

Australia's Preferential Trade Agreements: a quick guide

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This Quick Guide provides a brief background to Australia's preferential trade agreements (PTAs; often referred to as free trade agreements), in particular what they are, what they cover and commentary on whether they have been effective in increasing Australia's wider economic welfare.

What are Preferential Trade Agreements?

A PTA is essentially a contract between two or more countries. Once ratified, a PTA is a legally binding treaty to liberalise access to the parties' markets for goods, services and investment.

At first glance, PTAs appear to go against a key principle of the multilateral trading system, the Most-Favoured Nation (MFN) principle. In brief, the [MFN principle](#) stipulates that a country cannot ordinarily discriminate between its trading partners. However, a closer look reveals that PTAs can be accommodated within the multilateral trading system, if they comply with the rules.

Parliament and PTAs

Under the *Australian Constitution*, the [Government negotiates and enters into treaties](#). However, PTAs typically require implementing legislation, which must pass Parliament. This is often the stage at which the Parliament has the most significant input, after the negotiation process has already concluded. Most PTAs come into effect once both Australia and other parties to the agreement enact implementing legislation.

The process by which a treaty enters into force, and the [relationship between the powers of the Parliamentary and the Executive branch](#), can be complex. In addition to a [current inquiry](#) by the Senate Standing Committee on Foreign Affairs, Defence and Trade, the issue has been examined in:

- a 1995 report, [Trick or treaty: Commonwealth power to make and implement treaties](#), by the Senate Standing Committee on Legal and Constitutional Affairs and
- a 2010 report by the Productivity Commission, [Bilateral and regional trade agreements](#), which examined the decision making process for entering into negotiations, and when benefits are estimated.

What areas do they ordinarily cover?

Australia's PTAs aim to remove or reduce tariffs and restrict the use of non-tariff barriers. They also typically address non-tariff related issues such as government procurement, competition policy and behind-the-border regulatory issues that may restrict trade. In brief, PTAs aim to facilitate trade by expanding access to new markets and expanding trade in existing markets for the parties involved.

What are some of the most controversial areas covered by PTAs?

Increasingly PTAs contain commitments on intellectual property, investor protection and movement of natural persons. These provisions tend to attract significant attention due to the economic and social impact they can have on a country's domestic environment.

Intellectual Property

Most of Australia's trade agreements go beyond the coverage of goods and services to cover areas such as intellectual property (IP). In essence, IP laws provide creators of certain works with monopoly rights. IP laws that are either too weak or too strong can adversely affect a country's economy.

Some of these agreements, including those with [Singapore](#) and [Thailand](#), adhere to Australia's commitments under the World Trade Organization's (WTO's) [Agreement on Trade-Related Intellectual Property Rights](#) (TRIPS). Others, such as the agreement with the [United States](#) and the [Trans-Pacific Partnership](#) (TPP) agreement (currently under negotiation), go beyond Australia's current commitment to include so-called 'TRIPS-Plus' provisions. TRIPS-Plus provisions place additional demands on countries, including the extension of pharmaceutical patents, to those required by the WTO.

The Department of Foreign Affairs and Trade have made the [argument](#) that common approaches to IP can 'strengthen regional economic integration' and promote 'foreign investment, technology transfer and trade between the parties' (p. 36-37).

Critics such as Dr Philippa Dee from the Australian National University (ANU) have [argued](#) that TRIPS-Plus measures are 'only a little bit concerned with providing additional incentives for new IP to be created that might not be otherwise. They are greatly concerned with expanding the ongoing transfers of economic rents from the consumers to the producers of IP that already exists (and hence needs no further incentives).'

The increased tendency by countries to enter into bilateral and mega-regional agreements, like the TPP, is resulting in the rise of so-called 'trade bundling'. In brief, trade bundling is the offering of market access concessions by one country on a discriminatory basis in return for another country accepting a set of conditions including stronger rules of IP protection, such as those advocated by the US.

In its 2010 report on trade agreements, the Productivity Commission [noted](#) that a country's optimum design and level of IP protection 'depends on the extent to which they are net importers or exporters of IP' (p. 258). Australia is a net importer of IP, and this led the Productivity Commission to conclude that stronger IP laws similar to those agreed to under the Australia-US Trade Agreement impose a net cost on Australia. In her [assessment](#) of the impact of the Australia-US agreement, Dr Philippa Dee estimated that the IP provisions in that agreement could result in an annual net cost to Australia of up to \$88 million.

Investor State Dispute Settlement (ISDS)

In brief, an [Investor State Dispute Settlement \(ISDS\) provision](#) is a 'procedural mechanism' that has the primary aim of protecting a foreign investor against a decision by a host government to expropriate its investments, including IP rights and assets, without fair compensation.

Advocates of ISDS such as the United States Council for International Business [argue](#) that ISDS provisions can increase investment in the host country and potentially encourage the creation of a stable foreign investment regime. The inclusion of ISDS is [particularly](#) important, advocates argue, when dealing with developing countries with less robust legal and institutional frameworks.

The Productivity Commission however, found that available evidence does not point to the existence in Australia of a [market failure](#) warranting the use of ISDS. There is [evidence](#) that while the inclusion of national treatment provisions (treating domestic and foreign companies equally) within trade and investment agreements has a positive impact on the flow of investment to the host country, the inclusion of ISDS does not. Further, ISDS provisions can give foreign investors privileges that are not available to domestic firms.

In Australia, the Senate Standing Committee on Foreign Affairs, Defence and Trade [considered](#) a 2014 Bill that aimed to prevent the Australian Government from entering into trade and investment treaties that include ISDS provisions. While the Committee recommended that the Bill not be passed, the issue of ISDS attracted a significant degree of attention—the committee received over 11,000 emails from individuals opposing ISDS.

At January 2014, [more than 3,000](#) international treaties included ISDS provisions. The United Nations Conference on Trade and Development (UNCTAD) [reported](#) in April 2014 that the number of ISDS cases brought forward has increased from 5 in 1996 to 57 in 2013. Cases involving the US and the European Union account for 75 per cent of all cases. This increase in the number of such cases has led to concerns about the 'system deficiencies' of the process. In brief, as has been noted by the UNCTAD in a June 2013 [paper](#), some of the key areas of concern regarding the current system of ISDS include the following.

- **Lack of transparency, as many ISDS cases are heard behind closed doors:** The lack of public access to proceedings has fuelled perceptions about the lack of legitimacy and transparency of such provisions. When cases do become public, there appears to be inconsistency and errors in decisions, including ‘divergent legal interpretations of identical or similar treaty provisions as well as differences in the assessment of the merits of cases involving the same facts’ (p. 3).
- **Cost and time need to resolve cases:** Currently the average cost is around US\$8 million per party, per case. ISDS cases take several years to conclude. Delays often occur because ‘large law firms, who dominate the field ... employ expensive litigation techniques, which include intensive research on each arbitrator candidate, far-reaching and burdensome document discovery and lengthy arguments about the minutest case detail’ (p. 4).
- **The existence of loopholes permits foreign investors to ‘treaty shop’:** As outlined in a 2012 Organisation for Economic Co-operation and Development [working paper](#), treaty shopping refers to the practice whereby a foreign investor restructures its operations or establishes subsidiaries in host countries in order to obtain qualification for protections provided under investment and trade treaties that may be advantageous to their interests.

In Australia, these concerns were echoed in the Productivity Commission’s 2010 [report](#) on Australia’s trade agreements. In that report, the Commission noted that ISDS provisions in essence shift political risks ordinarily associated with foreign direct investment from international businesses to elected governments. The report recommended that the Australian 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’ (p. xxxii).

The issue of whether countries such as Australia, with its well-functioning, respected and independent legal system, should be offering international businesses the opportunity to challenge the decisions of national courts, was also raised by the Chief Justice of the High Court in a 2014 [conference paper](#).

In light of the rise in the inclusion of ISDS provisions in international agreements and the increase in awareness of the risks and ‘systematic deficiencies’ of the process, the UNCTAD [mapped](#) five reforms to the system. Its proposals included, in the short-run, the promotion of alternative dispute resolution, the tailoring of the current system to increase transparency, and limiting investors’ access to ISDS. In the long-run, the aim would be to completely overhaul the system by replacing the current system of ad hoc tribunals with the establishment of a permanent international investment court.

Movement of natural persons

Chapters concerning rules about movement of natural persons can also be contentious. This is particularly the case if the requirement for sponsors under 457 class visas to undertake labour market testing has been weakened under a PTA. Labour market testing refers to the requirement imposed on businesses to ensure that there is no suitable worker in Australia to fill the position available before filling it with an overseas worker.

Australia has made commitments not to apply labour market testing on some groups of skilled workers. For instance, under the recently signed [Korea-Australia agreement](#), Australia has agreed that Korean nationals entering Australia on a temporary basis as service suppliers or investors will not be subjected to labour market testing. It is not as yet clear, however, who might be defined as a service supplier. Korea has retained its right to apply labour market testing for skilled Australian workers entering Korea.

[Critics](#) of this policy argue the relationship between Australia’s trade commitments and immigration requirements lacks transparency and clarity and that there is not always a clear understanding of how Australia’s commitments under PTAs translate to specific [exemptions](#) from labour market testing. Submitters to the Senate Standing Committee on Foreign Affairs, Defence and Trade’s [inquiry](#) into the Korea-Australia agreement also [argued](#) that there is an imbalance in the commitments that has the potential to ‘contribute to local unemployment’ (p. 4).

Commentary on the trade benefits of PTAs

A direct and important benefit from PTAs is the increase in merchandise trade that follows a reduction in tariffs, and in some cases a removal of non-tariff barriers (in areas such as sanitary and phytosanitary measures and customs procedures). Estimating and assessing the extent of this benefit is difficult, as it relies on a number of assumptions, and in many cases tariff reductions are phased in over a number of years.

Estimates are often made of the benefits of an agreement before negotiations are completed. For instance, the [feasibility study](#) for the China-Australia Trade Agreement was completed in 2005, and the [feasibility study](#) for the Korea-Australia Trade Agreement was completed in 2008. The content of both agreements were finalised in 2014. This inevitably means the modelling must rely on assumptions about the final agreement, including how tariff barriers are removed. In its 2010 [report](#) the Productivity Commission was critical of this approach, noting ‘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 ... 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’ (p. xxviii). The Commission concluded that the ‘approach to conducting feasibility studies used for most previous Australian [PTAs] has produced overly optimistic expectations of the likely economic effects ... Such an approach does not provide an adequate basis for assessing their merits’ (p. 295). Responding to that criticism in the case of the Korea-Australia agreement, the Government commissioned [new modelling](#) after the conclusion of negotiations, which predicted that Australia’s total exports to Korea are likely to decline by 5 per cent by 2030 if the agreement was not to go ahead.

In its 2010 report (see particularly Chapter 8, and supplements, the Productivity Commission also examined the benefit of PTAs in depth, including both theoretical simulations and ex-post analysis. It noted the potential for diversionary trade, where an increase in trade between PTA partners causes a decrease in trade with other countries. In examining a number of simulated scenarios, the Commission concluded that for PTAs between two small countries, or between Australia and a large economy, a PTA was associated with an overall increase in trade, although there was some trade diversion. The report also noted the administrative costs associated with PTA rules of origin, and concluded that ‘non-discriminatory trade agreements are more likely to result in net trade creation and associated economic benefits than agreements with restrictive preference structures’ (p. 145).

Key Resources

- RS French, ‘[Investor-State Dispute Settlement—a cut above the courts?](#)’, paper presented to the Supreme and Federal Courts Judges’ Conference, Darwin, 9 July 2014.
- Department of Foreign Affairs and Trade (DFAT), ‘[Treaty making process](#)’, DFAT website.
- M Latek, [Investor-State Dispute Settlement state of play and prospects for reform](#), Briefing, European Parliamentary Research Service, 21 January 2014.
- Productivity Commission, [Bilateral and Regional Trade Agreements](#), Australian Government, November 2010.
- Senate Standing Committee on Foreign Affairs, Defence and Trade, [Trade and Foreign Investment \(Protecting the Public Interest\) Bill 2014](#), The Senate, 27 August 2014.
- United Nations Conference on Trade and Development (UNCTAD), [Reform of Investor-State Dispute Settlement: in search of a roadmap](#), UNCTAD, June 2013.

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