



# ITS Global

Consultants on Global Issues

## **Study of Regional and Bilateral Agreements by the Productivity Commission**

**Analysis of Recent Developments  
Commissioned and reviewed by the  
BCA**

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## **1. Executive Summary**

### **Australia, free trade agreements and the evolving global trade architecture**

The global trade and investment architecture is dynamic. It is shaped by the demands of the commercial environment and driven by a range of economic and policy developments.

A new factor and a major driver is the growing role and influence of Asia, especially China and India. A second is institutional paralysis in the negotiating processes in the World Trade Organization (WTO).

How Australia responds to these developments matters to Australian business. Australia's long term prosperity depends on continuing institutionalization of open economies in emerging markets and the ability of business to operate freely in global markets. To advance these interests, Australia requires appropriate policy approaches and responses to proposals for regional integration, such as free trade agreement (FTAs).

### **Assessing Australia's current agreements**

Australia now has five bilateral FTAs and one regional FTA with trading partners in the Asia-Pacific region. More are proposed or are being negotiated.

Analysis of the contribution of FTAs to the expansion of trade and investment may not produce significant quantifiable results in some cases. Australia already has low barriers to trade and investment by global standards. Where the partner economy is also open, quantifiable gains may be at the margin.

FTAs are effective in securing commitments which are desirable but not delivered through the multilateral system, for example to reduce barriers to investment and to introduce competition policy. They can also secure broader commitments to liberalise services than have been achieved in the WTO.

The Agreements also create binding legal rights for commitments which have been made in the WTO but not implemented; and to extend to Australia commitments made in bilateral and regional agreements to other trading partners which go beyond multilateral commitments.

The benefits of FTAs are best measured by the extent to which they create more open markets in Australia and in partner countries; improve the business environment for trade and investment, including "beyond the border;" advance economic integration in the region; promote structural reform and improve competitiveness, and, consistent with the WTO.

## **Creating more open markets**

It is undeniable that today, the Doha Round is stalled. This is despite the fact that tariff barriers remain an impediment in many industries. The incidence of non tariff barriers is significant. Barriers to services markets and investment are high and a major impediment to expansion of Australian business in regional markets. Yet the political rhetoric in support of more open markets remains strong among governments in the Asia-Pacific region.

Negotiation of FTAs by Australia in the East Asian and Pacific region, both bilateral and regional, creates institutional opportunities to achieve gradualist commitments to match the rhetoric. It can balance or counter preferential measures in FTAs among economies in the region to which Australia is not a party.

## **Improving the business environment**

Considerable importance is attached to a greater focus in FTAs on measures which directly improve the operating environment for business. The Asia Pacific Economic Cooperation (APEC) has promoted this as a major element in its programs to expand trade and investment.

Australia's FTAs have played a role in improving the trade and investment environment for Australian business in FTA partner countries. Legally binding frameworks and broad principles have been helpful for addressing regulatory impediments which extend 'beyond the border' in areas of interest to business.

This has included establishing frameworks to address standards and technical barriers, facilitating mutual recognition of professional qualifications and enhancing mobility of business personnel across borders.

Experience has demonstrated that these issues can be more effectively advanced through FTAs than through the multilateral system.

## **Promoting structural reform and improving competitiveness**

While significant trade and investment barriers remain in the East Asian region, promoting and institutionalising open economies now probably depends more on domestic policies in these economies - those which advance structural reform and improve competitiveness rather than just liberalise trade and investment flows at the border.

Official pronouncement by regional governments in APEC and ASEAN demonstrates recognition of this, but the challenge is to see introduction of commitments to programs which implement it.

FTAs are limited in what they can do to drive reform in other countries, but can play a role in promoting structural reform through commitments to sound regulation. It is in Australia's interest to promote legal frameworks to support capacity building initiatives which advance such reform.

Broader initiatives such as the APEC Agenda to Implement Structural Reform, which brings together policy makers across different policy areas, the technical assistance program to support the AANZFTA, and bilateral aid programs such as the 'Beyond WTO' program in Vietnam, are important. This is both as activities in their own right and for underlining the capacity to use FTAs to advance structural reform.

### **Advancing economic integration**

Business has a commercial interest in greater economic integration in the Asia-Pacific region. This optimizes opportunities for Australian companies to operate easily and profitably in other markets. That is why policies for liberalisation of trade and investment, as well as structural reform are supported.

FTAs should set leading standards for this. Australia should be active in promoting common standards for economic integration in the Asia-Pacific region. Completing the Trans-Tasman Single Economic Market stands to serve as a benchmark for closer integration across the region. The proposed Trans Pacific Partnership Agreement (TPP) also provides an opportunity to further that goal.

### **Supporting the WTO**

While efforts to negotiate new global commitments to open markets are stalled in the WTO and may remain so despite the best efforts of governments like Australia, it is vital that the integrity and legal authority of the network of legal commitments which the WTO system creates is upheld.

The WTO multilateral trading system is extremely important. Preferential liberalisation under FTAs carries some risks to that. For FTAs to support multilateral liberalisation, efforts must be made to ensure they result in comprehensive liberalisation across goods, services and investment and achieve consistency in the coverage and scope of commitments among agreements.

Many FTAs reference principles in WTO agreements in certain areas, such as treatment of non-tariff measures and technical standards. It is important this practice continues. FTAs should not be used as instruments for enforcing non trade interests, including climate change or other environmental policies.

Australia must continue to support activity in the WTO to highlight the importance of WTO principles and regional agreements which promote, and not inhibit, optimal improvements in economic welfare.

### **Prioritising resources**

Australia's' expanding FTA and economic integration agenda poses new challenges for optimising best use of finite resources. It creates new demands on business. It requires greater resources for government to cope with the workload of negotiating and administering a growing number of agreements.

Government resources should be prioritised to focus on negotiating FTAs which provide the greatest opportunities for the expansion of Australian business interests.

Along with this, consideration could be had towards improving the mechanisms for collaboration between business and negotiators. This should improve the sharing of information and the likelihood that high quality and beneficial outcomes can be achieved through completed FTAs.

### **Negotiating ‘best practice’ FTAs: benchmarks for global engagement**

Australia should lead in the negotiation of ‘best practice’ FTAs which serve as benchmarks to support open and competitive markets for trade and investment in the Asia-Pacific region.

Best practice FTAs are those which create more open and competitive markets for Australian business; complement efforts by governments to encourage structural reform; advance economic integration based on free and open global markets; support the multilateral trading system, and are consistent with 21<sup>st</sup> century business interests.

Best practice principles for FTAs have been agreed by APEC members as a basis for setting a high standard for quality FTAs. Australia’s involvement in promoting their adoption among economies in the region is to be commended.

## 2. Australia, FTAs and the evolving global trade architecture

The global trade and investment architecture is dynamic. It is shaped by the demands of the commercial environment and driven by a range of economic and policy developments. A new factor and a major driver is the growing role of China. Its share of global GDP and trade has risen markedly in the last five years.<sup>1</sup> Exports have grown rapidly.<sup>2</sup> A second is institutional paralysis in the negotiating processes in the WTO. These developments have altered the way in which international agreements to promote economic integration based on open economies will be developed in future.

How Australia responds to these developments matters to Australian business. Australia's long term prosperity depends upon continuing institutionalization of open market economies in emerging markets and the ability of business to operate freely in global markets. To advance these interests, Australia requires appropriate policy approaches and responses to proposals for regional integration, such as FTAs.

### Asia-led recovery and growth

Post the Global Financial Crisis (GFC) global growth will continue to be driven by China, India and to a lesser extent other developing countries. China's exports grew 8.5 percent in 2008, and India's 7.5 percent, compared with 1.5 percent for the world as whole.<sup>3</sup> China's projected GDP growth for the next three years is as high as 10 percent.<sup>4</sup> Recovery in the US, EU and the developed world is likely to be slow, with GDP expected to climb from negative levels in 2009 to just over 4 percent in 2011.<sup>5</sup> The Australian economy is expected to be robust.

Australia's trade policy needs to continue to pay close attention to developments in Asia and ASEAN. As economic growth and rising populations increase demand for food and commodities, these countries will become more important markets for Australia. Reduction of barriers to trade will be commercially significant.

So too will open investment regimes. Fast growing economies in Asia will increasingly need to position themselves to exploit regional sources of growth in the region. They require both increased inward investment and greater opportunities for outbound investment. China for example, is already seeking to expand investment in Australian resource and food industries.

### Protectionist 'creep' and trade disputes

While there has not been resort to levels of 'high intensity' protection in the wake of the GFC, 'creeping' protectionism may be increasing.

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<sup>1</sup> China's share of global GDP and trade has risen markedly in the last five years, from 8.5 to 11.3 percent<sup>1</sup> and from 5.2 to 8.3 percent<sup>1</sup> respectively. See <http://www.imf.org/external/pubs/ft/weo/2009/02/weodata/index.aspx> and

<sup>2</sup> Between 2000 and 2008, China's exports grew four times faster than global exports. See [http://www.wto.org/english/news\\_e/pres09\\_e/pr554\\_e.htm](http://www.wto.org/english/news_e/pres09_e/pr554_e.htm)

<sup>3</sup> [http://www.wto.org/english/res\\_e/statis\\_e/its2009\\_e/its2009\\_e.pdf](http://www.wto.org/english/res_e/statis_e/its2009_e/its2009_e.pdf).

<sup>4</sup> <http://www.imf.org/external/pubs/ft/weo/2010/update/01/index.htm>

<sup>5</sup> Ibid.

Creeping protectionism creates risks for trade, competitiveness and recovery. If it continues there is a risk of a winding back of past trade reforms which have underpinned high levels of growth. It could also erode efforts to build the momentum required for a successful conclusion of the WTO Doha Round.

This reinforces the importance of policy setting and measures, including FTAs, which support multilateral trade liberalisation and which guard against further barriers and protectionist actions.

### **ASEAN economic integration**

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.

A more integrated ASEAN region is both economically and strategically significant for Australia. ASEAN comprises a US\$1.5 trillion market of over 583 million people. Intra-regional trade has grown over the past ten years.<sup>6</sup> But barriers to trade and investment in ASEAN are still high. ASEAN's FTAs (with some exceptions) have typically been limited to tariff cuts. There has been little agreement on significant liberalisation in areas such as goods, services and investment.

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.

### **The rise and rise of Asia's FTAs**

Bilateral and regional agreements have proliferated since the 1990s, particularly in the Asia-Pacific region. There are now more than 160 FTAs in force spanning Asia, the Pacific, Europe and the Americas.<sup>7</sup> A third wave has been implemented since 2005, over half of these in Asia.<sup>8</sup> More are slated. There is talk of bigger region-wide FTAs including a Trans Pacific Partnership Agreement (TPP)<sup>9</sup>, a Northeast Asian FTA<sup>10</sup>, an ASEAN 'Plus Three' FTA<sup>11</sup>; an ASEAN 'Plus Six' FTA<sup>12</sup> and an APEC-wide FTA.<sup>13</sup> Japan has proposed an East Asian Community (EAS)<sup>14</sup> and Prime Minister Rudd an Asia-Pacific Community.

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<sup>6</sup> In 2008, the share of intra-ASEAN exports in total ASEAN exports was 27.6 percent across all of ASEAN, up from 22 percent in 2001. See ASEC 2008.

<sup>7</sup> See <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>

<sup>8</sup> The WTO reports 66 FTAs in force (2009) since 2005, including 26 in East Asia and 7 in West Asia.

<sup>9</sup> Including Singapore, Chile, Brunei, New Zealand, Australia, Peru, the US and possibly Vietnam.

<sup>10</sup> Comprising China, South Korea and Japan.

<sup>11</sup> That would unite northeast Asia (China, South Korea and Japan) and Southeast Asia (ASEAN).

<sup>12</sup> That would subsume the ASEAN plus 3 Agreement as well as India, Australia and New Zealand.

<sup>13</sup> Including APEC members.

<sup>14</sup> Possibly similar to the ASEAN+6 grouping; effectively the members of the East Asia Summit, which also includes India, Australia and New Zealand. With 2.2 for the Americas.



Liberalisation in FTAs, albeit to varying degrees, has delivered market access opportunities for business. Frameworks to support wider regulatory reform in Asian markets have been put in place.

At the same time however, preferential treatment in third party agreements has introduced competitiveness threats to Australian business. The sheer multitude of agreements has resulted in an increasingly complex “patchwork” of arrangements and obligations for traders.

This reinforces the need for a consistent approach to FTAs which delivers more open markets comprehensively across trade in goods, services and investment.

### **The slow road to Doha**

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.

This reinforces the importance of a policy approach to FTAs which is consistent with and supports broad, multilateral and non discriminatory liberalisation in the WTO.

### **‘Beyond border barriers’ and structural trade reform**

Microeconomic reform has taken on greater importance in the post crisis environment. Barriers to conducting business across borders are now less related to border restrictions such as tariffs, and more closely interlinked with the operating regulatory and policy framework in foreign markets. Policy on services and investment is now more important as business has become more globally integrated.

The ‘beyond the border’ barriers policy agenda extends to a wide policy area encompassing of structural reform and extending well beyond the traditional program of issues related to trade liberalisation obligations. More transparent regulatory frameworks, secure property rights, independence of the judiciary and wider application of competition principles offer substantial gains for international business. They foster open policy environments and improve competitiveness. Accordingly, structural reform, and even microeconomic reform, has taken on a new importance in regional forums such as APEC.

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 ‘beyond the border’ barriers to facilitate a more open and transparent business environment.

## **US leadership in Asian integration**

US involvement in the regional trade architecture is crucial from both an economic and strategic perspective. It is a major trade and investment partner for most countries, including Australia. Its priorities shape the regional trade landscape, including trade agreements.

Until recently, US trade policy in Asia has lacked a clear strategic direction. Under the Bush Administration it was largely reactive to the initiatives of others. US support for the concept of an APEC FTA and even the proposed TPP were mainly responses to proposals for pan-regional trade initiatives of China and Japan which excluded the US, rather than a reflection of a strategic view of how the regional architecture should develop.

The decision of the Obama Administration to participate in the TPP indicates a clear intention to engage on trade in the Asia-Pacific region. Involvement in the TPP will give new weight to the negotiations and provide impetus for progress by 2011, when the US will host APEC.

Greater Asian-Pacific engagement by the US is important. Whilst there is some uncertainty about US policy positions, its insistence on comprehensive agreements with clear targets for economy wide liberalisation and related domestic structural reform is very important.

This contention sets the stage for Australia and like minded economies to highlight the importance of US engagement in the region to forge greater economic integration which is built on open markets. This includes leading on trade agreements which support that. The Australia/US FTA (AUSFTA) sets a standard for current and future trade agreements in this respect.

## **Climate change and green protectionism**

Recent years have seen the rise of environmental regulations which act as barriers to trade.

The regulation of non-trade concerns in trade agreements risks impeding the competitiveness of Australian business in overseas markets. Attempts to regulate environmental barriers threaten trade wars and disputes among major traders and could have the potential to undermine the multilateral rules-based system.

It is important that trade agreements are not used to enforce non-trade interests, drive environmental policy in third markets or restrict trade for protectionist reasons.

## **Trans-Tasman investment integration**

Australia and New Zealand have achieved a high level of economic integration under the Australia/New Zealand Closer Economic Relations Trade Agreement (CER). While there is now almost completely free trade in goods and services, and free

movement of people, binding liberalisation of investment has lagged. A proposed Investment Protocol is yet to be finalised.

There is renewed political commitment to continue and expand economic integration in investment, taxation and a range of regulatory areas under the Single Economic Market initiative (SEM).

This is both needed and welcome. CER is widely regarded as a benchmark for high quality and liberalizing free trade agreements. Open, binding bilateral investment regimes would bring further benefits to the Trans-Tasman business environment and would set a standard for closer economic integration in the region.

### 3. Assessing the benefits of FTAs to business

To date Australia has concluded bilateral FTAs with New Zealand (CER), the US (AUSFTA), Singapore (SAFTA), Thailand (TAFTA) and Chile (CAFTA). It has a regional agreement with New Zealand and ASEAN countries (AANZFTA). Negotiations are underway with China, Japan, South Korea (Korea), Malaysia, and partner countries to the Trans Pacific Partnership Agreement (TPP).<sup>15</sup>

There is no standard methodology for measuring the economic impact of FTAs. FTAs do not automatically produce significant liberalisation. The extent to which preferential liberalisation among parties to an FTA might reduce, rather than enhance, the economic welfare of participants or their trading partners depends entirely upon the facts in each case. Broad analyses by the OECD and the World Bank found that it was unlikely, at large, that FTAs diminished the welfare gains of multilateral trade liberalisation, though found instances where the economic benefits were negative. It is generally presumed among analysts for example, that the Mercosur Agreement in South America does generate illiberal results.

There is a disposition to use econometric modelling to demonstrate gains from FTAs. Econometric modelling on the prospective effects of FTAs has produced results which roughly estimate the benefits from liberalizing trade in goods and to a degree services. Trade and investment statistics provide some indication of trade flows over the period since implementation.

Analysis of their contribution to expansion of trade and investment may not produce significant quantifiable results in some cases. Australia already has low barriers to trade and investment by global standards. Where the partner economy is also open, as is the case of Singapore and the US, quantifiable gains across the economy will of consequence be at the margin. This was demonstrated in modelling of the prospective gains of those two FTAs which was commissioned by DFAT.

It is generally accepted that econometric modelling also understates the dynamic benefits of the agreements in the longer term. In this respect it is observed that the efficiencies achieved from reductions of barriers create more economic activity than modelling of the gains calculated by the removal of the barrier concerned.

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.

As such, the benefits for business of Australia's FTAs need also to be assessed qualitatively in terms of the extent to which they have met key business interests and needs and support an open trade and investment environment in the longer term.

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<sup>15</sup> Currently New Zealand, Chile, Singapore, Brunei Darussalam. Australia, Peru, Viet Nam and the US are intending to join negotiations.

For example, in the case of AUSFTA, the Australian business community placed a high value on the gains to be achieved as a result of Australian business being more exposed to the business systems and methods utilized in US business arising from the removal of impediments to the US market and enhancement of the opportunity for US business to increase its presence in the Australian market.

The benefits of FTAs are measured by the extent to which they:

- Create more open markets in Australia and in FTA partners;
- Improve the business environment for trade and investment, including “beyond the border;”
- Advance economic integration in the region;
- Promote structure reform and improve competitiveness; and
- Are consistent with the WTO.

## 4. Creating more open markets

It is undeniable that today, the Doha Round is stalled. This is despite the fact that tariffs continue to be an impediment across many industry sectors. At the same time, the incidence of non tariff barriers is significant. Barriers to services markets and investment are high and a major impediment to expansion of Australian business in regional markets. Yet the political rhetoric in support of more open markets remains strong among governments in the Asia-Pacific region.

Negotiation of FTAs in the East Asian and Pacific region, both bilateral and regional, creates institutional opportunities to achieve gradualist commitments to match the rhetoric. They can balance preferential measures in FTAs among economies in the region to which Australia is not a party.

Australia's current FTAs have contributed to achievement of this goal, albeit to differing degrees. They have promoted more open markets for trade in goods and services as well as investment by reducing tariffs on goods in markets where barriers are still high and in areas where progress to reduce them at the multilateral level has been slow; by easing barriers to trade in services, and in supporting improvements in the investment climate in Australia and foreign markets.

### **Reducing remaining tariffs**

Tariff liberalisation under almost all of Australia's FTAs has been comprehensive and "WTO plus". Reduction of duties in markets of importance, and areas where Australian business is internationally competitive, have been achieved either immediately or are to be phased in over time. There have been benefits for business in sectors where barriers are high and where progress to reduce them at the multilateral level has been slow.

For example, (almost) completely free trade in goods achieved in CER has benefited Trans-Tasman trade. The phasing out of the US import quota on Australian beef under AUSFTA will, over time, produce significant access for Australian beef and dairy exports. Some Australian pharmaceutical and iron and steel exports will benefit from progressive reductions of tariffs under AANZFTA, including from rates as high as 50 percent to less than 10 percent.

Despite this, high tariffs remain across agriculture and manufacturing sectors. They are higher in ASEAN countries where some products are excluded from liberalisation commitments in FTAs or subject only to limited reduction.

Even where barriers are relatively low, Australia's FTAs play a role in securing access to growing markets in Asia by safeguarding against competitive disadvantages arising from third party agreements. In highly competitive markets, incremental market access improvements can matter. Preferential access to the Korean market granted to US dairy, beef and service exporters in its prospective bilateral FTA for example, may (if implemented) disadvantage Australian exporters.

While this should not be the sole motivation for negotiating FTAs, it is a commercial reality of the expanding ‘patchwork’ of agreements in the region. It highlights the need for broad liberalisation and consistency in commitments among agreements.

### **Easing barriers to services trade**

Most of Australia’s FTAs have made progress toward easing cross border trade in services, though to differing degrees. Some agreements have supported more open service markets than others.

Services are now economically important for Australia, where they generate over 70 percent of GDP, and about 20 percent of total exports. Education and tourism, account for more than half of that.<sup>16</sup> Services are also increasingly important for developing countries: they now account for more than 40 percent of China’s GDP, for example. They play a key role in supporting wider economic activity. The benefits of more open services, such as telecommunications regimes and financial systems, extend more broadly throughout the economy.

CER has achieved almost completely free trade in services between Australia and New Zealand. Australia’s agreements with the Singapore, Chile and the US in particular, deliver greater liberalisation than what is currently agreed to in the WTO.<sup>17</sup>

Agreements with ASEAN countries generally do not extend much beyond that, though ‘WTO plus’ commitments for foreign equity participation across some service areas should benefit Australian service providers. Some restrictions remain in areas of importance however, including financial and professional services, telecommunications and transport.

### **Improving the investment climate**

All of Australia’s FTAs include binding commitments to liberalise investment. While they have reduced barriers to FDI, the full benefit of more open investment regimes has been limited by inconsistencies in the scope of liberalisation among agreements.

Bilateral agreements with the US and Chile provide for broader liberalisation of foreign investment and its subsequent protection than those with Thailand, Singapore and the regional AANZFTA. There are no treaty level obligations for liberalisation of investment with NZ implemented under CER as yet.

The degree of Australia’s policy liberalisation with the US in AUSFTA is significant - the FIRB screening thresholds for US investment under AUSFTA (in non sensitive sectors) were raised from \$50 million to \$800 million.<sup>18</sup> While screening thresholds have subsequently been raised unilaterally, this most liberal treatment is still withheld

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<sup>16</sup> DFAT (2009) Trade in Services, Australia, 2008, Market Information and Research Section at [www.dfat.gov.au](http://www.dfat.gov.au).

<sup>17</sup> Under the WTO General Agreement on Trade in Services (GATS)

<sup>18</sup> For acquisitions of interests in Australian businesses, indexed annually. Levels were \$1.004 as of 1 January 2010.

from major sources of investment, particularly the EU and Japan as well other FTA partners. Until recently this included New Zealand.<sup>19</sup>

Consideration could be had to reviewing this policy to ensure that potential gains to Australia from broad liberalisation, including FDI from growing sources, are fully able to be captured. The EU is a major source of foreign investment and Japan has been in the past. China is emerging as a major investor.

Provision for capacity building and cooperation in FTAs to support implementation of liberalisation commitments in developing countries (such as in the work program for economic cooperation under AANZFTA<sup>20</sup>) is of benefit to business where it facilitates greater investment flows among the parties and encourages wider improvements in the investment environment.

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<sup>19</sup> Screening thresholds for FDI for New Zealand investments in Australia are now AUD\$953 million, equivalent to that provided to the US under AUSFTA.

<sup>20</sup> This provides for dialogue and workshops to increase awareness of new investment opportunities arising from the FTA and identify and address impediments



## **5. Improving the business environment**

Considerable importance is attached to a greater focus in FTAs on measures which directly improve the operating environment for business. APEC has promoted this as a major element in its programs to expand trade and investment.

Australia's FTAs have played a role in improving the trade and investment environment for Australian business in FTA partner countries. Legally binding frameworks and broad principles have been helpful for addressing regulatory impediments which extend 'beyond the border' in areas of interest to business.

This has included establishing frameworks to address standards and technical barriers, facilitating mutual recognition of professional qualifications, and enhancing mobility of business personnel across borders.

Experience has demonstrated that these issues can be more effectively advanced through FTAs than through the multilateral system.

### **Breaking down technical barriers**

Non-tariff and regulatory barriers have become increasingly significant for trade and investment as tariff barriers have fallen. Their reduction in key Asian trading partners with which Australia is currently negotiating bilateral free trade agreements (such as China, Japan and Korea) offer further potential benefits for business.

While the capacity of FTAs to influence regulatory policy in partner countries is limited, they can be effective in establishing frameworks for institutional cooperation to reduce technical impediments in partner countries.

All of Australia's FTAs provide for cooperation on standards and regulations for agricultural and manufactured products, which facilitate improvements in the regulatory environment to some extent and, in some cases, capacity building to support it. AANZFTA, for example, includes a built-in work program to advance the development of standards and technical regulations which facilitate trade and strengthen information exchange with lesser developed ASEAN parties.

### **Facilitating mutual recognition of standards and qualifications**

Cross-border recognition of product standards and technical regulations is beneficial to business where they ease the cost of complying with differing requirements across markets. This was effectively achieved through harmonization of food standards between Australia and New Zealand, enforced by a Trans-Tasman (bi-national) regulatory agency.

Harmonisation of standards is not necessarily a practicable strategy in all areas. Efforts in other areas under the CER framework were unwieldy and not successful. To a degree, this has also been the experience of the EU. Instead it has promoted mutual recognition of standards in foreign jurisdictions among its members.

FTAs can facilitate mutual recognition of services regulation and professional qualifications. For example, the Financial Services Committee (FSC) established under the AUSFTA has provided a framework Australia to pursue greater access to US securities markets. It set in place a work program and facilitated formal dialogue between regulatory authorities. A mutual recognition agreement (MRA) on US and Australian securities regulation was agreed in 2008 and is to be implemented soon. It will provide greater access to US markets for Australian investors.

Similarly, the AUSFTA Working Group on Professional Services has served as a platform for professional bodies in Australia to negotiate MRAs with their counterpart bodies in the US (such as the Law Institute, Engineers Australia and CPA Australia). Agreements for mutual recognition of qualifications and licensing arrangements have been concluded in the accounting and engineering professions. Professional bodies in several US states have implemented or are in the process of implementing regulatory changes to permit Australian lawyers to practice in the US. The outcomes have been commercially significant for some Australian legal and accounting firms operating in the US.

### **Enhancing business mobility**

Provisions which ease the mobility of workers and professionals across borders generate significant benefits for business. They tend to be politically sensitive and difficult to achieve at the multilateral level.

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 in the WTO, but they remain linked to immigration requirements and are restricted to business personnel, investors and certain categories of workers such as services professionals.

Arrangements for mobility with the US, although outside the FTA, have arguably been of greater benefit for business, though are limited to higher professionals.

No agreements (apart from CER) facilitate seamless mobility of business professionals, nor ease the movement of workers in areas of current demand in Australia such as the agriculture, manufacturing and mining sectors. This is in contrast to several other FTAs concluded in the region. Japan's FTAs with Indonesia and Malaysia provide rights, albeit highly circumscribed, for domestic help workers and those in the nursing and health care occupations to work in Japan.

## **6. Promoting structural reform and improving competitiveness**

While significant trade and investment barriers remain in the East Asian region, promoting and institutionalizing open economies now probably depends more on domestic policies in these economies - those which advance structural reform and improve competitiveness rather than only liberalise trade and investment flows at the border.

While many countries in South East Asia have undertaken significant economic reforms in the last decade, the business environment remains highly regulated in many economies. Improvements could be made in domestic markets, for example in the operation of regulatory frameworks, property rights, the independence of the judiciary, and competition principles.

Australian business would benefit therefore from further structural reform in South East Asia (and wider APEC region) which improves the trade and investment environment for business and supports the long term competitiveness of economies.

FTAs can play a role in promoting structural reform through commitments to encourage pro-competitive regulatory frameworks.

Broader cooperation and capacity building initiatives which bring together policy makers across different policy areas, and which support implementation of FTA commitments are therefore important.

### **Encouraging competitive regulatory frameworks**

Australia's FTAs include general obligations for cooperation on addressing anti-competitive practices and their enforcement. There are provisions to facilitate greater regulatory transparency in areas of competition policy, standards and technical regulations, intellectual property and investment policy. However, consideration should be had towards ensuring these mechanisms are as effective, transparent and enforceable as possible.

### **Capacity building for structural reform**

AANZFTA has a dedicated work program on economic cooperation which provides technical assistance and capacity building to assist ASEAN countries implement the agreement. Outcomes will benefit Australian business where they support development of institutions and policy frameworks in ASEAN countries which in the longer term lead to more open and competitive markets and enhance the prospects for growth.

It is understood that the Australian government's activities are focused on improving the efficient functioning of science-based quarantine policy; assisting with streamlining and harmonising of regulatory arrangements affecting services provision; developing sound systems for IPRs and their enforcement and; reducing impediments to internal

ASEAN integration in certain areas, including the dairy sector. Services and investment have been designated by governments as priority areas.

The Australian government is also financing<sup>21</sup> the Beyond WTO (BWTO) project, a six year bilateral program to assist the Government of Vietnam to strengthen its capacity to integrate into the global economy arising from commitments in the WTO and FTAs. As well as assisting implementation of liberalisation commitments, it is focused on strengthening the regulatory environment (including on competition policy, state owned enterprise reform and land management); building the capacity of key Vietnamese institutions that are responsible for economic reforms, and supporting the implementation of reforms at the provincial level.

The AANZFTA and BWTO programs are complementary to the broader APEC Agenda for structural reform. The broader APEC program focuses on domestic policies and institutions that affect the operation of, and access to, markets. Its reach extends beyond the historical focus of trade liberalisation to cover structural, macroeconomic and financial policies as well as trade and investment.

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<sup>21</sup> BWTO is funded by AusAID, jointly with DFID. AusAID will contribute AUD12 million and DFID will contribute GBP3.4 million for Phase II of the project to run from 2009-2014. The program will also receive technical assistance from the World Bank.

## **7. Advancing economic integration**

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.

FTAs should set leading standards for that. Australia should be active in promoting comprehensive and coherent integration in the Asia-Pacific region which fully engages the economic interests of like minded economies. The Trans Pacific Partnership is an opportunity to do so.

Broadening integration with a rapidly growing East Asia to prevent exclusion from fast growing regional markets, and completing the Trans-Tasman SEM as a benchmark for closer integration are also important priorities.

### **Leading Asia-Pacific economic integration**

FTAs will continue to be the driving force for economic integration in the Asia-Pacific region for some time. 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.

It demonstrates a need to ensure that integration frameworks in the region are based on open and competitive markets for trade and investment. FTAs should set leading standards for that.

Accordingly, 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. It 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.

From a practical standpoint, the TPP provides an opportunity for Australia business to advance its commercial interests by building on goods, services and investment liberalisation achieved in bilateral agreements, and advancing economic cooperation in areas of specific interest.

The TPP has been touted as a possible basis for an FTA involving all APEC members. Many of the (prospective) members already have agreements with Australia and each other. US involvement in the TPP will encourage, over time, broader membership from important economies in the region, including Korea, Japan and other ASEAN countries. With the US hosting APEC next year, it is more than a possibility that the TPP could assume an important role in Asian Pacific integration.

## **Engaging East Asia**

FTAs with important trading partners in Asia will enable Australia to secure access to growing markets and guard against exclusion from expanding East Asian integration efforts.

Asian economies, have increasingly sought to deepen economic integration among each other. FTA arrangements have been the policy tool of choice. The proposed ASEAN Plus 3 Agreement for example, does not propose to include Australia.

It is important for Australian business that prospective FTAs with Japan, China and Korea and other ASEAN nations are priorities for the Australian government and that the full benefits of the AANZFTA are realised over time. Agreements must be comprehensive, liberalizing and consistent with current FTAs and the WTO to be of value.

## **Completing Trans-Tasman economic integration**

A high level of economic integration has been achieved under CER. Trade liberalisation has not only benefited Trans-Tasman business but served as a regional “standard” for highly liberalizing FTAs. Advancing binding liberalisation of investment would bring greater certainty to the business environment and further this process.

Both economies have committed to further the level of integration through the Single Economic Market (SEM) initiative. This implies further alignment of domestic regulatory systems (including for competition and consumer policy, intellectual property, financial reporting), supported by binding agreements, to improve the cross Tasman business environment. It extends to investment and taxation policy. A CER Investment Protocol has been under negotiation for several years. A double taxation agreement was signed last year and is to be implemented. A Framework to continue liberalisation and expand the SEM has been agreed at Prime Ministerial level.

The SEM program is comprehensive, but integration of investment policy has lagged. The Investment Protocol has been slow to advance. Although last year governments agreed to liberalise threshold screening levels for bilateral FDI (to most liberal levels accorded to other FTA parties<sup>22</sup>) a treaty is yet to be concluded. There is support from business, including through the Australia New Zealand Leadership Forum.

The economic integration process, particularly on investment, must be completed if the full benefits of CER are to be realised. A Protocol which significantly liberalises investment policy would serve as a standard setter for deeper integration in the region.

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<sup>22</sup> Screening thresholds for FDI are now AUD\$953 million for New Zealand investments in Australia and NZD\$477 million for Australian investments in New Zealand.

## 8. Supporting the WTO

While efforts to negotiate new global commitments to open markets are stalled in the WTO and may remain so despite the best efforts of governments like Australia, it is vital that the integrity and legal authority of the network of legal commitments which the WTO system creates is upheld.

Good FTAs are capable of supporting the WTO, but preferential liberalisation does pose economic and systemic risks to broad multilateral liberalisation. These risks must be managed.

Efforts must be made to ensure FTAs result in comprehensive liberalisation across goods, services and investment and achieve consistency in the coverage and scope of commitments among agreements. WTO principles and measures must continue to be treated as the reference points for related measures in FTAs. FTAs should not be used as instruments for enforcing non trade related concerns, such as climate change or other environmental policies.

Australia should continue to support activity in the WTO to highlight the importance of principles that seek to encourage FTAs and regional agreements which adopt the above.

### **Delivering trade and investment liberalisation**

FTAs are capable of delivering benefits the WTO cannot. They enable deep liberalisation of trade in services which have been slow to advance under the GATS. They permit liberalisation of investment provisions which are not the subject of multilateral rules. They can deliver commitments to reduce “beyond the border” barriers which are not practically viable in the WTO (such as mobility of business persons and competition policy for example). In many FTAs, WTO agreements serve as reference points for agreed rules among the parties for treatment of non-tariff measures, trade remedies and the application of science-based quarantine measures.

Australia’s FTAs are no exception. Australia has secured liberalisation of trade in agricultural products in FTAs that it cannot secure through the WTO. Outcomes in services have built on those agreed in WTO agreements. In the case of CER, they have served as standards for liberalisation of services.

### **Managing discrimination and trade diversion**

The main economic concern of FTAs relates to inconsistency among measures in agreements, and that because they liberalise on a discriminatory basis, they may deliver potentially sub-optimal results than if liberalisation were delivered through the multilateral disciplines of the WTO.

Much has been made of the regulatory cost on trade of the multiplicity of regulation governing trade which FTAs inevitably produce, or the “patchwork” of existing FTAs.

While intuitively increased regulation should increase the costs of transactions, this is an area where only limited empirical evidence is available.

The concerns about trade diversion are real, but the impacts are very difficult to measure. Notably the extent of diversion that can be expected depends greatly on the breadth and depth of liberalisation that is agreed in the FTA. Agreements where each trading partner eliminates all its tariffs on imports from *all* countries is clearly the simplest and most desirable way to remove the scope for trade diversion.

If, however, such comprehensive elimination is impractical (and it often is), the only alternative is to assess the extent of trade diversion from the partial and/or incremental removal of barriers between partners on a case-by-case basis. FTAs which result in liberalisation in areas where each party is internationally competitive, and which avoid exclusion of products and sectors from commitments, can be expected to be less trade diverting than those which don't.

The degree of risk of discrimination depends greatly on the type of agreements which are negotiated. Commitment in FTAs which "lock in" most liberalizing services commitments (such as the "ratchet mechanism found in AUSFTA<sup>23</sup>), and to extend preferential concessions on a multilateral basis as they are granted (such as favoured in AANZFTA<sup>24</sup>) are consistent with achieving highly liberalizing trade agreements. They not only spread the benefits arising from future liberalisation, but also may prevent inconsistencies which arise from overlapping commitments in other FTAs which are subsequently negotiated by the parties.

While Australian FTAs have tended to be comprehensive and liberalizing, many that do not include Australia have been less so. This may have intensified the motivation to negotiate agreements to counter the competitive disadvantages arising from preferential treatment in third party agreements.

### **Upholding the rules-based trading system**

The rise of FTAs carries a prospective threat to the authority and thereby the effectiveness of WTO multilateral trading system. The risk is that as WTO members negotiate more and more FTAs, they come to neglect the institution and over time its pertinence and influence may diminish.

Neither must be allowed to happen. WTO principles and measures must continue to serve as the institutional foundation of the global trading system. FTAs must continue to adopt WTO rules as reference points and build on liberalisation commitments for goods and services which have been multilaterally agreed.

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<sup>23</sup> The "ratchet mechanism" secures commitments by the parties to lock in any subsequent unilateral liberalisation of measures. This provides certainty to business by locking in or 'binding' progressive liberalisation.

<sup>24</sup> Under AANZFTA Australia can request an ASEAN country to extend to Australian services and service suppliers any more favourable treatment (than is in AANZFTA) that it accords to a third country in a future ASEAN-wide agreement. (Except bilateral and plurilateral agreements involving Australia or New Zealand and one or more ASEAN countries) ASEAN countries have the same right in relation to future bilateral and plurilateral FTAs to which Australia is a Party.



### **Resisting regulation of environmental concerns**

There is a new threat to the WTO arising from moves by major traders to use trade measures to address non trade related concerns, such as environmental protection and climate change reduction. There is a risk trade agreements could be used as instruments to enforce environmental policy, creating barriers to trade and investment rather than facilitating more open markets.

Australia should ensure as far as possible that trade agreements negotiated in the region are not used to enforce environmental policy, or restrict trade for protectionist reasons.

## **9. Prioritising resources**

Australia's expanding FTA and economic integration agenda poses new challenges for optimising best use of finite resources. It creates new demands on business and greater resources pressures for government, principally DFAT, to cope with the workload of negotiating and administering a growing number of agreements.

Government resources should be prioritised to focus on negotiating FTAs which provide the greatest opportunities for the expansion of business interests and which best serve Australia's long term economic and strategic interests. In the current trade and investment environment, this demands a focus on broadening integration with emerging markets in the South East and East Asian region, as well as maintaining strong relationships with important economic partners and policy drivers such as the US.