 million was provided over two years for departments to continue those negotiations. In addition, \$4.3 million was allocated to agencies over two years to facilitate negotiation of an Australia–Japan BRTA. However, these appropriations represent only additional resources for government departments, above their baseline funding, and as such do not provide a complete picture of the costs of those negotiations. Such figures should also be seen in the broader context and the Commission does not have information on the cost of Australia’s participation in APEC over the years or the Australian Government’s cumulative investment in the Doha Round negotiations.

As part of this study, the Commission requested estimates from each Australian Government department of the cost of its participation in such negotiations. The Commission requested an estimate of each department’s total expenditure in 2008–09 on BRTA negotiation activities, including, where relevant, estimates of the costs incurred in travel.

For departments with a more material involvement in BRTA negotiations, the Commission also requested information on the total costs incurred in negotiating the:

- Australia–US Free Trade Agreement;
- Thailand–Australia Free Trade Agreement;
- ASEAN–Australia–New Zealand Free Trade Agreement; and
- Australia–China Free Trade Agreement (to date).

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For comparison purposes, the Commission also requested estimates from each department of their costs incurred to date in negotiating the WTO Doha Round.

The Commission received estimates from each government department involved except for DFAT, which said in response that it is not in a position to estimate the costs of its activities in this way (box 7.2).

The Commission finds it difficult to reconcile DFAT's position regarding the estimation of expenditure on one of its key functions. The preparation of cost estimates of this nature, including the allocation of joint costs among different functions, with caveats where necessary, is a common practice in the public sector. Several of the estimates provided by other departments involved attributing staff time and costs between BRTAs and other activities. DFAT's counterpart in New Zealand has previously published an estimate of the costs it incurs in undertaking BRTA negotiations.<sup>2</sup> DFAT itself has previously been able to provide some estimates of this nature, covering for instance the number of staff deployed in the Office of Trade Negotiations and the estimated proportion of their time spent on WTO activities vis-à-vis BRTA negotiations.<sup>3</sup> The negotiation of BRTAs also entails a number of discrete costs — for example, those associated with the travel and staff time entailed in sending Australian delegations abroad for particular rounds of negotiations — that should be readily amenable to quantification.

While the available information indicates that the Australian Government's total expenditure on BRTAs is not insignificant, DFAT's response leaves the Commission unable to provide a comprehensive estimate of the cost incurred by the Australian Government in negotiating BRTAs (or, indeed, its participation in APEC or the Doha Round under the WTO).

In regards to future policy settings, in the Commission's view there would be benefits to public policy in DFAT compiling estimates of the costs of negotiating different trade agreements, and making them public.

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<sup>2</sup> The New Zealand Ministry of Foreign Affairs and Trade has published indicative figures of the costs it incurred in negotiating an agreement with China. It estimated that the costs were in the order of \$760,000 for travel, accommodation and other direct costs in 2007/08, the final year of the negotiations when there was less travel than in the previous two years. (MFAT 2009, p. 47) The Department went on to conclude that this resulted in an estimated annual cost of approximately NZ\$1 million for the China negotiations, which ran from late 2004 to late 2007.

<sup>3</sup> House of Representatives Questions in Writing, Office of Trade Negotiations: Staffing, Question 2151, 31 October 2005.



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### Box 7.2 DFAT response to request for negotiation cost estimates

In response to the Commission's request for estimates of its negotiation costs, DFAT stated:

As part of its study into bilateral and regional free trade agreements the Productivity Commission requested that the Department of Foreign Affairs and Trade (DFAT) provide the following estimated costs:

- the cost to DFAT for the single financial year, 2008–09, associated with the negotiation of all (then current and prospective) bilateral and regional trade agreements;
- the total cost to DFAT associated with the negotiation of Australia's FTAs with the United States, Thailand and ASEAN (and New Zealand), and the costs to DFAT to date associated with the negotiation of Australia's FTA with China; and
- the costs to DFAT to date from participation in Doha Round negotiations.

Further, the Productivity Commission asked for an explanation that could be used in its report if DFAT was unable to provide the requested information.

DFAT is not in a position to provide estimations of these costs as trade work is completely integrated into the work of the department and cannot be separately identified and costed.

Trade work is integral to the Department's efforts to advance the interests of Australia and Australians internationally. Trade is mainstreamed and fully integrated across the Department's operations. Most DFAT work units in Canberra and almost all overseas posts and State Office staff, pursue an integrated foreign and trade policy agenda for the government.

Given this policy integration DFAT is unable to provide accurate estimates on the number of staff and their related costs (salaries, equipment, travel, etc) who work on trade policy, let alone the more specific break-down requested by the Productivity Commission.

We appreciate that some other departments and portfolio agencies may be able to provide their estimated costs data to the Commission due to the readily identifiable number of staff from those departments and agencies working on trade issues. Unlike DFAT, these staff work on trade issues as they intersect with their respective policy responsibilities. This is not the case with DFAT, where trade is core work for the Department.

DFAT was resourced for trade policy priorities within its baseline funding. It has received virtually no additional supplementation for trade initiatives. The Department's trade priorities within its budget from year to year reflect priorities as determined by Ministers. We do not consider these decisions relevant to the terms of reference set for this study.

Should the Productivity Commission wish it may use the above information provided by DFAT in its report.

*Source:* DFAT (pers. comm., 17 June 2010).

While allocating the cost of resources that may be jointly employed in multiple functions may not be straightforward, as noted, it is common practice for Australian Government agencies to make such allocations in preparing estimates or reports, caveated as appropriate, of particular expenditures.

In its response to the draft report, DFAT noted that it currently provides information in its annual reports, including:

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... against the output of ‘protection and advocacy of Australia’s international interests through the provision of policy advice to ministers and overseas diplomatic activity.’ Work to advance Australia’s interests through bilateral, regional and multilateral trade negotiations is a major and integral part of that policy output. (sub. DR98, p. 19)

However, this output covers a very broad range of activities with a total expenditure in 2008–09 of more than \$350 million (DFAT 2009a, p. 262). While the Commission recognises the importance of aggregate reporting, it also considers that DFAT should supplement these data, as required, with estimates of the costs it incurs in relation to various trade negotiation activities.

#### FINDING 7.2

*Although a major departmental activity, no useful information is publicly available regarding the staffing and other costs incurred by the Department of Foreign Affairs and Trade in pursuing BRTAs.*

#### RECOMMENDATION 7

*To enhance transparency and public accountability and enable better decision making regarding the negotiation of trade agreements, the Department of Foreign Affairs and Trade should publish estimates of the expenditure incurred in negotiating bilateral and regional trade agreements and multilateral trade agreements. These should include estimates for the costs of negotiating recent agreements.*

### **Implementation, administration and compliance activities**

Once an agreement has been concluded and signed by both countries, after a period of time, the agreement is said to ‘enter into force’. A number of activities, both of a one-off and ongoing nature, are associated with a new agreement becoming active.

#### *Implementation and administration*

In the first instance, legislative changes may be required to enact certain provisions of an agreement — for example, the changes to Australia’s intellectual property laws as a result of AUSFTA. Such legislative changes entail the costs of drafting legislation as well as the costs of the associated parliamentary processes.

Additionally, BRTAs that include preferential tariffs result in work for the Australian Customs and Border Protection Service (ACBPS, hereafter Customs). Customs advised the Commission that such changes relate to regulations concerning RoOs, as well as new or amended customs duty rates. Amendments may also be required to facilitate changes to customs procedures. In addition, Customs has an educative

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role, and delivers information sessions for stakeholders and customised online information for each agreement. Implementation costs can stretch over a number of years, particularly where tariff changes are phased in over an extended period.

Customs provided the Commission with estimates of its implementation costs for a number of Australia's current BRTAs. Over a four-year period, implementation costs for the AUSFTA have been approximately \$970 000 (or \$242 500 per year), while the costs for implementing AANZFTA over a one-year period were approximately \$180 000.

The agency also has a small though ongoing role in advising government departments on the customs aspects of BRTAs, as well as importers and exporters on tariff classifications, origin and valuations under various BRTAs. In 2008–09, Customs spent approximately \$35 000 on all BRTA administration activities.

### *Compliance activities*

Customs also has a role in ensuring that those importers claiming a tariff preference (including under a BRTA) are entitled to do so. It conducts Pre-Clearance Intervention inspections to ensure that any claimed preferences are valid and substantiated by the required paperwork, including verification of the country of origin. Post-Transaction Verification operates on a risk-based assessment of importers, and involves audits to ensure that where preferences have been claimed, they are valid.

In 2008–09, Customs incurred costs of approximately \$1 million in compliance-related activities across all of Australia's BRTAs.

## **Changes to government procurement procedures**

Australia's preferential trade agreements have impacted on the policies and practices of government procurement in Australia. Early trade agreements with New Zealand and Singapore had minimal impact on Australian Government procurement as they substantially focused on non-discrimination with minimal restrictions on the conduct of procurement. By comparison, the AUSFTA introduced new procedural rules and requirements that aim to safeguard non-discrimination and transparency. Generally, these new obligations have been implemented at the Australian Government level through the incorporation of Mandatory Procurement Procedures (MPPs) within the Commonwealth Procurement Guidelines. Consistent with the AUSFTA, the MPPs now contain provisions that:

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- create a strong presumption that open tenders will be used for most types of procurement valued above specified thresholds. Currently, these thresholds are \$9 million for construction services and \$80 000 for general goods and services in the case of agencies covered by the *Financial Management and Accountability Act 1997* (FMA). Relevant bodies covered by the *Commonwealth Authorities and Companies Act 1997* have a higher threshold for general goods and services of \$400 000;<sup>4</sup>
  - specify minimum time limits for suppliers to submit tenders (with a general minimum standard of 25 days, reducible to 10 days in specific circumstances);
  - limit use of procurement as a policy tool for achieving non-procurement objectives through limiting rules for requirements that may be placed on suppliers for participation and a general ban on use of offsets;
  - require technical specifications to be expressed in performance or functional terms and based on international standards where appropriate;
  - require additional reporting for contract award notices; and
  - require a common deadline for all suppliers (no late tenders).

Following the negotiation of the AUSFTA, new Commonwealth Procurement Guidelines (CPGs) were introduced, and while ‘guidelines’ suggest flexibility, in fact many of them are mandatory. As the Department of Finance and Deregulation (then the Department of Finance and Administration) notes:

The *Commonwealth Procurement Guidelines* (CPGs) incorporate all relevant international obligations into the procurement policy framework. Complying with the CPGs will ensure agencies meet all obligations under any free trade agreements to date. These obligations must be complied with in order to approve proposed procurement under FMA regulation. (DoFA 2006)

The revised procurement arrangements are generally seen as improving transparency and contestability. One by-product of the improved reporting and transparency arrangements is that the share of government contracts going to small and medium sized enterprises has increased in recent years.

At the same time, implementation of the AUSFTA increased the administrative costs and complexity of tenders (departments and agencies were provided ongoing supplementation amounting to approximately \$85 million over five years) and reduced flexibility for agencies in conducting procurement. The Commission expects that compliance costs for businesses have also increased. The Government

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<sup>4</sup> These amounts represent a rounding down of the actual thresholds that apply in the AUSFTA which are subject to biennial adjustment. By rounding down the thresholds, the Commonwealth has avoided a need to adjust domestic policy on each review of the AUSFTA thresholds.

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publicly anticipated at the time that Australia would benefit from the procurement changes because of the improved market access in the United States procurement market and accepted these costs as part of achieving an agreement (Vaile 2004). To date, the Commission has received little information on the extent of benefits from Australian businesses accessing the United States procurement market.

One area of concern raised by some interests is the \$80 000 threshold at which Australian Government procurement of goods and services are subject to the requirements of the AUSFTA. While agencies vary in how well they have streamlined open tender processes, there are some concerns that the low threshold requires a disproportionate cost for purchases of relatively low value. On the other hand, the low threshold may be a contributor to the greater apparent success of SMEs in Commonwealth procurement and it provides access for Australian exporters to sections of United States government procurement market where individual procurement transactions tend to be of low value.

The Commission has been advised that the net benefit of the \$80 000 threshold is being investigated by DFAT. The renegotiation of provisions takes time, and would place Australia back into a ‘give and take’ setting.

### **Changes in tariff revenue**

In addition to the cost of negotiating and implementing BRTAs, the granting of tariff concessions reduces the amount of tariff revenue collected by the Australian government. The Australian Treasury estimates the foregone tariff revenue cost from each proposed BRTA, based on the existing level and pattern of trade between Australia and the proposed partner country — that is, it does not account for any shifts in import sources away from non-members in favours of partners to the agreement. DFAT publishes the estimated revenue cost as part of its National Interest Analysis, which is tabled in the Australian Parliament after an agreement is signed, but prior to it entering into force. The resultant estimates (table 7.1) are generally small relative to the total government revenue obtained from the customs duty levied on imports, which was \$6.3 billion in 2008–09 (ACBPS 2009, p. 150). Of course, to the extent that lower tariffs are passed on to Australians in the form of lower prices, then reductions in tariff revenue represent a transfer to consumers rather than a net cost.

**Table 7.1 Estimated tariff revenue changes**

	SAFTA	AUSFTA	TAFTA	ACI-FTA	AANZFTA
Forward estimate period	2003–07	2004–08	2004–08	2008–12	2009–13
Estimated tariff revenue reduction (\$m)	130	1 460	335	13.9– 15.4	971

Source: DFAT (2003; 2004a; 2004b; 2008a; 2009b).

### 7.3 Summing up

Most business groups the Commission has heard from in this study made ‘in-principle’ comments on Australia’s policy of pursuing BRTAs. The Commission has also received evidence from a comparatively small number of businesses that have benefited from BRTAs, but the impacts are not uniform across sectors.

Where the Commission has received information about the effects on a business, manufacturing and agricultural industries appear to have benefited the most, consistent with the findings in chapter 6 that where Australia’s BRTAs have reduced barriers, it has related to the traditional merchandise trade sectors of manufacturing and agriculture.

Limited information has been received to suggest that businesses within service industries, which comprise the much larger component of Australia’s economy, have benefited to date from Australia’s agreements. In fact, as suggested by the ASR, the benefits for service industries might come predominantly through future negotiations in working groups and other forums. And for those businesses who do make use of these agreements, they do so with some compliance costs.

Further, the evidence available to the Commission about the cost to Australian Government departments of negotiating and implementing BRTAs, although incomplete, suggests that such costs are material. Ideally, in the future, the costs of negotiating agreements incurred by DFAT should be transparent to the government and the public.

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## 8 Trade and economic effects: merchandise

Reduced barriers to merchandise trade as a result of bilateral and regional trade agreements (BRTAs) can influence both trade and economic welfare. These impacts are assessed in this chapter. (The potential impacts from reductions in barriers to services trade and investment are assessed in chapter 9.)

The Commission's approach has been to make use of a number of models, along with information provided by participants, to illustrate the likely direction of change in, and relative magnitude of, trade flows and income brought about by different types of BRTAs.

The analysis presented takes an 'economywide' view of the potential impact of BRTAs and, in doing so, takes into account changes in the make-up of an economy and the use of resources by different sectors brought about as businesses respond to changes in the commercial environment. In the first instance, the analysis presented examines the 'outer-envelope' of the potential impacts of particular agreement scenarios — assuming full take-up of trade liberalisation benefits. However, where evidence exists, sensitivity tests are used to examine the implications of a partial achievement of liberalisation potential.

The chapter also considers empirical studies of the potential impact BRTA formation on merchandise trade and reports new analysis undertaken by the Commission in this area. The trade agreements analysed include those of which Australia is a member or which are likely to influence Australia's trade flows.

Section 8.1 highlights some key impacts that economic theory suggests may result from reductions in trade barriers, with section 8.2 detailing the potential impacts on Australia from BRTAs derived from economic models. Section 8.3 assesses the broader economic impacts that arise from changes brought about by BRTAs. Section 8.4 examines observed changes in trade flows to analyse what has actually occurred after the establishment of BRTAs, and identifies why the observed gains may not be the same as those identified in *ex ante* assessments.

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## 8.1 Some theory on impacts

There are a number of means by which liberalising trade policies can enhance economic performance. International trade allows countries to specialise production in their areas of relative strength and to exchange this output for products which other countries can supply at lower cost than can be produced at home. Trade enables access to a wider range of goods and services. Access to foreign products can help diffuse innovations and new production technologies. Liberal trade policies increase effective market size, which allows producers to reap ‘economies of scale’ and, thus, lower production costs. And openness to trade can provide a source of additional competition to keep local prices in check and domestic producers ‘on their toes’.

Importantly, the benefits of trade liberalisation come from enhanced opportunities to import as well as from enhanced opportunities for export. For example, as well as the direct benefits for consumers and commercial users of imports, the enhanced competition from imports can promote more efficient production by local firms.

It should also be recognised that, while increased export opportunities provide direct benefits for exporting industries, the net gains to a country are typically a small share of the gross gains for those sectors. This is because expansion in one sector typically draws resources away from other activities in the economy over the longer term. This process can be seen at present in relation to the mining sector, where increased export revenue has put upward pressure on the Australian dollar and the expansion in mining has seen labour drawn from other industries. Such pressures are likely to reduce the competitiveness and, over the longer term, the output of other sectors in the economy, although the net effect of such resource allocation changes would normally be expected to be positive.

The removal of trade barriers on a most-favoured-nation (MFN) basis is widely understood to afford the greatest potential benefit from international trade liberalisation, in part because prices for goods from all possible sources are likely to be lower than otherwise, increasing competitive pressures within markets.

Most BRTAs also remove tariff and other restrictions, but do so on a preferential basis for partners of an agreement, typically through the lowering of bilateral tariffs but also through the relaxation of tariff quotas (particularly in the area of agricultural products). In this situation, depending on the level of competition in the partner market, and the degree of product differentiation in those goods provided preferential access, it is possible that the price effects will be limited (Chang and Winters 2002; Feenstra 1989). Such limited price ‘pass through’ is more likely to



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occur if a bilateral preferential agreement is negotiated with a small country in which there is limited competition in the supply of differentiated products.

Reductions in tariff and other border measures on a preferential basis can both increase trade between agreement members and decrease trade between members and non-members. These impacts are termed:

- *trade creation* — where, due to reduced barriers, there is an increase in trade flows between countries; and
- *trade diversion* — where, due to reduced barriers being offered to one (or more) countries, goods imported from lower-cost suppliers are displaced by goods from higher-cost suppliers due to these suppliers facing lower barriers.

To the extent that trade diversion occurs, it erodes the potential gains from measures seeking to increase trade openness within economies. Whether or not trade diversion is likely to be significant depends on the difference between preferential and non-preferential tariffs. On this, some participants have suggested the scope for diversion is now fairly limited. For Australia, Lloyd has argued that the issue of trade diversion is not significant on the basis of Australia's relatively low tariff barriers, and an increasing number of agreements:

The first reason is that, as the number of trading preferential partners with whom we trade in the market for any importable expands as the number of agreements expands, the possibilities of (harmful or beneficial) trade diversion diminish. ...

The second reason is Australia's MFN barriers to imports of goods has been greatly reduced in the last twenty years ... (sub. 3, p. 3)

Despite the decline in tariff rates globally, it is the case that there remain pockets of high tariff barriers across countries and in certain product categories, and that some potential agreement partners to Australia still maintain relatively high average tariffs. Trade diversion therefore potentially remains a practical issue.

Ultimately, it is an empirical matter whether trade agreements act to increase trade overall and whether such increases flow on to raise incomes of partner countries. These issues are examined in the following sections with respect to merchandise trade, which accounts for nearly half of the transactions between countries (chapter 3).

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## 8.2 What other studies have said

Two broad approaches have been used to assess the likely impact of BRTAs on both trade flows and economic wellbeing:

- the *ex ante* approach, which attempts to estimate the likely changes in trade flows holding all else constant (done through computable general equilibrium modelling); and
- the *ex post* approach, which attempts to estimate from observed changes in trade flows the impact of trade agreements after controlling for changes in other variables that also influence trade flows (done through econometric analysis).

The first of these is associated with modelling of the potential gains that may be achieved through entering into an agreement. This approach has been used in Australia in undertaking ‘feasibility’ studies of prospective agreements. The second of these is used to shed light on the impact of previously formed agreements, most typically on merchandise trade flows. This section presents some results from applications of each approach.

### Feasibility studies of Australian agreements

In order to assess the potential gains from BRTAs, the Australian Government has commissioned a number quantitative modelling analyses. Typically, these analyses, which form a key part of feasibility studies, have estimated an outer envelope of possible gains for Australia and the partner country from bilateral tariff and other concessions through the reduction of tariffs to zero between partners (box 8.1). These studies have in all cases estimated positive trade and economic benefits from a prospective agreement.

Feasibility studies usually work under the assumption that (preferential) tariff levels will be reduced to zero and that the application of rules of origin have no impact on industry costs or production technology. Such an approach can be useful to determine the direction of change, and rank potential trade policy alternatives (such as unilateral non-preferential reform and bilateral concessions). However, for the assessment of individual agreements, a more realistic set of assumptions is needed if the aim is to provide an estimate of the gains from that agreement upon implementation. This point was stressed by a number of participants during meetings and submissions and is explored further in chapter 15.

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### Box 8.1 Feasibility studies of Australian agreements

A number of studies have been conducted of prospective BRTAs to estimate the impacts of reduced barriers to trade in merchandise, services and investment. A number of the feasibility studies have assumed full reduction of tariffs on trade between partners to zero with no carve outs or phasing in periods, with similar assumptions made for the liberalisation of services trade and investment. However, some feasibility studies have sought to model more gradual trade and investment liberalisation and carve outs. A number of the studies also assume that investment and productivity are responsive to changes in competitiveness.

The studies available within this framework include:

- ASEAN–Australia–New Zealand Free Trade Area — for which it was estimated that an agreement could raise the GDP of Australia and New Zealand by around 0.3 per cent 10 years after the agreement came into effect (CIE 2000).
- Australia–China Free Trade Agreement — for which it was estimated that an agreement could increase Australia’s GDP by around 0.7 per cent 10 years after implementation (CIE 2008b).
- Australia–US Free Trade Agreement — for which it was estimated that an agreement could increase Australia’s GDP by 0.4 per cent 10 years after the agreement came into effect (CIE 2001,2004a).
- Thailand–Australia Free Trade Agreement — for which it was estimated that an agreement could increase Australia’s GDP by 0.021 per cent 10 years out if the agreement went ahead (CIE 2004b).
- Australia–Japan Free Trade Agreement — for which it was estimated that an agreement could increase Australia’s GDP by 0.6 per cent higher 10 years out than it would otherwise be (CIE 2005a).
- Australia–India Free Trade Agreement — for which it was estimated that an agreement could increase Australia’s GDP by 0.2 per cent after 10 years than it would otherwise be (CIE 2008a).
- Australia–Indonesia trade and investment agreement — for which it was estimated that an agreement could increase Australia’s GDP by around 0.02 per cent 10 years after the agreement came into effect (CIE 2009).

With regard to the Australia–US agreement, a second modelling study of aspects of the actual agreement text was undertaken within a similar framework to the initial feasibility studies. This study estimated an increase in Australia’s GDP of 0.7 per cent 10 years after the agreement came into effect, approximately two thirds of which was due to the projected effects of investment liberalisation (CIE 2004a). The CIE, which has conducted the vast majority of the Australian Government’s feasibility studies, noted in its submission that it has undertaken significant model development over the last decade and that the results between feasibility studies were not directly comparable.

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### *Other studies of Australian agreements*

Along with those feasibility studies commissioned by the Australia Government, a number of other studies have examined both existing and prospective BRTAs. These studies vary from those used in feasibility studies and enforce stricter assumptions about the likelihood of barrier reductions.

In relation to the AUSFTA, two studies came up with differing levels of benefits by relaxing the assumptions of the feasibility studies. Due to rules of origin, the impact of intellectual property provisions and also a different approach to investment liberalisation, Dee (2004) found that the gains from the AUSFTA were likely to be significantly lower — 0.01 per cent increase in real GDP. Looking only at goods and services, ACIL (2003) concluded that instead of positive benefits, Australia could be worse off as a result of the agreement, due to carve outs, implementation periods and other factors.

Following the publication of the ACIL (2003) study, the CIE published an analysis of the differences between the ACIL results and those in the CIE study. Among other things, the CIE identified ACIL's use of a less elastic demand for Australian exports as a primary driver of the difference between the results (CIE 2004c).

Such differences in the results highlight that *ex ante* studies are highly dependant on the specification of the model and the appropriateness of the underpinning scenarios. This strengthens the case for the oversight of modelling by independent parties and the inclusion of clear and transparent methodology and sensitivity analysis (chapter 15).

### **Ex post analyses**

The literature contains numerous international *ex post* analyses of the impacts on trade flows brought about from BRTAs. While not seeking to be comprehensive, this section details some results obtained by such studies.

Heydon and Woolcock (2009) detail a number of findings from existing literature on the impact of BRTAs on trade flows. They conclude that:

Overall, the findings of *ex post* studies produce a fairly mixed picture, indicating that some PTAs boosted intra-bloc trade significantly, whereas others did not. There is some evidence that external trade is smaller than it might otherwise have been in at least some of the groupings, but the picture is mixed enough so that it is not possible to conclude whether trade diversion has been a major problem. In addition, these studies do not reach any definitive answer on the welfare impact of PTAs. Most of the studies using growth regressions suggest that PTAs have had little impact on economic growth. (p. 221)

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A similar picture was painted by Adams et al. (2003), De Rosa (2007) and Cipollina and Salvatici (2010), who all found that the majority of previous studies estimated almost all BRTAs to be net trade creating rather than net trade diverting.

The World Bank (2005) suggested the trade creating results of BRTAs were less clear. In an analysis of 17 research studies covering over 250 estimates of the overall impact of agreements on intra- and extra-member trade, the authors found that ‘... although agreements typically have a positive impact on intra-regional trade, their overall impact is uncertain. Actual experience reinforces that there can be no presumption that a preferential trade agreement will be trade creating’ (p. 63).

This suggests that, as was seen in the *ex ante* results presented previously, characteristics of BRTAs themselves and the composition of the membership have confounding influences on potential outcomes. This has been highlighted by a number of studies which have found differing impacts from open regional to closed regional to preferential bilateral agreements (see for example Bayoumi and Eichengreen 1995; Carrere 2002; Coulibaly 2007, 2009; Sova and Sova 2009; Armstrong and Drysdale 2010).

Despite the uncertain outcomes from a broad examination of BRTAs, some common elements have emerged. Where tariff levels are high, and concessions significant, the potential for trade diversion is also greatest. When agreements are struck between existing trading partners, trade creation is more likely (Heydon and Woolcock 2009). Further, a number of studies have consistently suggested that agreements based on open regionalism, such as ASEAN, are more likely to be trade creating for flows between members, and between members and non-members, compared to more preferential agreements such as NAFTA (Carrere 2002; Romalis 2005; Coulibaly 2007, 2009; Armstrong and Drysdale 2010).

### **8.3 Modelling the potential impact of reductions in barriers to merchandise trade**

For Australia, the type, detail and significance of the trading partner(s) of the BRTAs to which it is a member differ significantly. For example, Australia has a number of preferential bilateral trade agreements between economies of different sizes — such as Chile, Singapore, Thailand, and the United States. It is also a member of two regional agreements, APEC and AANZFTA. Australia also has a long standing bilateral agreement with New Zealand — the ANZCERTA — which aims at economic integration between the two economies.

Given the diversity of Australia’s agreements and divergent views about likely effects, the approach adopted by the Commission is to explore specific

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characteristics of BRTAs through different trade scenarios in order to assess the potential effects from pursuing different forms of agreements. To do so, the Commission has modelled a range of scenarios involving reductions in tariffs using the *Global Trade and Analysis Project* (GTAP) model (box 8.2).

**Box 8.2 Using GTAP to model changes in trade flows**

The GTAP model is a computable general equilibrium (CGE) model which has been used extensively in assessing the impact of changes in trade policy settings on global trade, production and consumption. The GTAP model is a multi-region and multi-sectoral general equilibrium model.

For the purposes of the scenarios, the GTAP database has been aggregated into 20 individual national economies and 5 multi-country, regional groups. There are 57 industry sectors in each country group. Policy changes or ‘shocks’ are applied to the model, with effects determined by the linkages between industries and regions, assumptions about the economic behaviour of firms and households, and resource constraints.

In the modelling, a longer-term perspective is adopted. Under this approach, it is assumed that labour is mobile between industries in each region and that it responds to changes in the relative competitiveness of industries. Aggregate labour endowments are assumed fixed (that is, not affected, in the longer run, by tariff policy changes).

It is also assumed that capital stocks by region and industry adjust in order to equilibrate rates of return on capital to their long-run steady-state value. Under this assumption, reductions in tariffs would be expected to initially raise average returns to capital, ultimately leading to a higher capital stock and output potential. Capital would also be reallocated between regional industries according to the relative loss in the competitiveness of those activities.

The results represent the potential changes given the assumptions of the model and estimated tariff barriers prevailing in 2004, the latest year for which comprehensive model data are available. Full details of the Commission’s GTAP modelling are provided in a supplement to the report.

The following tariff concession scenarios were examined:

- the reduction of bilateral tariffs to zero between Australia and a small country to illustrate the potential effects on trade flows when two relatively small economies conclude a bilateral preferential trade agreement (scenario T1);
- the reduction of bilateral tariffs to zero between Australia and a large country to illustrate the potential effects on trade flows when a relatively small economy concludes a preferential trade agreement with a relatively large economy (scenario T2);

- 
- the reduction of tariffs on a most favoured nation basis between APEC members to illustrate the potential impact of coordinated unilateral non-discriminatory trade liberalisation between regional economies (scenario T4); and
  - the establishment of a series of bilateral preferential trade agreements between Australia's four major North Asian and North American trading partners, with and without Australia's involvement, to illustrate the potential effects of being 'left behind' or abstaining from involvement in future agreements (scenarios R1 to R4).

The results illustrate the relative magnitude of the potential impacts, all else unchanged. They are 'outer-envelope' effects — that is, they are based on the best-case scenario. To the extent that items are excluded, or tariff levels are not brought down to zero, the estimated changes in trade flows and production would not be as large. Further, the estimates abstract from other 'real world' aspects of agreements such as rules of origin (RoO) and trade facilitation measures that may be included in an agreement, along with impacts driven by businesses such as the limited uptake of preferences and limited price pass through of tariff concessions. The Commission modelled these aspects separately in order to consider their potential effects as well.

The results from the modelling contrast 'what is' in the modelling base year to 'what would be' at some future point in time, after the full effects of the reduced barriers have worked through the economy.<sup>1</sup> The modelling also adopts a longer-run perspective, in which the initial impacts of policies have time to work through the economy and for fixed capital to adjust. In relation to such an economic environment for modelling impacts, the Rural Industries Research and Development Corporation noted:

... when gauging the impact of the trade liberalisation, it is perhaps more prudent to focus on the impacts over the longer term (say 10–15 years post liberalisation). That way the policy changes will have worked their way through the economy and any changes to GDP (etc) will have settled down to a constant deviation from baseline. (sub. 10, p. 23)

It should be noted that the modelling of merchandise does not account for other influences which may also impact on trade flows and incomes from observed changes in trade policy (box 8.3). However, the Commission considers that the simulation results provide sufficiently meaningful insights into the potential impacts of trade liberalisation scenarios to be of use for the purposes of this study.

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<sup>1</sup> In order to gain a longer-term perspective of the potential impacts of reduced barriers on trade flows, the model was calibrated so that capital stocks adjust in order to equilibrate the expected and actual rates of return on capital.

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### Box 8.3 **Other factors that could influence merchandise trade**

While GTAP modelling of the impact of reduced tariff barriers is useful in ascertaining the key implications from BRTAs, it does not capture all impacts. In particular, the modelling does not assess the implications of reduced services barriers and those related to investment (these issues are dealt with in chapter 9) and the flow-on these may have to the flows of goods trade. Thus, results centre on the likely impact of reduced barriers on goods trade and, as such, only yield a partial view of the likely impacts of BRTAs more generally.

Other aspects, such as changes in the trading relationship between member and non-member firms, are also not captured. For example, the Australian Dairy Industry Council suggested that simply the existence of preferential access to one market had the potential to impact prices received from third party buyers:

... the creation of new profitable market outlets in countries such as the US can have the effect of firming up Australia's negotiating position with buyers in third country markets. The increased flexibility in Australia's trading options can lead third country buyers to seek to lock in improved long term relationships with Australian suppliers. (sub. 38, p. 5)

Thus, even if new preferential market access provisions were not accessed by Australian producers, they may be of use to shore up buyers in existing markets. The existence of alternative markets also reduced the supply risk for Australian Dairy producers who are heavily exposed to international markets. These and other possible indirect benefits, such as resultant investments that embody improved technology that drive increased productivity within the sector, are not captured in the modelling.

Further, the results obtained depend on the assumptions of the model and the assumptions that underpin the scenarios examined. The GTAP model, as with other CGE models, is based on a stylised representation of the world economy and allows the impact of particular issues to be examined in isolation. Thus, many of the real world confounding factors are not included, such as non-fixed employment, non-uniform factor prices and impediments to capital mobility, so observed outcomes can vary significantly from the projections generated by this type of stylised model.

#### *Preferential bilateral tariff reductions*

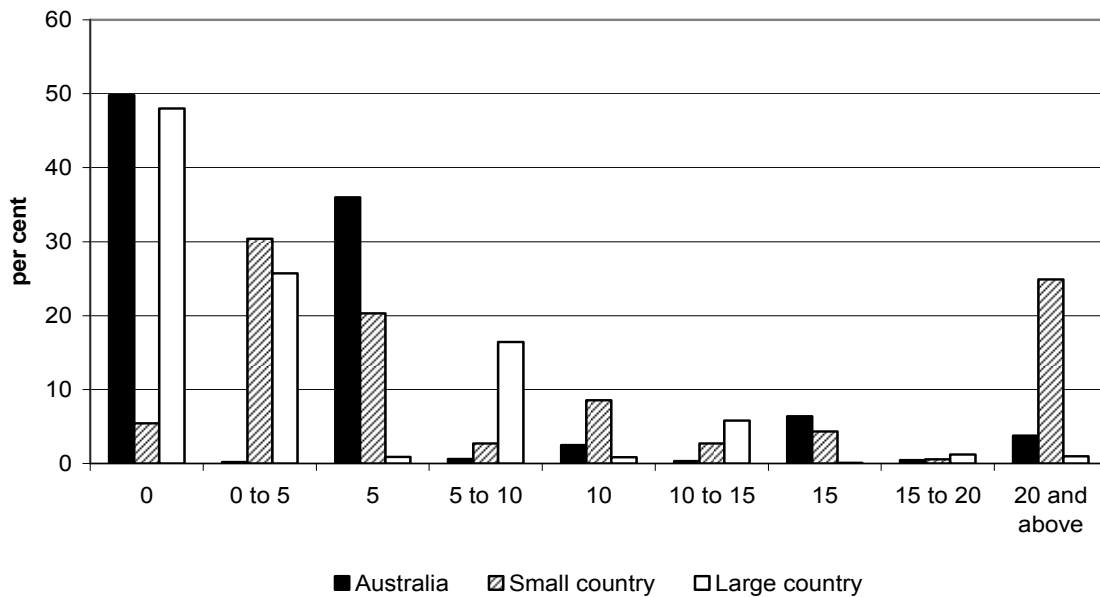
The estimated weighted average tariff rates in 2004 for Australia, the small and large country were 3, 8 and 2 per cent respectively.<sup>2</sup> The distribution of items attracting low and high tariff levels also differed (figure 8.1), with the small country having a greater proportion of high (above 15 per cent) tariff items. Because of the differences in economic size of the respective economies and differences in tariff regimes, the potential impact of bilateral tariff reductions on the respective economies also differs.

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<sup>2</sup> The simulations were based on tariff and economic data for a selected small country, and a selected large country with which Australia has a significant trading relationship. The Commission emphasises that the tariff profiles and results are illustrative only.



Figure 8.1 Illustrative MFN tariff rate profiles, 2004<sup>a</sup>



<sup>a</sup> Ad valorem tariffs only at the HS6 subheading level.

Source: Based on WTO Tariff Analysis Online Database.

With a bilateral elimination of tariffs between Australia and the small country examined, bilateral trade flows are projected to increase significantly (table 8.1). However, as economic activity is redirected towards bilateral trade between partners, trade with other countries is projected to decline. As the small country is a relatively small trading partner to Australia, and as trade flows to other markets are

Table 8.1 Estimated potential impacts on trade flows — Australia and a small country (scenario T1)<sup>a</sup>

Per cent

	<i>Australia</i>				<i>Small country</i>			
	<i>Change in bilateral trade flows</i>		<i>Change in total trade flows</i>		<i>Change in bilateral trade flows</i>		<i>Change in total trade flows</i>	
	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>
Australia	–	–	–	–	31.14	38.20	0.88	0.96
Partner	38.20	31.14	0.89	0.74	–	–	–	–
Rest of world	-0.49	-0.34	-0.47	-0.33	-0.01	-0.09	-0.01	-0.08
<b>Total</b>	<b>–</b>	<b>–</b>	<b>0.42</b>	<b>0.41</b>	<b>–</b>	<b>–</b>	<b>0.87</b>	<b>0.88</b>

<sup>a</sup> Simulations do not represent an analysis of existing agreements.

Source: Commission estimates.

reduced, Australia's overall export and import trade flows are only projected to increase around 0.4 per cent with the full implementation of the tariff reductions. For Australia, this represents an increase in trade value of nearly US\$1 billion.

As would be expected, the direction of possible effects of bilateral tariff reductions between Australia and the large country examined is similar but, as this country is assumed to be a larger trading partner and larger economy relative to Australia, the estimated impact on trade flows for Australia are commensurately larger (table 8.2). Again, some trade diversion occurs, and is projected to offset close to half the increase in bilateral imports and exports. Also, despite the large country representing a larger trading partner, the overall increase in Australia's trade flows is small, at around 1 per cent for both imports and exports.

**Table 8.2 Estimated potential impacts on trade flows — Australia and a large country (scenario T2)<sup>a</sup>**  
Per cent

	<i>Australia</i>				<i>Large country</i>			
	<i>Change in bilateral trade flows</i>		<i>Change in total trade flows</i>		<i>Change in bilateral trade flows</i>		<i>Change in total trade flows</i>	
	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>	<i>Imports</i>	<i>Exports</i>
Australia	–	–	–	–	14.50	18.06	0.26	0.13
Partner	18.06	14.50	1.97	2.33	–	–	–	–
Rest of world	-1.14	-1.44	-0.99	-1.17	-0.08	-0.01	0.26	-0.01
<b>Total</b>	<b>–</b>	<b>–</b>	<b>0.97</b>	<b>1.16</b>	<b>–</b>	<b>–</b>	<b>0.18</b>	<b>0.12</b>

<sup>a</sup> Simulations do not represent an analysis of existing agreements.

Source: Commission estimates.

A number of preferential bilateral agreements go beyond simply reducing barriers such as tariffs and quotas and also seek to facilitate trade in goods and to lower the costs of trading, including through streamlined customs procedures, mutual recognition of commercial documentation and mutual recognition of product standards. Such lower costs, regardless of where they occur in the supply and distribution chain, is analogous to a reduction in the costs of transportation of merchandise trade.

In some instances, it is possible that preferential tariff reductions may have a limited impact on trade flows as producers seek to pocket some of the concession rather than reduce their prices. At the extreme, a preferential bilateral trade agreement could in theory yield no direct increase in trade flows were buyers in the importing country to experience no reduction in the prices of goods from the partner country.

However, this is unlikely to be the case as in most markets there would be sufficient competition to see some pass through in practice.

Modelling the impacts of improved trade facilitation, either preferentially or non-preferentially, as part of the large country agreement, suggests that these measures have the potential to further increase trade flows. The results suggest that the greater the non-preferential nature of the change, the larger the impact (table 8.3). For example, for Australia, non-preferential improvements lead to a 4-times greater increase in exports, and a 3-times greater increase in import flows.

**Table 8.3 Stylised effects from enhanced trade facilitation**  
Per cent

	<i>Australia</i>		<i>World</i>
	<i>Exports</i>	<i>Imports</i>	<i>Total trade</i>
Australia–large country preferential basis (F1)	0.168	0.200	0.003
Australia–large country non-preferential basis (F2)	0.709	0.576	0.181

<sup>a</sup> Simulations do not represent an analysis of existing agreements.

Source: Commission estimates.

Other important determinants of the potential impacts of agreements are the extent to which preferences are taken up by businesses and areas excluded from tariff concessions. The decision to make use of a preference is a commercial one — that is, businesses balance the gains against the costs of trading under an agreement (such as RoO). For Australian agreements, evidence suggests that preference utilisation rates by firms exporting to Australia for agreements which offer an average margin of preference in the order of 5 per cent are relatively significant, ranging from 70 to 100 per cent. However, where the margin of preference is lower, such as the Singapore–Australia Free Trade Agreement (weighted average tariffs fell by 0.8 per cent — see chapter 6), uptake of preferences is considerably lower and in the order of 30 per cent (Pomfret, Kaufmann and Findlay 2010).

In the Australia–large country simulation, sensitivity testing involving limited preference uptake and exclusions result in tariff reductions in the order of 50 to 60 per cent of those possible, which scales back the projected changes in total exports and imports by around 25 per cent. (Simulation S5, table 8.6)

### *Non-preferential tariff reduction by a large regional trading group*

Apart from preferential bilateral agreements, other possibilities for trade liberalisation are possible from BRTAs. Examples exist of agreements where liberalisation commitments (non-binding or otherwise) are made on a non-preferential basis, such as the APEC agreement and the United States–Vietnam trade agreement. For this study, the APEC countries were used to examine the potential impacts from non-preferential trade liberalisation by a large regional group. APEC countries, collectively, account for approximately 40 per cent of world trade. Average tariff levels across APEC members were 3 per cent in the reference year for this study (2004), with significant variation in tariff levels between members. The non-preferential liberalisation of all tariff barriers by this group of countries therefore has the potential to significantly impact on Australian and world trade flows (table 8.4).

**Table 8.4 Estimated changes in bilateral trade flows from hypothetical APEC unilateral liberalisation of tariffs to zero (scenario T4)<sup>a</sup>**

\$US million (2004)

<i>Imports → Exports ↓</i>	<i>Australia</i>	<i>China</i>	<i>Japan</i>	<i>USA</i>	<i>European Union</i>	<i>Rest of APEC</i>	<i>Rest of world</i>	<i>Total</i>
Australia	–	2 074	2 829	640	-203	1 236	-183	<b>6 363</b>
China	3 238	–	11 428	24 454	13 913	37 888	6 053	<b>96 974</b>
Japan	913	17 352	–	139	-1 200	24 713	-891	<b>41 026</b>
USA	1 269	8 608	8 864	–	17 116	-4 914	8 817	<b>39 760</b>
European Union	506	12 922	2 856	-5 107	–	27 479	-9 712	<b>28 944</b>
Rest of APEC	1 612	48 135	13 148	19 447	18 749	–	14 372	<b>115 463</b>
Rest of world	-142	3 121	78	-1 627	-4 661	9 823	–	<b>6 592</b>
<b>Total</b>	<b>7 396</b>	<b>92 212</b>	<b>39 203</b>	<b>37 946</b>	<b>43 714</b>	<b>96 225</b>	<b>18 456</b>	<b>335 152</b>

<sup>a</sup> Simulations do not represent an analysis of existing agreements.

Source: Commission estimates.

Under this scenario, the increase in world trade is projected to be over 3 per cent. Given the non-preferential nature of barrier reductions, no trade diversion is projected. Nevertheless, some reallocation of trade between countries is likely as changes in relative competitiveness is projected to occur. For Australia, overall trade flows (imports and exports) are projected to increase by over US\$13.8 billion, representing a 6 per cent increase in total trade.

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### *Non-involvement in preferential bilateral agreements of major trading partners*

While the above approaches have focussed on the possible positive effects of reducing barriers to trade, BRTAs can also be used as a defensive trade strategy — that is, they can be used to maintain existing levels of market access. Thus, Australia's non-involvement in BRTAs is likely to be costly as Australia would suffer from trade diversionary impacts of other BRTAs.

A study by the CIE (2007) examined the potential effects for Australian agriculture exports if the United States were to ratify a preferential trade agreement with Korea and Australia was not able to negotiate a similar agreement with Korea. The study projected a 12.4 per cent drop in Australian agricultural food exports to Korea and a decrease of 0.06 per cent in Australian agricultural output overall in 2030, compared with Australian agricultural output that would be projected if the Korea–United States trade agreement was not ratified. However, the CIE study did not provide the projected economywide effects of the modelled scenarios, noting that:

... whether or not such an FTA is in Australia's national interest would mean appraising all other economic effects on other sectors as well as other considerations such as the impact on Australia's multilateral trading stance. (p. 21)

In order to help assess the economywide impacts of Australia's non-involvement in BRTAs, the Commission has modelled tariff reduction scenarios where Australia was either involved with preferential agreements with four major North Asian and North American trading partners (with and without them also having bilateral agreements with each other), and Australia's non-involvement. The modelling explored the 'outer-envelope' effects of these scenarios.

Overall, the modelling suggests that Australia's involvement in a series of agreements with four of its major partners has the potential to increase Australia's trade. Reflecting the intensity of Australia's trade with the region and overlap with APEC membership, the projected increases are of a similar order to those under the APEC scenario presented above.

The potential impact on Australia of being excluded, or choosing not to engage, depends on the actions taken unilaterally. Without any reform (trade or otherwise), the modelling suggests that Australian trade could fall as a result of our major trading partners establishing preferential bilateral agreements amongst themselves. That is, the trade diversionary impacts of these agreements could have a negative impact on Australia.

These results, however, are sensitive to the ability of Australia's export sector to take advantage of the potential new opportunities created by the economic growth of our trading partners. If supply constraints are relaxed on some of our major

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export items, then potential trade flows could increase when Australia is not involved in the preferential agreements. Further, Australia would be able to capture net increases in trade flows if it also undertook unilateral tariff elimination (although the increases would be less than those experienced were it also directly involved in the preferential arrangements).

### *Impacts of rules of origin*

As discussed in chapter 6, in order for countries to establish preferential access to their market under a trade agreement, there is a need to differentiate imports produced in a partner country from those which may originate in a non-partner country and be ‘transhipped’ within the preferential trade area. The common approach for this has been to adopt various RoO.

RoO vary in complexity and composition between agreements. As a number of study participants indicated and as reflected in chapter 7, both the combination of different RoO for different agreements, and the variation in complexity, can create a compliance cost for businesses seeking to take advantage of the reduced barriers under a preferential trade agreement. For Mexico, for example, Cadot et al. (2002) estimated that compliance costs related to NAFTA RoO were in the order of 2 per cent of the value of Mexican exports to the US.

Further, RoO typically seek to ensure that only products that have undergone a ‘substantial transformation’ in a member country can be considered as goods originating from that country and thus access the preferential arrangements. However, as the notion of substantial transformation is subjective and as RoO themselves form part of the negotiations, there is potential for them to overshoot the level required purely to avoid trade deflection, it is possible that the RoO in agreements will differ from the production processes that already exist (Portugal-Perez 2009). If a RoO requires greater transformation than already occurs, producers would need to increase the content of locally (or regionally) sourced inputs in order to satisfy the RoO. As this represents a change from current production processes, it will increase the supply costs of accessing the preferential market (otherwise producers would already have changed the input mix to take advantage of any cost saving). In this respect, one participant has suggested the costs are potentially significant for some products and shipments:

Various estimates suggest that the costs of compliance with rules of origin may be as much as 8% of the value of a shipment ... (John Ravenhill, sub. 36, p. 2)

This finding was supported by Cadot et al. (2005) in relation to product specific rules for the Pan-European agreements, with the majority of the cost comprised of administration costs. On the other hand, the Commission previously found

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additional costs associated with RoO could fall in the range of 1.5 per cent to 6 per cent of the value of shipment depending on the good and overall shipment value (PC 2004). Other estimates are also within this range, with Carrere and de Melo (2004) estimating that costs for firms complying with NAFTA RoO being around 6 per cent higher than similar firms exporting under MFN tariff regimes.

When RoO alter production costs they have been argued to provide an alternative form of protection. For example, as put by the Australian Industry Group:

There is evidence that some provisions in FTAs have increased barriers to trade, for example rules regarding the Change of Tariff Classification (CTC). ... In practice, the effect of these provisions [on Cotton] is that you can only access the preferential tariff treatment under AUSFTA if you sew your fabric together using cotton yarn made in Australia, which we no longer produce. (sub. 7, pp. 6–7)

This point was echoed in a study conducted by the Asian Development Bank:

Rules of origin are supposed to be technical and neutral rules to determine the country of origin of goods. However, rules of origin are frequently used as a trade policy instrument in some importing countries in the form of preferential trade agreements and arrangements, such as GSP and FTAs. In order to protect national interest rules of origin tend to differ from one FTA to another, reflecting different trade patterns and structures on a bilateral basis. (Ujii 2006, p. 3)

Given the impacts identified above, RoO can have two different effects on the cost of exporting under a preferential trading agreement:

- they create a compliance cost of businesses seeking to access the preferential conditions by seeking documentation so that the importing country can verify origin; and
- if a particular RoO does not match current production processes (input mix or composition of final output), there is an incentive for producers to shift to alternative higher-cost production techniques to access the tariff preference.

The incentive under the second effect depends on the relative cost of the change to production processes, and the potential gains — the margin of preference.

In principle, changes in RoO for existing agreements provide the potential for some analysis of their impact on trade flows, and as such, provide evidence as to whether different RoO types differ in possible impacts. Such a change has occurred in the ANZCERTA agreement and potentially provides an opportunity for analysis (Peter Lloyd, sub. 3). However, given a number of confounding factors and timeframes, little can be drawn from this change.<sup>3</sup>

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In order to examine the effects on trade flows and industry production, RoO which were assumed to impose compliance costs and increase the cost of production were modelled for both the Australia–small country and Australia–large country trade agreement scenarios (see box 8.4 for modelling approach).

#### **Box 8.4 Modelling RoO in GTAP**

Two different aspects of RoO were modelled using GTAP.

First, RoO were assumed to alter the costs of trading goods due to increased compliance costs.

Second, RoO were assumed to alter production costs by providing an incentive for exporters to increase the use of locally sourced, higher cost, inputs in order to satisfy the RoO. This was modelled by increasing the price of exports to the partner country in line with the increase in costs faced by producers and exporters. This creates a rent that is allocated back to the exporting industry. Although the additional costs accrue to producers who export to the partner country, this level of targeting is not practicable in the current version of GTAP. By allocating the rent to the industry, the price-raising effect of the RoO is kept within the industry and not redistributed to the economy as a whole. The rent is assumed to be dissipated by using more expensive local products. This is represented by a productivity decrease that affects the part of industry output that is affected by the RoO — typically a small part of an industry's output.

In its submission on the Draft Report, the CIE suggested that it was inappropriate to apply a uniform RoO compliance cost across all merchandise sectors. It also noted that the difference between the preferential and MFN tariffs would determine whether RoO compliance costs are likely to be applicable (sub. DR75, p. 14).

The Commission's modelling of the impacts of RoO — part of the sensitivity testing of the scenarios in which Australia removes bilateral tariffs preferentially — ensured that the impacts of RoO were modelled only for those industries where the difference between the MFN and preferential rate was greater than 9.5 per cent. The Commission's sensitivity testing also only applied RoO-induced compliance costs for those manufactured goods with an MFN rate greater than 9.5 per cent, rather than on a uniform basis. While recognising that a greater level of disaggregation could allow more detailed results, the level of detail available in GTAP is considered sufficient for the purposes of examining the potential economywide effects of RoO.

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<sup>3</sup> Since the change in RoO, New Zealand exports to Australia have increased, while Australian exports to New Zealand have decreased. The greatest change in trade flows have occurred for tariff items attracting a zero MFN rate — where it is unlikely that RoO are binding. It could, however, be argued that the new RoO prevented an analogous increase in trade from New Zealand to Australia for those items under preference. But as trade patterns reverse for Australian exports to New Zealand, it is not possible to conclude whether or not this is the case.



As the impact of RoO under the second scenario is constrained by the MFN tariff which applies, increased production costs were modelled only for those manufactured goods which attract MFN tariffs of 9.5 per cent or greater. In this case, it was assumed that the cost of exported goods would increase by 5 per cent.

Australian exporters to the small country face tariffs above 9.5 per cent for seven commodities, while small country exporters to Australia face tariffs above 9.5 per cent for three commodities. The rates faced by Australia are larger than those faced by the small country. For the Australia–large country scenario, only one Australian and two large country commodities were affected.

For Australia, the RoO as modelled have the potential to reduce bilateral import and export flows by close to 8 per cent for the small country bilateral agreement, and close to 5 per cent for the large country agreement (table 8.5).

**Table 8.5 Effects from stylised RoO scenarios<sup>a</sup>**

Per cent change from 'outer-envelope' scenarios

	<i>Australia–small country stylised bilateral agreement (scenario S1)</i>		<i>Australia–large country stylised bilateral agreement (scenario S2)</i>	
	<i>Australia</i>	<i>Small country</i>	<i>Australia</i>	<i>Large country</i>
Imports	-7.60	-6.43	-4.77	-2.65
Exports	-8.32	-6.21	-5.46	-2.24

<sup>a</sup> Simulations do not represent an analysis of existing agreements.

Source: Commission estimates.

## 8.4 Broader economic impacts of changes in trade flows

As highlighted above, BRTAs can have significant impacts on changes in trade flows, although the level and nature of potential impacts are sensitive to the features of agreements. In the course of this study, a number of views have been advanced concerning the potential benefits of agreements. For example the Business Council of Australia (sub. 41, p. 1) contends Australia's agreements could have delivered broad economic benefits, whereas opposing views have been put forward by groups such as the Australian Chamber of Commerce and Industry (sub. DR87, p. 9) and others. Elek, for example, contended that '...individual PTAs have no more than a marginal economywide effect. (sub. DR74, p. 2)

In order to gain an insight into the impacts changes in trade flows have on economic welfare, the Commission adapted the GTAP model to evaluate changes in

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Gross National Product (GNP) (box 8.5) that resulted from the simulations presented in section 8.3.

**Box 8.5 Assessing economic welfare effects of policy changes**

Changes in trade flows are brought about from changes in production by different sectors of the economy, and thus reflect changes in the relative use of resources. These changes in production occur in response to changes in prices received for the goods and services sold — those with improved price outlooks expand production, those with deteriorated outlooks reduce production. As different industries yield different returns, with some being able to gain greater returns from the resources used than others, the change in production has implications for welfare.

One indicator of changes in welfare, although not complete, is the estimated change in GNP. GNP provides a measure of the income received by residents from supplying labour and capital within the economy and abroad. It is calculated as the sum of the market value of all goods and services produced in one year within the economy (GDP) and the net income received from capital and labour employed abroad.

As such, changes in GNP in response to a policy change, such as changes in tariffs and other trade barriers, provides a measure of changes in incomes for residents of a country. Thus it gives an indication of how much better or worse off a country is due to changes in trade policy.

At the global level, estimated changes in income (GNP) are equal to changes in the value of production (GDP), because both measures represent the returns to all factors of production at the global level.

The results indicate that the greatest impact is likely to arise from broadly based arrangements that apply tariff reductions on a non-preferential basis (table 8.6). The scale of potential impacts declines as the scope of tariff reduction is narrowed, to the situation where they are applied between specific bilateral trading partners. The impacts of measures that have the effect of distorting trade, such as production-altering RoO, also decrease the potential gain in the simulations. Similarly, the limited uptake of available preferences limits the potential gains from preferential agreements. Conversely, those which increase trade, such as trade facilitation, increase the potential gain.

As note earlier, in some instances, it is possible that preferential tariff reductions may have a limited impact on trade flows as producers seek to pocket some of the concessions (rather than reduce their prices). In the case where Australian exporters are able to expropriate all the tariff revenues formerly levied by the partner country, and the revenues exceed those captured by the partner country's exporters (due to relatively lower tariffs in Australia), Australia gains (this occurs in the Australia–small country simulation: S2). In the reverse case, Australia is made worse off — this occurs in the Australia–large country scenario (simulation S4).

**Table 8.6 ‘Outer-envelope’ aggregate effects of tariff reductions<sup>a</sup>**  
Per cent change

Simulation	Australia			World	
	GNP	Exports	Imports	GDP	Total trade
T1 Stylised preferential bilateral reduction between Australia and a small country	0.045	0.394	0.471	0.002	0.011
S1 with compliance cost and production distorting RoO	0.044	0.361	0.435	0.002	0.010
S2 with no price pass through	0.001	-0.013	0.007	0.000	0.000
T2 Stylised preferential bilateral reduction between Australia and a large country	0.097	0.967	1.151	0.001	0.023
S3 with compliance cost and production distorting RoO	0.092	0.914	1.096	0.001	0.022
F1 with bilateral trade facilitation	0.062	0.168	0.200	0.001	0.003
F2 with non-preferential trade facilitation	0.351	0.709	0.576	0.078	0.181
S4 with no price pass through	-0.004	0.051	-0.029	0.000	0.000
S5 with limited preference uptake	0.071	0.728	0.850	0.001	0.018
T4 Stylised non-preferential reductions between APEC members	0.782	5.972	6.342	0.532	3.427

<sup>a</sup> Simulations do not represent an analysis of existing agreements. Further, estimates do not account for the effects of carve outs or timing in agreements, or other areas of liberalisation such as services and investment.

Source: Commission estimates.

While the benefits from individual non-preferential agreements outweigh individual preferential agreements, modelling results suggest that significant benefits are also possible from involvement in a number of preferential bilateral agreements. Australia’s involvement in a series of preferential bilateral agreements with four of its major trading partners can also yield significant benefits — in the order of an 0.8 per cent increase in GNP. However, such benefits are conditioned on partner countries’ non-involvement in other bilateral agreements. The benefits fall below those potentially achievable in the non-preferential setting of APEC if they were to also have preferential agreements which each other.

Further, there is a potential for trade diversion to impact negatively on Australia if other countries formed preferential bilateral agreements in Australia’s absence. Despite this, policy measures within Australia’s control have the potential to offset the effects of trade diversion. For example, the negative impact from four significant trading partners successfully completing ‘outer-envelope’ type agreements can be offset if constraints to exporting industries’ supply can be lessened. Further, Australia is able to still capture significant benefits in such a situation if instead it chose to unilaterally eliminate its tariffs.

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Given the likely costs associated with preferential agreements (such as RoO), and the likely coverage and agreement utilisation, it is possible that unilateral liberalisation in such a situation would yield more significant benefits to Australia than its involvement with a series of overlapping preferential bilateral agreements. On the other hand, as noted earlier, the potential for significant trade diversionary effects of additional BRTAs is likely to decrease as the scope of trade links covered by Australia's BRTAs expands.

As elaborated on in the empirical supplements to the report, the probable effect of a BRTA depends largely on its design and membership. Section 8.5 details the results of the econometrics supplement which explores, in part, the links between the style of a BRTA and its effects on trade flows, both between members and between members and non-members.

## 8.5 Observed changes in trade flows

While *ex ante* analyses can be used to illustrate potential benefits of reductions in barriers to trade, the complexities of agreements and the 'real world' circumstances in which agreements operate can have confounding influences on trade and investment flows. Indeed, as illustrated above, some of the potential increases in trade flows resulting from reduced barriers can be offset or augmented by these other factors.

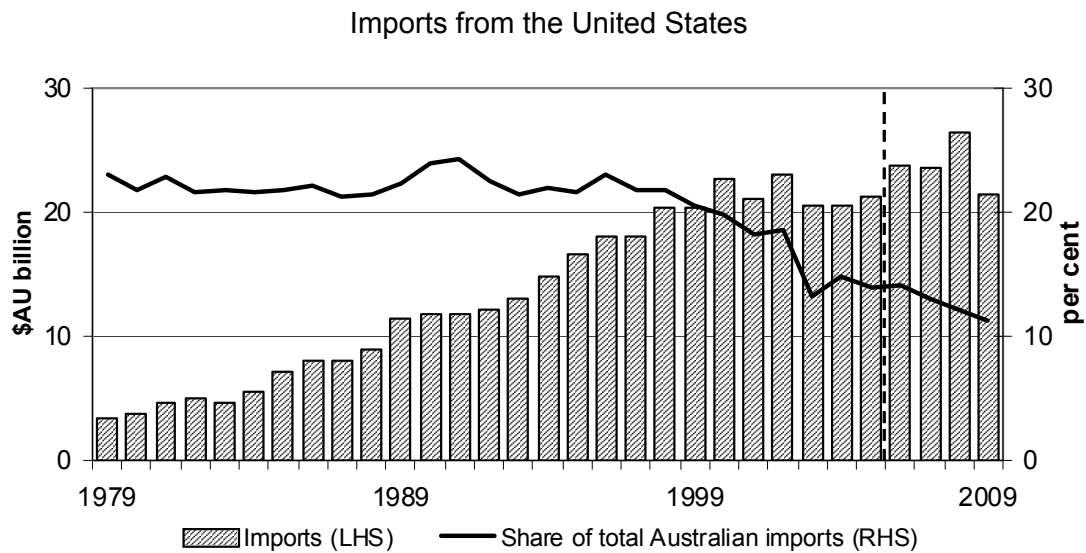
In order to overcome some of these uncertainties when using *ex ante* approaches to assessment, studies have examined, *ex post*, what has happened to trade and investment flows following the formation of an agreement, and to what extent these changes can be attributed to individual trade agreements.

In undertaking *ex post* assessments, however, it is important to avoid drawing conclusions based on overly simplified analyses of changes in trade flows. For example, an examination the level of merchandise trade between Australia and the United States shows an upward trend in the value of exports to and, more so, imports from the United States after the AUSFTA entered into force (figure 8.2).

On the one hand, some might suggest that because imports from the United States increased more than exports to that country, this is evidence that Australia is worse off as a result of the agreement. However, as noted in section 8.1, Australia can benefit from enhanced import competition as much as from expanded exporting opportunities. Thus, an increase in net imports from the United States following the AUSFTA, even if it could be tied to the AUSFTA, would not constitute evidence that the agreement had worsened Australia's economic performance.

**Figure 8.2 Bilateral merchandise trade: Australia and the US**

1979 – 2009, gross trade flows, current AUD



Note: The dashed lines indicate the year in which AUSFTA entered into force.

Source: Commission estimates using UN Comtrade Data.

On the other hand, some might argue that the increase in trade flows (imports plus exports) with the United States following AUSFTA is evidence that the agreement has ‘worked’. However, to sustain this conclusion, it would first be necessary to take into account other factors, such as general growth in trade and economic conditions in Australia and the United States, that may have worked to increase the value of trade between the two countries independent of the AUSFTA.

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Conversely, while the actual levels of imports and exports between Australia and the United States increased following the AUSFTA, the *share* of Australia's trade with the United States has fallen (the unbroken line in figure 8.2). Again though, this should not be interpreted as meaning that AUSFTA has failed to raise the value of trade above levels that would otherwise have prevailed.

Rather, when examining changes in observed trade flows, there is a need to isolate the myriad of other factors, such as changes in GDP and the broader economic environment in which countries trade, that bear materially on those flows. As put by Rural Industries Research and Development Corporation:

... it is likely that liberalisation conducted under PTAs increases bilateral trade — the trade figures seem to be moving in the right direction to support economic theory in that trade liberalisation increases/promotes trade. However, and without further rigorous econometric research, we cannot definitively say what the relationship is between bilateral trade liberalisation and trade flows. Exactly the same arguments can be made for FDI. (sub. 10, p. 21)

It should also be noted that changes in trade flows do not, of themselves, represent economic gains. As Dr David Robertson observed:

Measuring increases in bilateral trade flows over time may give satisfaction to governments, but with many variables affecting trade patterns, they tell us little about efficiency. (sub. 42, p. 14)

As such, the results from *ex post* studies of trade flows only paint a partial picture of the likely broad economic implications of BRTA formation.

For this study, the Commission has reviewed available *ex post* studies (section 8.2) and undertaken its own analysis of trade flows in order to examine the extent to which changes in flows are associated with the formation of selected BRTAs.

### **Assessing the impacts of BRTAs from observed changes in trade flows**

In all *ex post* evaluations, there is difficulty in 'netting out' the effects that are solely attributable to the trade agreement(s) examined from those of other influences which may have occurred at the same time and influenced trade flows. Thus, interpretation of results in all instances cannot be made uniformly, even when comparing the results from different BRTAs from the same model. Ultimately, confidence that the results obtained relate directly and causally to the trade agreements examined rests on the confidence that the approach used has taken into account the confounding elements sufficiently so as to capture the effect of the BRTA.

Further, the time frames over which many agreements come into place makes short-term assessment of outcomes difficult. As noted by the Business Council of Australia:

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Many changes arising from FTAs will also take several years to emerge as business adjusts to new trading rules and as barriers fall progressively. For example, access for beef under AUSFTA will take 18 years to eventuate. Some liberalisation commitments under AANZFTA are to be phased in over a 15 year period. (sub. 41, Attachment 1, p. 12)

The difficulties in isolating the impacts of BRTAs necessitate careful interpretation of results.

### *The Commission's empirical analysis of the impact of trade agreements*

To further analyse the effects of trade agreements, the Commission undertook an econometric analysis of the impact that the formation of selected agreements had on levels of merchandise trade. Using a 'gravity model' of global merchandise trade, in which trade flows between countries are determined by their relative size and income levels, but offset by distances apart and other factors (Anderson 1979), the impact of a range of BRTAs was assessed. The study focused on the common change in trade flows for BRTA members that occurred post agreement establishment (see box 8.6).

#### **Box 8.6 Econometric estimates of the impact of trade agreements on trade flows**

Econometric modelling is useful in determining the link between the formation of trade agreements and observed changes in trade flows, while holding other factors which affect trade flows constant.

A gravity model of trade which relates the trade between two countries to their economic size and the distance between them was used to examine the effects of 27 trade agreements. The model was fitted using a Poisson estimator on a comprehensive sample of trade flows between 140 countries over the period 1970–2008. The model takes the broad form:

$$\text{Trade flows} = f(\text{GDP}, \text{time}, \text{bilateral fixed effects}, \text{BRTA})$$

In the gravity model, estimated trade flows between country *i* and country *j* in year *t* depend on the log of the sum of GDPs of each country, the log of the similarity of the size of each countries' economy and the relative incomes in each country. In addition, the common change in trade flows between members of various agreements and the common change in imports and exports between members and non-members as a result of the agreement were also estimated. Changes in trade flows were also estimated to be a function of time-specific effects and time-invariant asymmetric bilateral fixed effects to capture multilateral trade resistance between countries over the sample period.

(continued next page)

**Box 8.6** (continued)

To examine the net effect of the trade agreements on regional and global goods trade, holding all other factors constant, the model estimates are re-weighted to take into account the relative size of the trade flows of the members to global trade flows.

Full details of the Commission's econometric modelling are provided in a supplement to the report.

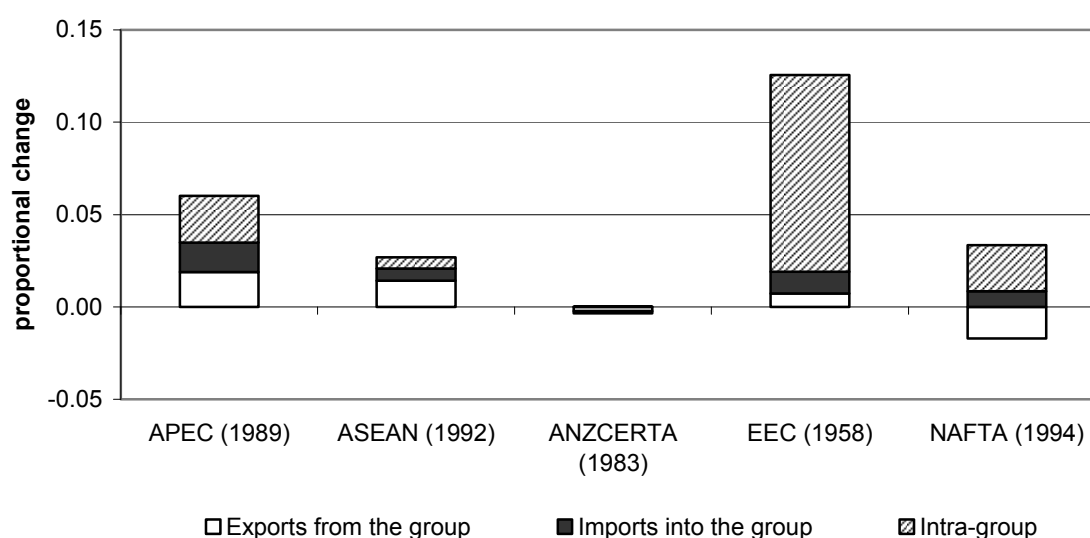
The three types of changes in trade flows that were examined were those that related to:

- intra-group trade, that is, trade between members;
- imports by members from non-members; and
- exports by members to non-members.

In this way, both trade flows created by a BRTA, and those potentially diminished (through a change in focus or members or trade diversion influences), can be separately explored.

The estimated impact of selected agreements on world trade was found to be significant, with clear differences observed between different agreement types (figure 8.3). Regional agreements which covered a large proportion of world trade, and had a large membership base, had the largest estimated impact on world trade.

**Figure 8.3 Estimated effects of selected BRTAs on global trade, 2008<sup>a</sup>**



<sup>a</sup> The base used to compute the proportional change is the estimated trade levels in the absence of any BRTA.

Source: Commission estimates.



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From the analysis, members of those agreements with a more ‘open’ preference structure were found to trade with non-members to a greater degree than other agreements. For example, for the APEC grouping of countries, while contention exists over the underlying cause of the estimated effect, trade within the group and between group members and the rest of the world was greater than it would otherwise have been. One interpretation of this is that, if the impacts on trade flows are driven by domestic policy decisions distinct from the members being involved in APEC, the improved trading is a result of domestic policies for which the member countries have undertaken similar reforms (those which have achieved a common effect). On the other hand, to the extent that the APEC process has played a facilitating role in reducing trade barriers, it suggests that agreements which favour a non-preferential approach, and which seek to establish a cooperative forum intended to facilitate economic integration, can have positive impacts on trade flows.

The ASEAN and EEC agreements also produce a net positive impact on all types of trade flows examined (within and external to agreement partners). For the ASEAN agreement, while it is preferential, the agreement explicitly allows for non-preferential reductions in tariffs by countries to act as preferential concessions, thereby allowing them preferential access to other member countries. In this sense, the agreement does not inhibit overall trade openness as it does not create external stakeholders to trade policy decisions to the same extent as other preferential agreements. For these and other reasons, Hill and Menon (2010) describe the ASEAN agreement as embodying the practice of ‘open regionalism’ (box 8.7). In contrast, while for the EEC, the same positive impact is observed, the result is dominated by the impact on trade between members. The likely driver of this result is the more closed nature of the agreement (the EEC is a customs union based on a common external tariff) and its larger regional grouping.

For NAFTA, while there are strong positive impacts on intra-group trade, this is partly offset by reductions in trade to non-member countries. The results suggests that the preferential nature of this agreement brings with it some costs. For NAFTA members, while the agreement has been net trade creating, it is also seen to ‘reshuffle’ a significant amount of trade between sources.

While the ANZCERTA agreement has had little impact on world trade flows, it was estimated to have a positive impact on intra-group trade. Despite this, it was also estimated to have a negative impact on Australia’s and New Zealand’s trade with the rest of the world. In this sense, the analysis suggests that the preferential nature of the agreement appears to have altered the focus of many exporters (and importers) in these economies to the smaller markets within the agreement, foregoing some of the potential gains that would have otherwise been expected from exploring trading opportunities in markets elsewhere.

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### Box 8.7 The ASEAN agreement

The ASEAN agreement came into effect in 1967 with the Bangkok Declaration. The agreement's aim is to foster economic growth, social progress, cultural development and regional peace and stability. The agreement also aims to promote assistance between members in these areas.

In 1992, members of ASEAN agreed on the ASEAN Free Trade Area which was embodied by the Common Effective Preferential Tariff (CEPT) scheme. Given the importance of non-member trade, and members desire to not have overly binding conditions enforced on them through the agreement, the scheme has several features which have led to it being considered as 'open' or 'preference light'. These include:

- a low value Regional Value Content RoO of 40 per cent;
- the explicit ability of members to offer tariff reductions on an MFN basis and qualify for preferential access to other member markets; and
- the exclusion of agricultural products (ASEAN 2010).

Given the conditions of the CEPT, the importance of non-member trade, and the focus on matters that extend past border barriers, the ASEAN agreement has been argued to represent an example of open regionalism (Hill and Menon 2010). During the period of the agreement, members MFN tariffs have been reduced significantly and, in practice, only around 10 per cent of member trade makes use of the concessional arrangements — notwithstanding the margin of preference remains significant on some products. The agreement also provides an ongoing forum for pursuing economic and regional development issues, including trade facilitation measures.

The CEPT was replaced in 2009 by the ASEAN Trade in Goods Agreement (ATIGA). Unlike the CEPT, ATIGA includes agriculture and given the extent of the tariff commitments in a range of areas, there is potential for ASEAN to become more 'closed' than under the CEPT. Despite this, the new agreement also contains the explicit provision of the CEPT. ATIGA also permits a choice of RoO: the original 40 per cent RVC rule or a CTC rule at the 4-digit level. The agreement therefore continues the potential for ASEAN to remain an example of an relatively preference light agreement.

## 8.6 Summing up

The quantitative analysis of this chapter suggests that while participation in BRTAs is likely to increase trade and raise activity levels, the extent of any changes would depend on the nature of specific agreements.

Preferential trade agreements are likely to increase trade flows between partner countries, but at some expense to trade with other trading partners. The analysis also indicates that this would be particularly so when remaining tariffs are high. Despite the potential for increased bilateral trade flows, once account is taken of the

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offsetting effects of trade creation and trade diversion and the resource allocation effects associated with changes in trade, the resulting changes in economic activity and income are likely to be small. The use of RoO, which may distort production and restrict trading opportunities, also has the potential to erode the potential net gain from such agreements.

The modelling also indicates that Australia could be adversely affected by the formation of preferential agreements among our trading partners; that is, without Australia's inclusion. The ultimate impact on Australia, however, would depend on its own reform actions domestically (such as reduction of its tariffs to improve competitiveness) and adaptation by Australian exporters to take advantage of new opportunities created by growth amongst trading partners.

Non-preferential agreements and agreements loosely implemented on an 'open regionalism' model, like the ASEAN-CEPT, have the potential to provide broader-based reductions in barriers to trade and deliver greater economic gains both across member countries and globally. A greater positive impact on trade between members is also observed in the case of the European Union's customs union because of the more closed nature of the agreement and its large regional grouping. These observations are supported by *ex ante* modelling of hypothetical tariff reductions and *ex post* gravity modelling and other studies of agreements (including by the Commission).

FINDING 8.1

*Based principally on various quantitative studies on the effects of BRTAs and other trade liberalisation scenarios:*

- a) While bilateral tariff preferences between the members of a trade agreement can yield economic benefits to those countries, the net benefits are likely to be small. Greater net benefits are available through countries lowering their own trade barriers on a non-discriminatory, most-favoured-nation basis.*
- b) The potential impacts on Australia of being excluded from, or choosing not to engage in, preferential trading agreements among its trading partners depend partly on Australia's own policy actions and the market responsiveness of its exporters.*
- c) The application of rules of origin in preferential trade agreements can lead to additional administrative costs for importers and exporters of merchandise goods.*
- d) Non-discriminatory trade agreements are more likely to result in net trade creation and associated economic benefits than agreements with restrictive preference structures.*



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## 9 Trade and economic effects: services and investment

Bilateral and regional trade agreements (BRTAs) contain provisions addressing barriers to services trade and international investment (chapter 6). As with merchandise trade, the Commission has sought to explore some of the potential impacts of BRTAs on service trade and investment flows and the broader economy.

Where BRTAs have material impacts on barriers to trade in services and investment, assessing their economic effects requires meaningful measures of the barriers themselves and the likely effects of changes to them. This is more problematic than is the case for trade in goods, however, due to difficulties in obtaining appropriate estimates of services barriers and the shortcomings in available estimates of services trade flows (box 9.1).

The difficulties in identifying impediments to services trade and international investment, and in separately identifying the effects of provisions in bilateral and regional agreements, apply both to *ex ante* assessments of what the potential impacts of a BRTA might be and to *ex post* assessments of the impact of provisions once implemented. There is also only limited quantitative analysis of the effects of bilateral and regional agreements on services trade and investment. There are more qualitative studies with some indications that, in some instances, reductions in barriers are not being widely utilised by businesses (chapter 7).

This chapter draws on the available studies of the impacts of reducing barriers to services trade, information submitted to this study and, in the case of investment, some new economic modelling by the Commission, to assess the economic implications of BRTAs on services trade and investment. Section 9.1 examines the trade and economic effects of reduced services barriers, while section 9.2 considers the potential effects of reduced investment barriers.

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**Box 9.1 Some difficulties in identifying and assessing barriers to services trade and investment**

Services trade is typically associated with the need for buyers and sellers to directly interact, with the barriers to that trade typically implemented through the regulation of the activities of businesses and individuals, and the movement of people. In broad terms, the public interest case for services sector regulation is to solve problems of market failure, including: lack of information and natural monopoly; and the need to achieve broader economic and social objectives (such as stabilisation of financial markets, income distribution or issues related to service quality and cultural matters).

Assessments of the trade and broader economic impacts of change need to take account of the extent to which regulations address such problems and both the potential costs and benefits of reform.

Although barriers to services trade can exist 'at the border', as is typically the case with barriers to merchandise trade, many barriers to services trade occur 'behind the border', that is, they are implemented through the regulation of activities within an economy. As discussed in chapters 6 and 7, there is a trend towards BRTAs including provisions on services which extend past what is included in WTO agreements (so called third-wave provisions).

Because of the nature of services transactions, it is difficult to access reliable data on services flows, or to obtain accurate estimates of impediments to services trade and assess the impact of regulatory change. For example, improved communications technologies may make it possible to deliver services via cross-border supply (GATS mode of delivery 1 (box 3.1)), whereas before those technological and supporting institutional developments, trade might have required the establishment of a commercial presence, or the temporary movement of persons (GATS modes 3 and 4, respectively). Regulation of technologies and the way firms do business therefore could have a significant impact on the nature of services trade, not just on the costs of individual transactions (as would a goods tariff in the case of merchandise trade) complicating assessment of the impacts and potential benefits of reform.

## 9.1 Services trade

### Potential impacts from services reforms

A number of studies have examined the potential impacts that flow from reforms to barriers to services trade on a non-preferential basis. In general, changes modelled which increase competition encourage firms to reduce costs and expand outputs in their areas of greatest competitive advantage, increasing the potential for trade in services and improvements in welfare (box 9.2).

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## Box 9.2 Studies of potential gains from services trade liberalisation

A number of studies have estimated the potential gains from (non-preferential) reductions in services barriers. In those studies, it was suggested that increases in world GNP from services liberalisation were driven by a number of effects, including:

- Allocative efficiency gains: policy changes that remove distortions in the use and movement of resources, allowing them to shift to the areas in which they will be the most productive, increasing welfare.
- Changes in the return to capital endowments: an increase in the return on capital due to freer movements in FDI results in a rise in the real world gross product.
- Increases in product variety: increased product variety benefits consumers by expanding their choice of consumption options (Dee and Hanslow 2000; Verikios and Zhang 2001).

In Dee and Hanslow (2000), a computable general equilibrium model was used to determine the impact of various trade liberalisation scenarios, including liberalisation of services trade. Because of large barriers relative to other countries, the results indicated that liberalisation of trade in services across the world would raise services activity particularly in China (whose services sector was projected to expand by approximately 33 per cent after liberalisation) and in a number of other Asian economies. Services sectors of a number of other countries, such as Australia, Canada, New Zealand, and the United States were projected to become slightly smaller than otherwise, partly due to low existing barriers to trade, because of the expected expansion in services activity in the newly opened Asian countries.

Verikios and Zhang (2001) analysed the impact on trade and welfare from complete liberalisation of financial services and telecommunications. For the two sectors, three trade liberalisation scenarios were examined. The first consisted of removing restrictions on national treatment (national treatment referring to the practice of treating foreign goods and services equally after they have entered the national market), the second consisted of removing barriers to market access, while the third related to a combination of the first two scenarios, and thus represents complete liberalisation.

For both sectors, the scenario of complete liberalisation led to the greatest gain in world real GNP — approximately 0.1 per cent for each sector (Verikios and Zhang 2001). Most of the gain in telecommunications was estimated to come from removing restrictions on market access, while the removal of restrictions on national treatment were relatively less important. The opposite conclusions applied for the simulation involving financial services.

In an empirical study, Kalirajan found that the imposition of regulatory regimes which apply more restrictive treatments to foreign firms than to domestic firms experienced increased production costs compared to those regimes which provide equal treatment (Kalirajan 2000). In the case of food distributors, it was also found that in 18 different countries, that the cost-raising impact of restrictions on the establishment of foreign firms was up to 8 per cent.

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### Box 9.2 (continued)

In a recent study prepared for DFAT, the CIE modelled the effects of global ‘overnight’ liberalisation of all barriers to trade in services delivered via cross border supply of services and commercial presence using the CIE-G-Cubed CGE model (CIE 2010). Globally, around 85 per cent of international trade in services is estimated to occur via these two modes of supply.

In preparing the study, the CIE noted a number of difficulties entailed, particularly in regards to obtaining accurate measures of barriers to trade in services. The issues identified included the fact that barriers are self-reported by each country, that only MFN barriers were reported (no treatment of preferential barriers) and that non-policy institutional or informal restrictions were not included.

To allow for the possibility of dynamic productivity gains associated with services trade liberalisation, the CIE’s estimates included dynamic productivity gains arising from increased import competition, learning by doing in export markets and FDI related transfers of technology.

The modelling results suggested that substantial increases in dollar terms in global production could be achieved through liberalisation of trade in services. Under the modelling scenarios considered by CIE, these could amount to an increase of 0.4 per cent in global production above the baseline after 15 years (ie by 2025 in the modelling). Production in developed countries was projected to increase to 0.20 per cent above the baseline while production in developing economies was projected to increase to 0.90 per cent above the baseline. GDP in Australia was projected to increase to above the global average (0.81 per cent).

The results also suggest that reductions in barriers to trade in services delivered via commercial presence have the potential to deliver greater economic gains than reductions in barriers to trade in services delivered via cross border supply (although the report suggests this may also reflect inadequate estimates of barriers to Mode 1 services trade).

As pointed out by DFAT, the gains depicted in many economic modelling studies capture only those ‘static’ impacts from changes in policy settings. DFAT has argued that from overall trade liberalisation, and more so services trade liberalisation, dynamic productivity gains are possible (sub. 53). In September 2010, DFAT released a study by the CIE which examined the potential benefits of global services trade liberalisation, with the modelled gains embodying improvements in productivity (box 9.2).

Ultimately, studies both with and without the inclusion of dynamic productivity gains indicate that welfare gains are possible from all countries reforming their service trade barriers on a non-discriminatory basis. This is consistent with the Commission’s assessments of behind-the-border domestic reforms in Australia, such as those delivered through National Competition Policy (PC 2005).



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## Impacts of BRTAs on services trade

While there is little doubt that there are potentially material gains from services trade liberalisation, the extent to which these can be secured through BRTAs depends ultimately on whether such agreements reduce the type of barriers that materially impede services trade in a way that enhances welfare. This is dependant on a range of factors.

### *Nature of impacts*

One consideration is whether the barriers amenable to reform are ‘cost increasing’ for businesses or ‘rent creating’. Some services barriers are primarily cost increasing in that they raise the real resource cost of producing a given quantity of output. Many of these barriers may arise from broad competition policy settings that are non-discriminatory in a trade sense, whereas other barriers have the potential to be discriminatory, such as retraining and accreditation costs incurred by foreign businesses and professionals wishing to operate across borders.

On the other hand, barriers to services trade such as quantitative restrictions that artificially restrict supply can be viewed as primarily rent creating. Reductions in these barriers (whether on both a preferential and non-preferential basis) may have limited economic welfare impacts, especially when compared to gains from reducing cost raising barriers. Indeed, Adams et al. (2003) and Dee (2005) note that the possibility of net welfare losses due to trade diversion arises under PTAs — but only if the barriers involved are rent creating, rather than cost increasing. Bosworth and Trewin commented:

... allowing foreign investment in a statutory monopoly could reduce the country’s national welfare by distributing rents overseas and to the preferential partner if done under a PTA. The adverse efficiency effects of providing preferential access through commercial presence can be substantial and long-term since the advantages of being ‘early into the market’ are significant in many major services sectors. (sub. 32, Attachment 1, p. 5)

The ultimate impact of restrictions on services trade is likely to be more complex. While the findings are provisional, Dee and Dinh (2008), when analysing the insurance sector of a number of countries, estimated that services trade barriers are both cost increasing and rent creating. In a similar vein, Dinh (2009) found a mix of cost raising and rent creating effects in the banking sector.

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### *Likelihood of BRTAs influencing barriers to services trade*

Another consideration is the extent to which BRTAs can address such barriers. Elek submitted that most services trade barriers which are likely to be the type that are cost raising generally cannot be eliminated through bilateral negotiations. Instead, for the most part, these can be addressed only through domestic competition policy reforms:

Negotiations can hope to eliminate some particularly restrictive regulations, for example to agree on mutual recognition of some professional qualifications. However, complex legislative changes, such as better competition policies cannot be enforced by negotiation. (sub. 44, p. 16)

Francois and Hoekman (2010) argue that one reason for the limited scope afforded by BRTAs to drive services-trade reforms is the lack of domestic constituencies. They note that, with the exception of the European Union, most services-policy reforms to date have been domestically driven:

Achieving domestic reform of services markets through external trade agreements has proven difficult in practice. ... One factor explaining the limited use of trade agreements by governments to support and anchor policy reforms in services may be that export interests are weaker than in manufacturing or agriculture because services are more difficult to trade. (pp. 677–8)

Even where opportunities exist through BRTAs to overcome bilateral barriers that inhibit services trade, some participants have suggested that trade agreements are likely to have had only a limited impact, while others have commented that either opportunities have not been pursued, or that there remain impediments to service trade not covered in BRTAs (see chapter 7). DFAT (sub. 53, p. 27) also noted that BRTAs to date, have had limited success in reducing barriers and opening up new opportunities, and instead were more likely to bind existing levels of openness (see chapter 6). In a similar vein, Bosworth and Trewin drew on research to suggest that while BRTAs have the potential to go beyond multilateral reform in services trade reform, this seems to have been relatively limited in practice:

While it is generally acknowledged that the GATS – with few exceptions, such as in telecommunications and commitments of certain countries negotiating WTO accession — has performed little actual liberalization, ... PTAs suffer to a greater degree from the same weaknesses. (sub. 32, Attachment 1, p. 18)

### *Some international empirical evidence*

A few studies have examined changes in services trade following the formation of a BRTA, or the potential impact from preferential liberalisation scenarios (box 9.3).

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### Box 9.3 Studies of the impact of BRTAs on services liberalisation

Roy, Marchetti and Lim (2007) examine the extent to which services liberalisation undertaken preferentially goes beyond the parties' GATS commitments. They find that while some PTAs do go further than GATS, particularly those agreements to which the United States is a party, 'the picture is nevertheless nuanced, as there are areas where the value-added of PTAs is more limited'. In particular, they note that agreements between larger countries (for example, China, the United States, Japan, EC, India and Brazil) or agreements between smaller developing countries and larger developed countries (other than the United States) appear to provide a more 'limited set of GATS commitments' (p. 39).

Miroudot, Sauvage and Shepherd (2010) examined the impacts of BRTAs on observed services trade through a quantitative study of changes services trade costs between members of PTAs and differences in these costs for non members. Focussing on services delivered via cross border supply and consumption abroad, they find that trade costs for services trade is about double that for goods trade. They also found that the BRTAs examined 'did not offer clearly improved market access for foreign service providers' (p.19).

In a recent study conducted by the OECD (Miroudot, Sauvage and Shepherd 2010), the effects of more than 200 BRTAs on the costs of international trade in services was examined to test whether or not BRTAs reduced services trade barriers.

The study found that BRTAs did reduce service trade barriers, but to a much lesser extent than those seen for goods. Unsurprisingly, it found that the more extensive the provisions in the BRTA relating to services, the greater the likelihood of barrier reductions.

The authors also found that the ability for BRTAs to reduce barriers preferentially was much more limited than for goods trade. The authors believed that while this result was driven *partly* by the liberal rules of origin for services within most agreements; it was primarily driven by the nature of barriers to services trade, which means that:

... at the end of the day, it is unilateral and non-discriminatory policy reforms that matter most in services markets: they are effectively the basis for anything that happens at the regional and multilateral levels. (p. 22)

In an earlier qualitative study of services BRTA provisions, Roy, Marchetti and Lim (2007), while also emphasising the importance of such domestic reforms, argued that PTAs could bring benefits where they facilitate them:

Preferential deals can bring benefits to participants by allowing them to undertake important reforms leading to the removal of costly domestic restrictions. (p. 40)

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### *The Australian experience*

The approach of Australian agreements to services trade has been to use both negative and positive lists to determine the coverage of services in an agreement. Agreements that adopt a negative list approach (including ANZCERTA, SAFTA and AUSFTA) cover a more extensive range of services than other agreements (such as TAFTA) which adopt a positive list approach (chapter 6). The potential impact of any particular agreement is likely to depend on the approach taken and matters such as the level of economic development of agreement partners. As noted though, while reforms to services in such BRTAs may cover barriers in a range of services industries, the benefits obtained depend in large measure on the subsequent uptake of opportunities by business, which in turn will depend largely on the extent to which the services barriers addressed in the BRTAs are important for facilitating commerce.

Some potential impacts from bilateral services trade liberalisation, modelled as resulting from Australia's agreements, have been examined in a number of feasibility studies. The majority of studies have been conducted by the CIE, so the approach to measuring the potential benefits has a number of common elements.

In those studies, the CIE modelled the impact of prospective preferential trade agreements as possible reductions in costs. Using this modelling approach, the CIE estimated that the prospective agreements could have significant impacts on production and trade. For example, in an early study of the potential impact of reductions in services barriers for a prospective Australia–New Zealand–ASEAN free trade area, it was estimated that services production could increase in 2012 in the order of US\$1.5 billion for Australian and New Zealand, and close to US\$2 billion for ASEAN countries compared to the baseline (CIE 2000).

The CIE also noted that the most-favoured-nation provisions around services trade in the AUSFTA limited the potential trade diversion of subsequent agreements (CIE 2004a). Given the existing liberal regimes of the partners, only specific areas included in the agreement were modelled — professional services; financial and insurance services; and transport. For the areas examined, with the impacts modelled as reductions in costs (as done in its earlier work), services trade liberalisation accounted for close to 37 per cent of the gains from overall trade liberalisation (merchandise goods, services and government procurement).

However, these analyses are *ex ante* and do not take into account the potential difficulties that service providers face in accessing other markets, even when 'on paper' barrier reductions are achieved. Further, it is likely that the assumption that such barriers are all cost increasing will overstate the potential benefits. These

aspects suggest that the benefits achieved to date from service trade barrier reforms with BRTAs are likely to be significantly less than the potential gains put forward in the feasibility studies.

Changes in services flows, as measured in the balance of payments, pre and post the establishment of Australia's bilateral trade agreements could provide some indicative evidence of their actual impact (table 9.1). For each of the agreements which came into effect over the period for which data are available — Singapore, Thailand and the United States — services trade grew faster (both imports and exports) compared to pre-agreement rates. However, as noted in chapter 8 with respect to merchandise goods trade, such simple comparisons do not provide direct evidence of the agreement's success or otherwise due to a number of other confounding factors which have not been controlled for.

**Table 9.1 Services trade with BRTA partners — average annual growth rates, 2001-02 to 2008-09**

	<i>Credits</i>		<i>Debits</i>	
	<i>Pre agreement</i>	<i>Post agreement</i>	<i>Pre agreement</i>	<i>Post agreement</i>
	%	%	%	%
Chile	45	–	23	–
New Zealand	–	2	–	7
Singapore	0	9	4	13
Thailand	4	15	8	26
United States of America	-2	6	1	13
ASEAN	6	–	9	–
Total non-partner	6	–	6	–

*Source:* ABS (International Trade in Services by Country, by State and by Detailed Services Category, Financial Year, 2008-09, Cat. no. 5368.055.003).

Some participants also put forward examples where Australia's BRTAs had beneficially enhanced services trade. In the area of telecommunications, Telstra submitted that a number of agreements have secured 'WTO-plus' reforms in the telecommunications services area (sub. 31). The main driver of increased services flows, from Telstra's point of view, has been the ability of these agreements to improve regulatory certainty in overseas markets. The Business Council of Australia (sub. 41) also canvassed the possibility that many of Australia's BRTAs may have played some role in liberalising services trade, citing, for example, the provisions for Australian lawyers to practice foreign law on a fly-in-fly-out basis in Delaware following AUSFTA.

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Despite evidence of increased trade flows, as reported in chapter 7, the limited evidence from services businesses together with the views of their representative groups (such as the ASR 2008) suggest that Australian firms have made little use of the services provisions in the recently negotiated BRTAs. Rather, while many believed *ex ante* such agreements are likely to yield greater opportunities, as illustrated by changes in perceptions about the Australia-Thai agreement (AFG Venture Group, sub. DR69, Attachment 1, p. 9), actual experience significantly reduced positive perceptions of the benefits of BRTAs. This suggests that while potential exists for BRTAs to enhance services trade between partners, to date Australian agreements are likely to have had limited success in this direction.

In relation to the likelihood that expectations will be better met in the future, as discussed in chapter 7, processes established under Australia's agreements may yield benefits in specific areas of services. For example, while it is unclear that much use has been made of the provision allowing Australians to practice foreign law in Delaware, working group discussions with Delaware are provided for under the auspices of AUSFTA. This has potential to engender further cooperation towards outcomes with other jurisdictions and on other matters (such as the recognition of Australian law degrees for admission to practice in the United States), although this could be expected to take many years.

## 9.2 Investment

The impact of reforms to Australia's investment barriers under BRTAs is contentious and there are varying views concerning the restrictiveness of Australia's investment barriers, particularly those created by the operation of the Foreign Investment Review Board (FIRB). On one hand, some have argued that these barriers alter the risk premium of investing in Australia and therefore have a significant impact on FDI flows. On the other hand, the FIRB is thought by some just to add a small transaction cost and therefore have little to no impact. Investment provisions of trade agreements may also be considered to provide an additional element of certainty around access to the capital markets of partner economies and the regulatory environment in which businesses invest.

Modelling of provisions negotiated in the AUSFTA, conducted by the CIE, examined the issue of potential changes to Australia's investment barriers. Given the prospect for the AUSFTA to both reduce the transaction costs of investing in Australia (through increased notification thresholds on investments) and improve the certainty of investments (through an improved legal framework and altered notification thresholds), it was suggested that FDI into Australia was likely to increase (CIE 2004a).

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Under the CIE approach, a proportion of the long-run equity risk premium that exists between Australia and the United States (taken as 1.2 percentage points) was assessed as relating to investment barriers. The possible change from bilateral liberalisation in investment barriers was estimated to be 5 basis points. The 5 basis point fall in Australia's equity risk premium was then modelled allowing capital to be sourced from all countries (that is, no further restrictions were added to the source of capital inflows). The results showed a significant increase in investment, both domestically and internationally sourced, which at its peak leads to an increase in investment of nearly 1.4 per cent above levels that would otherwise apply (without the agreement) a decade out (CIE 2004a).

The CIE found that the reduction in investment barriers could increase real GDP — potentially by up to 0.4 per cent (CIE 2004a). The estimated impact on welfare measured by GNP is smaller, although significant, due to adjustment costs and time lags in capital investment flows. Putting these results in context, the gain to Australia from the investment reforms modelled was considerably larger than the gains from liberalisation in goods and services trade between Australia and the United States.

However, the approach taken by the CIE has not been without controversy. A number of commentators raised reservations about the scale of the premium reduction and the approach taken. For example, on the issue of scale, Quiggin stated:

Estimates based on the efficient market hypothesis suggest that the equity premium ought to be no more than 1 percentage point. Most of the premium is due to some combination of market failures, investor irrationality and distortions arising from taxes and regulations. (Quiggin 2004, p. 70)

Further, he stated that while the focus on the equity premium was right, the assumption it would be reduced and have no adverse impacts was not:

... the CIE is right to focus on the equity premium. The difficulty is in the assumption that capital market liberalisation will reduce the equity premium and will have no offsetting adverse effects. The proposed changes are tiny by comparison with the floating of the dollar, the associated removal of exchange controls over the 1970s and 1980s and the associated domestic liberalisation. Yet there is no convincing evidence that these changes had any effect on the risk premium for equity. (Quiggin 2004, p. 70)

Similar reservations were put forward in a study commissioned by the Senate *Select Committee on the Free Trade Agreement between Australia and the United States of America* (SCFTAAUSA 2004). It was argued by the author, Dee, that the link between FIRB and the equity premium was not valid:

The DFAT/CIE report treats FIRB screening as something that has added to investor uncertainty. They therefore claim that the relaxation of FIRB screening can be modelled as a reduction in the equity risk premium in Australia. It is by no means clear

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that this is the appropriate way to model FIRB screening. The equity risk premium is a concept that captures the effects of events that happen *ex post*, after an investment is made, that reduce or eliminate the expected returns on that investment, and hence affect the stock market valuation of the company making the investment. FIRB screening is an event that happens *ex ante*, before the investment is made. A negative ruling does not put at risk the entire amount that would have been invested. The potential investor still has their uninvested capital that they can put elsewhere. The only thing that is lost by FIRB screening is the cost of lodging a notification or application, and this is lost whether or not the application is successful. (Dee 2004, p. 29)

Dee (2004) also suggested that the only impact of FIRB relates to transaction costs, with the majority of such reductions accruing to United States investors:

So what effect does FIRB screening have? As noted in the DFAT/CIE report, it is a source of transactions costs. But most of the cost savings from relaxed screening will accrue to US investors overseas — Australia will still need to employ Treasury officials to continue screening of non-US investors and in sensitive sectors. And FIRB screening has an unknowable, but probably small, deterrent effect on a few particular investments, but nothing like the number of investments that would be affected by a generalised change in the risk premium. (p. 28)

Outside Australia, some international studies have also examined the link between investment flows (typically FDI) and BRTAs. For example, Waldrich (2003) examined the impact of NAFTA on FDI flows using regression analysis and found a positive effect for Mexico. It was estimated that United States and Canadian FDI into Mexico would have been 42 per cent lower in the absence of NAFTA. Despite this, as the CIE (2004a) caution, such evidence is biased as the level of foreign investment is also affected by domestic savings, investment balance, and changes in production activity due to reduced barriers, all of which could change following trade liberalisation.

Using regression analysis, the OECD has also suggested that investment provisions with BRTAs are positively related to both trade and investments flows (Leshner and Miroudot 2006). Those provisions had the greatest impact on FDI flows between member countries.

### **Impacts from other investment provisions in BRTAs**

Other benefits from BRTAs relate to improved investor certainty, particularly for Australian investors in countries where a lack of confidence in institutional arrangements may discourage investment. Typically if such concerns exist, Investor-State Dispute Settlement (ISDS) mechanisms are put in place (chapter 14). However, these arrangements are not unique to BRTAs and have been used extensively in bilateral investment treaties (BITs) — in Australia these are termed



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Investment Promotion and Protection Agreements (IPPAs). While little empirical work has been conducted on the impact of such arrangements in relation to BRTAs, a number of studies have examined BITs. Examining this literature, Bonnitcha and Aisbett suggest that few benefits have been created:

A basic survey of the BIT – FDI scholarship reveals eight studies that claim statistically significant findings to support the hypothesis that signing BITs increases FDI. This count includes studies that find only some types of BITs increase FDI and a study that makes a finding of a ‘minor and secondary’ relationship between BITs and FDI. A further five studies reject the hypothesis that BITs increase FDI. Not all these studies should be treated equally. Some studies draw on more comprehensive data sets and apply more appropriately specified statistical models to those data sets than others. The problem of controlling for policy shifts made concurrently with ratification of BITs and disentangling reverse-causality effects with data for such a small population is endemic to them all. However, it is clear that those studies whose empirical approach better accounts for endogeneity concerns generally do not find a link between BITs and FDI. Our appraisal of the current literature is that it does not provide any sound evidence that investor protections promote mutual direct investment. (sub. 45, pp. 5-6)

Further, during consultations over the course of this study, some participants suggested that not only were the benefits limited and questionable, but ISDS provisions also created some risk for governments when making domestic policy decisions. Further, it was also suggested to the Commission that, while Australia has included these provisions in BITs, they have not been used by Australian investors. Given the above factors, it is likely that the benefits from such provisions in BRTAs (and more broadly) are small.

### **Modelling reforms to investment barriers**

In order to gain an understanding of the potential impacts of preferential bilateral and non-preferential investment liberalisation, the Commission undertook some modelling using the GTAP model (see chapter 8 for a description of the model).

As discussed above, investment liberalisation could have different effects depending on assumptions about the effects of the barriers and of the liberalisation. Two possibilities include:

- quantitative restrictions to foreign investment, created through screening of certain investments, which may translate into a higher price for foreign capital, and thus increased returns to foreign owners and an economic rent for foreign capital owners; and
- the FIRB screening process which may increase the sovereign risk associated with foreign investment, resulting in a risk-premium (leading to a higher rate of return than otherwise).

The first type of barrier would require accounting for the economic rent in the database — something which is difficult. However, the sovereign risk approach assumes that the risk premium is in the data. While a number of commentators have questioned the ability of FIRB to alter the risk premium, others have suggested that it may have an impact, although the direction of change is questionable.

For illustrative purposes, and following the CIE (2004a) study (while noting its limitations), the assumption that FIRB barriers influence the sovereign risk of investments was modelled. As in CIE (2004a), it has been assumed that the change to arrangements reduces the level of sovereign risk. But unlike the CIE approach, investment flows from specific partner countries were identified, allowing for a preferential barrier reduction to be simulated. Results were also scaled according to the shares of FDI in total foreign owned capital.

The results of a reduction of 5 basis points in the required rate of return for foreign investment in Australia *and* the United States on a preferential and on a non-preferential basis are presented in table 9.2.

Reducing the cost of investment increases demand for, and the resulting supply of, capital in Australia and the United States.<sup>1</sup> Increasing the capital base of both economies, increases their production capacities, thus increasing GDP.

**Table 9.2 Effects on real GDP and GNP of reducing barriers to investment between Australia and the United States<sup>a</sup>**

5 basis points reduction in required rate of return; US\$ million

	<i>Australia</i>		<i>United States</i>	
	<i>GDP</i>	<i>GNP</i>	<i>GDP</i>	<i>GNP</i>
Preferential	58	-169	46	390
Non-preferential	392	321	5 976	5 008

<sup>a</sup> Simulations do not represent an analysis of existing agreements. GNP is a measure of the income received by residents from supplying labour and capital within the economy and abroad. It is calculated as the sum of the market value of all goods and services produced in one year within the economy (GDP) plus (net) income received from capital and labour employed abroad.

*Source:* Commission estimates.

Despite this, whether barrier reductions are preferential or non-preferential has a significant bearing on projected changes in national income, as measured by GNP. Because Australia is a net borrower of capital and the United States is a net lender to Australia, where reductions in barriers are undertaken preferentially, an increase

<sup>1</sup> A longer-run environment is adopted (chapter 8), in which increased demand is satisfied by allowing the supply of capital to adjust the point where the initial rate of return is obtained.

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in the output of both countries is projected to lead to Australia increasing its (net) borrowing to support the accumulation of additional capital, while the United States is projected to increase its (net) lending. After accounting for the respective changes in capital income flows, national income for Australia is projected to decline.

On the other hand, if barriers to investment in the Australia and the United States were reduced on a non-preferential basis, the consequential inflows of capital to the liberalising economies would be drawn from diverse sources. With more funds available to the liberalising economies, GDP is projected to increase more than in the preferential liberalisation case and Australian income is projected to rise.

### 9.3 Summing up

The inclusion of services and investment provisions within BRTAs, particularly where they extend commitments beyond those in the GATS, is likely to have led to at least some increase in services trade and investment flows. The limited evidence on, or assessments of, such provisions, and the relatively short lifespan of Australia's agreements, mean that definitive assessments of the extent of these effects are difficult to make.

Taking account of qualitative studies of BRTAs, the views of participants and the (limited) quantitative analysis available, the Commission's judgment is that the effects to date are generally likely to have been small. Although the processes established under Australia's BRTAs provide scope for greater benefits in the future, achieving meaningful reform is not straightforward. It is also important to note that reforms not directly initiated under BRTAs, but associated with their development, could also bring benefits.

#### FINDING 9.1

*The evidence available to the Commission indicates that the direct economic impacts from services and investment provisions in Australia's BRTAs to date have been modest. More significant gains may be achieved in the future through some of the processes established under Australia's agreements. However, their realisation will require concerted efforts from Australia and its BRTA partners over many years.*



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# 10 Other possible economic effects of BRTAs

Bilateral and regional trade agreements (BRTAs) can have broader impacts on the economies of partners apart from those that directly result from changes in trade and investment flows. In particular, some BRTAs contain provisions that extend past trade related matters and deal with domestically focused regulations. BRTAs can also have an influence on barriers between markets and the potential for economic integration.

Section 10.1 examines the potential impacts of behind-the-border reforms, while some of the impacts from greater economic integration embodied in BRTAs are discussed in section 10.2.

## 10.1 BRTAs and domestically focused regulation

There is the potential for BRTAs to influence domestically focused policies in a number of ways. First, BRTAs may result in partner countries directly negotiating changes to domestic regulations aimed at local markets but which may inhibit trade — for example, registration requirements for service professionals to operate in their field of expertise. Alternatively, BRTAs may place pressure on inefficient and production distorting domestic policies by subjecting industries to increased competition that would otherwise be unattainable. Such increases in competition may then contribute to broader reforms within a domestic economy.

### Direct influences on domestically focused regulations

BRTAs sometimes have a direct influence on behind-the-border regulations. In some instances, such influences are likely to create additional rigidities in domestic regulations. For example, the Music Council of Australia believes that provisions drawn in from BRTAs, such as the ANZCERTA and AUSFTA agreements, have hindered Australia's ability to regulate to protect its cultural industries:

The Closer Economic Relations (CER) agreement with New Zealand resulted in a curious – and unexpected – outcome: Australian television productions must now be defined as being both Australian and New Zealand programs for the purposes of the

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Australian Content Standard with which Australia's free-to-air commercial television broadcasters must comply. ...

Notwithstanding the openness of the Australian market and whilst already subject to considerable cultural domination by the United States, Australia was nonetheless forced to compromise its capacity to regulate to protect its own cultural industries. 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)

Other examples of rigidities include the intellectual property (IP) rights provisions within AUSFTA. Further, some provisions can potentially create negative impacts for an economy, for example as was perceived with the Pharmaceutical Benefits Scheme (PBS) during the AUSFTA negotiations during the AUSFTA negotiations. These issues are discussed below.

### *IP rights under AUSFTA*

All of Australia's more recent agreements include a chapter on IP provisions. However, in most cases these agreements are high level principles-based undertakings that codify existing commitments. For instance, provisions in agreements often simply reaffirm commitments in the WTO Trade-Related aspects of Intellectual Property Rights agreement. One exception to this is the agreement with the United States which included a number of additional provisions and, as noted by IP Australia (sub. 24), was the only agreement that involved legislative changes. (The recent agreement with Chile also includes some of the provisions of the United States agreement, such as the copyright extension — both Australia and Chile having pre-existing agreements with the United States.) As detailed by DFAT (2010c), these include:

- protection for copyright owners, including:
  - agreement to implement the World Intellectual Property Organization (WIPO) Internet Treaties; and
  - an expeditious process that allows for copyright owners to engage with internet service providers (ISPs) and subscribers to deal with allegedly infringing copyright material on the Internet;
- tighter controls on circumventing technological protection of copyright material together with a mechanism for examining and, as necessary, introducing public interest exceptions in relation to technological protection measures, along with a transition period to provide the opportunity for public submissions in this area;

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- agreement on standards of copyright protection;
  - an increased term of protection for copyright material;
  - enhanced intellectual property enforcement, including:
    - increased criminal and civil protection against the unlawful decoding of encrypted program carrying satellite TV signals;
    - agreed criminal standards for copyright infringement and on remedies and penalties; and
  - reinforcement of Australia’s existing framework for industrial property protection.

The extension to copyright terms was the most contentious of these and subject to a number of investigations (for example, the Senate Inquiry — SCFTAAUSA 2004). Some of the broader economic effects of this extension are discussed below, along with some of the other IP related provisions.

#### *Extension of copyright provisions*

IP rights can encourage innovation and the production of certain goods by conferring monopoly property rights to an individual or business so that the additional benefits gained compensate for the costs borne in developing the good. In this way, an environment where innovation can occur is created, generating significant benefits to the economy.

Despite this, there is uncertainty over the time period required for such monopoly rights to exist, such that there is sufficient incentive for the production of these goods. If too short, there is a risk that a socially desirable level of production of these goods will not exist. If too long, there is a risk that consumers will pay too much for these goods, and the owners of these goods will receive what are termed ‘economic rents’.

Prior to the AUSFTA, Australia and the United States had different durations of protection for copyright material. However, as part of the agreement, Australia agreed to extend the duration of protection from life of an author plus 50 years to the longer US duration of life of an author plus 70 years, despite previously rejecting calls for such an extension (SCFTAAUSA 2004). Subsequently, there has been debate as to whether these changes to Australia’s domestic regulation have been beneficial.

Participants in this study have expressed differing views on the changes under

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AUSFTA. On one hand, the Copyright Agency Limited (CAL) stated:

As far as CAL is aware, trade agreements have resulted in an improved environment for the production of, and legitimate access to, copyright content. Outcomes from trade agreements that have contributed to this improved environment include obligations to accede to multilateral treaties such as the Agreement on Trade Related Aspects of Intellectual Property (TRIPS), standards or obligations that exceed those required by multilateral treaties, such as border controls, and assistance with capacity building. (sub. 34, p. 3)

However, Telstra expressed caution as to the operation of IP chapters and suggested ‘... Australia’s trade agreements should not include matters which are not settled under Australian law.’ (sub. 49, p. 2)

John Ravenhill also suggests that such provisions, while being spread by the United States through BRTAs, may not be welfare enhancing:

The US now has agreements with Australia, Canada, Chile, Mexico, Peru and Singapore: it has signed but not ratified an agreement with Korea, and has been negotiating with Malaysia. These are the most comprehensive agreements in the region and could provide a foundation and framework for multilateralization (although they contain provisions that arguably are not welfare-enhancing, including some on intellectual property rights and the exceptions granted to US agricultural production). (sub. 36, p. 4)

In terms of AUSFTA, Dee provided some estimates of the effects suggesting that the copyright provisions could result in an annual net cost to Australia of up to \$88 million:

The DFAT/CIE report made some simplifying assumptions in order to quantify the benefits of extending the term of copyright protection. While the report was not able to make the same assumptions to quantify the costs, this has been done in Box 2. The net effect is that Australia could eventually pay 25 per cent more per year in net royalty payments, not just to US copyright holders, but to all copyright holders, since this provision is not preferential. This could amount to up to \$88 million per year, or up to \$700 million in net present value terms. And this is a pure transfer overseas, and hence pure cost to Australia. (Dee 2004, p. 31)

### *Other IP provisions*

The AUSFTA also required Australia to make a number of other changes to aspects of its copyright system. While some of the commitments in the agreement to join the WIPO ‘internet treaties’<sup>1</sup> may yield benefits in terms of creating a unified international system to deal with piracy issues, as the Senate observed, other

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<sup>1</sup> The WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty.



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measures are more likely to have created net costs. In this regard, a number of concerns have been expressed about the copyright provisions in the AUSFTA, both then and since, including the:

- enshrining in domestic regulation business activities that would otherwise be anti-competitive (such as permitting the use of region codes on DVD players), and making circumvention of such technology an infringement;
- failure to adopt a definition of ‘fair use’ that more closely aligned with the broader US approach; and
- extending ‘safe-harbour’ regimes for ISPs, which removes potential liability for secondary-infringement if ISPs ‘act expeditiously’ to remove infringing content once notified by rights holders, without a requirement for rights holders to prove in a court that such material is infringing.

At the time of the agreement, a Senate Inquiry questioned a number of these provisions, and in regard to the technological protection measures (TPMs) or anti-circumvention devices, the committee concluded:

... the Committee remains concerned that the AUSFTA goes too far. TPM circumvention may be done for legitimate, non-infringing purposes, not simply piracy. A ban on TPM circumvention, while possibly assisting to curb some piracy, may also prevent many legitimate purposes. This severely interferes with the rights of consumers to do as they wish with property that they have legally purchased. It is important to ensure that certain classes of copyrighted work be exempt from the normal TPM circumvention prohibitions where the circumvention is for a noninfringing use. (SCFTAAUSA 2004, p. 90)

Reflecting on Australia’s overall experience following AUSFTA, the Australian Digital Alliance and the Australian Libraries Copyright Committee submitted that the:

...net impact of implementing AUSFTA in Australia was to set a level of copyright protection that is, in practice, even higher than that in the United States. This is because we matched their higher level of copyright protection, but have maintained our lower level of copyright users’ rights. Thus, the balance of interests favours copyright owners to a greater extent in Australia than in the United States. (sub. DR79, p. 6)

As with the term of protection, IP provisions regarding the scope of rights, anti-competitive activities and non-infringing uses by consumers should foster access to knowledge and innovation while protecting against unnecessary and excessive rents accruing to producers. In the Commission’s view, the changes following the AUSFTA have make it less likely that an appropriate balance between supplier and user interests prevails in Australia’s intellectual property system.

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### *PBS scheme and AUSFTA*

At the time of negotiating AUSFTA, there was considerable contention over the impact on the operation of Australia's PBS scheme. For example, it was argued by some in the medical professions that:

Provisions in the Australia-United States Free Trade Agreement (AUSFTA) may threaten the Australian Pharmaceutical Benefits Scheme (PBS), the "gold standard" of such programs worldwide. (Outterson 2004, p. 1)

The provisions within the agreement were aimed at procedural changes which provided drug manufactures more opportunities to have drugs listed on the PBS. Burton and Varghese (2004) provided a summary of the changes, noting that only applications for new listings rejected by the Pharmaceutical Benefits Advisory Committee (PBAC) are eligible for an independent review. It was feared that the changes would undermine Australia's control over the PBS through the addition of a review process.

Despite this, as argued by Burton and Varghese (2004), and detailed in SCFTAAUSA (2004), much of the public debate at the time of the AUSFTA deal was incorrect. Burton and Varghese (2004) found that the AUSFTA provisions did not require the review findings to be binding on the PBAC decision, and thus were unlikely to influence Australia's control. Further they stated:

... AUSFTA does not change the Committee's legislative requirement to make decisions on the basis of therapeutic effectiveness and cost-effectiveness. So whatever form the review process takes, the Committee remains bound to these criteria. If new drugs are listed on the PBS as a result, it could be argued that consumers will be better off because they will pay less for these medicines and have access to more effective drugs. (Burton and Varghese 2004, p. 1)

At the same time, the AUSFTA negotiations were used to achieve greater transparency in the process.

Despite this, the Commission was informed during consultations that the potential for an adverse outcome was real, and that vigilance was required to ensure this did not arise. The Senate inquiry into the AUSFTA reached a similar conclusion:

This committee appreciates that Australia's negotiating team has negotiated long and hard in the face of considerable pressure to ensure that Australia's commitments in this area have much less impact on our existing law and policy than US negotiators would no doubt have liked. (SCFTAAUSA 2004, p. 140)

But the Senate inquiry also questioned the inclusion of these provisions in the first

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instance on wider public interest grounds:

By allowing the PBS to enter a trade negotiation in the first place, the government has opened the door to forces that it ultimately may not be able to control. (SCFTAAUSA 2004, p. 140)

Given these concerns, and those put to the Commission during consultations, bringing domestically focused regulation aimed at public-good outcomes, such as the PBS, under the umbrella of trade agreements risks incurring substantial and potentially unforeseen costs.

### **Indirect influences on behind-the-border regulations**

The influence that BRTAs have indirectly on behind-the-border reforms is difficult to assess. For example, if reform-minded governments are more likely to be involved in BRTAs, then the existence of a BRTA, or the provisions embodied may not directly influence the reform path that occurs subsequently as governments would have otherwise taken that path. Alternatively, governments may use BRTAs as a means of driving behind-the-border reforms by reducing domestic concern over reform by making it a *quid pro quo* for improved market access in partner countries. For example, the United States-Vietnam bilateral trade agreement in 2001 led to many changes in border and behind-the-border regulations in Vietnam in return for a normalisation in trade relations between the two countries (Parker, Quang and Anh 2002). Vietnam adopted a number of investment, services and intellectual property reforms, and agreed to reduce tariffs on a number of products on a most-favoured-nation basis under the agreement.

It may also be the case that the impacts from a BRTA may play a role in domestic reform, but not be the sole driver. For example, the Australian Dairy Industry Council suggested that the ANZCERTA was a key driver of the reforms to domestic dairy industry regulation during the 1980s, which has had subsequent effects on industry rationalisation and investment:

The introduction of this agreement was a key factor in the rationalisation of commercial and policy arrangements with the Australian dairy industry from the mid 1980s.

Prior to the introduction of CER two-way dairy trade between Australia and New Zealand was minimal with both countries maintaining barriers to trade. In more recent years exports from Australia to New Zealand have exceeded \$100 million per annum while imports into Australia from NZ regularly exceed \$300 million. There has been significant investment in Australian dairy by the New Zealand dairy company Fonterra over the past decade. (sub. 38, p. 9)

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Nevertheless, the Council recognised that:

Given Fonterra's activities in other countries around the world it is reasonable to speculate that this investment would have occurred even in the absence of the CER Trade Agreement. (sub. 38, p. 9)

Despite the varying influence BRTAs may have on domestic reform, it remains the case that these reforms do not necessarily rely on trade agreements to progress. A number of submissions have highlighted this point. For example, as put by the Business Council of Australia (BCA):

Policy options which support trade reform enhance the prospect for delivery of long term growth in the Asia-Pacific region. FTAs are not a substitute for properly designed strategies for economic reform. However, they are limited in the policy changes they can drive to encourage and stimulate programs to address 'behind the border' barrier to facilitate a more open and transparent business environment. (sub. 41, Attachment 1, p. 9)

Further, arguments have been put forward suggesting the use of BRTAs to gain such reform is not the best way forward. The Joint Submission by Nineteen Australian and New Zealand Business Leaders and Economists (sub. 5) suggests that to gain meaningful behind-the-border (and at-the-border) reform, while allowing domestic governments to maintain sovereignty and control over policy, transparency in domestic policy effects and policy making needs to be improved. For this to occur, governments should be encouraged to develop institutions which highlight the economy-wide impacts of policy decisions.

## 10.2 Economic integration impacts from BRTAs

Economic integration has been variously defined (box 10.1). Integration occurs as a result of barriers between members of a particular area being reduced allowing the freer flow of goods, services, people and investment across borders within the integrated area, and is seen by some as reflecting the dynamic gains that can result when increased trade openness leads to increased competition in merchandise, services and investment markets. In this way, the processes which determine the prices of these goods, services and capital become common between the economies involved.

Integration in this sense goes beyond the commitments to reduce trade barriers within BRTAs. Some participants believe that BRTAs are differentiated by the degree of economic integration embodied. For example, as put by Lloyd:

... one should distinguish between agreements that pursue the objective of "trade liberalisation", as mentioned in the Terms of Reference, and those that pursue the objective of "economic integration". The Closer Economic Relations (CER) agreement between Australia and New Zealand is distinct from the other five actual agreements in

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that it has evolved into an agreement that can be regarded as pursuing the objective of economic integration. (sub. 3, p. 1)

### Box 10.1 Economic integration and trade openness

Economic integration is believed to occur along a continuum which extends from trade openness between economies, to common monetary and fiscal policy settings which exist within the European Union. While broadly consistent, a number of definitions of economic integration exist. Lloyd (2005) defines economic integration in relation to BRTAs as:

... the process of removing government measures which discriminate against foreign suppliers of goods and providers of services and suppliers of factors. In the regional context, the relevant “foreign” suppliers are those located in the other countries which are members of some regional agreement.

Two or more national economies in a region will be completely integrated if all measures that discriminate against regional suppliers are removed. The concept of complete integration provides a standard by which we can assess the extent of economic integration at any one time in any RTA. ...

Three sets of policies are involved in the achievement of a completely integrated market: the elimination of *border* barriers to cross-border trade; the elimination of *beyond-the-border* laws and regulations that inhibit cross-border trade or delivery of services; harmonisation of measures *across-borders* ... (pp. 3–4)

Corbett observes that economic integration occurs when prices in the integrating economies are established by a common process (Corbett 2010). Others suggest that economic integration can be associated with the reduction of trade barriers. For example, as put by the BCA in their submission in relation to ASEAN:

Over the past decade, ASEAN nations have sought to deepen economic integration amongst themselves and with other trading partners in the Asian region. Trade and investment liberalisation in both bilateral and regional trade agreements are core to this. (sub. 41, Attachment 1, p. 8)

Another important element is the freer movement of labour. For example, Elek (sub. 54, attachment 1) points out that impediments to the freer movement of factors of production (including labour) are significant impediments to economic integration.

A common element in all definitions is trade openness, that is, reduced trade and investment barriers promote economic integration. However, while increased trade openness can provide scope for economic integration to occur, it does not mean it will occur. Instead, in order to reach a point where price formation processes are common, actual improvements in competition and conditions which allow the freer movement of factors of production need to be observed.

There are a range of potential benefits which flow from economic integration. In financial markets, for example, potential gains include (Corbett 2010):

- the larger pool of capital available for one party once barriers are removed increases investment and promotes the efficient use of capital through greater competition for funds; and

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- improvements in productivity through a greater degree of knowledge transfer between economies.

In a similar vein, the BCA claimed that economic integration was important for business profitability:

Business has a commercial interest in furthering economic integration through the Asian Pacific region which optimizes opportunities for Australian companies to operate easily and profitably in other markets. It is important that integration frameworks in the region are based on open and competitive markets for trade and investment and promote economic growth in the longer term. (sub. 41, Attachment 1, p. 21)

Benefits from economic integration are also seen as arising in the form of dynamic productivity gains, and deriving from the freer movement of labour within the integrated area. These aspects are discussed below.

### *Dynamic productivity gains*

The CIE (2004a) identified four sources of dynamic productivity gains in an integration context.

- Dynamic investment: a reduction in tariffs on investment goods improves the return to capital of these goods, and therefore productivity.
- Pro-competitive effects and scale economies: increasing competition can discipline domestic businesses, encouraging them to be more efficient. Further, the potential to increase market size through exports promotes specialisation, increasing productivity.
- Endogenous productivity: foreign firms with relative production efficiencies are most likely to expand into a domestic market once trade barriers are reduced, bringing with them new technologies, better practices and innovations which can be absorbed by domestic competitors.
- Endogenous capital flows: foreign direct investment (FDI) may bring with it new technologies which could have a flow on impact on productivity in the rest of the economy.

Examining past research, the CIE (2004a) also found that the impact of these dynamic effects was significant. On average, it was found that a 1 per cent unilateral reduction in tariffs for a sector led to a 0.3 per cent increase in the productivity of that sector.

A number of other studies, including by the Commission, have also found links between protection and productivity. For example, a 1998 study by Commission staff found that general decreases in industry tariff protection were found to

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increase output growth. However, the result was not uniform across each of the manufacturing sectors consolidated, suggesting that industry structure also plays a role (Chand, McCalman and Gretton 1998). The Commission has also found that reductions in assistance have contributed to productivity improvements in particular Australian industries through its inquiry program (for example, PC 2002, 2003, 2009). More generally, the Commission has found that Australia's program of tariff reductions and domestic economic reform contributed to the high productivity growth experienced in the 1990s (PC 2005).

Applying these general conclusions to the particular case of bilateral agreements, the CIE (2004a), as part of the study into the AUSFTA, modelled some of the potential benefits from such dynamic productivity improvements (through an assumption of induced productivity improvements). Overall, dynamic productivity benefits were estimated to account for somewhere between 5 to 10 per cent of the net gain from the agreement.

However, the emergence of *dynamic* productivity gains is not universally accepted. For example, in a critique of the CIE approach, Quiggin observed:

The first assumption relates to the so-called 'dynamic productivity gains', supposed to arise from trade liberalization. Belief in these dynamic gains is something of an article of faith for Australian supporters of microeconomic reform. They are undeterred by the fact their position is inconsistent with mainstream economic theory, and unsupported by empirical evidence. (Quiggin 2004, p. 70)

Others have adopted a more cautious view. In reviewing submissions and modelling commissioned for the Senate *Select Committee on the Free Trade Agreement between Australia and the United States of America*, the committee in its findings suggested that given the uncertainties involved, such benefits should not be considered when making policy decisions:

It is clear to the Committee that the CIE's estimates of the dynamic benefits of the AUSFTA should, at the very least, be treated with a great deal of caution and scepticism. Instead, the Committee should follow the approach recommended by Dr Dee and Dr Brain, and indeed by Treasury in previous inquiries. The Committee recognises that dynamic effects may result, and may have substantial benefits. However, as Professor Garnaut points out, they may not. Policy decisions in relation to the FTA should therefore be made principally on the basis of the direct effects, with the recognition that dynamic effects may eventuate. (SCFTAUSA 2004, p. 205)

Some commentators have also been sceptical of the potential for trade-related productivity gains to arise from preferential agreements. For example, Sally (2010) states that, to date, preferential agreements within Asia have had limited success:

In short, with few exceptions, Asian FTAs are not strong enough to change existing national practice in a liberalising or trade-facilitating direction. (p. 7)

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Despite the debate over the nature of the benefits, there has been little empirical research that sheds light on the economic integration actually achieved under BRTAs, and to what extent agreements are likely to yield benefits, such as the dynamic productivity gains often associated with trade liberalisation.

A couple of examples exist in assessments of US agreements — the United States-Canada Free Trade Agreement and NAFTA. Trefler (1999) examined, amongst other effects, the influence on productivity of the United States-Canada Free Trade Agreement. The tariff cuts associated with the agreement were found to increase labour productivity in the manufacturing sector by 0.6 per cent per year for the sector as a whole. Polaski (2006) also suggested that NAFTA played a role productivity improvements in Mexico, due to the extent of the tariff reductions involved. On this matter, Hornbeck (2004) cited research which suggested Mexico's productivity levels would be 4 to 5 per cent lower in 2002 were it not for its involvement in NAFTA.

However, in the Canadian Government's *NAFTA@10* review, Harris (2006) cautioned:

The productivity effects of the FTA have been the most controversial of the ex post FTA results after employment. (p. 25)

Reviewing a number of studies, Harris (2006) examined the productivity changes related to increased specialisation and scale, and those related to variety and the price of goods and services. On the former, Harris observed that a number of studies provided evidence that suggested that NAFTA had increased the specialisation of firms, and thus was likely to have also increased productivity. On the latter, Harris found that the evidence was not as strong.

The *NAFTA@10* study also included the work of Gu and Rennison (2006), who examined the impact NAFTA had on export and import industries. The authors found that NAFTA had increased productivity in these sectors relative to previous growth paths and other sectors. Overall, total factor productivity improvements in the NAFTA period were 1.8 and 1.9 per cent greater annually for export and import industries respectively.

In this study, the Commission used the GTAP model to investigate the potential gains from FDI led productivity improvements. FDI is often thought to embody technical change, which is likely to improve the productivity of the industry in which it occurs. Following the investment scenario presented in chapter 9, a productivity scenario was modelled through a 5 per cent productivity improvement accruing to industries in Australia and the United States in proportion to their use of FDI from



Australia and the United States in the preferential case. In the non-preferential case, the improvement was applied to all industries using FDI from any source.

The addition of a productivity improvement embodied in FDI flows would increase the potential for gain from lowering barriers to FDI, from levels otherwise achievable (table 10.1). For Australia, a hypothetical 5 per cent improvement in productivity by FDI activities is projected to raise the potential benefit of non-preferential investment liberalisation (by US\$103 million in the scenario considered). A similar productivity improvement, but associated with preferential liberalisation, is projected to deliver a lesser benefit (US\$72 million). The net effect of preferential liberalisation is, however, potentially negative for Australia in this hypothetical example, because Australia is a net importer of capital from the United States — the trade agreement partner (see chapter 9).

**Table 10.1 Potential gains from productivity improvements due to increased FDI**

US\$ million

	<i>Australia</i>		<i>United States</i>	
	<i>GDP</i>	<i>GNP</i>	<i>GDP</i>	<i>GNP</i>
Incremental impact of an FDI-induced 5 per cent increase in productivity <sup>a</sup>				
Preferential	82	72	20	23
Non-preferential	115	103	407	382
Net impact of reduced barriers FDI and 5 per cent rise in productivity				
Preferential	140	-97	66	413
Non-preferential	507	424	6383	5390

<sup>a</sup> Productivity shocks were applied at the industry level in proportion to each sector's FDI content. The FDI intensity is higher in Australia than in the United States.

Source: Commission estimates.

### *Freer movement of labour*

Closer integration between economies can also arise through policies that provide for the freer movement of labour. Such policies can have a variety of impacts, for the employees relocating, their country of origin (the donor country) and the receiving (or host) country.

As noted in chapter 3, the GATS defines international services trade into four modes, where mode 4 involves a business supplying a service in another country through the presence of a natural person overseas. Mode 4 is generally seen as covering:

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- a business in one country sending employees to another country in order to provide a service directly;
  - independent service providers selling a service to a company or individual in another country; and
  - a person employed overseas by a foreign business established in the host country.

While not strictly a form of mode 4 trade, people may also travel overseas to work for a domestic firm in a host country, such as under a temporary skilled or unskilled migration program. Such movement of people can be distinguished from permanent migration on the basis that those employees will eventually return to their country of origin. However, there is no formal definition of ‘temporary’ migration, and therefore such arrangements may in practice be for many years.

As noted in chapter 4, Australia has a visa system that enables Australian businesses to temporarily bring labour into Australia (through the 457 visa program), subject to meeting certain conditions, and it is not uncommon for other countries to operate similar systems. In addition to domestic policy settings and preferences, partner countries can include provisions that recognise these conditions and relax them on a preferential basis through BRTAs. Most of Australia’s BRTAs contain concessions by the partners regarding the movement of business people (including managers, executives, specialists or other technically-skilled personnel) into their countries and can also contain specific concessions. For example, Australia agreed to specific concessions for the entry of Thai chefs as part of TAFTA.

As well as provisions agreed in BRTAs, countries can liberalise restrictions on labour movement unilaterally or in coordination with other countries. For example, APEC has developed provisions to ease the movement of business personnel between member nations. The APEC Business Travel Card Scheme allows accredited business people to obtain multiple short-term business visitor visas to participating nations. Further, card holders can access streamlined process lanes when travelling through immigration arrival or departure (Department of Immigration and Citizenship 2010). Similarly, while the AUSFTA does not contain any commitments by the United States on the movement of natural persons, the United States separately agreed to introduce a special visa category — the ‘E3’ — for Australians temporarily engaging in certain forms of work in the United States.

The economic literature suggests that relaxing restrictions on the movement of labour between countries can have a range of benefits. They can enable eligible workers, particularly from less developed countries, to earn higher wages in other countries (some of which may be remitted home). Working abroad can enable

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workers to acquire new skills and technological know-how that on return can improve productivity in the donor country. And the prospect of better employment opportunities abroad may result in greater numbers of people pursuing education, again improving productivity in the donor country. That said, in some cases, such as where a highly-skilled employee temporarily transfers from one developed country to work in another, the benefits for the employee and the host country will be largely offset by the loss of employment resource and associated output in the donor country. Nevertheless, at a global level, measures to facilitate the movement of people may improve efficiency through the better use of labour resources, including allowing better matching of employee skills with labour needs in different markets and overcoming labour bottlenecks or shortages in particular countries at particular times (Winters 2002).

Indeed, the trans-Tasman labour movement provisions in the CER agreement are often seen as having helped address short-term imbalances in both the Australian and New Zealand labour markets, particularly at times when the countries have been at different points in the business cycle. The BCA said that Australian businesses had seen ‘deliverable and practical benefits’ from such provisions in BRTAs, although it noted that the extent of liberalisation varied between agreements:

... CER, through the Trans-Tasman Travel Arrangement has achieved almost complete labour mobility between Australia and New Zealand. Provisions for the cross border movement of business persons in AANZFTA, SAFTA, TAFTA and CAFTA tend to improve on commitments made under the WTO, but they remain linked to immigration requirements and are restricted to business personnel, investors and certain categories of workers such as service professionals. (sub. 41, Attachment 1, p. 18)

The BCA also indicated that benefits had arisen from increased labour mobility as a result of the visa initiatives agreed with the United States (sub. 41, p. 2). Indeed, at a policy forum on the Draft Report, one business participant estimated that the E-3 program could result in as much as \$6 billion per annum of business in the United States.<sup>2</sup> However, while the E-3 program has undoubtedly delivered benefits for some Australians, it is unlikely that there have been major benefits to Australia in net terms from the program to date. This is because the take-up of E-3 visas has to date been limited, and may have involved some substitution away from other means of servicing the United States market.<sup>3</sup> And to the extent that there has been a net

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<sup>2</sup> ‘E-3’ visas are valid for up to 2 years for an Australian working for a US business, and are subject to an annual quota of 10 500. The estimate was based on an assumption that there were 12 000 E-3 visa holders, earning on average half a million dollars each per year in the United States. Data is not available, however, on the incomes earned by E-3 visa holders while in the United States, nor on what proportion of those incomes might be repatriated to Australia.

<sup>3</sup> Determining the extent of any increase in Australian’s supplying the United State market, consequent upon the E-3 program, is difficult. Australians may enter the United States for work

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increase in Australians supplying the US market, this will have entailed a transfer of Australian labour resources (and associated output) to the United States market from the domestic or other export markets.

While measures that facilitate the cross-border movement of labour can generate benefits for some workers and, potentially, for the donor and/or host country, some participants submitted that the inclusion of such matters in a BRTA is inappropriate. For example, the CPSU stated that:

Our position on labour mobility begins with the principle that people are not commodities and cannot be traded. There is no place for agreements about movement of natural persons... (sub 22, p. 4)

Others suggest that such provisions can have a negative impact on Australia's domestic labour market, through the greater use of foreign skilled workers in place of domestic employees. For example, the CFMEU argued that because Australia's commitments under some of its BRTAs preclude the use of labour market testing, they amount to:

...a significant downgrading of the rights of Australian workers to jobs within Australia, ahead of foreign nationals,... [a development that] is proceeding with little or no public debate. (sub. DR90, p. 9)

More broadly, the CFMEU acknowledged in its submission that while there had been changes to the 457 visa program (sub. DR90, p. 9), it still considered that the movement of labour was an issue for immigration policy, stating:

The Commonwealth government has given top priority to employer-sponsored PR [permanent residency] visas in its skilled migration program, and over one half of all 457 visa holders now seek PR. (sub. DR90, pp. 9–10)

Overall, some of Australia's BRTAs to date have relaxed the conditions on the movement of labour and business personnel, with the CER agreement providing the least restrictive conditions. The freer movement of labour and business personnel can afford advantages to Australia, including providing opportunities for

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purposes under a number of different visa classes, depending on the type of work and duration of stay. The general H1-B work visa offers similar conditions to Australia-specific E-3 visa, and there may have been some substitution away from the H1-B after the E-3 visa was created. For example, in 2004, approximately 1600 Australians were granted H1-B visas. In 2009, this had fallen to 442, while 2191 E-3 visas were issued (US DHS, 2009). In addition, Australians may travel on the short-term B1/2 visa, and intra-corporate transferees may work in the US under the L-1 visa system. That said, determining the extent of substitution between different visa classes is confounded by other factors, such as changes in economic conditions in different countries, that may affect the propensity of Australians to pursue work in the United States. It is also possible that any increase in Australians supplying the United States market in person might be at the expense of other modes of supply, such as cross-border supply.

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Australians wanting to work abroad and providing means of obtaining additional labour in Australia to provide specialist skills and address bottlenecks. However, the net benefits arising from such provisions can be overstated, and there are concerns relating to the general system of labour mobility, its relationship to immigration policy and its extension on an ad hoc basis through BRTAs. Chapter 14 considers in further detail the need for greater analysis of such matters before they are included in a BRTA.

### **The possible contribution of BRTAs to regional integration**

While there is a range of potential benefits from economic integration between partners to a BRTA, given that at least for preferential bilateral agreements, the direct impact on overall trade flows and GNP is small (see chapters 8 and 9), the integration effects of agreements are also likely to be small. Even where an agreement has strong integration potential, such as ANZCERTA, stimulus to bilateral trade flows and hence integration between partner economies is likely to have been at the expense of some reduced flows to global trading partners.

Against this background, debate exists over the role that BRTAs can play in respect to broader regional integration — that is, with a range of trading partners, both members and non-members to a particular BRTA. Where BRTAs contain discriminatory provisions that exclude regional parties, such as those of preferential bilateral agreements, they necessarily work against regional integration. However, a regional trade agreement could potentially be used to further regional integration (as inferred by changes in trade flows). On this, empirical evidence suggests that larger regional and non-preferential agreements have had a greater trade creating impact (both for members and non-members) and thus have a greater potential to contribute to broader regional integration.

The ASEAN agreement, and the recent AANZFTA along with the APEC agreement, are generally regarded as more open than other BRTAs seen worldwide. Given the less or non-preferential nature of these agreements, the scope for economic integration to occur at a regional level also increases. For example, some see potential for future BRTAs to contribute to regional integration. The BCA argued in the context of ASEAN that:

It is important that Australia is part of a regional trade and investment architecture which involves ASEAN. That should be supported by FTAs which deepen economic integration and foster policy reform to reduce regulatory barriers in ASEAN economies. (sub. 41, Attachment 1, p. 8)

Further, the BCA felt that BRTAs would be able to facilitate the achievement of these benefits in future:

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FTAs will continue to be the driving force for economic integration in the Asia-Pacific region for some time. ... there is an opportunity for Australia and like minded economies to lead in the standard setting of FTAs and to highlight the importance of US engagement in the region. The TPP — involving Chile, New Zealand, Brunei, Singapore and now Australia, Peru, Vietnam and the US — will be important for doing so. (sub. 41, Attachment 1, p. 21)

Others, however, were sceptical of the role of BRTAs. Malcolm Bosworth and Ray Trewin, for example, put that:

... 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. (sub. 32, Attachment 2, p. 54)

In a similar vein, Sally (2010) states that to date, BRTAs have had limited success:

... with few exceptions, Asian FTAs are not strong enough to change existing national practice in a liberalising or trade-facilitating direction. Clearly, they have not proved to be a force for regional integration — at least not so far. Nevertheless, FTA proponents argue that they are stepping-stones to wider regional-integration initiatives. (p. 7)

Further, the barriers that exist today, and the treatment of sensitive sectors, will continue to prove a stumbling block for BRTAs to yield regional integration:

Therefore it is pie-in-the-sky — psychedelic cloud-nine politics — to expect very large group cooperation to produce a strong, clean, comprehensive FTA in Asia — not for a long time to come. It will take Herculean policy-making to iron out wide differences in tariff rates, treatment of quantitative restrictions, sectoral exemptions, ROOs and other provisions spread across so many bilateral and plurilateral FTAs, and fold them into a sensible regional FTA. Rather the result is likely to be a very low common denominator — another trade-light FTA with complicated ROOs, adding to (not subtracting from) an expanding noodle bowl. Finally, such FTA activity distracts attention from further unilateral liberalisation and domestic reforms ... That will probably hinder, not help, the cause of regional economic integration. (Sally 2010, p. 12)

Notwithstanding these comments, there has been considerable progress reaching convergence in areas such as rules of origin (RoO) within the East Asia region. For example, the ASEAN Trade in Goods Agreement and the ASEAN agreements with Australia and New Zealand, Japan and Korea all involve a co-equal approach of a 40 per cent regional value content or 4-digit change in tariff classification based RoO. The Commission also notes that further work is being undertaken in this area:

... a work program is just beginning which involves the countries of ASEAN, and the six countries (Australia, China, India, Japan, New Zealand and South Korea) with which ASEAN has regional FTAs [which] ... is looking at the ROOs in these FTAs with a view to improve their complementarity and coherence in promoting regional economic integration. (DFAT, sub. DR98, p. 9)

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As for economic integration, little literature exists examining the actual outcomes of BRTAs in this area. However, the econometric modelling work conducted by the Commission, set out in chapter 8, provides some evaluation of the potential for BRTAs to contribute to regional integration.

As discussed above, trade openness provides an opportunity for economic integration to occur. If trade openness as a result of a BRTA occurs to goods, services and investment suppliers from both member and non-member countries, then it is possible that agreements will foster *regional* integration (and not just economic integration between partners as would be possible from improved member trade flows). By examining the openness of agreements and how much trade creation occurs between members and non-members, an insight into whether or not BRTAs contribute, through increased trade, to regional integration outside the member base can be gained. While not a direct measure of regional integration, if a significant proportion of trade is created with non-members due to a BRTA, then it is likely that such agreements at least do not create barriers to regional integration.

Examining the estimated ratio of extra-bloc to intra-bloc trade creation from the gravity model presented in chapter 8 and the coverage of agreements, for a range of agreements, reveals a general trend — as the share of intra-bloc to total trade decreases, the ratio of extra-group trade creation to intra-bloc trade creation increases (table 10.2). That is, agreements that cover a greater amount of trade for partners are generally more inward focused, with those covering a lesser amount being more outward focused.

However, the APEC and ASEAN agreements do not fit the general trend. While the share of intra-bloc trade in the APEC group of countries total trade is the largest of the agreements examined, extra-bloc trade creation is estimated to be one third greater than intra-bloc trade creation — compared to the EEC (with a share of intra-group imports of 45 per cent) where extra-group trade creation is one fifth of the estimated intra-group trade creation.

Similarly, while the share of intra-group trade in the ASEAN group of countries' total trade is 13 per cent (in between the share of intra-group imports of United States–Canada at 18 per cent and MERCOSUR at 10 per cent), the estimated extra-group trade creation is more than three times that of the intra-group trade creation (in comparison with approximately nine tenths and one to one for the United States–Canada and MERCOSUR agreements respectively).

**Table 10.2 Ratio of extra-bloc to intra-bloc trade creation and agreement coverage, 2008**

11 selected agreements

<i>Agreement</i>	<i>Ratio of extra-bloc trade creation to intra-bloc trade creation in 2008</i>	<i>Share of intra-bloc trade in total trade (average)</i>
	Ratio	Per cent
EEC	0.18 : 1	45
NAFTA <sup>a</sup>	0.34 : 1	28
United States–Canada	0.92 : 1	18
MERCOSUR <sup>a</sup>	0.98 : 1	10
<b>APEC</b>	<b>1.37 : 1</b>	<b>50</b>
Andean	2.20 : 1	4
<b>ASEAN</b>	<b>3.48 : 1</b>	<b>13</b>
LAIA	4.44 : 1	8
CEFTA	9.10 : 1	6
CACM	36.25 : 1	8
EFTA	62.48 : 1	2

<sup>a</sup> NAFTA and MERCOSUR are also estimated to have a trade diversionary effect; the ratio of extra-bloc to intra-bloc trade creation excludes this trade diversionary effect.

*Source:* Commission estimates.

These results suggest that open regional agreements, such as APEC and to a lesser extent ASEAN, have the potential to promote regional integration. In comparison, while a large agreement, NAFTA is not an open one, and while its inward focus is by design, it is not likely to foster broader regional integration outside its member base, and may even inhibit it through its trade diversionary effects (see chapter 8).

The impact that a trade openness focus can have on promoting trade flows with non-members, and thus a greater scope for regional integration is further evidenced by examining the Central American Common Market (CACM) in its two incarnations. Initially launched in 1960, the agreement was formulated to foster import substituting industrialisation or closed regionalism. Following a regional crisis in the mid-80s, it was relaunched in the early 1990s as a model of open regionalism (Bulmer-Thomas 1998). The estimated ratio of extra-bloc trade creation to intra-bloc trade creation for the agreement following its relaunch in 1993 is significant at 36:1. For the precursor incarnation, the estimated ratio of extra-bloc to intra-bloc trade creation for the agreement modelled from 1960 to 1985 is significantly lower at 3:1.

Despite the paucity of evidence, it is likely that, overall, the degree of regional integration achieved will depend on the scope of these agreements to non-



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discriminatorily reduce barriers and open trade. Available evidence suggests that both APEC and ASEAN have at least been partly successful in doing this in the trade-in-merchandise-goods area. However, as cautioned by a number of commentators above, this scope is limited by both the exclusion of sensitive sectors and the continued proliferation of bilateral preferential agreements.

### 10.3 Summing up

This chapter examined two broader impacts from BRTAs — those related to direct and indirect reforms to domestic regulation, and those related to economic and regional integration.

For Australia, those domestic regulations that have been incorporated in BRTAs, in particular AUSFTA, have resulted in mixed outcomes. While the extension of copyright provisions (in particular, for existing works) has clearly imposed a net cost on the Australian economy, the relative costs and benefits of other provisions are less clear. Despite this, as seen in the case of the PBS, there are significant potential risks to incorporating certain domestic regulations in trade agreements. For those with a domestic public good focus (such as the PBS), the inclusion in trade agreements has the potential to impose costs beyond the benefits that can be obtained and reduce economic welfare (even though, in the PBS case, the outcome appears to be reasonably benign and even positive).

In terms of integration, possible outcomes are mixed. On the one hand, economic integration can occur between members to an agreement. Additionally, bilateral agreements may evolve into larger agreements and, over time, become a means to achieve wider economic integration. For example, the Canada-US bilateral agreement can be seen as a predecessor to the broader NAFTA agreement. On the other hand, as discussed in chapter 13, little use has been made of accession clauses to expand existing agreements. Further, the extent of broader regional integration (as observed in trade flows) and the economic benefits that arise depend on the openness of the agreement in question. In particular, the Commission's econometric analysis suggests that, insofar as they focus trade towards a partner country, preferential agreements can detract from broader regional integration, while agreements based on open regionalism, such as APEC and to a lesser extent the previous ASEAN-CEPT agreement in the Asia-Pacific, appear to foster economic and regional integration.



PART D

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# FUTURE APPROACH TO BRTAs



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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;

- 
- 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.



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## 12 Future approaches to trade liberalisation and the role of BRTAs

The terms of reference request the Commission to analyse the role of bilateral and regional trade agreements (BRTAs) in reducing trade and investment barriers both in Australia and other countries, and in promoting regional integration. In this context, as noted in the previous chapter, BRTAs are one of several options available to governments to achieve these goals. Based on the analysis in part C and chapter 11, this chapter considers what form of trade liberalisation mechanism (or mix of mechanisms) potentially provides the greatest net benefits to the community. Section 12.1 looks at unilateral reform, section 12.2 at multilateral reform and 12.3 at the role for bilateral and regional agreements.

### 12.1 Unilateral reform

Over the last three or so decades, Australia has gained significant economic benefits as a result of programs of unilateral reform, which entailed reducing domestic trade barriers without the need for any specific international engagement (Banks 2010). The Commission considers that continued unilateral reform is the most productive option for achieving the objective of lower domestic barriers to trade and investment as it provides the most direct means of delivering the benefits of trade to Australian consumers, businesses and the economy more broadly.

As the Commission has stated previously, domestic liberalisation also secures the majority of benefits available from trade liberalisation, regardless of existing trade and investment barriers abroad (see, for example, PC 2001). Of course, the proportion of a country's gains that arise from domestic liberalisation will depend on the level of existing barriers. That is, the lower the domestic barriers, the larger the relative gains from foreign, rather than domestic, reductions.

While Australia's previous unilateral reform efforts have reduced tariffs substantially, even at current tariff levels the preliminary modelling conducted as part of this study (chapter 8) suggests that the majority (approximately 60 per cent in the simulations undertaken (table 12.1)) of the gains in GDP available to Australia from tariff reductions are likely to arise from unilateral reform. The modelled gains from further unilateral reform are substantially larger than the

estimated gains possible from the full bilateral tariff reductions modelled in relation to Thailand and the United States — countries with which Australia has recently entered bilateral trade agreements.

**Table 12.1 Simulated aggregate effects of reducing tariffs to zero**

<i>Simulation</i>	<i>GDP-Australia</i>	<i>Share of potential world gain</i>
	Per cent change	Per cent
T1. Australia-small country <sup>a</sup>	0.05	5.7
T2. Australia-large country	0.12	12.4
<b>T3. Australia unilateral</b>	<b>0.56</b>	<b>59.5</b>
T4. Stylised APEC	0.86	91.7
T5. World	0.94	100

<sup>a</sup> Simulations are representations of the effects of the removal of barriers to trade. T1 Represents zero tariffs on all trade between Australia and a small country, T2 on trade between Australia and a large country. T3 simulates unilateral liberalisation as the removal of tariffs on all imports into Australia. T4 simulates zero tariffs on imports into all APEC countries and T5 simulates zero tariffs worldwide.

*Source:* Simulation results.

Australia also stands to gain if barriers in other countries are reduced, an objective that domestic reform is unable to (directly) affect. As such, while unilateral reform affords the greatest potential benefits in terms of reducing domestic barriers, in terms of an overall approach to trade policy, multilateral agreements or BRTAs can yield additional benefits by providing frameworks for trade and investment between countries and for coordinated reductions in trade and investment barriers. It is the interaction of unilateral reform with these other agreements that raises a potential policy issue, discussed below.

### **‘Bargaining coin’ issues**

Where there exists further scope for the pursuit of trade agreements, the issue arises as to whether Australia should delay or withhold otherwise beneficial domestic reforms in order to retain ‘negotiating coin’ to offer in future trade agreements.<sup>1</sup> The issue arises from the perception that, while Australia gained significant domestic benefits from the unilateral reform already undertaken, as a result, it has little negotiating coin left.

<sup>1</sup> In addition to BRTA negotiations, this argument also applies to WTO negotiations that are normally undertaken on the basis of ‘bound’ restrictions rather than applied levels. As the Commission has previously noted, ‘[w]here “negotiation coin” can come from the binding of liberalisation already undertaken, there is no benefit in delaying liberalisation.’ (PC 2001, p. 5)



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However, given Australia's relative size in international trade, there is some scepticism about the ability of any remaining negotiating coin to 'buy' valuable concessions from partner countries:

... Australia already has low applied tariff rates, which indicates that it's not the economic benefits of greater market access that attract countries to form PTAs with Australia. (RIRDC, sub. 10, p. 12)

Australia is a small player in international trade and its economy is already among the most open in the world, leaving our trade negotiators little to offer by way of 'concessions' to lure potential negotiating partners to the table and to induce them to make good offers. (Capling and Ravenhill 2008, p. 2)

Further, some contend that unilateral reform does not necessarily impede the pursuit of reduced barriers in other countries through the use of trade agreements:

Australia's ability to pursue the reduction of barriers to our exports has been heightened when Australia has itself pursued an ambitious economic reform agenda domestically. This is for two reasons. First, such reform enables the economy to be more competitive and thereby enables economic actors to be able to compete in global markets. Second, it provides a valuable demonstration effect. Domestic reforms give Australia credibility in trade negotiations. Agreeing to bind such reforms provides useful negotiating coin. (DFAT, sub. 53, p. 3)

Where a demonstration effect and the binding of existing reforms can be used in negotiations, there may not even be a 'trade off' between further unilateral reform and further bilateral, regional, or multilateral reform.

Indeed, an important consequence of Australia's approach to unilateral reform is that reductions in tariff rates have not always been 'bound' to the same extent in Australia's WTO schedule; meaning that, in effect, this form of bargaining coin has been preserved. For example, while the current applied tariff rate for imported motor vehicles is five per cent, Australia's bound rate for vehicles is 40 per cent.

Regardless of the effectiveness of various forms of negotiating coin, unilateral reform has a number of features that commend it over reliance on retaining existing impediments to trade as negotiating coin for trade agreements. First, the ability to undertake unilateral reform is a decision solely for the Australian government, and thus is more certain (and can be implemented sooner) than reforms that may come out of a negotiation process with one or more partner countries. Second, it is possible that countries may agree to an outcome under a trade agreement, only for the effective gains to be diminished by later domestic actions from partner countries. Third, the negotiation process itself comes at a cost (chapter 7).

Moreover, there are still pockets of protection and unnecessary regulation in the Australian economy where domestic reform can offer considerable gains (for

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example, in relation to the Foreign Investment Review Board). The case for delaying reform of such policies in the name of retained bargaining coin is particularly weak.

Overall, the Commission's assessment is that beneficial unilateral reforms should be identified and pursued as part of normal Australian policy processes, and not delayed on account of bargaining coin considerations that may be claimed for possible future negotiations.

In this context, the Commission notes that as part of the last *Review of Australia's General Tariff Arrangements*, conducted in 2000, the Commission recommended that existing general tariffs (those at 5 per cent or lower) should be removed as soon as possible (PC 2000). The Commission in subsequent studies has reaffirmed the benefit of this course of action (PC 2003, 2005 and 2009c). In light of the time that has elapsed and the estimated gains available, the Commission's assessment is that there would be merit in the government revisiting this issue.

Similarly, the Commission notes the modeling conducted in chapter 9 of this study indicated that moving from preferential to non-preferential reductions in barriers to investment under the Foreign Investment Review Board (FIRB) processes could afford benefits to Australia. Previous work by the CIE (2004a) and others also reported significant benefits (though there was contention over the magnitude). Given that it was deemed to be appropriate to extend these reductions to investors from the United States, the question arises as to why it is not appropriate to extend them to others, and why such further reform should be delayed. In this context, the Commission notes that Australia is currently negotiating with New Zealand to conclude an ANZCERTA Investment Protocol, which will include lifting the screening thresholds to \$953 million (in 2009) for New Zealand investors (Rudd and Key 2009). As such, the Commission's assessment is that the issue of extending these reductions on a non-preferential basis also merits examination by the government.

#### RECOMMENDATION 8

***The Australian Government should examine the potential to further reduce existing Australian barriers to trade and investment through unilateral action as a priority over pursuing liberalisation in the context of bilateral and regional trade agreements. The Government should not delay beneficial domestic trade liberalisation and reform in order to retain 'negotiating coin'.***

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## 12.2 Multilateral reform

As illustrated in table 12.1 (above), the largest potential gains to Australia come as a result of multilateral trade reform. To date, efforts at multilateral liberalisation have been pursued through the GATT and WTO institutions (chapter 4).

### The current state of WTO negotiations

As discussed in chapter 4, the WTO's Doha Round of negotiations, which commenced in 2001, is yet to be concluded. Participants in this study put forward several reasons for this, for example:

[W]ith 153 members, progress on more far-reaching trade liberalisation through the WTO, Doha Round has been frustratingly slow. By attempting to overload the WTO with non-trade issues that are not directly relevant to its objectives (e.g. environmental, animal welfare and labour standards, landscape management, food security and the socioeconomic viability of rural areas), some members are not helping this situation. These elements only act to distract the WTO mandate and weaken its capacity to deliver on trade reform. (National Farmers' Federation, sub. 13, p. 8)

The negotiations collapsed over issues of agricultural trade between the United States, India and China, in particular, disagreement between India and [the] United States over the agricultural special safeguard mechanism. (Government of South Australia, sub. 56, p. 7)

In light of the current situation, there are differing views on the prospects for conclusion (with meaningful gains) on the topics under negotiation in the Doha Round being reached in the short term. The WTO itself acknowledges that progress has been slow, but is still committed to working towards a conclusion for the Doha Round, as Director-General Pascal Lamy recently stated:

... although we have made some progress since 2008, there is no denying the fact that we are not where we wanted to be by now. ... Everyone agrees that no miracle solution is available to us at this point in time.

[However] ... Everyone is still very much committed to the mandate of the Round and to its successful conclusion. ... While there is certainly disappointment that we are not closer to our goal, I have not detected any defeatism. (WTO 2010c, p. 1)

Some participants in this study were also optimistic about the conclusion of the Doha Round:

Multilateral liberalisation under the auspices of the Doha Round will likely be realised; but at this point in time it is hard to say what the scope and pace of liberalisation will be. However, RIRDC sees the issue as not so much whether multilateral liberalisation will be realised, but when. (RIRDC, sub. 10, p. 4)

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Others were less confident about the prospects of multilateral reform:

The Doha Round has failed, and what we are left with is to decide whether to have its funeral or push on to finalise an agreement that is already so badly compromised through negotiations that it is worth very little, and certainly no recipe for trade liberalisation and transparency. While inherent weaknesses in the WTO system, including a far too wide an agenda and diverse membership, have no doubt contributed to this situation, there is little doubt that governments' growing pre-occupation with DTAs has been a major factor. (Malcolm Bosworth and Ray Trewin, sub. 32, p. 2)

The outcome of the WTO Doha Round is unclear. It is unlikely it will be concluded this year. Maintaining the integrity of the WTO is crucial for the future of the multilateral trading system. While concluding the Round would give an important boost to that, it is equally imperative that developments in the trade architecture do not undermine further efforts to continued trade and investment liberalisation. (Business Council of Australia, sub. 41, Attachment 1, p. 9)

Though some momentum was re-built through the WTO's Seventh Ministerial Conference held in Geneva in December 2009 where all members committed to the common objective of concluding the Doha Round in 2010, substantive progress has been slow and the prospects of an expeditious breakthrough in the near future are not particularly bright. (Government of South Australia, sub. 56, p. 7)

Based on the views expressed to date, it is apparent that the Doha Round has, for the present, stalled. While this means that some other actions may be necessary if trade liberalisation is to be pursued in the short term, it does not mean that the Doha Round is 'dead'. Indeed, efforts to conclude the round should be maintained in order to build on work done so far, particularly given the potential gains at stake:

... successful conclusion to the Doha Round, involving as it does 153 WTO members, has the potential to deliver an outcome which is more commercially significant than is possible via any FTA. (DFAT, sub. 53, p. 46)

The Commission notes that DFAT has stated that the conclusion of the Doha Round negotiations 'remains the Australian Government's highest trade policy priority' (sub. 53, p. 3) and supports the continuation of this approach.

Further, it is important that any actions taken in the interim serve to bolster, rather than undermine, the multilateral trading system. While BRTAs are one option that can be pursued at the same time as ongoing WTO negotiations, their effect on the multilateral trading system is the subject of some debate (chapter 6). As such, actions that can be pursued that would more clearly support the prospects for multilateral liberalisation should also be considered.

In the course of this study, the Commission has examined courses of action that could be pursued to support the multilateral trading system under the WTO.

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## **Strengthening WTO requirements for trade agreements**

As discussed in chapter 4 (box 4.2), trade agreements that would otherwise breach the ‘most-favoured-nation’ requirements of the WTO are permissible under GATT Article XXIV provided that (among other things) they apply to ‘substantially all trade’. The WTO also aims to add transparency to the formation of trade agreements by requiring that they are examined by the Committee on Regional Trade Agreements (CRTA). Given the recent proliferation of trade agreements, rules governing their interaction with the multilateral system take on a heightened importance. However, the present rules appear to be having little effect, as ‘substantially all trade’ remains undefined and the CRTA has yet to finalise an examination report since it was established in 1996. Following the Draft Report, some participants called for a greater focus on disciplines within the WTO:

... Australian policy makers should be implored to redouble their efforts to bring PTA’s under multilateral surveillance and discipline in the WTO. Article XXIV of GATT, The WTO Understanding on Interpretation of Article XXIV and GATS Article V all need elaboration ... (Graeme Thomson, sub. DR82, p. 2)

The Commission understands that Australia is already taking action in this area (box 12.1). It is clear that there are difficulties involved in this process, such as the number of parties and interests involved and Australia’s ability to influence change in multilateral settings. Further, as has been the experience with multilateral reform generally, it is likely that real outcomes would only be reached over a longer time frame.

Nonetheless, given the potential benefits to the multilateral system, and in line with recommendation 6.1 of the Mortimer review, the Commission endorses the action already taken and believes that the Australian Government should continue in its efforts to improve the RTA transparency mechanism at the WTO.

## **Domestic transparency measures**

It is widely acknowledged that a fundamental obstacle to international trade reform is political resistance within each trading country. The GATT (and WTO) was originally conceived as a means of creating explicit export winners from domestic liberalisation through the reciprocal concessions provided by trading partners, thus helping to balance the political opposition of perceived ‘losing’ industries on the import side. This logic also extends to reciprocal concessions within bilateral trade and regional agreements, where the potential exporting beneficiaries can also sometimes be more clearly identifiable. But the experience over a long period has been that the domestic import-competing interests remain the dominant influence.

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This is largely because there is more at stake for them than the relatively dispersed or uncertain ‘winners’ from domestic liberalisation, who typically also lack information about the gains, to them and the wider economy, from trade reforms. The upshot is that countries generally approach international trade negotiations as exercises in obtaining maximum concessions in foreign markets, while at the same time minimising their own. This is not conducive to rapid agreement or sustainable progress. Thus, as noted, the Doha Round has now been going for over nine years, with no conclusion in sight, while Australia’s negotiations with China are five years old.

**Box 12.1 Australian advocacy of improved WTO scrutiny of RTAs**

Australia has been active in advocating improvements in the WTO processes for trade agreements under GATT Article XXIV. In regard to adding transparency to the formation of agreements, DFAT submitted that:

Australia has played a central role in this area of the Doha Round as it sees greater clarity with respect to the rules as helping to guard against low quality agreements, which would ultimately be to the detriment of the WTO.

... The [negotiations to enhance transparency have] produced a positive result, with an RTA transparency mechanism having been agreed (and applied) provisionally in late 2006. Australia seeks to ensure that the mechanism, under which WTO members have agreed to subject all FTAs (including those agreements notified under the enabling clause) to a standardised notification, reporting and review process, will be permanently adopted as part of a final Doha Round package. Australia is a leading advocate on RTA standards and transparency in the WTO. (sub. 53, pp. 47–48)

Australia has also been active in working towards a definition of ‘substantially all trade’, although this issue:

... has been much more contentious and little progress has been made. Australia has been one of the most active participants in these negotiations submitting a number of formal detailed proposals on the question of substantially all trade. At the core of Australia’s submissions was a quantitative benchmark, which would require an RTA to eliminate tariffs on at least 95 per cent of tariff lines in order to meet the substantially all trade requirement.

In the absence of any real prospect of agreement to a rigorous definition of substantially all trade, the current focus in the Doha Round negotiating group on rules is shifting to a possible forward work program on RTAs. Australia is considering such a work program as a means of building on the success of the transparency mechanism and informing future consideration of the substantially all trade issue. (sub. 53, p. 48)

These essentially political obstacles to reform are not easily overcome, but could be ameliorated through the use of more transparent policy processes within each country to shed light on the economy-wide effects of reform. As the Commission has previously noted:

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The sticking point in the Doha Round — the divisions between the EU, US and developing countries regarding the adequacy of current concessions — relates to perceptions within those countries regarding the source of the benefits of trade liberalisation and how this translates to the multilateral negotiating arena. Resolution of these differences will not be straight-forward, and there is currently no process within the WTO trade negotiation process that can solve the underlying problem.

What is needed are processes and institutions within member countries that can promote a better understanding of the domestic tradeoffs in trade liberalisation, and help counter the political influence of protected industries by demonstrating which sections of the economy and community bear the costs of trade protection and which sections benefit. (PC 2007, p. 4.8)

These insights are of course not new, and have been raised in international forums since the mid-1980s. For example, institutional requirements to this end were considered in some detail by a study group chaired by Olivier Long, former Director-General of the GATT (Long, 1987). The Long Report concluded that the fragmented administrative arrangements found in most government bureaucracies had compounded the undue influence of industry groups resisting reform:

The achievement of an economy-wide, long-term perspective in trade policy requires that influences wider than those associated with claimant industries should be brought to bear on the policy-making process. This will not occur on its own. It depends on having procedures that provide for public scrutiny of protective action and that promote domestic understanding of its effects. We call this ‘domestic transparency’ – open, informed policy-making. (Long 1987, p. 21)

The report proposed that an agreement be negotiated within the then Uruguay Round on a code which would establish some broad design principles for domestic ‘transparency institutions’(citing the then Industries Assistance Commission in Australia as one example). This was carried forward within the negotiating group on the ‘Functioning of the GATT System’, but was ultimately displaced by efforts to create the Trade Policy Review Mechanism. While this constructive initiative has enhanced awareness and scrutiny internationally of WTO members’ trade policies, its effectiveness in shaping those policies is inherently limited by the fact that it is external to the domestic policy-making environment.

In the context of the present review, a group of prominent Australian and New Zealand businessmen and economists have reasserted the arguments for domestic transparency mechanisms:

Protectionism results from decisions taken by governments at home, for domestic reasons. Any response to protectionism must therefore begin at home, and bring into public view the domestic consequences of those decisions. G20 leaders should sponsor domestic transparency arrangements in individual countries, to provide public advice about the economy-wide costs of domestic protection. The resulting increase in public

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awareness of these costs is needed to counter the powerful influence protected domestic interests exercise over national trade policies. (sub. 5, Attachment 2, p. 1)

It is recognised that transparency mechanisms in themselves could not guarantee significant gains in the short term. Indeed, in the Australian experience, momentum for reform was only achieved over a long period:

Building a pro-reform constituency in government and the wider community is a gradual process. It took Australia four decades to get tariffs down and more than a decade tackling sources of underperformance in economic infrastructure services. And neither reform program is yet complete. That said, reforms once made in Australia have tended to stick, having stronger foundations of support or acceptance within the community precisely because the basis for reform *was* transparent. (Banks 2010, p. 279)

Thus, the introduction of such mechanisms would not see a speedy resolution to the Doha Round. However, the very difficulties in successfully concluding the Doha Round (as well as some current BRTA negotiations) underline the need to have a better basis for the progress into the future.

In order to pursue this and other possible options to reinforce the multilateral system, the formation of a new international study group has been proposed:

... with membership drawn from private policy institutes in Australia, New Zealand, the US and the EU. ... It will not focus on the Doha Round, but will concentrate on the longer-term options available to improve outcomes from future Rounds of multilateral trade negotiations and to counter the on-going threat of protectionism. (Saul Eslake and Peter Corish, sub. 59, Attachment 1, p. 1)

The Commission was informed that, in response to this suggestion the then Minister for Trade, in March 2010, indicated that he was happy to lend support to a study group of senior business and think-tank representatives ‘... to build on broader efforts to increase the domestic transparency on the cost of protectionism and promote the benefits of trade liberalisation’. (sub. 59, Attachment 2, p. 1)

The Australian Government is well-placed to lend support to such initiatives. The Productivity Commission, the descendant of the Industries Assistance Commission, continues to be cited internationally as one such institutional mechanism to assist structural and trade reform:

The [Productivity Commission] has been an important part of the institutional architecture for regulatory reform in Australia and it provides a model with many features that could usefully be emulated outside Australia in other OECD countries. (OECD 2010b, pp. 99–100)

The New Zealand Government has recently taken steps to establish its own New Zealand Productivity Commission, with the new body scheduled to commence



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operations in early 2011 (English and Hide, 2010). Some other countries have also demonstrated an interest in such institutional arrangements, including developing countries in the Asia-Pacific. At the 2008 APEC Meeting in Melbourne, Ministers agreed to a new ‘structural reform initiative’, noting that:

... robust institutional arrangements and processes are key to driving and achieving structural reforms on an ongoing basis, and that these arrangements and processes require strong support from government. (APEC 2008)

Since 2008, the G20 has assumed a larger role, and has itself promoted the need for increased transparency in some policy areas (G20 2009; 2010).

In sum, the Commission accepts that the cause of international trade liberalisation, whether conducted multilaterally, regionally or bilaterally, would be well served by nations giving greater attention to the domestic institutional requirements for identifying what is at stake domestically from their own liberalisation. Initiatives directed at this end could yield a significant pay off in the longer term and deserve support.

### **Other possibilities for furthering broadly based trade reform**

While it would appear that negotiations to conclude the Doha Round have, at present, stagnated, the potential benefits at stake suggest that efforts to conclude the round should be sustained. Further, it will be important to ensure that trade policy actions contemplated in the interim and in the post-Doha environment serve to support, rather than undermine, the multilateral system.

In this context, there may be merit in the Government weighing up with like minded countries the costs and benefits of a critical mass agreements (CMAs – box 12.2), or other broadly-based mechanisms, to push for reform. CMAs may be one effective mechanism for achieving broad plurilateral agreement in a number of areas. However, the Mortimer review — reporting in 2008 — questioned whether they would be widely subscribed. Of course, it may be difficult to effectively advance a CMA agenda without leadership from nations with significant trading power. This crucial role could be played by leading groups of nations, such as the G20, which could drive substantial progress through CMAs if none were forthcoming through the Doha Round.

Were the use of CMAs to gain momentum, Australia should not necessarily take part in every agreement. As with any sort of agreement, it would be necessary to first analyse any CMA to ensure that acceding to it is in Australia’s benefit.

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### Box 12.2 Critical Mass Agreements

One suggestion for regaining momentum at the international level has been the use of plurilateral agreements (involving a sub-set of WTO members) such as critical mass agreements (CMAs). These agreements (such as the Information Technology Agreement mentioned in chapter 4) come into effect once the signatories account for a designated percentage (90 per cent in the ITA) of world trade in the product in question. Once in effect, they impose obligations on signatories, with the resulting concessions typically offered on a MFN basis by signatories. When a large percentage of world trade has been covered, there can also be a secondary sign-up effect as remaining countries can be reluctant to be 'left behind' in the eyes of markets and investors.

As part of its report on WTO reform, the 2007 Warwick Commission recommended that:

... consideration be given to the circumstances in which a "critical mass" approach to decision-making might apply. The key implication of this approach is that not all [WTO] Members would necessarily be expected to make commitments in the policy area concerned. ... Among the criteria for considering a critical mass approach to defining the agenda are the need to identify a positive global welfare benefit, to protect the principle of non-discrimination, and to accommodate explicitly the income distribution effects of rule-making. (University of Warwick 2007, p. 3)

In commenting on this matter, the 2008 Mortimer review argued:

The Review believes that there are a number of factors that would need to be considered before such an initiative was launched. In particular, the prospect of success is far from secure. At present, many developing countries see very limited commercial interest in services exports and are, as a result, generally disinclined to give market access undertakings without reciprocal access in areas of high priority to them, such as agriculture and textiles. Without the scope for cross-issue trade-offs, it is unclear whether a services-only negotiating process could generate sufficient critical mass. We consider that more work is required to develop the proposal and Australia should include this issue as part of its post-Doha agenda. (Mortimer 2008, p. 82)

### Summing-up

The Commission's assessment is that work can be done to improve the prospects of multilateral (and other forms of) reform. While Australia is already supporting reform within the WTO regarding the transparency of trade agreement formation, the Commission's assessment is that more should be done to advocate domestic reforms in other countries, and investigate the possibility of pursuing reform with groups of like-minded countries.

*The Australian Government should support worthwhile efforts to achieve multilateral liberalisation. Should meaningful progress within the WTO prove elusive, the Government should weigh up with like-minded countries the feasibility of appropriate broadly based agreements to advance reform.*

*The Australian Government should lend support to initiatives directed at the establishment of domestic institutions in key trading countries to provide transparent information and advice on the community-wide impacts of trade, investment and associated policies .*

### **12.3 Bilateral and regional agreements**

While Australia has already undertaken substantial liberalisation of its own trade barriers and should continue to do so, there are still benefits that could accrue to Australia from the reduction in barriers to trade and investment in the economies of our trading partners.

Reductions in barriers in other countries would ideally be achieved through unilateral reforms or the multilateral processes of the WTO, but other trade policy options should also be considered in order to achieve the potential gains.

Notwithstanding the increasing interest in CMAs in academic circles, presently the most prominent tool directed at this objective is the use of BRTAs. As noted in chapter 11, the Commission's assessment is that there is a legitimate policy rationale for bilateral and regional agreements to reduce barriers in partner countries, and that such agreements can also promote economic cooperation and integration. However, the extent of potential benefits that Australia can gain in pursuing these objectives through such agreements depends critically on the nature and design of those agreements.

#### **Frameworks for trade**

One area in which bilateral and regional agreements can play a positive role is in setting the institutional frameworks and rules for trade between nations. Agreements between governments should aim to establish clear and consistent systems that would have several benefits for businesses, including easing entry into new markets,

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reducing compliance costs and increasing certainty of operating in a given market. Such systems include:

- like systems for contracting between parties;
- clear allocation and definition of property rights;
- transparent regulatory frameworks;
- transparent and objective criteria and processes for dispute resolution; and
- mutual recognition (or harmonisation) of standards and accreditation for goods and services.

The Commission recognises that much work has already been done in multilateral forums to establish the broad frameworks for trade. Nevertheless, there remains a substantial role for bilateral and regional agreement on many, more detailed, matters. Typically, these include domestic regulation where simple differences in regulatory settings can act as behind-the-border barriers (such as mutual recognition of professional qualifications and standards). Effective cooperation on such matters hinges on the development of regulatory trust between partner countries. Therefore, such topics naturally lend themselves to building bilateral agreements (as initial steps in expanding recognition to progressively wider groupings).

While such areas of cooperation are not traditionally considered as the ‘core’ area of trade agreements — which tend to focus on reducing more visible at-the-border barriers — their importance (along with trade facilitation measures discussed in chapter 13) for modern trading economies is increasing:

Today, we must find [ways] to deal with:

- problems of communications and logistics, often linked to security concerns;
- lack of efficiency, transparency, needless divergence and sometimes arbitrary implementation of economic policies in different economies.

These are the dimensions of cooperation where the marginal benefits of cooperation are now greatest. Research, including by the OECD, the World Bank and the ADB, tells us that the potential gains from reducing transactions costs other than traditional border barriers are enormous. (Elek, sub. 54, pp. 3–4)

It is important to note that while such cooperation can occur under the umbrella of a BRTA, it can also take place through a number of different forms of agreement (examples of such agreements are discussed in box 12.3). Indeed, the use of such alternative agreements could be beneficial where they serve to meet the objectives at hand more cost effectively, without entailing the negotiations and complications involved with achieving a single undertaking to a wider trade agreement involving trade-offs between various provisions.

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### Box 12.3 **Alternative types of agreement**

While the pursuit of BTRAs has been prominent in recent years, they are not the only option available to governments seeking to influence the trade policy of other countries. In addition to the unilateral and multilateral options noted earlier in the chapter, there are a range of different sorts of agreements.

For example, as noted by DFAT:

Other non-binding bilateral arrangements such as Trade and Investment [Framework] Agreements (TIFAs) and MOUs [Memoranda of Understanding] are routinely utilised by the Department on behalf of Government to achieve narrower trade, investment and economic objectives which can promote productivity improving reform in partner countries. (sub. 53, p. 67)

MoUs and TIFAs are potential options for focusing on particular topics for agreement between countries, and fostering broader cooperation between governments and agencies. For example, the Commission notes that, while negotiations for a trade agreement have yet to be finalised, ten new agreements with China were recently announced, including several MoUs. While many of the agreements involve private businesses, some were also concluded between governments, including an MoU between the Australian Department of Resources, Energy and Tourism and the National Energy Administration of the People's Republic of China on cooperation in the field of energy, and a protocol of Phytosanitary Requirements for the Export of Apples from Tasmania to China (Rudd 2010).

Further, standards and accreditation agreements or mutual recognition agreements (MRAs) can reduce behind-the-border barriers for businesses, allowing a wider range of goods and service providers into countries, while satisfying regulatory standards for a number of objectives such as health and safety.

These can be sector-specific agreements that focus on a particular range of products (such as the APEC MRA for Conformity Assessment of Telecommunications Equipment, or the Australia-EC MRA on standards and conformity assessment, which covers eight particular sectors). Wider MRAs typically exist between trade agreement partners, such as the Trans-Tasman MRA between Australia and New Zealand.

Another alternative form of agreement that can be used to further cooperation in particular areas are CMAs, discussed in box 12.2.

## **Reducing barriers to trade**

As well as establishing general frameworks for trade, bilateral and regional agreements can play a positive role in reducing specific barriers to trade and investment.

Based on the evidence and analysis in this study, greater gains would be available to all parties from trade liberalisation where it is possible to devise agreements that could be implemented on a non-preferential basis. This suggests that Australia

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should give weight, in prioritising and negotiating agreements, to non-preferential agreements (such as open regionalism agreements like APEC) or ‘preference-light’ agreements (such as the original ASEAN CEPT agreement).

However, the process of reaching agreements necessarily involves other, sovereign, parties. These parties may not be willing to negotiate with Australia on a non-preferential basis. Thus, although the potential gains from preferential agreements are smaller than those from non-preferential ones, they are nonetheless likely to be positive. Rather than forfeit any potential gains by refusing to negotiate preferences where partner countries insist upon them, the Commission’s assessment is that Australian negotiators should not be precluded from accepting such conditions.

### **Broader considerations**

While there is a potential role for BRTAs in establishing frameworks for trade and the reduction of existing barriers to trade and investment, earlier chapters have shown that particular provisions (and as such, agreements as a whole) can vary in the extent of the benefits and costs that they provide, depending on design. Further, given the major trading partners with which Australia already has negotiated agreements or is currently at some stage of negotiation, it is likely that the additional benefits attainable through future agreements may be relatively small, although the risks associated with adverse trade diversion from preferential arrangements also diminish as the scope of Australia’s agreements expands. With smaller impacts in prospect, the value of such agreements to Australia is likely to become increasingly more marginal.

In the Commission’s view, to ensure that any future agreements are in the public interest, it is important that agreements are subject to more transparent assessments of their economic benefits and costs before they are entered into and that they compare favourably with other trade liberalisation options (chapter 15). In this context, as with any policy instrument, the relationship between BRTAs and other mechanisms is also important, particularly if they can act as complements or must be prioritised as alternatives. It is important that any assessment of a potential BRTA identifies not only that it would be likely to yield net benefits, but also that it is part of the most cost-effective package of actions to achieve trade liberalisation objectives.

As discussed in chapter 11, some agreements may have impacts on strategic or security objectives. However, as detailed in that chapter, given the availability of more appropriate options for achieving those objectives, the Commission considers

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that such considerations should not be part of the analysis used to inform the decision of whether to pursue a trade agreement.

RECOMMENDATION 1

***The Australian Government should only pursue bilateral and regional trade agreements where they are likely to:***

- ***afford significant net economic benefits; and***
- ***be more cost-effective than other options for reducing trade and investment barriers, including alternative forms of bilateral and regional action.***

Where a trade agreement is pursued, there are a number of framework considerations that can be adopted to maximise the potential gains. In particular, as noted in chapter 8, the use of non-preferential (or preference ‘light’) tariff provisions can enhance the potential for economic benefit. Likewise, as noted in chapter 9, the nature of most barriers to services trade means that non-discriminatory reforms are likely to provide the most benefit. Further, as discussed in chapter 13, there are several other areas where non-discriminatory reforms have been identified as more beneficial than preferential treatment, including government procurement, competition policy, technical barriers to trade, capacity building and trade facilitation measures. The pursuit of bilateral or regional agreements also should avoid impeding the expansion of agreed conditions to (larger) regional or multilateral groupings, or the pursuit of beneficial unilateral reforms.

RECOMMENDATION 2

***The Australian Government should ensure that any bilateral and regional trade agreement it negotiates:***

- ***as far as practicable, avoids discriminatory terms and conditions in favour of arrangements based on non-discriminatory (most-favoured-nation) provisions;***
- ***does not preclude or prejudice similar arrangements with other trading partners; and***
- ***does not establish treaty obligations that could inhibit or delay unilateral, plurilateral or multilateral reform.***

In addition to these general guidelines, the extent of potential benefits that Australia can gain through future agreements also depends on the nature, scope and design of those agreements. It is therefore important that any future agreements follow good design principles (chapter 13) and have appropriate limits to their scope (chapter 14). The processes surrounding the initiation, negotiation and implementation are also important in improving the potential gains from them. Such process matters are discussed in chapter 15.





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## 13 Design of future BRTAs

Whether any particular BRTA generates net benefits, and the extent of those benefits, depends crucially on its design. This chapter sets out a range of design matters that, together with the ‘good process’ requirements discussed in chapter 15, should help minimise the risk that Australia might enter into welfare-reducing BRTAs and enhance the likelihood that BRTAs negotiated will be of most benefit.

Of course, the optimal design of BRTAs will vary to some extent from agreement to agreement, depending on the characteristics of particular partner countries and Australia’s economic relationships with them. Further, whatever Australia may consider to be an ideally designed BRTA, some divergence from this ideal may be necessary where prospective partner countries hold a different view. This calls for a degree of variability between BRTAs and some flexibility during negotiations.

This chapter first catalogues existing sets of ‘best-practice’ principles suggested for BRTAs (section 13.1). Drawing on those principles, and the analysis presented earlier in this report, the chapter then discusses:

- the appropriate coverage of Australian BRTAs (section 13.2);
- the role and appropriate form of rules of origin embodied in preferential BRTAs (13.3);
- options for multilateralising provisions in BRTAs (13.4); and
- assisting other countries through trade facilitation and capacity building (13.5).

### 13.1 Existing best practice principles

In recent years, a number of Australian and international bodies have produced best-practice principles or guidelines for BRTAs. While many of these have some key features in common, they also differ in their level of detail, focus and on some particular issues.

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## APEC and the Asian Development Bank

APEC Economic Leaders adopted a set of non-binding best-practice principles for free trade and regional trade agreements at their meeting in Santiago in November 2004. These principles emphasise consistency with broader APEC principles and goals, consistency with the WTO rules for trade agreements, and going beyond WTO commitments. Other key aspects are comprehensiveness of coverage, transparency, inclusion of mechanisms for consultation and dispute settlement, simple rules of origin that facilitate trade, scope for accession of third parties, and provision for periodic review.

Observing the highly general nature of the WTO rules regarding trade agreements, the Asian Development Bank (ADB) considered it would be useful to define some best practice rules that would minimise the negative effects of free trade agreements and maximize the positive effects. The rules devised by the ADB extend APEC's best practice principles to include guidance on specific matters such as investment, intellectual property, anti-dumping and technical barriers to trade. They emphasise the desirability of non-discriminatory provisions and transparent processes and procedures (box 13.1).

### Box 13.1 Asian Development Bank principles for BRTAs

The ADB's best practice rules address the following major areas:

- comprehensive coverage of goods and services;
- rules of origin should be as low as possible and consistent;
- customs procedures should follow global best practices and GATT/WTO-consistent protocols;
- intellectual property rights guidelines should be non-discriminatory and consistent with TRIPS, TRIPS Plus, and related international conventions;
- foreign direct investment provisions should embrace national treatment and non-discrimination, shun performance requirements, have a highly inclusive negative list, and provide the usual protection to foreign investors;
- antidumping procedures and dispute resolution need to be transparent and fair;
- government procurement should be as open and non-discriminatory, and procedures as clear and open, as possible;
- competition related policies should create a level playing field for all partners and should not disadvantage non-partner competition; and
- technical barriers to trade should be kept to a minimum and harmonized in a non-discriminatory way.

Source: ADB (2008).

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## Rural Industries Research and Development Corporation

In 2005 the Rural Industries Research and Development Corporation (RIRDC) published a set of guidelines which details the features of a ‘good’ preferential trade agreement (box 13.2).

### Box 13.2 Features of a ‘good’ preferential trade agreement — RIRDC

In *‘Free’ Trade Agreements: Making Them Better*, the Rural Industries Research and Development Corporation sets out ten features of a ‘good’ PTA:

- ensure that prices are reduced — the greater the price reduction, the greater the probability that the agreement will facilitate trade creation rather than trade diversion;
- do not exclude ‘problem’ industries — while typically sensitive, reform in these industries can also be the most beneficial; PTAs provide a good opportunity to gently expose sensitive industries to international competition, as well as those sensitive industries delivering some of the greatest price reductions from trade liberalisation;
- make PTAs comprehensive — no industry or sector should be exempted from a PTA, as this creates distortions and entrenches protection and special treatment;
- make rules of origin simple and consistent — inherent to the formation of a PTA are rules of origin which can restrict trade and increase compliance costs. RoO should be minimised and simplified to minimise this cost;
- maximise certainty — this is achieved through consistency of rules and when trade and investment restrictions are low;
- investment liberalisation — by including this area in PTAs, the potential benefits from the agreement are improved. Furthermore, investment liberalisation is key to services trade liberalisation;
- avoid ‘new protectionism’ — there is some shift towards including issues such as intellectual property, competition laws, labour market regulations and the environment into PTAs. However, since there is disagreement about how these issues should be managed, it is best not to let these issues cloud the more important ones of trade and investment liberalisation;
- transparent process, consultation and detailed analysis — transparency is important at all stages to ensure that the political motivations do not hijack PTA negotiations;
- continue commitment to WTO — PTAs should be structured to complement WTO negotiations through either a sunset clause or the winding back of preferences; and
- pursue evolutionary PTAs — to facilitate the shift of preferential agreements to free trade, PTAs should be designed to be able to include more economies over time.

Source: CIE (2005b).

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## University of Sussex

The University of Sussex has developed a framework to enable the elements of a proposed trade agreement to be set out — and systematically evaluated using a set of policy ‘rules of thumb’ — allowing an overall judgement on the likely balance of economic welfare effects of the proposed agreement (box 13.3).

### Box 13.3 **Sussex Framework**

The Sussex Framework was developed particularly for trade agreements involving developing countries and is intended to encourage consideration of the political, social and economic viability of a proposed agreement. The main factors to be evaluated include:

- the nature of the economic relationship between the partner countries and the existing barriers to trade;
- the nature of the proposed agreement and the extent to which it will overlap with other agreements and be WTO compatible;
- the expected ease or difficulty of the negotiations and the role of foreign donors in driving the agreement; and
- the presence of elements of deep integration — such as investment rules, competition policy alignment and rules on movement of natural persons — in the proposed agreement.

Source: Evans et al. (2006).

## Mortimer review

The Mortimer review (2008) considered it would be in Australia’s best interests to maintain sufficient flexibility in its approach to agreements to enable it to participate in as many emerging ‘free trade agreement clusters’ as possible. Accordingly, it did not favour Australia adopting a model free trade agreement or an overly prescriptive approach to the design of trade agreements.

However, it considered there would be value in the Government adopting clear principles to guide its future approach to free trade agreements. In this regard, it proposed that the Government should, when assessing prospective free trade agreement partners, determine whether the agreement has the potential to:

- counter trade diversion or deliver substantial commercial and wider economic benefits more quickly than would be possible through other efforts;
- be fully consistent with WTO provisions;

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- deliver ‘WTO-plus’ outcomes in the form of liberalising commitments that are broader and deeper than those undertaken in the WTO;
  - provide for substantial liberalisation — including by eliminating virtually all tariffs and delivering new and significant access opportunities for services and investment — within a reasonable time period;
  - allow, where possible, for the accession of third countries and be consistent with the goal of regional free and open trade and investment; and
  - promote Australia’s foreign and security policy interests.

## 13.2 Sectoral coverage of agreements

As noted in chapter 4, Article XXIV of the GATT requires that in BRTAs formed by WTO members, duties and other restrictive regulations on commerce must be eliminated on ‘substantially all the trade’ between the parties. For BRTAs covering trade in services, GATS Article V mandates that a BRTA must have substantial sectoral coverage (requiring *inter alia* that there are no *a priori* exclusions of any mode of supply) and provide for the absence or elimination of substantially all discrimination between, or among, the parties in the sectors covered. Although there are important disagreements among WTO members over the precise definition of terms like ‘substantially all the trade’, many countries state their desire of substantial coverage when forming BRTAs (for example, as noted in chapter 6, Australia advocates coverage of 95 per cent of tariff lines as consistent with ‘substantially all’).

Beyond this ‘substantial’ coverage of most or all traded goods or services, trade agreements can also be ‘comprehensive’ in their scope by including not only goods and services, but also investment; competition policy; intellectual property; trade facilitation measures; and labour issues, among other topics (see chapter 14) .

In its initial submission, DFAT stated that ‘Australia seeks to ensure that its agreements are comprehensive in coverage and scope and reflect contemporary expectations of both border protection and behind the border measures’ (sub. 53, p.7). According to the Mortimer review, Australia’s agreements are among the most comprehensive, being at least as comprehensive as those negotiated between other industrialised countries and, on average, much more comprehensive than those negotiated between developing countries (Mortimer 2008, p. 96).

Even so, Australia’s recent agreements have allowed significant protection to remain in some areas (chapter 6) and many provisions, particularly in services, do not appear to have been taken advantage of by Australian exporters. Elek (sub. 44,

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p. 30) has suggested that it is not realistic to expect most prospective partners to make politically difficult decisions to secure a comprehensive agreement with Australia, given that Australia is not a large market for these partners. The current difficulties in progressing a BRTA with China may in part reflect such dynamics and the challenges that arise when pursuing ‘ambitious’ agreements.

Importantly though, to meet the WTO guidelines, agreements do not necessarily need to be ‘comprehensive’ in scope. For instance, the WTO does not stipulate that agreements must address both services and merchandise in a single undertaking. In this vein, the Mortimer review suggested that consideration could be given to an agreement between Australia and the European Union covering only services. This raises the broader question of whether Australia should be willing to trade off the pursuit of comprehensive agreements in order to obtain at least some reductions in barriers to trade and investment.

There are, of course, several advantages to achieving comprehensive agreements that cover all (or most) sectors (including both goods and services). Endeavouring to include sensitive sectors, which often enjoy the highest protection, increases the potential gains, in particular where the agreement is on a non-preferential basis or where one of the partners is a low cost producer (by global standards) of the protected products. If low cost foreign producers are involved, including as many sectors as possible also increases the likelihood that domestic industries will become subject to increased competition — the key source of the benefits of trade liberalisation. Indeed, some suggest that, in this way, trade agreements ‘provide a good opportunity to gently expose sensitive industries to international competition’ and that allowing for sensitive areas to be ‘carved out’ of agreements ‘creates distortions and entrenches protection and special treatment’ (RIRDC, sub. 10, p. 25). In addition, negotiating agreements that minimise carve outs in the partner country maximises the market access for Australian exporters.

As alluded to above, however, the pursuit of comprehensive agreements can also bring costs. Negotiations for comprehensive agreements can be lengthy and difficult, requiring the attention and resources of Australia’s trade negotiators, and risking compromising liberalisation potential and even souring of relations between Australia and partner countries. They can entrench a mentality of ‘tit-for-tat’ concession trading between parties rather than focussing on areas that offer mutual benefit with minimal costs, as the goal of comprehensiveness can be indiscriminately pursued by negotiators and governments, losing sight of the underlying economic benefits at stake.

One important consideration is that negotiations over sensitive sectors can significantly delay, or even preclude, the parties from concluding an agreement. It

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has been suggested, for instance, that Australia may be unable to successfully negotiate a comprehensive trade agreement with the European Union or Japan given sensitivities, particularly around the agricultural sectors, in both economies. In such circumstances, the benefits of reduced barriers in non-sensitive areas are also delayed (or even forgone). If reductions to barriers in non-sensitive areas make up a significant proportion of the likely benefits of an agreement, on balance, their delay (or loss) might outweigh any possible benefits from further reductions in barriers to sensitive sectors in the partner country. These drawbacks are particularly likely in the case of ‘single undertaking’ agreements, where agreements cannot be concluded until all topics are agreed to.

Reflecting such considerations, in its submission to the Mortimer review, the Australian Services Roundtable argued for the:

Cessation of automatic Australian priority to “comprehensive” bilateral negotiations covering Goods (Agriculture) as well as Services. (ASR 2008, p. 6)

On the other hand, the National Farmers’ Federation (sub. 13, p. 10) cautioned:

... sensitivities are not merely isolated to agriculture, but can include a variety of sectors such as automotives and services. .... There will always be temptations for Governments to omit these sensitive sectors in the realisation that doing so would make it much easier to finalise a deal. However, reform in these industries can also often be the most beneficial, with the potential to lead to significant price reductions, encourage new innovation, better management techniques and quicker adoption of best-practice production. Excluding these sectors from trade agreements can instead entrench the protection of these groups making it more difficult to achieve future reform of those industries.

The Department of Agriculture, Fisheries and Forestry (sub. 6, p. 4) stated:

As agriculture can be a difficult aspect of many trade agreement negotiations, it could be argued that it would be easier for Australia to aim for sector-specific agreements rather than the current comprehensive policy. The department has significant concerns about this proposal, recognising that it may leave agriculture out of most agreements indefinitely, to the detriment of a valuable export-focused sector. Such concern is justified as some trading partners have already attempted to marginalise or exclude agriculture from FTA negotiations. A shift to a sector-by-sector approach would only encourage narrow-focused agreements, creating an unfortunate precedent for Australia’s broader trade policy agenda, including at the multilateral level.

While noting the concerns expressed by the Federation and the Department are not without substance, in the Draft Report the Commission put forward the idea that the Australian Government should adopt a more flexible approach to the comprehensiveness of BRTAs it pursues. There were two aspects to the draft recommendation. First, that the government consider less comprehensive but still WTO-consistent agreements, such as separate agreements in goods or in services, in

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its initial consideration of the costs and benefits of its trade options. And second, that the government should make greater use of implementation schedules that rely on built-in agendas to promote reductions in barriers to trade and investment where negotiations prove to be very protracted and where reductions in barriers in non-sensitive areas make up a significant proportion of the likely benefits of a comprehensive agreement. In these circumstances, the Commission considered it could be appropriate to abandon the single-undertaking approach and to utilise a built-in agenda.

While the two options could in fact stand alone, they were essentially directed at the same objective: the earlier capture of ‘low-hanging fruit’ and the pursuit over the longer time frame of those elements that require more protracted negotiation.

In response to the draft recommendation, some participants expressed concerns regarding the spirit and the potential impact of this recommendation. For example, Professor Peter Lloyd suggested that the ‘spirit of both GATT Article XXIV and GATS Article V is that of comprehensiveness. Taken together, they imply (but not legally) that comprehensiveness across both sectors is desirable’ (sub. DR77, p. 1).

A number of organisations expressed concern that the draft recommendation would reduce the chance of attaining reform in sensitive sectors, particularly agriculture (box 13.4). In particular, DFAT (sub. DR98, pp. 7) stated:

A less-than-comprehensive approach risks reducing the negotiating leverage and the range of possible trade-offs that are critical to achieving a balanced outcome in FTA negotiations, including improved access in sensitive market sectors and products. It runs the risk of reducing the positive impact on domestic economic reform that an FTA can potentially provide. It could also signal, ahead of the start of negotiations, where Australian policymakers envisaged FTA partner governments would be unlikely to respond completely to Australian requests.

The Commission considers that, at least in part, some of the concerns expressed arose due to a misunderstanding of its recommendation. It is important to clarify that the Commission was not suggesting that the agriculture sector, or specific agricultural industries, be excluded from any negotiation covering goods-specific PTA. Rather, it suggested that the option of WTO-compliant goods-only or services-only agreements be considered, where appropriate, noting that potential benefits should not be foregone where they can be largely secured through a less comprehensive approach.



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**Box 13.4 Participants' comments on Draft Recommendation 2**

National Farmers' Federation (sub. DR85, p. 2):

From the NFF's perspective, this is the most concerning recommendation within the draft report, ... As previously stated, the NFF believes that all-inclusive trade agreements, whether they are bilateral or multilateral, must be Australia's bottom line.

Sheepmeat Council of Australia (sub. DR73, p. 2):

Trade liberalisation through international fora should remain an Australian Government priority. This can be achieved through negotiating comprehensive BRTAs and must be a high priority given the protracted and problematic nature of multilateral trade negotiations ...

Australian Sugar Industry Alliance Ltd (sub. DR93, p. 2)

In the bilateral trade arena comprehensiveness is similarly important. The Australia—US FTA is the only FTA either country has concluded that does not include ... sugar. In addition to delivering no new access for Australian sugar to the US market, the exclusion of sugar has been noticed by other countries, some of these are parties to FTA negotiations with Australia. This has increased the difficulty Australia faces securing improved market access in those negotiations for both sugar and other sensitive agricultural products.

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

The department's view remains that the maximum benefits for Australian agriculture — and other sectors — will come from providing liberalisation across all parts of the economy.

In relation to the second element of the draft recommendation that there be greater use of implementation schedules that rely on built-in agendas to promote reductions in barriers to trade and investment, DFAT responded that this already occurs in Australia's BRTAs, noting that:

[Australia's FTAs] all contain various built-in agendas that allow for the continuing work to promote further liberalisation and reform over time, as well as the scope to move onto new areas in response to the needs of today's business community ... However, the scope to make use of built-in agendas should not be used as an excuse by the parties not to confront the difficult areas of reform upfront when the FTA is initially negotiated. (sub. DR98, pp. 7-8)

The Cattle Council echoed this concern, arguing that securing the non-contentious components immediately while settling on a 'working group' approach to advance more sensitive issues would 'effectively sideline agricultural market access discussions from the negotiation of BRTAs. This approach, if followed, would be a retrograde step in Australia's trade policy' (sub. DR97, p. 3).

While the Commission maintains that a more flexible approach to the scope of agreements could bring benefits in some instances, it has not retained this element of its recommendation in this final report. In part, this reflects the lack of further evidence following the Draft Report that would indicate that the gains on offer from a services-only agreement could not be achieved by pursuing a broader goods and

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services agreement. It is also possible that a policy of striking sector-specific agreements could alter other countries' approach towards Australia in negotiating trade agreements more broadly, including in multilateral fora. As pointed out in chapter 9, the gains from the inclusion of services in agreements will often take many years to realise, and probably does not constitute 'low-hanging fruit'. But the opportunities and challenges of each bilateral relationship do vary.

However, the Commission continues to consider that greater use of implementation schedules that rely on built-in agendas would be beneficial. This would retain all sectors in an agreement but progress reform through a staged approach.

The appropriate scope and negotiating approach to any future BRTA might pursue, and the merits of other options for obtaining reform to trade and investment barriers in partner countries, are matters to be considered in the revised approach to pre-negotiation assessments recommended in chapter 15.

### **13.3 Rules of origin**

Where PTAs are entered into, the question arises as to the appropriate design of associated rules of origin (RoO). As noted earlier, RoO are incorporated in PTAs to determine whether items of merchandise trade entering from the partner country qualify for preferential tariff treatment. That is, they restrict the availability of preferential entry to goods deemed to originate from the partner countries.<sup>1</sup>

The best-practice principles listed in section 13.1 do not provide much detailed guidance on the design of RoO, although they do suggest that any rules should not unduly raise barriers to trade. For example, the ADB principles simply state that 'rules of origin should be as low as possible and consistent', while the RIRDC principles state 'inherent to the formation of a PTA are rules of origin which can restrict trade and increase compliance costs. RoO should be minimised and simplified to minimise this cost'. The Commission considered the design of RoO more closely in its 2004 study of the RoO in the ANZCERTA (CER) with New Zealand.

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<sup>1</sup> Such rules are also applied to confer origin in services trade, but in these areas they are less onerous and contentious than in merchandise trade. RoO are also used in international trade for a variety of other purposes, including for trade statistics, to implement antidumping measures, to determine whether imported goods qualify for MFN treatment or for one-way tariff preferences, and for labelling and marking requirements. RoO also serve the purpose of assessing cumulation in BRTAs involving more than two parties.

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The principal justification used for RoO in PTAs is to avoid ‘trade deflection’ — that is, the utilisation of preferences by producers in non-partner countries by transshipping products through members of a PTA with the lowest tariff (see chapter 8). While trade deflection need not always be welfare-reducing<sup>2</sup>, the Commission has taken the view that there is a legitimate case for the use of RoO in this context.

To achieve this, RoO must require a degree of transformation of the product in the partner country that is sufficiently substantial to discourage the transshipment of the same product from third parties.<sup>3</sup> Equally, however, if the transformation required is unduly onerous, potential gains from trade are likely to be diminished. Among other things, as discussed in chapter 8, overly restrictive RoO can provide an incentive for firms to alter their production processes and use higher cost regional inputs in order to qualify for preferences.

With the objective of avoiding trade deflection in mind, in principle RoO in PTAs are only required if the value of the ‘margin of preference’ — the difference between the MFN tariff and the preferential tariff — is greater than the costs of transshipment. Where this is not the case, there is no incentive for parties in a third country to engage in transshipment to take advantage of the tariff preference. Thus, the application of RoO in such circumstances would not impact on trade deflection. However, it would still entail compliance costs and, depending on how the RoO are specified, risk necessitating adjustments to the production processes and input mixes of firms in the partner country.

On the other hand, where the margin of preference exceeds the costs of transshipment, appropriately designed RoO can discourage trade deflection. Designing RoO to achieve this objective is not easy, as the minimum level of transformation that is sufficiently substantial to avoid trade deflection will vary from product to product, as transport costs and margins of preference vary. Further, in designing RoO, a range of other considerations are relevant. These include the impacts of RoO on incentives to innovate, compliance costs, the costs to governments involved in negotiating RoO and the scope of different forms of RoO to be used for protectionist purposes.

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<sup>2</sup> Technically speaking, trade deflection need not always entail a welfare loss, as it is possible that in some cases there may be benefits to consumers of a transshipped product, in the form of greater consumer surplus associated with being able to access lower-priced imports, that will outweigh the additional costs entailed in transshipment.

<sup>3</sup> Goods designated as being ‘wholly obtained’ from the partner country automatically qualify for preferences, without a requirement for substantial transformation. Wholly obtained goods are typically natural resource-based goods which are deemed the produce of a single country or final goods which are manufactured in a party from such wholly-obtained inputs (sub. 53, p. 16).

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## *Evolution in Australia's approach to RoO*

The RoO in the 1983 CER agreement with New Zealand were based on a regional value of content (RVC) approach, with a requirement that the last process of manufacture take place in the exporting country. The originating materials and processing used in this last process were required to represent a minimum of 50 per cent of the ex-factory cost of the exported product. This same broad approach was used in Australia's PTA with Singapore, albeit with some modifications and a lower RVC requirement.

In its 2004 report, the Commission found that, given the maturity of the agreement and the low levels of tariff protection in each country, there should be no change to the RVC method then used for determining origin in CER, that had been in use since the agreement was established in 1983. In doing so, the Commission considered the merits of the product-specific CTC method but found that, while it potentially offered benefits such as lower compliance costs and increased certainty for business, it would also entail significant risks:

... a change to a CTC rule would be a significant move in the way Australian and New Zealand businesses and the Customs Service determine origin in the CER. There is considerable doubt about whether determination of what constitutes manufacture would be more rigorous than current procedures — some firms could be advantaged while others would be disadvantaged relative to their situation under current arrangements. Furthermore, there is considerable evidence that the CTC method is easily manipulated to provide protection to sectional interests in a non-transparent manner and concern among some participants about such an outcome. (PC 2004, pp. 151-152)

Since 2004, however, the Australian Government has adopted the CTC approach in most of its PTAs. According to DFAT, the catalyst for the change to the CTC approach was the negotiation of the AUSFTA, in conjunction with feedback from industry that reiterated that adoption of the approach would reduce a number of problems it saw under the RVC approach (box 13.5).

However, in the AANZFTA (with ASEAN and New Zealand, which took effect at the start of 2010), businesses have a choice of using either a CTC rule or a RVC rule for many products. (Likewise, following changes to the CER that took effect in 2007, businesses presently have the option of qualifying for preferences under either the pre-existing RVC-based RoO or under new CTC-based rules). According to DFAT, the key benefit of the approach in the AANZFTA is that it:

... marries the objectivity of the CTC approach – there is a single, clear rule for each tariff line – with ASEAN's greater familiarity and comfort with the value added approach. The agreement to provide a choice of ROO allows additional flexibility for exporters who may choose to export their goods under either test. (sub. 53, p. 19)

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### Box 13.5 The move to CTC-based rules of origin in Australia's PTAs

The ANZCERTA ROO, when it entered into force in 1983, was based on a value added approach with a requirement that the last process of manufacture take place in the exporting country. The originating materials and processing used in this last process were required to represent a minimum of 50 per cent of the ex-factory cost of the exported product.

This approach was retained in the SAFTA ROO [with] some modifications...

The catalyst for Australia's decision to change its approach on ROO was the commencement of FTA negotiations with the United States. The United States had previously concluded a number of FTAs – including the North American Free Trade Agreement (NAFTA) with Canada and Mexico and its Agreement with Singapore – using Product Specific ROO (PSR) mainly based on a CTC approach.

Furthermore, wide discussions with Australian industry in recent years had flagged some doubts about the capacity of the value added approach to meet the criteria for effective ROO. Some industry contacts had raised concerns about the lack of clarity in determining allowable and non-allowable costs under the value added approach. Importantly these calculations involved considerable compliance and administrative costs for business. The ex factory cost method also requires industry to obtain and keep records solely for the purpose of determining ROO. These records are a cost to industry as they are not required for the general running of their businesses.

Australian industry has expressed three main concerns about the value added approach. First, the value added test is the least certain method of calculating origin as it is highly susceptible to changes in the costs of non-originating materials. ... A second issue raised by industry was the constraints the value added approach placed on innovation. ... A third key concern raised by industry was the failure of the value added approach to take into consideration the concept of substantial transformation across industries.

During consultations with industry it became clear that CTC methodology would resolve many of the concerns identified with the value added approach. This led Australia to adopt PSR based on a CTC approach in AUSFTA. Australia also adopted PSRs based on a CTC approach in TAFTA. In many cases the required PSR are similar to those under AUSFTA.

Following the 2005 entry into force of both AUSFTA and TAFTA, further consultations have been held with industry to examine the application of the ROO. These consultations have confirmed industry support for the CTC-based approach and have resulted in this becoming Australia's preferred approach in FTAs.

In recent years Australia and New Zealand have re-negotiated the ROO in ANZCERTA to use PSR based on a CTC approach. This approach was also used in ACI-FTA.

*Source:* DFAT (sub 53, p. 19).

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### *Future approach to RoO*

The Commission has encountered a range of views during this and previous studies about the merits of different RoO. What is clear is that, although the CTC approach has now been adopted in most of Australia's agreements, there remain differences in the detailed rules in different agreements (chapter 6). While the use of product-specific rules can provide a simpler process for assessing origin and reduce costs for some producers, the Commission remains concerned that differences between agreements can add to costs and distort trade patterns. In its response to the Draft Report, DFAT noted that a regional work program had just begun that was seeking to improve the 'complementarity and coherence' of RoO in the region. (sub. DR98, p. 9).

DFAT also restated its preference for CTC-based rules:

... at this time, and based on our experience and advice provided by industry, DFAT believes that the CTC methodology for the most part provides the best means of achieving the outcome of an appropriate set of rules that are liberal and flexible in ensuring the application of the principle of substantial transformation. ... in most cases, CTC rules provide a simple and unambiguous test of origin, making alternative rules unnecessary. (sub. DR98, p. 9)

The Department of Innovation, Industry, Science and Research also supports the 'predominantly CTC-based approach to PSR, negotiated on a line-by-line basis, as the only methodology which will ensure robust processes of substantial transformation on each product within the Harmonised System' (sub. 94, p. 1).

However, in the Commission's view, the composite approach recently adopted in the AANZFTA offers clear advantages. It offers choice for exporters with different production methods and, depending on the RVC threshold adopted, may reduce the potential for the RoO to be used for protectionist purposes. The Commission's assessment is that this composite model should be adopted as a basis for RoO in future PTA negotiations.

In the Draft Report, the Commission also recommended that, in future PTA negotiations, Australia seek the inclusion of a waiver of RoO requirements to be applied where the difference between the preferential and MFN rates for a particular import are 5 percentage points or less. DFAT argued that the Commission had not provided supporting evidence or clearly specified a rationale for this recommendation. It continued:

Unless strong evidence could be assembled which provided a solid basis for concluding that the risk was low that the implementation of a waiver of the ROOs requirement would result in trade deflection and consequent welfare losses, DFAT could not support this recommendation. (sub. DR 98, p. 11)

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As noted earlier in this section, to avoid trade deflection, RoO in PTAs are required only if the value of the ‘margin of preference’ — the difference between the MFN tariff and the preferential tariff — is greater than the costs of transshipment. In its 2004 study of the RoO in the ANZCERTA (CER), the Commission drew on data on freight costs between Australia and New Zealand in supporting a waiver in cases where the difference in the countries MFN tariffs was 5 percentage point or less. The Commission found that such a waiver would ‘deliver broad-based gains and should reduce compliance costs significantly’ (PC 2004). Data for other trading partners suggests that average freight costs are typically higher than those for trans-Tasman trade.<sup>4</sup>

RECOMMENDATION 3

*The Australian Government should adopt the composite model for rules to determine origin in merchandise trade, as in AANZFTA, as the basis for rules of origin in any future preferential trade agreement. In adopting this model:*

- *a choice of Regional Value Content and Change in Tariff Classification rules for determining origin should be afforded for each item of merchandise;*
- *the least restrictive variant of each test should be adopted, consistent with preventing trade deflection; and*
- *Australia should seek a waiver to rules of origin requirements where the difference between the MFN tariff rates in the partner countries is 5 percentage points or less.*

## 13.4 Multilateralising provisions

As noted in chapter 6, differing preferences and trading rules across BRTAs can lead to a ‘noodle bowl’ effect that can raise the costs of trade relative to a consistent multilateral trading system. Given that the process of reform through the WTO has stagnated, at least temporarily, it may be possible to create new, consistent, trading rules through different means, to re-invigorate trade liberalising reform in the international trading system administered by the WTO.

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<sup>4</sup> Using detailed import clearance data from the Australian Bureau of Statistics, average freight costs for imports into Australia were estimated as the difference between the ‘free-on-board’ and ‘cost-insurance-freight’ values as a proportion of the customs value. Over the period 2002 to 2009, calculated average freight costs ranged from 10.6 per cent for imports from the United States to about 7.7 per cent for imports from Japan and New Zealand.

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BRTAs, in their various forms, represent one means of doing so. The following sections examine accession and ‘MFN’ clauses — two potential mechanisms for expanding the application of (or ‘multilateralising’) preferences and measures to reduce barriers to trade and investment beyond the original parties to a BRTA.

### **Accession clauses**

Broadly, an accession clause provides that other parties may join an agreement, by agreeing to implement the same reductions in barriers to trade and investment and abide by the same conditions and rules embodied in the accession agreement (and subject to approval by the original parties). This allows a BRTA to expand to cover additional nations on the same basis. Examples include the process for new members to join the European Union, subject to a pre-set range of conditions, or at the multilateral level, accession to the WTO.

While accession clauses have some in-principle appeal, there are practical difficulties with their application that may diminish some of their potential benefits. First, comprehensive BRTAs are negotiated across a wide range of sectors and issues between parties. When other parties seek to join a BRTA they effectively ‘free ride’ off the original negotiating process and the trade-offs that resulted from it. Given different sensitivities and trade profiles between nations, it may be the case that the original parties would not benefit from the accession of certain countries. In particular, negotiators would face pressures from interest groups in all the original parties, rather than just their own domestic interests. As Elek noted:

In practice, accession is likely to be limited to those who do not create serious new competition for the interests protected within existing agreements (either by exemptions or rules of origin). (sub. 44, p. 26)

As such, the economic benefits from the accession of new parties can be limited.

Second, the comprehensive nature of some BRTAs can make the accession process complicated and arduous. This may create an incentive for new parties to simply seek new agreements with each of the original parties, unless the benefits of joining the existing agreement are substantial. As such, accession clauses are more likely to be of use as part of larger regional agreements whose size is sufficient to be an incentive for other nations to take part. However, the Commission understands that, to date, there are no PTAs between major economies. Instead, there are a number of agreements existing around the ‘hubs’ of major economies, often through bilateral (rather than regional) agreements with other nations. While the reasons for this are complex, a contributing factor is the desire of major economies to negotiate agreements that suit each of them best, rather than agreeing to standards dictated by



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others. Although some regional agreements with major economies are under consideration (such as the TPP), the ‘track record’ to date casts doubt on the ability to truly multilateralise conditions of an agreement.

One way to reduce the complexity of acceding to agreements would be to allow accession to particular clauses, or subsets of agreements, for example in relation to particular topics. The Commission notes, however, that negotiating parties may take issue with such an approach, as it could unbalance the ‘negotiating calculus’ of a comprehensive agreement. As such, accession clauses are likely to be more effective when used in agreements that focus on particular sectors or topics, that allow for easier harmonisation of rules and up front consideration of the effect of additional parties joining an agreement (such agreements could essentially become critical mass agreements (CMAs), as discussed in chapter 12).

The Commission’s assessment is that while appealing in principle, accession clauses may only be of substantial benefit when used as part of larger regional agreements, or in single topic agreements such as CMAs.

FINDING 13.1

*No preferential trade agreements have been entered into between major trading blocs. While accession clauses are often seen as a means to multilateralise preferential agreements, little use has been made of them to date by either large or small countries.*

## **MFN clauses**

‘MFN’ clauses refer to provisions in BRTAs that seek to preserve at least equal treatment for the partner countries if one (or more) of them later negotiate more liberal preferences with other parties. In this way, they seek to imitate multilateral most-favoured-nation treatment (of course, in terms of preferential barriers to trade, the simplest way to grant MFN treatment to others would be to negotiate on a non-preferential basis).

Australia has such MFN clauses in two trade agreements, in relation to services and investment, but not goods:

AUSFTA and ACI–FTA [Chile] have a MFN provision, which requires Australia and its FTA partner to accord to each other’s service suppliers, investors and investments, treatment no less favourable than that it accords, in like circumstances, to service suppliers, investors and investments of a non–Party. This means, for example, that if either Party signs a new, more liberalising FTA, the benefits of that will flow automatically to the other Party. AUSFTA and ACI–FTA also include a ratchet mechanism for services and investment, which means that any liberalisation that a

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Party undertakes unilaterally with respect to certain listed measures will also be automatically locked in to the respective FTA. (DFAT, sub. 53, pp. 73–4)

The use of MFN clauses can act as an inbuilt ‘defensive reaction’ to existing trade agreements in countering any later trade diverting negotiations by partner countries. In doing so, they can be seen to support the multilateral trading system, by reducing the degree of preferential trade undertaken.

However, it is inappropriate to apply MFN clauses in BRTAs indiscriminately. First, they may be redundant where, due to existing multilateral agreements, areas of trade policy can only be changed on an MFN basis even if covered in a BRTA. Intellectual property (chapter 14) is one example of this, due to the MFN clause contained in the TRIPS agreement.

Second, there are some areas that do not easily lend themselves to MFN clauses, but rather to direct cooperation between governments to set (and ensure the enforcement of) mutually agreeable standards. One example of this is mutual recognition agreements (MRAs) surrounding the registration of service providers, where the governments involved must satisfy themselves of the standards of services regulation in each jurisdiction before allowing the freer movement of service providers. Automatically extending an MRA offered to one country to all trading partners could undermine the pursuit of valid regulatory objectives regarding, for example, health and safety.

One other notable concern with MFN clauses is that their use can add to policy ‘lock in’ (discussed in chapter 11) simply by increasing the number of countries that are stakeholders in a given trade barrier in Australia. Importantly, as noted in chapter 11, this can lock in the form of trade barrier as distinct from the level, potentially constraining policy makers in the future from liberalising a barrier with new regulatory approaches.<sup>5</sup>

The Commission notes that existing Australian practice preserves some flexibility. For example in relation to negative list agreements, Australia maintains the ability to modify measures subject to reservations, to the extent that they remain in

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<sup>5</sup> The Office of International Law (sub. DR83, p. 3) noted that it is the level of treatment accorded by a barrier, rather than the particular barrier itself, that is bound. As discussed in chapter 11, determining if a barrier that has changed in form (for example, from a monetary threshold to a sectoral focus) is in fact more favourable to particular partner countries or not is more difficult than, say, a tariff reduction. This could reduce the willingness of regulators to examine more fundamental changes in regulatory schemes that could be more beneficial than simple reductions in barriers within existing frameworks.

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conformity with the relevant obligations (Office of International Law, Attorney-General's Department, sub. DR83, p. 3).

As discussed in chapter 14, the Commission is concerned with a number of areas covered in some trade agreements that are traditionally areas of domestic policy. To the extent that the application of MFN clauses exacerbates concerns in these areas, further caution is warranted.

As noted in chapter 12, in relation to Australia's domestic barriers, reforms that are identified as beneficial should, in the Commission's view, be expedited on a unilateral basis, thus applying the same liberalised settings to all trading partners.

### **13.5 Providing trade-related assistance to other countries**

In the course of negotiations for existing BRTAs, particularly those involving developing countries, it is becoming commonplace for Australia to offer assistance to negotiating partners. Broadly, this can take two forms, trade facilitation and capacity building.

#### *Trade facilitation*

Trade facilitation measures are actions that lower the cost of trade such as improving physical or regulatory infrastructure to streamline the movement of goods through ports. As noted in chapter 8, improving trade facilitation was found to have a small but positive impact on trade flows, with a greater impact for non-preferential improvements.

Trade facilitation measures can be implemented through direct engagements between governments — for example, the exchange of expertise for customs processing — and does not necessarily need to be undertaken as part of a BRTA.

Nonetheless, the Commission's assessment is that, if a BRTA is determined to be beneficial, the offer of trade facilitation measures to partner countries that could stand to benefit can enhance the gains available from a given agreement (provided trade facilitation measures are at least as cost-effective as the inclusion of other provisions). As noted in chapter 8, the Commission considers this should be done on a non-preferential basis (that is, improving the procedures in a manner that improves access to all, not simply 'express' access to the goods or services of one country).

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FINDING 13.2

*Trade facilitation measures are an effective means of enhancing trade. Such measures can be included in a BRTA, but are most beneficial if undertaken on a non-preferential basis.*

### *Capacity building*

The provision of capacity building assistance to other, particularly developing, countries can have many benefits. Typically, capacity building is targeted at the good governance and institutions of recipient countries, and often takes the form of training for local officials, or the exchange of government officials with partner countries to improve the experience of both sides. Such forms of capacity building can improve domestic policy, and assist developing countries in the negotiation of bilateral, regional and multilateral trade agreements.

As discussed in chapter 12, the Commission considers that capacity building measures that aim to improve domestic transparency are of particular benefit. In the context of developing countries, a first step towards this would be to improve domestic analytical capacity. This could assist the countries in identifying valuable reforms for themselves, rather than ‘conceding’ to reforms advocated by developed countries in the course of trade negotiations (the Commission acknowledges that substantial aid may be required from developed nations to assist such mechanisms). Once the analytical capacity of the country in question has been developed, the outcomes from policy processes could be further improved by moves to increase domestic transparency.

Whether capacity building should be included as part of BRTAs is a separate question, as there are drawbacks to the use of BRTAs in this context. Offering capacity building as part of a BRTA with a developing nation can lead to perceptions of conflicts of interests, as attempts to train negotiators from ‘the other side’ or pursue capacity building in particular sectors can be seen to benefit the developed country more than the recipient. Such perceptions can arise even where the capacity-building is offered without any expectation of exchange. For example, in the context of the PACER Plus negotiations, a statement from Pacific civil society organisations, churches and trade unions contended that:

... a clear conflict of interest arises when [negotiation] training programmes like these are directed by Australia or [New Zealand]. It is extremely unusual for trade officials to improve their negotiating capacity by discussing their national issues and concerns with those they would then negotiate with! Trade officials from Pacific countries need independent and objective sources of information, training and capacity building in order to engage in trade negotiations with Australia and NZ. (2009, p. 6)

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These perceptions — whether justified or not — can be diminished where training is conducted at arm’s length from government. Moreover, AusAID argued that such training can have advantages for both parties:

... while it may seem counter-intuitive to train developing country partners in the technical aspects of trade negotiations, it would lead to a number of benefits for Australia, including:

- (i) a more efficient negotiating process for the trade agreement;
- (ii) achieving a more optimal outcome from the agreement (including broader, deeper and more immediate market opening);
- (iii) better implementation of the agreement which would lead to better access for Australian exporters; and
- (iv) building up general capacity of the developing country partner(s) to pursue trade agreements that are WTO consistent and supportive of multilateralism. (sub. 46, p. 10)

The Commission supports ongoing capacity building programs by the Australian Government as a central feature of our assistance to developing countries, particularly those in our region, and considers that these should continue to be pursued regardless of whether BRTAs with the assisted countries are also pursued. In particular, the Commission notes that these programs can be undertaken through direct provision of assistance, or by using development or economic cooperation agreements.

In the context of trade agreements, the Commission’s assessment is that the identification of partner countries should take account of the ability of the partner to accurately assess the relative costs and benefits of an agreement themselves. If it is deemed that the prospective partner country does not have the capabilities required in order to negotiate an agreement, the appropriate trade policy approach to that country should instead focus on broader economic capacity building (which would include institutional exchanges that can serve to highlight the potential benefits of trade liberalisation). Such capacity building should be directed at ensuring that the frameworks (in markets, government institutions, and physical infrastructure such as ports) in the country are developed to such a point that they are more able to take advantage of the potential gains from trade. Such factors should be assessed as part of any initial analysis of Australia’s trade policy approach to relevant developing countries (through, for example, the trade policy strategy process discussed in chapter 15).

If it is determined that negotiations should go ahead with a developing country partner, then they should proceed at a pace that takes account of the partner’s relative level of preparedness, as well as whether or not capacity building programs appropriate to the circumstances are in place. Of course, capacity building should be

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funded and delivered in a clearly unbiased manner, to minimise potential (or perceived) conflicts of interest. Further, any capacity building that is provided should be clearly de-linked from any obligation on the part of the developing country partner, either to negotiate an agreement or to negotiate the agreement according to a schedule dictated by Australia.

RECOMMENDATION 6

*If it is deemed that capacity building should be part of a trade agreement development process, the Australian Government should fund and deliver capacity-building programs in a manner that minimises potential (or perceived) conflicts of interest. Any such programs should not impose an obligation to negotiate a trade agreement.*

While such negotiation capacity building can be of benefit, some participants questioned its merit relative to more general capacity building:

... rather than offer assistance for enhanced negotiating capacity we should continue to support more general economic development through international agencies. Attempting to harness BRTAs for this task seems ill advised. This is especially true of the small and micro states of our region. (Greg Mahony, Public Policy Institute, Australian Catholic University, sub. DR78, p. 1)

Indeed, the Commission's assessment is that broader economic capacity building — directed at institutions, markets, infrastructure and domestic analysis capability — offers considerably greater benefits to recipient countries than negotiation-specific programs. In the context of broader Australian trade policy, and in a situation where the resources available for capacity building are limited, greater priority should be devoted to programs that have broader economic impact, rather than those conducted simply to facilitate the negotiation of trade agreements.

## 13.6 Summing up

A degree of variability is inevitable — and, indeed, desirable — in the design of BRTAs, not least because optimal design will vary in accordance with the nature of the economic relationship Australia has with a prospective partner. Nonetheless, some useful broad approaches to the design of future BRTAs can be drawn.

There would be merit in the Australian Government adopting a more flexible approach to the comprehensiveness of the BRTAs it pursues, particularly if negotiations are likely to be, or become, difficult or protracted, or if there are clear and significant gains available from securing early agreement on non-contentious areas.

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A composite model should be adopted as a basis for RoO in future PTA negotiations in order to reduce compliance costs for exporters and lessen the potential for RoO to be used for protectionist purposes.

Multilateralising provisions, such as accession clauses and MFN clauses, have some in-principle appeal, but there are some practical difficulties with their application. MFN clauses should avoid locking in any particular form or level of trade barrier, which could then constrain future liberalisation.

Trade related assistance to developing countries, such as capacity-building, should be funded and delivered transparently, and be de-linked from any obligation on behalf of the country concerned to negotiate an agreement with Australia.





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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.***





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# 15 Processes for establishing BRTAs

Just as good design principles and appropriate limits on scope can contribute to the quality of BRTAs (chapters 13 and 14), so can well structured government processes for making such agreements. However, participants raised various concerns about aspects of the processes currently employed by the Australian Government. These relate to:

- choice of prospective bilateral or regional partner countries;
- assessment of the economic and strategic impacts and benefits likely to flow from an agreement;
- consultation with interested parties; and
- the roles of the executive vis-à-vis parliament for approving agreements.

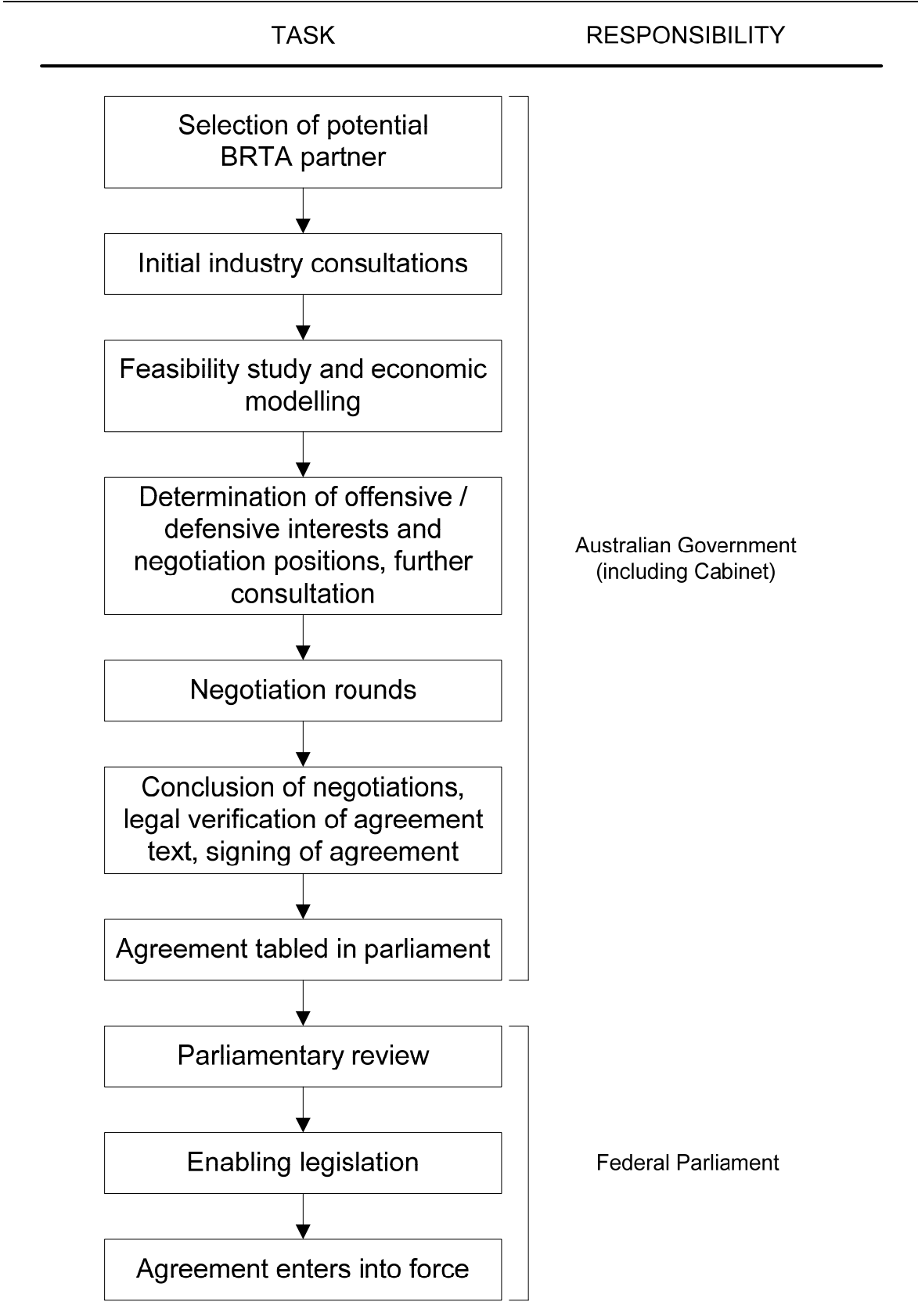
The Draft Report considered the current processes for establishing trade agreements, and examined the concerns with that process raised by participants. The Commission has received further feedback on the problems identified with current processes, as well as the draft recommendation. While the emphasis of submissions has been on preferential agreements, the options for reform relate more broadly to a range of trade policy options.

## 15.1 Current processes

The current process for BRTAs commences with the emergence and choice of potential partners to reflect strategic, trade and economic development interests of the prospective members. All agreements involve some level of commitment to future action and involvement between members. These commitments are arrived at through a process of negotiation between partners and are given effect through enabling legislation, regulation or government policy announcements, as appropriate.

For the preferential agreements recently entered into by Australia or that are in prospect, the broad approach involves, from the identification of potential partners: domestic consultation; negotiating rounds with prospective partners; finalising an agreement with the partner(s); and enacting enabling legislation to give effect to the commitments made in the agreement (figure 15.1).

Figure 15.1 Current process for establishing preferential trade agreements



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Some of these steps are the responsibility of the executive arm of government; others fall within the ambit of the parliament. In some circumstances, some of the steps may be omitted, repeated, or sequenced slightly differently.

There is no set length of time for establishing an agreement, and the length of time taken from the initiation of a new agreement to its implementation differs based on a wide range of factors. These include the level of existing barriers between Australia and the partner country, the sensitivity of particular sectors, and the difficulty of concluding negotiations. While some of Australia's BRTAs have been concluded in a short period of time (for example, AUSFTA), others are more protracted. For example, negotiations with China commenced in 2005 and it is not clear that a final agreement is close to being reached.

## **15.2 Concerns with the current process**

### **Selecting and prioritising agreement partners**

While the stated intention of the Australian Government is to pursue BRTAs that are comprehensive in nature and that support multilateral liberalisation efforts (DFAT, sub. 53), the Commission is unaware of any clearly articulated principles that are currently used by the Government for selecting prospective BRTA partners and for prioritising the negotiation of different BRTAs. Indeed, the Winemakers' Federation of Australia stated:

Questions are raised concerning prospective partners for FTAs. It appears to us that there is no coordinated plan on priority FTAs. (sub. 1, p. 11)

And the Office of Horticultural Market Access stated:

The process for determining prospective partners for possible trade agreements is unclear. However it is important that there is a pre-decision process which gives a chance for industry to present initial views prior to government decision to proceed to negotiations. For example horticulture views that the Australia-Chile FTA did not follow such a process. (sub. 39, p. 16)

In practice, a range of matters no doubt influences which countries are selected for pursuing agreements, and the timing of those negotiations, including political considerations and the willingness of other country's governments to engage in discussions, as well as judgments about possible economic or other benefits to be had from such agreements. In this regard, the Commission notes that the then Minister for Trade highlighted in February 2010 Australia's lack of any trade agreements with either Europe or African nations as being a 'missing link' in Australia's policy (Crean 2010).

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Following the Draft Report, several participants expressed a desire for a more transparent and coordinated approach to prospective agreements:

... the NFF agrees that it is a good objective for the Australian Government to attempt to enhance scrutiny of the reasons for, time frames, exit strategies, potential impacts and benefits of prospective agreements. At a time where there is an increasing global focus on pursuing ‘geo-political’ deals that have little interest in genuine trade liberalisation, it is important that the Australian Government makes it clear to stakeholders about what direction they intend to drive the negotiations. (NFF, sub. DR85, p. 5)

ACCI would like to see a greater strategic and coordinated approach to trade policy, in order to both benefit domestic industry and also to provide Australian business with better access to overseas markets. (ACCI, sub. DR87, p. 7)

... current processes for assessing, prioritising, and reporting outcomes of [trade agreements] lack transparency and tend to oversell benefits of the agreements. A3P supports more transparency in the [trade agreement] negotiating process. (Australian Plantation Products & Paper Industry Council, sub. DR64, p. 2)

In response to concerns raised in the Draft Report, DFAT submitted that:

Decisions to embark upon FTA negotiations are “whole-of-government” decisions made by Cabinet. The resource implications; potential costs, benefits, risks; and specific issues that may emerge during the course of negotiations are assessed during the Cabinet process. The Government’s practice has been that consideration of whether to embark upon FTA negotiations, and the negotiating mandate, follows wide public consultation associated with the preparation of an FTA feasibility study, including assessment of the economic and broader bilateral relationship with the country in question, and the costs and benefits associated with an FTA. (sub. DR98, p. 16)

Notwithstanding these observations, based on broader consultation during this study, the Commission is concerned that initial consideration of the decision to enter a trade agreement by Cabinet is often rushed and heavily reliant on the findings of the feasibility study or other overly optimistic assumptions (discussed below). There was also a perception that, not only does a public commitment to undertake a feasibility study appear to create a strong expectation that there will be negotiations and a deal will be reached, but that feasibility studies can sometimes be commissioned after a decision to pursue negotiations has been taken, in order to build public support for the undertaking. Further, while Cabinet is involved in agreeing to a negotiating mandate, and has to agree to any subsequent changes to the mandate, the Commission heard that it does not, as a matter of course, receive regular updates on BRTA negotiations and the extent to which they are meeting the original objectives.

A broader concern raised during the Commission’s consultations was that the advancement of trade objectives with a given partner country appear to be

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‘automatically’ pursued through preferential trade agreements, without apparent consideration of alternative instruments (or combinations thereof) that may be more targeted means of addressing particular trade issues. In this light, the Australian Chamber of Commerce and Industry (ACCI) noted that one significant theme that emerged from its survey of businesses was that:

The BRTA process is seen by some companies as self-serving and that there may be more cost efficient processes available to government in delivering the current BRTA agenda. (sub. DR87, p. 9)

Of course, matters of partner and instrument selection may well form part of the consideration of trade policy priorities by DFAT and relevant Ministers. Indeed, in relation to partner choice, the Commission notes that some of Australia’s major trading partners are amongst those countries with which Australia has negotiated, or is negotiating, a trade agreement.

Despite this, it is apparent from participants’ comments that, at a minimum, the basis for partner and instrument selection have not been effectively communicated in a public manner.<sup>1</sup>

### **Assessing the potential impacts**

Following the identification of a potential trade agreement partner and confirmation of an interest in negotiating with Australia, DFAT prepares a feasibility study, usually in consultation with other government departments and private consultants. Feasibility studies were prepared prior to the negotiations of Australia’s current agreements with the United States, Thailand, Singapore and Chile, as well as for some agreements currently being negotiated, including China, Japan, Korea, Malaysia and the Gulf Cooperation Council. Feasibility studies have also been prepared in advance of possible negotiations with India and Indonesia. Consideration of entry into the AANZFTA negotiations in 2004 was informed by a High Level Task Force Report conducted in 2000, rather than a specific feasibility study at the time. As far as the Commission is aware, no feasibility study was conducted prior to entering negotiations for the Trans-Pacific Partnership agreement.

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<sup>1</sup> Of course, some considerations currently included in the trade agreement process (for example security and strategic relationships) may not easily lend themselves to detailed public consideration.

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A number of participants in this study raised concerns with the way feasibility studies, and the modelling on which they are based, are currently undertaken, including with the:

- stage at which the modelling and analysis of likely effects are prepared in the overall process;
- assumptions used to underpin any economic modelling of potential costs and benefits; and
- use of such studies once completed, in particular their use to unduly raise expectations about the benefits that might flow from concluding an agreement.

In brief, there are concerns that pre-agreement modelling is used to overstate the benefits likely to be reaped from BRTAs, and that the assumptions and other qualifications surrounding the modelling tend to be downplayed in public statements by those promoting BRTAs (box 15.1). In the Commission's assessment, this leads to unrealistic expectations about what will be obtained, and skews consideration of the merits of proceeding with negotiations.

It should be acknowledged that assessing the potential benefits and costs of many policy measures can be difficult, and BRTAs are no different. Because feasibility studies and their associated economic modelling are prepared prior to the commencement of negotiations, they are unable to model an actual agreement. Instead, as the CIE indicated, 'the Australian Government typically wants comprehensive and overnight liberalisation modelled, with liberalisation spanning merchandise trade, service trade, investment, non-tariff barriers (if estimates are available) and inclusion of dynamic productivity gains'. (sub. DR75, p. 6) The studies generally have not taken into account possible carve outs, the effects of rules of origins or the potential for tariff cuts to not be passed on in the form of lower prices. However, the recent India and Indonesia studies have included simulations of both five and ten year phase-in periods for tariff cuts.

A further aspect raised by several participants is the limitations of any modelling used as part of a feasibility study. While modelling can be a useful component of economic analysis of policy, such analysis often proceeds using other quantitative and qualitative methods in addition to any modelling. On the specific limitations of modelling BRTAs, DFAT stated:

Modelling can provide an indication of the possible quantitative impacts of an FTA on the basis of certain assumptions and particular data sets. Such modelling can be a very useful input both to policy-making processes and to public debate ... However, modelling can never provide a full assessment of a trade agreement as it cannot adequately assess all the impacts of an agreement. Many elements of trade agreements are simply not amenable to quantitative assessment. For example, models generally do

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not have a means to adequately quantify the impacts of tariff bindings on investment or of provisions disciplining and limiting the use of non-tariff measures ... [or] the streamlining of customs procedures, greater transparency and good regulatory practice in domestic regulations, or greater regulatory dialogue and consultation to reduce the impact of non-tariff measures. (sub. DR98, p. 17)

The CIE added that the limitations of modelling do not mean that it should not be used, but rather that care should be taken in the use of any results:

... modelling results should only be used to infer the direction of outcome of trade liberalisation (positive or negative) and the broad magnitude of such impacts (small or large). It is inappropriate to, for example, report modelling results to the 2nd decimal point and claim that as the unambiguous impact of any trade reforms. That is, only broad messages and trends should be taken from the modelling results. ...

What economic modelling can do is to provide a rigorous and best available quantitative framework for estimating the potential economic impacts of an FTA, noting the above comments about how modelling results should be taken. Without such a tool there is no real way of knowing whether a particular FTA should be pursued, or allowing potential FTAs to be prioritised. (sub. DR75, p. 5)

It is doubtful whether feasibility studies overall, as they are currently produced, are an adequate decision making tool for deciding whether to proceed with negotiations or not. While it is important to determine if an agreement is 'feasible', the more important questions are whether an agreement, in a form that might feasibly be reached, is likely to generate net benefits within a reasonable time scale, and whether it compares favourably to the relative merits of other approaches to trade liberalisation (or other use of government resources).

Achieving the most meaningful estimates possible of prospective impacts would, in practice, depend on the final text of an agreement — information not available at the feasibility study stage. While the analysis for some of Australia's agreements has been updated as negotiations have progressed (such as for the AUSFTA), this is not standard for all agreements. And while National Interest Analyses (NIA) and Regulatory Impact Statements are tabled in Parliament with concluded agreements, and various Senate committees have the option of investigating the impacts of an actual agreement, these analyses are unable to inform Cabinet's decision as they all come after an agreement has been signed.

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### Box 15.1 **Some participants' concerns about feasibility studies**

Victorian Government (sub. 40, p. 3):

Economic modelling has a useful role to play in projecting the impact of a proposed FTA, and modelling based on reasonable assumptions can assist in the evaluation of the impact of an FTA. However, there are limitations to modelling. As an FTA is being negotiated its scope can change and this can have an impact on the modelling results. The modelling scenarios may have to make assumptions about the final scope of the FTA and it is possible that the final outcome may differ from that assumed. Results generated under these conditions, with assumptions that do not reflect the reality of an agreement, are not only ineffective but can also be misleading and counterproductive because they can be used to support arguments about the impact of trade agreements on certain industries and/or the economy as a whole.

Office of Horticultural Market Access (sub. 9, p. 16):

Feasibility studies do not seem to penetrate to the heart of industry concerns and situations. It may be unreasonable to expect them to do so, as many issues become evident during the course of the negotiations. Feasibility studies may need to bring to greater prominence the rationale for and against choice of partner country for a trade negotiation.

Carmichael, B., Cutbush, G., Hussey, D. and Trebeck, D. (sub. 43, p. 3):

The feasibility study on an agreement with China, for instance, also relied on projections of possible gains for Australia from a 'nirvana' agreement that will bear no relationship to what is ultimately agreed. Although those projections were qualified to a degree in the body of the study, they were subsequently used without qualification to support the conclusion (posted on the DFAT website) that '*there would be significant economic benefits for ... Australia ... through the negotiation of an FTA (sic).*' Such a conclusion could not be drawn from either the projections of possible gains or from the outcome of negotiations, which had not yet begun.

As happened in negotiations with the United States, the all important distinction between possible gains (as measured in the econometric projections) and the actual outcome of (future) negotiations became blurred. This is evident, for instance, in the study's conclusion that: '*Australian merchandise exports to China are estimated to increase by around A\$4.3 billion or 14.8 per cent in 2015 as a result of the FTA.*' The contribution to community understanding made by this slide from possible to actual outcomes is reflected in a Sydney Morning Herald editorial comment [of 21 April 2005], following release of the study: '*The government has released a feasibility study which promises (sic) a \$24.5 billion bonanza for Australia from the China deal over the next decade (sic).*' The study was used to create this quite specific public expectation about the magnitude of our gains from negotiations, which had not yet begun.

The Music Council of Australia (sub. 35, p. 4):

The Music Council considers that during this decade the value of bilateral free trade agreements has been considerably oversold and the benefits do not appear to be living up to the expectations posited at the time negotiations commenced.

The Centre for International Economics (sub. DR75, p. 10):

Due to (likely) differences between comprehensive liberalisation and the actually negotiated provisions in an FTA, the modelling results from FTA Feasibility Studies should not be used to portray the gains that could be expected from a negotiated FTA.



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The upshot of commissioning analysis that is likely to overstate the benefits of an agreement prior to the decision to enter negotiations, and the lack of a comprehensive and robust analysis of the benefits and costs of the actual provisions in an agreement before it is signed, is that Australia risks entering agreements that will ultimately reduce welfare or foregoing options with potentially greater net benefits.

FINDING 15.1

*The approach to conducting feasibility studies used for most previous Australian BRTAs has produced overly optimistic expectations of the likely economic effects of BRTAs. Such an approach does not provide an adequate basis for assessing their merits.*

## **Engagement and consultation**

DFAT currently provides substantial public information, and seeks community input, on trade agreements. The department operates an online portal that provides information on Australia's existing and proposed trade agreements. For agreements under consideration, the website provides information about the partner country as well as the opportunities available under a trade agreement, makes publically available the feasibility study and seeks submissions on potential issues related to the agreement. For agreements currently under negotiation, the department provides ongoing updates following each round of negotiations.

In addition to the provision of information, following the Draft Report DFAT submitted that its current processes involve wide public consultation:

DFAT's public consultation processes for FTAs involve invitations for submissions; meetings in Canberra and state capitals with state governments and participants from the private sector and broader community; as well as ongoing day-to-day engagement with interested parties. ... Throughout the process of FTA negotiation, Ministers, officials and State and Territory Governments have made use of a wide range of industry and other forums, as well as official websites, to seek to ensure that the community is aware of the negotiations and understands the issues being discussed, and to encourage the provision of any comments or information... (sub. DR98, p. 16)

While some participants — for example the National Farmers' Federation (sub. DR85) and the Australian Sugar Industry Alliance (sub. DR93) — supported the efforts of DFAT to consult with the community, others saw room for improvement. For example, the Business Council of Australia (BCA) stated:

The BCA appreciates the longstanding commitment of DFAT to consulting widely with business and other stakeholders. The department's approach has resulted in high quality and beneficial outcomes for Australia. At the same time, the BCA considers that an

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improved mechanism for collaboration between business and negotiators could be developed. (sub. 41, p. 3)

Some participants also indicated that there are reasonable opportunities for early consultation with the department, but that those opportunities were much more limited during negotiations. For example, Telstra Corporation stated:

The best outcomes are achieved when decision makers have the most timely and relevant data. Although DFAT is open to industry input in its initial consultations, the negotiations themselves are conducted without ongoing industry involvement. This prevents Australian industry from being able to provide timely and contextual advice to Australian negotiators. (sub. 31, p. 4)

More critically, LyondellBasell Australia stated:

During the negotiations of the recent FTAs, consultation with our industry (via PACIA) has often been unstructured and last minute. They have mostly concentrated on macro issues such as Rules of Origin and there has been very little opportunity for input from industry at the enterprise or even tariff code line item level. Negotiating teams have been very reluctant to discuss detailed progress or take company input during the course of their discussions until after a deal is struck and then its of course too late. Its not clear to us how the national benefit is judged especially in regards to potential benefits. (sub. 16, p. 2)

Other participants considered that the breadth of consultation was not sufficient. For example, ACCI suggested that ‘... wider industry consultation is necessary and at present many industry players are not being included in the consultation process.’ (sub. DR87, p. 7)

Further, in relation to the AUSFTA, the Australian Digital Alliance and Australian Libraries Copyright Committee submitted that consultations regarding copyright matters were rushed and lacked transparency:

The process of negotiating AUSFTA was closed and accelerated. Although some consultation processes took place throughout 2003, participants in the consultations were not privy to information at an appropriate level of detail so as to fully comment on the nature of the provisions being considered. When the draft text was released in March 2004, its content was largely settled between the parties and was substantially different to assurances given during the consultation process. (sub. DR79, p. 4)

During consultations, the Council of Textile & Fashion Industries of Australia indicated that it had been inadequately consulted during the negotiation of one recent PTA (the AANZFTA), leading to a concession being provided to the partner country in the TCF area without the benefit of the Council’s input. The Council also expressed concern about the sheer volume of PTAs being negotiated, pointing out that it was difficult for industry bodies to contact and provide feedback to negotiators within tight timeframes, especially during negotiating rounds. The same

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issue can also affect government departments involved in the broader trade negotiation process (beyond DFAT), who must also prioritise the limited resources they have available for trade issues.

In regards to input from the states and territories, the Victorian Government indicated that it was ‘primarily engaged in the process at the negotiating stage and there is limited involvement beyond that once an agreement enters into force.’ The Victorian Government also noted concerns around ongoing industry consultation:

For example, in the horticulture sector, there is a perception that the Department of Foreign Affairs and Trade (DFAT) could consult on a more ongoing basis with stakeholders about the impacts of FTAs in a ‘real world’ commercial context. In particular, there is a perception that DFAT would benefit from more industry-specific knowledge (such as becoming familiar with the movement of fruit into export markets) before making future concessions on behalf of such industries. (sub. 40, p.7)

This view was supported by the Office of Horticultural Market Access (sub. 39, p. 17), and the Cherry Growers of Australia (sub. 26, p. 2).

While recognising the consultation undertaken by DFAT prior to the commencement of negotiations on a trade agreement, the evidence before the Commission is that there is at least a perception amongst industry groups and businesses that consultation during negotiations is inadequate and that it does not always take account of prevailing industry policies and conditions. The Commission also heard the view that groups with the ‘loudest voices’ can exert the most influence over negotiations. As well as disadvantaging some industry sectors, this could potentially lead to consumer interests, and those of other sectors, being downplayed or even disregarded.

## **Parliamentary involvement**

Previous parliamentary inquiries into Australian trade policy have examined the issue of parliamentary involvement in establishing trade agreements, including bilateral and regional agreements — an issue raised by participants in this study. Current government policy, as expressed by DFAT, states that:

The power to enter into treaties is an executive power within Section 61 of the Australian Constitution and accordingly, is the formal responsibility of the Executive rather than the Parliament. Decisions about the negotiation of multilateral conventions, including determination of objectives, negotiating positions, the parameters within which the Australian delegation can operate, and the final decision as to whether to sign and ratify are taken at Ministerial level, and in many cases, by Cabinet. (DFAT 2010d)

While this statement relates to the negotiation of multilateral treaties, the same policy applies to the negotiation of bilateral and regional trade agreements.

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Tensions over whom is the correct body to commence and conclude negotiations for a trade agreement arise because of a separation of powers within the Australian Constitution itself. Section 61 of the Constitution gives broad powers to the executive for the ‘execution and maintenance of [this] Constitution, and of the laws of the Commonwealth’. However, the power to *implement* treaties is a legislative power, conferred on the parliament by section 51(xxix) of the Constitution.

Submitters to previous inquiries have argued that there is insufficient parliamentary scrutiny of trade agreements prior to their signing, as opposed to following their signing but prior to their legislative implementation (SFADTC 2003). Under the current policy in Australia, the executive decides with whom to negotiate a trade agreement, as well the initial negotiating ‘positions’ and any concessions that will be accepted. In addition, trade agreements are signed at the conclusion of negotiations by the executive; however, agreements are tabled in parliament prior to any enabling legislation being enacted.

As noted by DFAT (see above), on the one hand, this process gives the government the ability to negotiate with flexibility and authority, without having to seek parliamentary authority prior to making decisions. The counter argument to this is that trade agreements frequently involve making binding commitments with a trade partner, both around substantive trade barriers (such as a bilateral reduction in tariffs), as well as process issues (such as dispute mechanisms between investors and partner countries) that have implications for industry, social and environmental policy, and the economy overall. Once entered into force, they also bind both the current and future parliaments to such decisions. Thus, in regard to making decisions that bind future parliaments, parliament itself would be the appropriate body to decide whether to enter a trade agreement or not.

In its 2003 report *Voting on Trade*, the Senate Foreign Affairs, Defence and Trade Committee concluded that reforms to the system were necessary to permit greater parliamentary oversight of trade agreements. The committee stated:

In the Committee’s view, the argument that the treaty-making process is sufficiently democratic because governments are elected and because legislation is required to be passed to implement treaties into domestic law does not have a great deal of force with regard to trade treaties which bind future governments and parliaments. Moreover, governments seldom, if ever, could be said to have a mandate to enter into trade agreements given that such agreements are rarely referred to or given coverage prior to elections. (SFADTC 2003, p. 34)

The committee went on to recommend changes to the process for negotiating and concluding trade agreements, to improve parliamentary oversight of the process (box 15.2).

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**Box 15.2 Voting on Trade: Recommendation 2**

In its 2003 report *Voting on Trade*, the Senate Foreign Affairs, Defence and Trade Committee recommended:

- a) Prior to making offers for further market liberalisation under any WTO Agreements, commencing negotiations for bilateral or regional free trade agreements, the government shall table in both Houses of parliament a document setting out its priorities and objectives, including comprehensive information about the economic, regional, social, cultural, regulatory and environmental impacts which are expected to arise.
- b) These documents shall be referred to the Joint Standing Committee on Foreign Affairs, Defence and Trade for examination by public hearing and report to the parliament within 90 days.
- c) Both Houses of parliament will then consider the report of the Joint Standing Committee on Foreign Affairs, Defence and Trade, and then vote on whether to endorse the government's proposal or not.
- d) Once parliament has endorsed the proposal, negotiations may begin.
- e) Once the negotiation process is complete, the government shall then table in parliament a package including the proposed treaty together with any legislation required to implement the treaty domestically.
- f) The treaty and the implementing legislation are then voted on as a package, in an up or down vote, ie, on the basis that the package is either accepted or rejected in its entirety.

The legislation should specify the form in which the government should present its proposal to parliament and require the proposal to set out clearly the objectives of the treaty and the proposed timeline for negotiations.

Source: SFADTC (2003), p. 40.

A similar recommendation was made by the Joint Standing Committee on Treaties (JSCOT 2008) during its study of the Australia-Chile FTA. Recommendation 3 of that report states:

The Committee recommends that, prior to commencing negotiations for bilateral or regional trade agreements, the Government table in Parliament a document setting out its priorities and objectives. The document should include independent assessments of the costs and benefits. Such assessments should consider the economic regional, social, cultural, regulatory and environmental impacts which are expected to arise.

The Australian Government has responded to the earlier JSCOT inquiry, stating that it is already implementing the recommendation (in relation to the proposed Trans-Pacific Partnership Agreement) through a range of transparency activities including tabling the Government's priorities for that agreement and an outline of the views expressed during initial consultation regarding potential costs and benefits of the TPP (Australian Government 2010).

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In response to the Draft Report, AFTINET (sub. DR68) contended that this response was inaccurate, highlighting the ‘very short consultation period’. In fact, the Australian Government announced that it would consider participating in the TPP on 23 September 2008 (Crean 2008). DFAT held consultations throughout October 2008. The then Trade Minister, Simon Crean, announced that Australia would join the negotiations at an APEC meeting on 20 November 2008, and again in the Australian Parliament on 26 November 2008 (sub. DR68, pp. 15–16).

AFTINET also noted that the document tabled in parliament:

... does not contain an independent assessment of the costs and benefits. The time frame involved did not allow for a feasibility study to be conducted. This highlights the need for a process which enables proper parliamentary and public scrutiny for the BRTA process. (sub. DR68, p. 16)

There has been no response to the broader 2003 recommendation of the SFADTC.

In this study, some participants have also submitted that the current process does not allow for an appropriate role for parliament. For example, the Australian Digital Alliance and Australian Libraries Copyright Committee contended that:

Parliament has a limited role in treaty making: it is unable to influence the negotiation process, the terms, or even the decision of ratification. The ability of Parliament to influence the implementing legislation is too little too late. It gives no ability to influence the terms of the treaty and limits public discourse to whatever flexibility may be found within the interpretation of those terms. (sub. DR79, p. 14)

While trade agreements operate by restraining the future actions of sovereign states (including preventing ‘backsliding’ on otherwise agreed trade liberalisation between agreement partners), the newer form of ‘third wave’ agreements deal with a much wider range of issues. As discussed earlier, some of Australia’s current trade agreements have involved changes to areas that have traditionally been solely domestic policy, including government procurement rules, investment, competition policy and intellectual property. Indeed, elements of these are included in the express powers granted to the parliament by section 51 of the Constitution.

### **15.3 Improving the process**

The Commission’s examination of the current processes for establishing BRTAs has identified a range of concerns. While many aspects of the current process are conducted effectively, there are also problems and deficiencies. Some of these are inherent to the process of establishing trade agreements, but others suggest that the current system can be improved.

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Broadly, the concerns discussed above can be summarised as:

- a perception that the selection of partner countries is not prioritised or coordinated in a strategic fashion;
- inadequate (public) assessment of all available options for advancing trade policy objectives with partner countries before embarking on BRTAs;
- given the timing and lack of realism of analysis in feasibility studies, agreements are not subject to meaningful, transparent assessment before they are signed;
- lack of transparency, coverage and pace of consultations (particularly once negotiations have begun); and
- an inadequate role for Parliament in the process.

More broadly, the Commission is concerned that, at least in some quarters, there tends to be a mindset of ‘agreements for agreements sake’, premised partly on the view that Australia must follow a trend in other countries. Some negotiations have run on for several years with few signs that a worthwhile outcome is close. The resources devoted to different negotiations are not made public, and it is not clear that other trade liberalisation options are given sufficient consideration before decisions to pursue BRTAs are taken.

In the Commission’s view, a more transparent and strategic approach is required to ensure that there is an appropriate focus on policies that are most in Australia’s interests.

Many of these concerns are interrelated, so it is important to consider the overall framework for establishing BRTAs. In the Commission’s assessment, the process can be improved in particular through:

- the formal development and publication of an overall trade policy strategy;
- improvements to the scope and realism of the pre-negotiation assessment process; and
- independent and transparent post negotiation analysis.

Importantly, the Commission’s proposal operates in stages. In particular, both the trade policy strategy and pre-negotiation analysis involve the consideration of, and decisions on, options before advancing to later stages of the process. Each stage of the Commission’s framework is discussed in turn below.

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## Trade Policy Strategy

In the Commission's view, there would be value in the preparation, analysis and publication of a formal trade policy strategy, involving all aspects of trade policy development including, among other things, options for multilateral, plurilateral, bilateral and non-discriminatory reductions in trade barriers. As ACCI noted:

In order to more greatly benefit Australian industry, BRTA and wider trade liberalisation reform is necessary. BRTAs are one part of the process of trade liberalisation and need to be understood in this context. As Carmichael pointed out, a spectrum of approaches to trade liberalisation will all yield benefits (from unilateral to multilateral), but ideally these should be delivered under a single strategic framework. (sub. DR87, p. 8)

While substantial information on the progress of agreements is currently publicly available for each agreement through agreement home pages on DFAT's website, their 'agreement-by-agreement' nature inherently lacks an overall strategic perspective.<sup>2</sup> The Commission is aware that past practice (until 2007) involved publication of 'Trade Outcomes and Objective Statements' (later called 'Trade Statements'), annual documents which detailed the trade policy environment, progress at the WTO and other forums such as APEC, trade agreements both existing and under consideration at the time, and other trade matters such as e-commerce and biosecurity. While a return to such a publication would provide an overview of trade policy, it could be developed further to provide a forward-looking element to the development of trade policy measures in Australia.

The Commission envisages that the strategy would include priority lists of relevant trade policy developments in the broad, and, where they are identified, key issues with prioritised partner countries or regional groupings.

In order to prioritise trade policy developments and possible countries with which to undertake specific actions to improve trade opportunities, the strategy would take into account:

- the nature and level of impediments to trade and investment in Australia;
- existing bilateral trade flows and the size and nature of the potential partner country's economy;

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<sup>2</sup> The Commission heard during consultations that some of the information provided lacks specificity, and is of limited practical value. While there may be scope for improvement in this regard (discussed in the consultation section below), the Commission acknowledges that a balance needs to be struck between providing useful, public, information and the need for confidentiality so as to not prejudice the outcome of negotiations.



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- the existing barriers faced by Australian industries' in that country (for example, tariffs, regulatory cooperation on services regulation, or physical infrastructure constraints);
  - the extent to which a potential partner country might be considered a low cost producer in a range of products of interest to Australian producers and consumers; and
  - the likelihood of the country undertaking trade liberalising reforms, including consideration of its existing trade agreements.

In addition, the Commission agrees with the Mortimer recommendations that consideration be given to prioritising those potential agreements that can achieve substantial liberalisation within a reasonable time period, as well as agreements that promote open regionalism. However, the Commission considers that this assessment should apply to broader possibilities for trade liberalisation, from domestic actions to consideration of what may be achieved internationally, through bilateral, regional or broader negotiations.

Further, consultation for, and publication of, a trade policy strategy could improve public understanding of, and support for, the trade policy objectives to be pursued.

Before being released, the strategy should be considered by Cabinet. The Commission appreciates that sensitivities with other countries may limit the specificity of the publicly released version of the trade policy strategy, but believes that the 'full' version of the document should be considered by Cabinet. While preparation of the initial strategy would require broad consultation, the following annual updates could be conducted in a more streamlined fashion. Annual review of the trade policy strategy (including progress of existing agreements) provides a structured forum to guard against negotiations continuing for an inordinate time period, without mandating set timeframes for conclusion, and for liberalisation options that provide the greatest benefit to be passed by.

The publication of a trade policy strategy — with clearly prioritised trade policy objectives and opportunities — would contribute to the more effective use of limited resources (in government, industry and the community) for consultation and involvement in any trade liberalisation that may eventuate, alleviating 'consultation fatigue' issues amongst industry. The strategy would also assist in managing the overall process, including assessing whether particular opportunities should be pursued as they arise.

A requirement for annual (explicit) review of the strategy by Cabinet would also formally ensure that trade policy matters (which affect a broad range of government portfolios) receive the appropriate consideration on a whole of government basis,

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and allow the strategy to evolve in response to domestic and international developments.

The strategy would provide the Government with the opportunity to consider and pursue trade liberalisation options that afford the greatest opportunities for benefit to Australia.

### **Pre-negotiation analysis**

If, as part of the strategy, it is decided to pursue trade liberalisation objectives in conjunction with particular partners, this would lead to a pre-negotiation analysis of policy options for furthering trade liberalisation objectives with the nominated partner(s).

While several elements of the current approach should be retained, there are also some deficiencies in the feasibility study process as it is currently conducted. The Commission believes that improvements could be made, particularly regarding the consideration of options for action, and realism of assessment.

As with current practice, background information on existing trade flows with the partner would be provided in the pre-negotiation assessment, and consultation with industry and other interested parties would be conducted as an input into identifying the barriers, opportunities and concerns that could be addressed with the partner country. Official exchanges with the partner country would be also held to share information and form judgments about the likely receptiveness of the partner to different liberalisation scenarios.

Importantly, the assessment would also explicitly consider the spectrum of possible approaches for furthering Australia's trade objectives with the selected partner, including actions such as mutual involvement in critical mass agreements or negotiation of bilateral and regional trade agreements, investment treaties, cooperation frameworks, arrangements for technical exchanges, capacity building initiatives and mutual recognition arrangements, among other things. Drawing on assessments of the relative costs and benefits likely to be achievable under the key options, the impact assessment would advise on the most effective means for achieving trade objectives with the partner country. As DFAT noted (sub. DR98), this need not be a single mechanism, but could involve a combination of trade policy actions. However, as with single policy options, it is important that where options are pursued concurrently it is because, together, they are judged to constitute the most cost-effective approach (rather than simply because the pursuit of multiple options is possible).

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Importantly, the advised approach may not necessarily include a comprehensive trade agreement, but rather more focussed instruments where they can provide more efficient, effective and achievable means of accomplish the objectives in question. While past experience suggests that many trading partners are open to entering more targeted arrangements, it is possible that some potential trading partners may not be willing to negotiate mutual recognition arrangements, investment protections and other, individual trade reforms outside the scope of a broader agreement in which more trade-offs are possible. In such cases, the assessment would need to consider whether the likely benefits of the comprehensive approach would warrant going ahead, or whether instead no further action should be taken.

While the analysis conducted in the impact assessment would include economic modelling, it should serve as a component alongside other quantitative and qualitative policy analysis. As at present, careful judgement and an appropriate combination of analytical methods will be required in determining what benefits and costs are likely to be realised under different approaches. It is important that the combination of analytical tools is used comprehensively, with explicit consideration of the impacts of a given policy on producers, consumers and government, as well as the economy as a whole.

To illustrate the broad context of a potential agreement and the implications of partial liberalisation, future impact assessments could substantially improve the realism of the analysis undertaken by using a ‘tops-down’ approach, starting with the current full liberalisation as the base scenario, then moving to contemplate more realistic or even pessimistic scenarios. These scenarios would consider likely ‘carve outs’ or phase-ins, based on past practice (recent examples of this approach are discussed in box 15.3). These could be compared to the base scenario to show the ‘loss’ that could be incurred in each case. Publicly framing each step away from comprehensive liberalisation as a loss would allow for more realistic assessment, without prejudicing the outcome of negotiations. The public discussion would not specify which combination of scenarios is regarded as the most likely, but such advice (based on past agreements and expertise within DFAT) would be provided to Cabinet, including warnings of particularly unadvisable approaches and unachievable objectives.

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### Box 15.3 'Realistic' approaches to impact assessment

A key criticism of the current feasibility study process is that 'outer-envelope' scenarios typically used in modelling are unlikely to resemble the actual outcome of agreements, limiting the usefulness of the studies. One example of such criticism arose in relation to government procurement in the AUSFTA:

The DFAT–CIE study of the economic effects of the agreement considers this issue at length, and judges that as a result of market opening, Australian market penetration of the United States might reach 30 per cent of that of Canadian businesses (\$200 million per year for Australia, compared with \$650 million for Canada). This is doubtful. Canada tends to trade significantly more than normal with the United States on all fronts, not just on government procurement, because the countries are adjacent to each other ... The United States trades as much with Canada as it does with all 15 countries of the EU combined, and its trade with Ontario exceeds its trade with Japan (Wall 2000). This is not surprising, given that nearly 90 per cent of the Canadian population lives within 160 kilometres of the border with the United States ... The Canadian economy is about 70 per cent larger than the Australian economy and the Australian economy is almost 30 times further away from the United States than is Canada ... (Dee 2004, pp. 19–20)

As noted earlier, other concerns include the credibility of assumptions that tariff reductions or other liberalising actions will occur in full and immediately.

The 'realism' of studies undertaken before negotiation could be improved. For example, recent feasibility studies for both India and Indonesia included scenarios for 5 and 10 year phase-ins of tariff reductions.

The Commission also notes that, in the case of the NZ-Korea feasibility study, the scenarios used were:

... developed through consideration of what liberalisation has been achieved/negotiated by NZ and Korea in recently commenced trade agreements. (NZIER et al 2007, p. 50)

The scenarios developed for that study reflected past practice by both parties in relation to specific sectors. For New Zealand, 10 year phase-ins were assumed for textiles, leather products, wearing apparel, motor vehicles, transport and electronic equipment and some machinery and manufactures. For Korea, 10 year phase-ins were assumed in the case of meat and dairy products, 20 year phase-ins for processed rice and vegetables fruit and nuts, and paddy rice was not included (NZIER et al. 2007, p. 51).

There would be merit in having any quantitative analysis (including modelling and other forms of quantification of potential policy outcomes) undertaken as part of the options assessment overseen by a body independent of the executive. This should enhance its credibility and validity, heading off any concerns that modelling approaches or results may reflect pressures to legitimise a particular course of action. Further, the results, scenarios and assumptions used in the analysis should be made public, to allow them to be assessed and considered more widely.

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After completion and publication of assessment, Cabinet would determine (and announce) the selected trade policy action or combination of actions. If the selection includes a trade agreement, Cabinet would determine (but not publish) ‘minimum acceptable outcomes’, as well as exit strategies and/or fallback outcomes that may be achieved should progress with negotiations become frustrated. The following assumes that some form of negotiated agreement (including a BRTA) is one of the selected options.

## **Negotiation process**

While the Commission’s proposed approach should provide discipline to the options under consideration and the assessment of (potential) outcomes, it would not entail substantial change to the process of negotiation of Australia’s agreements.

Some participants made suggestions for improvement to the consultation process. For example, both the Business Council of Australia (sub. 47) and the Law Council of Australia (sub. 41) suggested the model of private sector involvement in the preparation of advisory committee reports used in the United States. However, the Commission does not consider that it would be appropriate to pursue such a model in Australia at this time, given the available consultation resources in Australia, and the sectoral outlook it could engender.

While DFAT does undertake consultation during negotiations (Mugliston 2009, p. 10), other possibilities for improvement could still be considered. To respond to concerns from some in industry that consultation during negotiations is limited both in scope of parties consulted and depth of detail, the Commission considers that further use of confidentiality deeds (as utilised in consultation on taxation matters) could be explored to facilitate greater industry and public involvement in those stages of the negotiation where confidentiality is necessary to avoid prejudicing negotiations. In addition to existing consultation, the use of confidentiality agreements would act as a proxy for trust and understanding built up between DFAT and experienced participants over years, potentially allowing the Department to expand the reach of its consultations during negotiations to include a broader variety of parties. It may also be possible for the Department to use the confidentiality agreements, where appropriate, to respond to requests for consultation by interested parties not already involved in the process.

In relation to wider concerns that negotiations can be left open without meaningful progress for substantial periods, one possibility would be to require six monthly Cabinet review of progress, through a brief submission updating the status of ongoing BRTA negotiations (including the length and cost of negotiations so far,

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potential benefits still in play and likelihood of conclusion). However, the Commission considers that the annual update to the trade policy strategy would provide adequate Cabinet oversight of the progress of negotiations.

Subject to Cabinet approval, negotiations would continue until agreement is reached and the text is finalised. It would *not* be signed at that stage, but submitted for a post-negotiation analysis.

## Post-Negotiation analysis

In addition to pre-negotiation assessment, the Commission considers that the economic implications of any proposed BRTA should be analysed *after* the completion of negotiations and prior to the signing of an agreement. At this time, there should be analysis of the likely costs and benefits of the actual provisions of a prospective agreement. As the CIE argued, analysis of a negotiated agreement can provide useful information, not included in a feasibility study, to decision makers:

... we see a role for quantitative analysis at several stages in the FTA evaluation process — in the Feasibility Study, to help inform the negotiations, and in quantifying the expected economic impacts of the negotiated agreement. ... The negotiated agreement should also be subjected to a rigorous quantitative exercise to assess/estimate the expected economic impacts. It is on the basis of this modelling exercise, plus assessment of qualitative and geopolitical considerations and risks, that the decision should be based about whether or not a country should enter into a particular agreement. (sub. DR75, pp. 8,10)

To ensure that such processes are as clear and robust as possible, they should be commissioned and overseen by a body that is independent from the executive. A transparent process should be adopted to ensure that the assumptions made as part of any economic modelling and other analyses are open to public scrutiny. This may also provide scope to formally elicit the views of stakeholders on the proposed agreement. There would be efficiencies (in time and consistency) in the same independent body overseeing both the pre- and post-negotiation analyses.

Such a process would provide more realistic information about the likely benefits and costs Australia may realise from entering into an agreement and illuminate any potential aspects which would likely have particularly adverse impacts that may have arisen during the course of negotiations, providing a better basis for a final decision by government as to whether the agreement in question should be proceeded with. While the prospective impact assessment process above can improve information available before initiating an agreement, the nature of the negotiation process means that a post-negotiation assessment will be more realistic than one conducted before negotiations have begun. Indeed, the substantial amount

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of change agreed to as negotiations near finalisation alone would limit the usefulness of any pre-negotiation assessments.

While such a process would be intended to bolster confidence in the likely economic gains of any agreements, a number of participants expressed concerns about the Commission's draft recommendation that agreements be subject to final post-negotiation scrutiny (box 15.4).

**Box 15.4 Some participants' concerns with post-negotiation analysis**

Office of International Law (sub. DR83, p. 3):

It would be difficult, once an agreement has been negotiated, to suspend its conclusion, usually signified by signature, until after further assessment. Rather the two stage process for States to become bound by a treaty, namely signature and ratification, allows such an assessment to take place between signature and ratification. Indeed after signature each treaty is considered by the Joint Standing Committee on Treaties prior to being ratified. The review by the [JSCOT] could incorporate an economic analysis. We do not think it is necessary to create a new body to deal with an economic analysis when there is already a process, such as the [JSCOT], which can be utilised.

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

The department agrees that there should be greater scrutiny of potential benefits prior to negotiations, but equally, assessments of actual benefits of agreements require a longer term view. At the same time, the department is not convinced that a post-negotiations "full and public assessment of a proposed agreement" ... as recommended by the PC would be beneficial. There would be a risk that such an assessment could destabilise years of negotiation and deter trading partners from committing to negotiate or sign agreements with Australia. However, we acknowledge that this is an issue that deserves closer attention.

Department of Foreign Affairs and Trade (sub. DR98, p. 17):

There are significant practical difficulties with proposals to release negotiated FTAs for purposes of public and independent assessment before the agreement is signed. Under Australian treaty practice, and in accordance with international practice, the details of the FTA package are not released until the FTA has been formally signed. DFAT's view is that to do otherwise could risk creating tensions with the negotiating partner country; damage confidence in Australia's credibility as a negotiating partner; and complicate the process of finalising the FTA. For example, such an approach would allow interest groups within the partner country to seek further changes to the negotiated agreement, and hence cause difficulties in being able to bring the FTA to a final conclusion.

National Farmers' Federation (sub. DR85, p. 5):

However, the NFF does acknowledge that, in practice, additional scrutiny after the completion of negotiations could be difficult to achieve and has the potential to politicise the agreement sign-off process to a standstill. It may also have the potential to undermine the integrity of an 'in good faith' negotiation process.

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The Commission accepts that the additional processes it has recommended could apply some braking to the development of BRTAs. In particular, it could lengthen the time required for consideration and approval of a given agreement. Further, the Commission acknowledges that not all prospective partners would be as amenable to entering negotiations with Australia, particularly where the likely benefits are marginal, as they would be under the current arrangements (without post-negotiation analysis).

Nonetheless, on balance, the Commission's assessment is that the concerns raised are not sufficient to override the benefits from the recommended approach.

Specifically, in relation to concerns of uncertainty or 'destabilising' the negotiation process (DFAT, sub. DR98; DAFF, sub. DR95), the Commission's considers that these changes would improve the likelihood that any BRTA agreed and entered into is in Australia's public interest. Indeed, the Commission considers that if earlier steps in this process are followed, and negotiations proceed within the broad parameters envisaged, the post-negotiation analysis would ordinarily serve to confirm the benefits of the agreement. Prospective negotiating partners would be notified of Australia's processes before negotiations commence, providing a clear indication of the broad policy parameters with which Australia's negotiators are working. They are also likely to provide incentives for negotiators from partner countries to be mindful that whatever is offered to Australia within an agreement will be subject to public analysis.

Another concern was that public exposure of an agreement before signing could 'cause difficulties' by allowing interest groups (including in partner countries) to comment on the agreement as negotiated (DFAT, sub. DR98). While this may be true, the Commission considers that the transparency entailed is appropriate given the sometimes broadranging nature of the issues subject to negotiations, and the concerns raised in relation to some past BRTA processes. Given the impact on several domestic policy areas, the Commission's view is that it is appropriate that domestic stakeholders are consulted before a government commits to an agreement. The post-negotiation analysis would provide an opportunity for experts and interested parties from outside of the government to comment on the details of the agreement. It would also facilitate the testing of the veracity of the assumptions, analysis and results presented, improving accountability and confidence in the final analysis that emerges. In the Commission's view, trade agreements that would deliver significant net benefits should be sufficiently robust to be able to withstand such scrutiny.

In relation to the concern about introducing a delay to the agreement process between conclusion of negotiations and signing (OIL, sub. DR83), the Commission



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notes that current practice includes a process of legal verification to ensure that there are no technical errors and that the text accurately reflects negotiated outcomes. In the case of the AANZFTA negotiations, this process meant that there was over six months between the substantive conclusion of negotiations and the signing of the agreement (Mugliston 2009, p. 12). The Commission acknowledges that its proposal would also entail a time period between initialling and signing of an agreement, and would bring forward an evaluation that might otherwise be undertaken, to some degree, by JSCOT. As noted above, however, the present JSCOT process cannot be utilised to provide improved information to Cabinet before a decision is made. While JSCOT would still of course be at liberty to undertake its own assessment, it could draw on the already published independent analysis during its considerations, supplementing it with further analysis if it saw fit.

Following the completion and publication of the post-negotiation analysis, Cabinet (informed by the analysis) would determine whether or not to sign the agreement.

### **Parliamentary process and enabling legislation**

Under the Commission's proposed approach, the process for the implementation of agreements (including parliamentary review and enabling legislation) would remain largely unchanged, except that the improved economic analysis would be available when enabling legislation is presented to Parliament.

The Commission is cognisant of the recommendations of past Senate committees for greater parliamentary involvement both in endorsing negotiations and voting on treaties. However, the Commission does not consider that direct parliamentary involvement in the signing of agreements is necessarily appropriate, as the proposed approach should bring an appropriate level of transparency and accountability to the process of establishing trade agreements, by providing improved information to allow Parliament to assess the implication of ratifying agreements through the passage of enabling legislation.

Such assessments should not have the effect of penalising trade policy proposals that are likely to deliver significant economic gains.

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## 15.4 Proposed approach

To achieve the improvements envisaged under its process framework (set out in figure 15.2), the Commission recommends:

### RECOMMENDATION 5

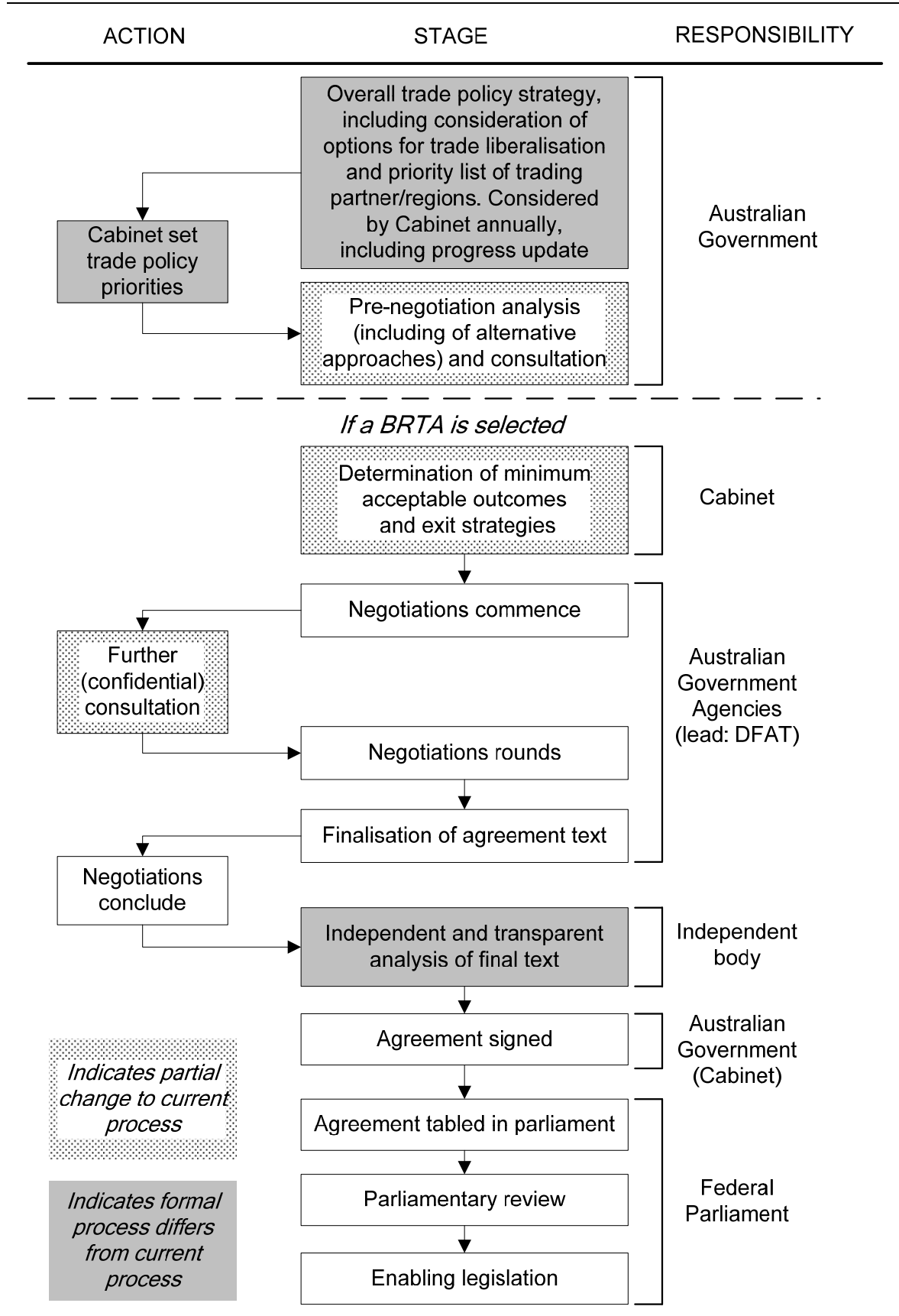
***The Australian Government should improve the scrutiny of the potential impacts of prospective trade agreements, and opportunities to reduce barriers to trade and investment more generally.***

- a) It should prepare a trade policy strategy which identifies impediments to trade and investment and available opportunities for liberalisation, and includes a priority list of trading partners. This trade policy strategy should be reviewed by Cabinet on an annual basis, and be prepared before the pursuit of any further BRTAs. A public version of the Cabinet determined strategy should be released.***
- b) Before entering negotiations with any particular prospective partner, it should undertake a transparent analysis of the potential impacts of the options for advancing trade policy objectives with the partner. All quantitative analysis and modelling should be overseen by an independent body.***
- c) It should commission and publish an independent and transparent assessment of the final text of the agreement, at the conclusion of negotiations, but before an agreement is signed.***

In relation to existing agreements, there is some reason to leave those aspects of the process that directly affect the negotiating partner as they are, as changes to the procedures mid-negotiation could run the risk of harming relations with partner countries, and therefore progress in negotiations. However, the Commission considers that, where possible, aspects of the process that are within the Australian Government's control and do not directly impact on relations with partner countries, could be improved for those negotiations already in train. In particular, consultation during negotiations could be improved and the feasibility study could be updated and enhanced with consideration of potential scenarios, including already publicly announced aspects of an agreement.

The Commission also considers that formal Cabinet oversight of progress of agreements could be instituted in the short term, in order to examine progress against milestones for existing agreements, as an input to the first trade policy strategy.

Figure 15.2 The Commission's proposed process framework





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# APPENDIXES



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# A The Associate Commissioner's views

There are a number of areas in the Commission's final report where the Associate Commissioner, Andrew L. Stoler, disagrees with the report. His views are outlined below in relation to specific recommendations, findings and some other matters.

## A.1 The report's recommendations

### Recommendation 1

The Australian Government should only pursue bilateral and regional trade agreements where they are likely to:

- afford significant net economic benefits; and
- be more cost-effective than other options for reducing trade and investment barriers, including alternative forms of bilateral and regional action.

The Associate Commissioner (the 'Associate') has indicated that he disagrees with this recommendation for several reasons. First, in his view, it suggests that Australia has a number of alternative options that are always available to it and that the Government chooses a BRTA as an alternative to other approaches. The Associate notes that DFAT has indicated that the Government does not pursue FTAs only as a last resort, when alternatives are not practical. Rather, DFAT has indicated that it is important to keep all policy options in use and to pursue a range of strategies that are complementary.

Second, the Associate believes the goal of successfully testing BRTAs for significant net economic benefit is unattainable, due to current statistical inadequacies and inadequate approaches to measuring the impact of a number of BRTA components. Services account for more than 70 percent of most countries' GDP but, in the Associate's view, statistics on international trade in services are both incomplete and inadequate for the purpose of assessing real flows of services. In addition, the impact of services barriers is far more difficult to quantify than are tariffs or other barriers to trade in merchandise. The Associate considers that similar problems exist for investment and other 'WTO-plus' elements of BRTAs. His view

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is that if it is not possible to assess ‘significant net economic benefits’ with any accuracy, the negotiation of a BRTA cannot be conditioned on such an exercise.

Third, the Associate considers that the second bullet point suggests the possibility of some kind of assessment of the desirability of a trade agreement based on its cost of negotiation – a concept he rejects. In his view, an acceptable re-formulation of this recommendation might read:

The Australian Government should continue to pursue bilateral and regional trade agreements when they:

- contribute to the realisation of Australian foreign policy objectives;
- lead to trade liberalisation consistent with WTO principles;
- provide benefits for Australian importers, exporters and consumers; and
- supplement and complement other initiatives aimed at reducing trade and investment barriers.

## Recommendation 2

The Australian Government should ensure that any bilateral and regional agreement it negotiates:

- as far as practicable, avoids discriminatory terms and conditions in favour of arrangements based on non-discriminatory (most-favoured-nation) provisions;
- does not preclude or prejudice similar arrangements with other trading partners; and
- does not establish treaty obligations that could inhibit or delay unilateral, plurilateral or multilateral reform.

In the Associate’s view, although the first bullet point in this recommendation is couched in ‘as far as practicable’ language, it fails to capture the notion that a reciprocal trade negotiation conducted outside of the WTO and in line with GATT and GATS rules for BRTAs will of necessity be essentially preferential (or ‘discriminatory’) in nature. The Associate considers that this will be the case with respect to tariff reductions, services liberalization commitments and other important aspects of the trading relationship, such as related mutual recognition agreements addressed to professional qualifications or product standards. He considers that a BRTA could not be based largely on MFN provisions.

The Associate does not object to the second bullet point, except insofar as the wording ‘similar arrangements’ suggests that they too might realistically be MFN-based agreements.



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The Associate considers that the third point is too vaguely expressed to judge its meaning, but that some might use it to argue against the inclusion of IP in trade agreements or that lowered thresholds for United States investors complicate the reform of FIRB review guidelines.

#### **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 comprehensive review of the implications and available 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.

The Associate believes that intellectual property rights protection (the subject of point (b) in this recommendation) should be a core concern in Australia's bilateral and regional trade agreements, and that the Australian Government should maintain a flexible position in respect of the possible inclusion in its trade agreements of investor-state dispute settlement (the subject of point (c) in the recommendation).

In the Associate's view, the Commission's position on intellectual property is based mainly on the fact that because Australia is a net importer of materials protected by intellectual property, the Australian economy suffers a net loss by protecting IP and therefore it is not in Australia's interest to pursue IP protection either at home or overseas through BRTAs. The Associate considers this is an overly simplistic way of assessing the relative merits of protecting IP, and argues that it suggests that Australia will forever be an exporter of rocks and an importer of technology and creative works, and that it ignores completely the very significant interests of Australian right holders in economically benefitting from the IP they create. The report also expresses concern that IP protection may be greater than what is necessary to create an incentive to create new works, and refers to a brief (in footnote 1 to chapter 14) that suggests that this is the case with respect to copyright laws in the United States. In the Associate's view, the report's concern is not

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supported by any work done in connection with the current study on BRTAs and how various forms of IP are treated in actual agreements negotiated by Australia.

The Associate notes that DFAT pointed out, in its comments on the Commission's draft report, that counterfeiting and piracy are prevalent in many of Australia's important trading partners and that IP is an increasingly valuable component of Australia's exported goods and services. In the view of the Associate, it is indefensible to argue that IP should not be an important element of our trade agreements.

The Associate also considers that the Commission's position ignores the important role of BRTA IP provisions as building blocks contributing to better multilateral protection of IP. The WTO's TRIPS Agreement was negotiated in 1993 and the Associate considers that technological advances since then have created the need to enhance certain forms of IP. In the Associate's view, while post-TRIPS WIPO conventions have tackled the problem, these provisions have not been added to TRIPS so they are only reasonably enforceable if they can be incorporated in bilateral and regional trade agreements.

The Associate also gives weight to the argument that Australia, as a good global citizen, has a responsibility to pursue effective IP protection through BRTAs on rule of law grounds. In the Associate's view, it would not be enough to focus exclusively on whether there might be an economic cost associated with legally protecting creative stakeholders' interests.

The Associate also disagrees with the Commission's recommendation regarding the inclusion of investor-state dispute settlement (ISDS) in future Australian BRTAs. He notes that foreign direct investment is very important in the modern economy and that Australians have significant investments in other economies. He considers that where the Australian Government deems it appropriate to negotiate a BRTA with a partner, that agreement should promote and protect investment and where the legal system of a partner is judged as not sufficiently developed to effectively handle investment disputes, Australian negotiators should preserve the option of including ISDS in the agreement.

The report argues that Australia's investors do not require this added protection and that, by including ISDS, the Australian Government is taking on a risk (of being sued by foreign investors). The Associate notes that the report suggests that the investors are able to protect their overseas interests by accessing a variety of insurance schemes. In the view of the Associate, this is analogous to arguing against the need for a fire department because homeowners can buy property insurance.

The Associate notes that those who oppose ISDS in BRTAs also tend to cite the risk of 'regulatory chill' for Australia — in other words, the Australian Government

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might elect not to proceed with certain policies or regulations because it may be afraid of being sued in the ICSID. Opponents of ISDS cite cases such as where governments may back off regulating cigarette packaging due to the threat of a suit by a foreign investor. In the Associate's view, the appropriate response to these concerns is to ensure that the ISDS-related provisions of a BRTA are drafted carefully enough that they preclude challenges to those regulatory areas that Australia wants to ensure are protected (for example, health-related policies). In addition, in the Associate's view, there is reason to believe that a little bit of 'regulatory chill' might be a good thing, even in Australia.

Finally, the Associate considers that it is not realistic to suggest, as in his view part (c) of the recommendation suggests and the report implies, that it might be possible to agree an ISDS provision in a BRTA that does not give foreigners rights not available to nationals, or that a BRTA partner might seek to offer ISDS to Australia without seeking a reciprocal grant of ISDS rights.

## **Recommendation 5**

The Australian Government should improve the scrutiny of potential impacts of prospective trade agreements, and opportunities to reduce barriers to trade and investment more generally.

- a) It should prepare a trade policy strategy which identifies impediments to trade and investment and available opportunities for liberalisation, and includes a priority list of trading partners. This trade policy strategy should be reviewed by Cabinet on an annual basis, and be prepared before the pursuit of any further BRTAs. A public version of the Cabinet determined strategy should be released.
- b) Before entering negotiations with any particular prospective partner, it should undertake a transparent analysis of potential impacts of the options for advancing trade policy objectives with the partner. All quantitative analysis and modelling should be overseen by an independent body.
- c) It should commission and publish an independent and transparent assessment of the final text of the agreement, at the conclusion of negotiations, but before an agreement is signed.

The Associate disagrees with the bulk of the contents of chapter 15 in the Commission's report and thus disagrees with this recommendation. He considers that the multipronged trade policy strategy now being pursued by the Australian Government is both constructive and effective.

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In relation to part (a) of the recommendation, the Associate considers that the Commission makes too much of the suggestion from some participants in the process of developing the report that there is a problem in the way BRTA partners are selected by the government. First, he argues that if one accepts that BRTAs are appropriate instruments for furthering our trading relationships and protecting our exporters' interests in overseas markets, few would disagree that Australia should be negotiating BRTAs with its most important trading partners in ASEAN, China, Japan, Korea, the United States and New Zealand. The Associate accepts that the Chilean agreement might be an exception, but considers that is not an agreement that materially threatens interests in either country. Second, the Associate notes that DFAT pointed out in some detail in its submission in reaction to the draft Commission report:

Decisions to embark upon FTA negotiations are “whole-of-government” decisions made by the Cabinet. The resource implications; potential costs, benefits, risks; and specific issues that may emerge during the course of the negotiations are assessed during the Cabinet process. The Government's practice has been that consideration of whether to embark upon FTA negotiations, and the negotiating mandate, follows wide public consultation associated with the preparation of an FTA feasibility study, including assessment of the economic and broader bilateral relationship with the country in question, and the costs and benefits associated with an FTA. (sub. DR98, p. 16)

In the view of the Associate, the process described by DFAT — with whole-of-government decisions made by the Cabinet — does not support the idea that there is inadequate assessment of prospective agreement partners.

In relation to part (b) of the recommendation, the Associate's view is that, if it is based on past criticisms of the ‘feasibility study’ process for BRTAs, it begs the questions of who will act as the independent analyst and who will set out the options.

In relation to part (c) of the recommendation, the Associate notes that, in their submissions to the Commission made after the circulation of the draft report, the Attorney General's Department and DFAT made clear that the approach suggested in this recommendation's third bullet point would be problematic. Certain private sector groups also agreed that it would not be a workable proposition to conduct a new analysis at this stage. On the basis that the Commission has heard that the idea is unworkable, the Associate believes it should not form the basis for a recommendation in the report.

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## Recommendation 7

To enhance transparency and public accountability and enable better decision making regarding the negotiation of trade agreements, the Department of Foreign Affairs and Trade should publish estimates of the expenditure incurred in negotiating bilateral and regional trade agreements and multilateral trade agreements. These should include estimates for the costs of negotiating recent agreements.

The Associate considers that the Commission's attempt to quantify the cost to the Australian Government of negotiating trade agreements is both outside the scope of the report's terms of reference and inappropriate in any discussion of the process of negotiating trade agreements. In chapter 7, the Commission report includes the following paragraph:

In considering the overall costs and benefits of BRTAs, the costs of negotiating such agreements need to be taken into account. While in some cases they will small relative to other costs and benefits, they may be important where agreements are more finely balanced (for example, with smaller countries). An understanding of the costs of negotiations is also important for determining the extent to which disciplines should be placed on the negotiating process to bring about swifter outcomes. The provision of estimates of the costs incurred in developing the various trade agreements Australia is or has been pursuing could also help to establish the appropriateness of the balance of government resources directed towards the different negotiations, as well as between trade negotiations and other government priorities. (page 109)

The Associate disagrees with several aspects of what he perceives to be the thinking that underlies the language of the paragraph. First, the Associate does not consider that the cost of negotiating a trade agreement is important as an element of judging its value. Second, in the case of modern trade agreements, he does not believe that it is currently possible to conduct a meaningful assessment of broader 'benefits' to be measured against 'costs'. Finally, he does not consider it realistic to suggest that any government is going to set itself a time limit on how long it would be willing to negotiate a trade agreement in order to ensure that the cost of the negotiation would be kept within some pre-determined limit.

The Associate argues that the cost of negotiating a trade agreement is no measure of whether the agreement is worthwhile, citing WTO negotiations as an example. The Uruguay Round lasted effectively from when it was first mooted in 1982 until the end of 1993. The Associate argues that the round entailed eleven years of flying scores of Australian negotiators half-way across the world to one of the most expensive destinations on the face of the globe, but that most people would say the Uruguay Round was well worth it, no matter what the cost.

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When DFAT officials were requested, as a part of this study, to provide estimates of the cost of trade agreement negotiations, they replied that currently they are unable to do so given the policy integration in the Department where trade is mainstreamed across the Department's operations. The Associate considers that the DFAT response to the Commission, which is reproduced in the report, is understandable.

## Recommendation 8

The Australian Government should examine the potential to further reduce existing Australian barriers to trade and investment through unilateral action as a priority over pursuing liberalisation in the context of bilateral and regional trade agreements. The Government should not delay beneficial domestic trade liberalisation and reform in order to retain 'negotiating coin'.

In the Associate's view, unilateral reform might be a sound approach, but there is no reason why it should be given priority status over BRTAs or multilateral trade negotiations, particularly as in his view its unilateral character makes it inherently insecure for the business community. The Associate notes that liberalisation that is unilateral completely preserves the government's policy space and what has been done can readily be undone if the government is not somehow legally bound to maintain a liberal trading environment. He argues that what keeps Australian officials from raising our applied tariffs is not the WTO, where, for example, Australia's bound tariff rate for passenger automobiles is 40 percent *ad valorem*. Rather, in the Associate's view, in most cases it is our BRTAs that legally bind the country to a liberal tariff environment. The Associate considers that the same can also be said about services trade, where the top-down, negative list approach followed in certain BRTAs precludes the introduction of protectionist or discriminatory measures.

The Associate believes that the Commission's focus on unilateral liberalisation also ignores the political economy considerations that often dictate that political support for liberalisation is conditioned on perceptions of reciprocal liberalisation in our trading partners.

The Associate also considers that there is also no need for the second part of this recommendation, as there are no concrete examples of the Australian Government delaying domestic trade liberalisation and reform in order to retain negotiating coin. He further notes that DFAT's second submission categorically denies that this could be the case.

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## Recommendation 10

The Australian Government should lend support to initiatives directed at the establishment of domestic institutions in key trading countries to provide transparent information and advice on the community-wide impacts of trade, investment and associated policies.

The Associate does not support the inclusion of this recommendation in the Commission's report because he considers that it is outside the scope of the terms of reference. In addition, because the Associate does not believe it is currently possible for 'transparency agencies' to produce meaningful communitywide impact studies (at least insofar as modern BRTAs are concerned), he also does not accept the recommendation on substantive grounds.

## A.2 Findings made in the report

### Finding 7.2

Although a major departmental activity, no useful information is publicly available regarding the staffing and other costs incurred by the Department of Foreign Affairs and Trade in pursuing BRTAs.

The Associate disagrees with this finding on several grounds. First, as noted above, he considers it inappropriate to judge the value of a trade agreement on the basis of what it costs the government to negotiate the deal. He thus questions why information on DFAT negotiating costs would be useful. Second, he considers that the statement is an opinion and that it is incorrect to classify it as a finding. Finally, he considers that the 'cost of negotiation' question is outside the report's terms of reference.

### 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.

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The Associate objects to this finding on several grounds. First, he considers that it ignores the fact that political economy considerations often require domestic reforms to be couched as reciprocal actions undertaken in response to gains in overseas markets through a trade agreement. Second, as noted above, he considers that purely unilateral reform is inherently insecure from a business perspective, since the government of the day is completely able to reverse the reform if it is not legally bound to maintain it. Finally, he views it as another example of an opinion incorrectly classified as a finding. He argues that it is not a factual finding that pursuit of BRTAs can delay unilateral reforms as concrete evidence of this does not exist.

### **Findings 14.1 and 14.2**

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.

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

The Associate objects to both of these findings and notes that the reasoning behind them underlies the Commission report's recommendation that ISDS provisions should not be included in Australia's BRTAs. The Associate's reasons for arguing in favour of maintaining the option of including ISDS in BRTAs are detailed earlier. In the context of Australian BRTAs with certain developing countries, the Associate believes that the potential benefits to our investors of ISDS clearly exceed the downside risk to the Australian Government.

In the view of the Associate, the possible invocation of fair and equitable treatment provisions in an ISDS case involving alleged indirect expropriation is analogous to the WTO concept of nullification and impairment where a WTO Member's 'reasonable expectations' have been undermined by the policy actions of another Member. An investor might not be able to count on securing his or her government's support for a dispute and, in the Associate's view, should have the right to pursue relief through ISDS. In relation to the finding concerning other countries' experiences with ISDS, as noted earlier, the Associate considers that the appropriate response is to ensure that BRTA provisions are drafted carefully enough to preclude challenges to what might be considered to be 'off limits' regulatory areas.



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## A.3 Other matters

### Trade diversion

In chapter 8, the Commission report maintains that trade diversion from BRTAs potentially remains a practical issue. Other references to possible trade diversion are found elsewhere in the text of the report, including in comments received in submissions made to the Commission. The Associate disagrees that trade diversion is a practical issue, citing the reasons laid out in two submissions made to the Commission in the course of the report's preparation.

The first submission, by Peter Lloyd, which is referred to on page 119 of the report, stated:

There are two further reasons why trade analysts in Australia need not waste time on attempts to assess trade diversion costs. The first reason is that, as the number of trading preferential partners with whom we trade in the market for any importable expands as the number of agreements expands, the possibilities of (harmful or beneficial) trade diversion diminish. With multiple partners, trade diversion must have diminished considerably since the signing of the first agreement with New Zealand in 1983. If Australia does sign an agreement with the republic of China in the near future that is reasonably comprehensive in terms of commodity coverage and depth of cut, we can forget about trade diversion as China is the least-cost supplier of so many of the imported manufactures subject to border barriers.

The second reason is Australia's MFN barriers to imports of goods have been greatly reduced in the last twenty years. For both goods and services markets, Australia is now one of the most open economies in the world. Apart from the two partners, New Zealand and Singapore, Australia's barriers to imports of goods and services are generally lower than the barriers to goods and services exported from Australia into the markets of the partner countries. To put it another way, our concern with the effects of bilaterals and regions on market access should be primarily with the effects on our export market rather than on our import market. (sub. 3, pp. 3-4)

The second, submitted by the Centre for International Economics in September 2010, following the issuance of the draft Commission report, stated:

Furthermore, the Commission's quantitative analysis does not appear to take into account policies — such as the presence of other FTAs or unilateral action — that can act to reduce the amount of trade diversion attributable to any one single FTA.

For example, as a country's FTAs increase in number, the effective liberalisation will eventually approach multilateral liberalisation. Hence the quantum of trade diversion will be lower with each additional FTA. By way of example, Australia's existing FTAs, with ASEAN, Chile, New Zealand and the US, sees 30 per cent of Australia's total (import and export) merchandise and service trade in 2008 being subject to preferential trade liberalisation. If Australia concluded FTA negotiations with China, Japan and

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South Korea then a further 32 per cent of total trade would be covered by FTAs. Hence these seven FTAs could see some 62 per cent to total Australian trade being subjected to preferential trade liberalisation; well on the way to achieving multilateral liberalisation. (sub. DR75, p. 12)

## **BRTAs and regional integration**

At the end of chapter 10, the Commission report sums up with the following final paragraph:

In terms of integration, possible outcomes are mixed. On the one hand, economic integration can occur between members to an agreement. Additionally, bilateral agreements may evolve into larger agreements and, over time, become a means to achieve wider economic integration. For example, the Canada-US bilateral agreement can be seen as a predecessor to the broader NAFTA agreement. On the other hand, as discussed in chapter 13, little use has been made of accession clauses to expand existing agreements. Further, the extent of broader regional integration (as observed in trade flows) and the economic benefits that arise depend on the openness of the agreement in question. In particular, the Commission's econometric analysis suggests that, insofar as they focus trade towards a partner country, preferential agreements can detract from broader regional integration, while agreements based on open regionalism, such as APEC and to a lesser extent the previous ASEAN (CEPT) agreement in the Asia-Pacific, appear to foster economic and regional integration.

The Associate has several comments on this paragraph. First, he notes that, while the original ASEAN CEPT scheme might have been considered by some to be 'preference lite', more recent ASEAN agreements like ATIGA and ASEAN trade in services rules have more in common with other BRTAs in the region than they do with APEC. Second, in his view, APEC is not an 'agreement' that should be compared to what most people would regard as a trade agreement. Finally, the Associate also emphasises that he considers that there are a number of cases where bilateral agreements have served as building blocks for broader regional integration initiatives. In addition to the move from Canada-USA FTA to NAFTA, ASEAN's numerous bilateral agreements with China, Japan, South Korea, India and Australia & New Zealand have created the basis for broader regional integration discussions through CEPEA. Originally bilateral-only agreements between Singapore and the USA, Australia and New Zealand have greatly facilitated the Trans-Pacific Partnership negotiations.

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## **Non-economic BRTAs**

At the end of chapter 11, the Commission report includes a paragraph that reads:

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.

The Associate notes that, during the study, a number of submissions and interviewees commented that there are often political motives for choosing to negotiate BRTAs; however, at no point did anyone suggest to the Commission that Australia has negotiated — or would consider negotiating — a BRTA that could not be justified on economic grounds. The Associate recognises that one might disagree with the feasibility study findings or other claims made about a particular agreement, but considers that to be an entirely different matter.



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## B Public consultation

The Commission received the Terms of Reference for this study on 27 November 2009. In line with its normal study procedures, the Commission has actively encouraged public participation.

- Soon after receipt of the Terms of Reference, it advertised the study in national and metropolitan newspapers and sent a circular to people and organisations thought likely to have an interest in the study.
- In December 2009, it released an issues paper to assist those wishing to make written submissions. 61 submissions were subsequently received before the release of the Draft Report and a further 40 after its release (see table B.1 below).
- As detailed in table B.2, the Commission met with various domestic stakeholders and government agencies.
- On 17 May 2010, the Commission convened a workshop in Canberra to gain feedback on a draft of two quantitative analysis undertaken for the study. Participants who attended the workshop are listed in table B.3.
- The draft report was released on 16 July 2010 and set out the Commission's preliminary views on the matters under reference.
- Further feedback was received at a policy forum hosted by the Crawford School of Economics and Government at the Australian National University held on 25 August 2010.
- A roundtable focussing on Investor State Dispute Settlement (ISDS) was held on 29 September 2010 (participants are listed in table B.4).

The Commission would like to thank all those who have contributed to the study.

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**Table B.1 Submissions received**

<i>Participants</i>	<i>Submission no.</i>
AFG Venture Group	DR69
Aisbett, Dr Emma and Bonnitcha, Jonathan	45
American Chamber of Commerce in Australia	58
APRA / AMCOS (Australasian Performing Rights Association Limited and Australasian Mechanical Copyright Owners Society)	27
AusAID	46
Austrade	52
Australia and New Zealand Banking Group Limited (ANZ)	57
Australian Chamber of Commerce and Industry	DR87
Australian Chamber of Commerce, Singapore (AustCham)	DR7
Australian Council of Trade Unions	19, DR80
Australian Dairy Industry Council	38
Australian Fair Trade and Investment Network	33, DR68
Australian Federation Against Copyright Theft	25
Australian Industry Group	7
Australian Manufacturing Workers' Union	21, DR72
Australian Plantation Products and Paper Industry Council's (A3P)	DR64
Australian Pork Limited	DR91
Australian Publishers Association	12
Australian Sugar Industry Alliance	15, DR93
Bosworth, Malcolm and Trewin, Ray	32, DR92
Business Council of Australia	41
Cattle Council of Australia	DR97
Centre for International Economics	DR75
CFMEU (Construction, Forestry, Mining and Energy Union)	18, DR90
Cherry Growers of Australia Inc	26
Copyright Agency Limited	34
CPSU-SPSF (Community and Public Sector Union – State Public Services Federation Group)	22
Cutbush, Greg	DR89
Dela Rama, Maria	9
Department of Agriculture, Fisheries and Forestry	6, DR95
Department of Foreign Affairs and Trade	53, DR98
Department of Innovation, Industry, Science and Research	DR94
Department of the Premier and Cabinet Western Australia	37
Edwards, Geoffrey	DR81

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**Table B.1 continued**

<i>Participants</i>	<i>Submission no.</i>
Elek AM, Dr Andrew	44, 54, DR74
Employers and Manufacturers Association Northern Inc	11
Eslake, Saul and Cornish, Peter	59
Ford Motor Company of Australia Limited	51
Fox, Prof Kevin	DR66
Government of South Australia	56
Mahony, Greg, Public Policy Institute, Australian Catholic University	DR78
Heydon, Ken	DR65
Horticulture Australia Ltd, Office of Horticultural Market Access	39, DR70
International Legal Services Advisory Council	DR96
IP Australia	24
Joint submission – ACTU and AFTINET	DR100
Joint submission – Australian Digital Alliance and the Australian Libraries Copyright Committee	DR79
Joint submission by Bill Carmichael, Greg Cutbush, Denis Hussey and David Trebeck	43, 55, 60
Joint submission by nineteen Australian and New Zealand business leaders and economists	5, 23, DR86
Kantor, Mark	DR62
Law Council of Australia	47, 48, DR84
Lehmann, Prof Jean-Pierre	29
Lloyd, Prof Peter	3, DR77
LyondellBasell Australia	16
Moir, Dr Hazel V J	DR76
Music Council of Australia	35, DR88
Music Industry Piracy Investigations	28
National Farmers' Federation	13, DR85
National Institute of Accountants	20
Nottage, Associate Prof Dr Luke	DR63
O'Donnell, Carol	2, DR101
Office of International Law, Attorney-General's Department	DR83
O'Toole, Melanie	50
Ravenhill, Prof John	36
Richardson, Prof Martin	8
Robertson, Dr David	42
Rural Industries Research & Development Corporation	10
Sheepmeat Council of Australia	DR73

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**Table B.1 continued**

<i>Participants</i>	<i>Submission no.</i>
Stevenson, James	14
Stoeckel, Dr Andrew	30
Telstra Corporation Ltd	31, 49
The Institute of Chartered Accountants in Australia	4
Thomson, Graeme	DR82
Tienhaara, Dr Kyla	DR67
Trebeck, David	61
Universities Australia	17
Van Harten, Prof Gus	DR99
Victorian State Government	40
Winemakers' Federation of Australia	1

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**Table B.2 Visits and Meetings**

Attorney-General's Department
AusAID
Austrade
Australia China Business Council
Australian Business Foundation
Australian Chamber of Commerce and Industry
Australian Council for International Development
Australian Industry Group
Australian Institute of Architects
Australian Services Roundtable
Business Council of Australia
Capling, Prof Ann
Dairy Australia
Department of Agriculture, Fisheries and Forestry
Department of Broadband, Communications and the Digital Economy
Department of Foreign Affairs and Trade
Department of Premier and Cabinet
Gallagher, Dr Peter
European Australian Business Council
Federal Chamber of Automotive Industries

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Federation of Automotive Products Manufacturers  
 Group of nineteen Australian and New Zealand business leaders and economists  
 Hall, Mr Peter  
 Institute of Chartered Accountants of Australia  
 International Trade Services  
 IP Australia  
 ITS Global (Alan Oxley and Kristin Bonidetti)  
 Law Council of Australia  
 Lowy Institute  
 Meat and Livestock Australia  
 Medicines Australia  
 Minerals Council of Australia - Stephen Deady  
 Mortimer AO, Mr David  
 National Association of Testing Authorities (NATA)  
 National Farmers' Federation  
 New South Wales Business Chamber  
 PACIA (Plastics and Chemicals Industries Association)  
 Ravenhill, Prof John  
 Standards Australia  
 The Centre for International Economics  
 The Treasury  
 Trade Queensland and Queensland Treasury (teleconference)  
 Victorian Government (Department of Innovation, Industry & Regional Development and  
 Department of Premier and Cabinet)

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**Table B.3 Modelling workshop – Canberra 17 May 2010**

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Matthew Harding	AusAID
Yeon Kim	Australian Bureau of Agricultural and Resource Economics
Arnold Jorge	AusAID
Amy Schwebel (video)	Australian Council of Trade Unions
Ian Manning (video)	Australian Council of Trade Unions
Nicole Forrester	Australian Industry Group
Prof Peter Drysdale	Australian National University
Prof Ron Duncan	Australian National University
Dr Shiro Armstrong	Australian National University

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Dr Andrew Elek AM	Australian National University
Dr Ray Trewin	Australian National University
Dr David Vanzetti	Australian National University
Prof Philip Adams (video)	Monash University
Elizabeth Howard	Department of Agriculture, Fisheries and Forestry
Jan Adams	Department of Foreign Affairs and Trade
Brent Perkins	Department of Foreign Affairs and Trade
Ron Wicks	Department of Foreign Affairs and Trade
Karen Gilmour	The Treasury
Liangyue (Li) Cao	The Treasury
Daniel Bunting	The Treasury
Qun Shi	The Treasury
Prof Christopher Findlay	University of Adelaide
Associate Prof Russell Hillberry	University of Melbourne
Assistant Prof Terrie Walmsley	University of Melbourne
Prof Peter Lloyd (video)	University of Melbourne
Malcolm Bosworth	
Dr David Robertson	
Patricia Scott (Commissioner)	Productivity Commission
Andrew Stoler (Associate Commissioner)	Productivity Commission
Paul Gretton	Productivity Commission
Patrick Jomini	Productivity Commission

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**Table B.4 Workshop – Canberra 29 September 2010**

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Harvey Purse (video)	AFTINET
Stephen Bouwhuis	Attorney-General's Department, Office of International Law
Amy Schwabel (video)	Australian Council of Trade Unions
Dr Emma Aisbett	Australian National University
John Larkin	Department of Foreign Affairs and Trade
Kim Debenham	Department of Foreign Affairs and Trade
Angela McGrath	The Treasury
Nirmalan Amirthanesan	The Treasury
Dr Luke Nottage	University of Sydney
Perry Shapiro	

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