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# **Review of bilateral and regional trade agreements**

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## **Productivity Commission**

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## Introduction

1. The Law Council of Australia (Law Council) welcomes the opportunity to make a submission to the Productivity Commission in response to its Issues Paper on 'Australia's Bilateral and Regional Trade Agreements.' This submission has been prepared by the International Trade and Business Focus Group of the International Law Section of the Law Council.
2. In summary, the position of the Law Council regarding preferential trade agreements, whether bilateral or multilateral, is as follows:-
  - (a) 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;<sup>1</sup>
  - (b) the Law Council recognises that entry into bilateral and regional preferential trade agreements may be of benefit to the Australian economy. However, 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;
  - (c) assessment as to whether a bilateral or regional preferential trade agreement will deliver substantial economic benefits to Australia within a reasonable period of time should be measured against clear objective criteria. This assessment should involve the private sector given that such agreements are intended to benefit the private sector;
  - (d) the ability to address industry specific issues in a comprehensive manner through preferential trade agreements is diminished because of the comprehensive nature of preferential trade agreements and the range of issues that they aspire to address (e.g. trade in goods and services, trade related investment and intellectual property rights, sanitary and phytosanitary measures, rules of origin, trade barriers, etc).
  - (e) 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;
3. The Law Council's more detailed comments on the issues raised in the Issues Paper are set out below.

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<sup>1</sup> See, for example, Jagdish Bhagwati, 'Termites in the Trading System, How Preferential Agreements Undermine Free Trade', Oxford Uni Press, Oxford, 2008

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## **Regional or bilateral preferential trade agreements?**

4. The Law Council considers that one form of preferential trade agreement should not be given preference over the other as both have distinct advantages and disadvantages. Whether Australia should pursue any preferential trade agreement should depend upon whether the proposed agreement will deliver substantial economic benefits to Australia within a reasonable period of time without having trade distorting effects.
5. Advantages of regional preferential trade agreements include the ability to achieve outcomes with many trade partners simultaneously, which enables a more efficient use of limited negotiation resources and provides greater uniformity and consistency in trade rules amongst those trade partners. However, there are also disadvantages with regional preferential trade agreements, including the difficulty of achieving strong outcomes. This is because there is typically a need to 'water down' offers to achieve outcomes that satisfy the lowest common denominator.
6. 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. However, the utility of bilateral agreements is hampered by numerous factors including the cost to business of compliance with differing international trade rules.
7. 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.
8. Finally, the pursuit of regional preferential trade agreements has the potential to create separate trading blocs within regions such as the Asia-Pacific region that could result in trade diversion. The Law Council suggests that a more useful approach might be to examine how existing preferential trade agreements could be harmonised and merged.

## **Best practice in entering into preferential trade agreements**

9. The Law Council supports the benchmarks for preferential trade agreements proposed in the Mortimer Review. However, the Law Council considers that these benchmarks may be further refined. The benchmarks or principles for entering preferential trade agreements noted in the 'Mortimer Report'<sup>2</sup> consist of the Government determining whether the proposed 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 World Trade Organisation (WTO) provisions;

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<sup>2</sup> David Mortimer AO, 'Review of Export Policies and Program', Commonwealth of Australia, Canberra. at p. 104.

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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, security and policy interests.
10. While supportive of these principles, the Law Council notes that there are some aspects which require clarification. For example, what economic model should be used to assess the “substantial commercial and wider economic benefits” and who determines whether the proposed agreement is fully consistent with WTO provisions?
  11. In this context the Law Council notes that achievement of these principles is, essentially, a matter for determination by Government. The Law Council believes that there should be a mechanism for private sector involvement in determining whether the proposed agreement has the potential to achieve outcomes that are of relevance to the private sector. Ultimately, it is the private sector that the proposed agreement is intended to benefit.
  12. A model for a mechanism to facilitate private sector involvement in assessing preferential trade agreements can be found in the United States.
  13. Section 2104(e) of the *Trade Act* of 2002 (USA) requires that advisory committees provide the President of the United States of America (U.S.), the U.S. Trade Representative and Congress with reports required under section 135(e)(I) of the *Trade Act* of 1974 not later than 30 days after the President notifies Congress of his intent to enter into an agreement. Under section 135(e) of the *Trade Act* of 1974, each advisory committee is required to include in its report an advisory opinion as to whether, and to what extent, the agreement promotes the economic interests of the United States and achieves the overall and principal negotiating objectives set out in the Trade Act of 2002.
  14. In relation to the Australia-United States Free Trade Agreement, 31 trade committees, comprising over 700 practitioners from a wide range industries and backgrounds, presented their respective reports on the agreement to the President, the U.S. Trade Representative and Congress. Committees that provided reports included:
    - (a) the Advisory Committee for Trade Policy and Negotiations;
    - (b) Agricultural Policy Advisory Committee;
    - (c) Agricultural Technical Advisory Committee for Trade;
    - (d) Industry Functional Advisory Committee;
    - (e) Industry Sector Advisory Committee;
    - (f) Trade and Environment Policy Advisory Committee;
    - (g) Intergovernmental Policy Advisory Committee; and
    - (h) Labor Advisory Committee.

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15. A copy of the Report submitted by the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13) is **attached** to this submission. As is evident from the list of members to that Committee appearing at the end of the Report, members are not only suitably qualified persons, but also from a wide range of backgrounds.
  16. The Law Council believes that a similar model could be adopted in Australia. Such a Committee could operate on a smaller scale and report directly to the Minister for Trade and Parliament on whether a proposed trade agreement meets the principles recommended by the Mortimer Review.
  17. In this context, the Law Council, while supportive of the principles advocated by the Mortimer Review, considers that they could be further developed into more tangible objectives such as the following:-
    - (a) to obtain more open and reciprocal market access for goods and services;
    - (b) to obtain the elimination and/or reduction of barriers to trade that restrict export of goods and services to the market in question;
    - (c) to adopt measures that strengthen the international trading system and which do not divert or distort trade in goods or services.
  18. The Law Council submits that consideration should be given to enacting legislation which requires the establishment of similar committees and identifies their obligations to consider and report on proposed trade agreements. Such legislation could also set out the extent of such a committee's involvement in the negotiation process.

#### Comprehensive agreements

19. The Law Council submits that agreements that are issue specific or industry specific are more likely to achieve greater economic benefits and more likely to deliver 'WTO-plus' outcomes than comprehensive agreements. This has been the experience of the Law Council with respect to legal services. The Law Council does not believe that comprehensive agreements are the best way forward.
20. Further, the Law Council submits that comprehensive agreements often merely contain commitments already given in the WTO. For example, in relation to sanitary and phytosanitary measures, technical barriers to trade and trade related investment.<sup>3</sup>

#### Improvement of processes in negotiating trade agreements

21. The Law Council is not in a position to provide substantial commentary on whether the processes in negotiating trade agreements can be improved. Notwithstanding, the Law Council submits that a process should exist to evaluate free trade agreements that Australia has entered into against the principles identified in the Mortimer Report and identify whether those principles have been achieved and, if not, why not.
22. Such an evaluation process may provide guidance for improving processes to identify possible trade agreements and to identify the extent to which stakeholders from both the private and public sector could be meaningfully involved in the negotiation of trade agreements.

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<sup>3</sup> see for example, articles 7.3 and 8.2 of the Australia – US Free Trade Agreement and articles 604 and 703 of the Thailand – Australia Free Trade Agreement.

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## The future role of bilateral and regional preferential trade agreements

23. The Issues Paper invites responses as to the future role of bilateral and regional preferential trade agreements in supporting WTO activity.
24. The Law Council submits that a key step in considering the future role of bilateral and regional preferential trade agreements is to evaluate Australia's existing preferential trade agreements against the principles identified in the Mortimer Report. Such an evaluation would greatly assist in the development and improvement of processes and criteria to identify the value of preferential trade agreements, whether bilateral or regional, for Australia.
25. Such an evaluation should also indicate what role preferential trade agreements, should have for Australia. That is, do they:
  - deliver substantial commercial and wider economic benefits within a reasonable period of time; and
  - provide new and significant access opportunities for the export of goods and services and investment opportunities; or
  - provide some other substantial trade or economic advantage?
26. The very nature of bilateral and regional trade agreements gives rise to the potential for them to both assist and hamper multilateral efforts in a variety of ways. The Law Council considers that preferential trade agreements are important vehicles for trade negotiation, particularly in relation to WTO-plus issues, including highly specialised sectors such as legal services. However, it is important that negotiation of bilateral and regional preferential trade agreements contribute to, rather than undermine, multilateral efforts.
27. Non-multilateral agreements increase regulatory complexity and hence transaction costs for end-users such as exporters. They also increase the potential for suboptimal trade diversion. These are the 'stumbling blocks' to the type of genuine, multilateral, less trade restrictive possibilities offered by the WTO.<sup>4</sup>
28. From a legal perspective, a web of trade agreements creates undesirable possibilities for jurisdictional arbitrage, as has been well illustrated by the North American Softwood Lumber disputes.<sup>5</sup>
29. Another major drawback of non-multilateral agreements is that the negotiation process in particular causes resource strain. This is an issue not just for Australia, but also for our neighbours in the region, where experienced negotiators are already scarce. Resource strain can lower the overall quality of agreements.
30. On the other hand, the difficulties associated with the WTO negotiations make bilateral and regional trade agreements more realistic fora for progress to be made. Bilateral and regional trade agreements can build institutional negotiating capacity and create standards that have the potential to be converted to WTO agreements in the future.

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<sup>4</sup> Bhagwati, for example, comments that proliferation of agreements causes "the proliferation in turn of discriminatory access to markets, with a whole maze of trade duties and barriers that vary according to source." *A Stream of Windows* (1999) at 290. But see also Zahrnt, Valentin: "How Regionalization can be a Pillar of a More Effective World Trade Organization" 39 *Journal of World Trade* 671 (2005).

<sup>5</sup> For a history of these disputes see <http://www.for.gov.bc.ca/HET/softwood/disputes.htm>

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## Preferential trade agreements as ‘testbeds’ for liberalisation

31. The Law Council submits that in areas where multilateral resolution is unlikely at this point in time, preferential trade agreements can act as important “testbeds” for liberalisation. The Law Council considers that four areas in which preferential trade agreements can serve as ‘testbeds’ for liberalisation include:
- (a) use of most favoured nation clauses (MFN clauses);
  - (b) investment provisions;
  - (c) expansion of private and semi-private actions; and
  - (d) framework to test new forms of co-operation.
32. Each of these areas is addressed below.

### Use of most favoured nation clauses

33. Cases since *Maffezini v Spain*,<sup>6</sup> including the recent case of *Tza Yap Shum v Republic of Peru*<sup>7</sup> demonstrate the potential for MFN clauses to be invoked to ‘claw in’ concessions given in preferential trade agreements not immediately applicable to both disputing parties. They also demonstrate the potential for MFN clauses to further complicate the network of treaty obligations. It, therefore, is imperative that MFN clauses not be simply included in preferential trade agreements as a matter of course, as concessions may inadvertently be given away which could be used as bargaining chips.
34. The legal risk of adverse investment arbitration decisions can be minimised by clear language, for example, by clarifying whether MFN provisions should apply to substantive concessions or also to procedural concessions, such as access to dispute resolution processes in a particular case.

### Investment provisions

35. Future negotiating practices can circumvent, at least to some extent, current controversies as to the breadth of the definition of an “investment”, for example, as illustrated in *Patrick Mitchell v Democratic Republic of the Congo*,<sup>8</sup> where a law firm was not considered to be an investment. The question that arises is whether an investment dispute is arbitrable and who decides that question.
36. Where the dispute resolution mechanism chosen is the International Centre for the Settlement of Investment Disputes (ICSID), as is common practice, 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.<sup>9</sup>
37. Similarly, the inherently close linkages between trade in services and investment should command particular attention in the drafting of future preferential trade

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<sup>6</sup> ICSID Case No. ARB/97/7 (Argentina/Spain BIT).

<sup>7</sup> ICSID Case No. ARB/07/6 (China/Peru BIT). See in particular the Decision on Jurisdiction and Competence of the Arbitral Tribunal dated 19 June 2009.

<sup>8</sup> ICSID Case No. ARB/99/7. An Ad Hoc Committee subsequently annulled the arbitral award on the basis that the tribunal had manifestly exceeded its jurisdiction.

<sup>9</sup> The most recent discussion is in the annulment proceedings for *Malaysian Historical Salvors Sdn Bhd v the Government of Malaysia* ICSID Case No ARB/05/10 (16 April 2009).



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agreements. The 2007 Economic Partnership agreement between Japan and Indonesia provides one example of how this can be achieved.<sup>10</sup> In that agreement, investment remedies are extended so that improper limitations on a commercial presence can give rise to a claim for compensation rather than to the more limited remedies for breach of the services chapter.

#### Expansion of private and semi-private actions

38. 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. This increases the utility of the preferential trade agreement for private parties who may be unable to rely on domestic legal processes in a host state, but who also might be unlikely to have their claim brought by the Australian Government in a state-state action.
39. When the progression of a free trade area or a customs union is created by agreement there is great scope to advance trade-enabling private law issues, such as cross-border small claims procedures, as well as to facilitate the harmonisation of standards and procedures, in order to develop the market. These mechanisms can be modelled on either European models or the current cooperation models between Australia and New Zealand. This more creative use could expand the growth of the legal infrastructure for cross-border trade in goods and services at little marginal cost.
40. This approach will be much more important when the ASEAN Free Trade Area is in full operation.
41. At present, there is little use for private law advantages in the negotiating opportunity that preferential trade agreements create. The Law Council submits that there should be greater use of expressions of interest and a desire to co-operate on such matters in the future. Even where more definite agreement can not yet be reached, the use of Working Party procedures similar to those in the Australia-US Free Trade Agreement can advance issues in a more structured way.
42. This is also true in the area of on-line transactions where there is not a complete set of global rules. The Law Council submits that on-line dispute resolution processes need to be developed, especially where it relates to consumer matters. This is of particular relevance in the Southeast and East Asian region.

#### Preferential trade agreement negotiations can provide a framework for testing new forms of co-operation

43. In relation to the preferential trade agreement being negotiated with the People's Republic of China, Australia has proposed for legal services the concept of "commercial association" as a trial or "test bed" to breakdown barriers. This concept, if agreed, initially would allow Australian firms with an existing foreign lawyers licence to work with a Chinese firm in the People's Republic of China effectively as a joint-venture enabling client sharing, fee sharing, joint marketing, co-location of offices, etc.
44. While noting the challenge of securing such an agreement, this sort of commercial association agreement could either be part of a preferential trade agreement, or be a concession made to demonstrate a willingness to ultimately reach an agreed preferential trade agreement.

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<sup>10</sup> For the text of the agreement, see <http://www.mofa.go.jp/region/asia-paci/indonesia/epa0708/index.html>

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## **Attachment A: Profile of the Law Council of Australia**

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The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 50,000 Australian lawyers, through their representative bar associations and law societies (the “constituent bodies” of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- Australian Capital Territory Bar Association
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society of the Australian Capital Territory
- Law Society of the Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar Association
- The Victorian Bar Inc
- Western Australian Bar Association
- LLFG Limited (a corporation with large law firm members)

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.