



**Australian PTAs In Services: “Much Ado About Nothing”; Recent Unilateral Trade Policy Re-focus Promises Much More**

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**1. Introduction**

The importance of enhancing services productivity in improving the Australian economy’s efficiency and performance is widely acknowledged. Trade liberalization in services is seen as an important means to this end. It is therefore worth assessing the extent to which Australia’s acceleration into Preferential Trade Agreements (PTAs), all of which have included services, have contributed to liberalization. In Australia and internationally, PTAs may have gone up to or even beyond GATS commitments in some areas, and hence appear more liberalizing ‘on paper’. However, the relevant question remains as to whether they have actually significantly opened services and increased trade and investment beyond what has been achieved unilaterally? If not, what has been their real liberalization value? Have they led to better regulations and performance such as generating more or improved Mutual Recognition Agreements (MRAs) and achieved more open trade in professional services? Have regional public goods, such as joint institutions, been formed off or through PTAs and led to better performance and regional integration? Could well-performing regulations and institutions have been introduced without the significant additional cost and complication of entering PTAs?

These issues were recently addressed by the Australian Productivity Commission (PC) in the government-commissioned public study on Bilateral and Regional Trade Agreements (PC 2010). This watershed Study offered a major opportunity to reflect on Australia’s experience with PTAs, including in services. The Study led to the Government’s April Trade Policy Statement, which signalled reinvigorating and returning Australian trade policy, including for services, to the unilateral economic policy roots of the reform period of the 1980s and 1990s to help reverse the slide in Australian productivity growth over the past decade.

Services are by far the largest component of the Australian economy, accounting for some 70% of GDP and employment. Total services exports stood at around \$89 billion in 2008-09, 1.7 times greater than suggested on the basis of the level of cross-border services exports; embodied services in merchandise exports were estimated at about \$35 billion (ITS Global 2010). These were primarily in property and business services, transport and storage, wholesale trade, and mining services; key ‘carrier’ exports are in minerals. Australian overseas subsidiaries (including joint ventures) deliver substantial services, with estimated sales of over \$100 billion annually (ITS Global 2010). For every percentage point increase in the intensity of intermediate services

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used in production, embodied services exports are estimated to rise by at least \$1 billion annually. This highlights the critical link services have to Australian competitiveness.

This Chapter argues that Australian PTAs have delivered little significant actual services trade liberalization, and may have obstructed it. Moreover, on the few occasions where they have changed measures, their economic value is questionable at best, leading to discriminatory measures and/or changes that have not been adequately assessed economically, instead being “negotiated outcomes”. The Chapter also explains recent trade policy developments in Australia, and explains why the Australian Government’s planned return to unilateralism offers far more liberalization potential than the pursuit of PTAs.

The Chapter is structured as follows. Section 2 looks at the economics of services trade liberalization, including why unilateralism matters most. Section 3 examines Australia’s PTAs, and the increasing role played in Australian trade policy. Section 4 discusses liberalizing services trade through PTAs, including their inherent limitations relative to other trade liberalization approaches and the associated problems of piecemeal reform in services. Section 5 draws on Australia’s experience with using PTAs in services. Section 6 highlights the essential role that transparency coupled with unilateralism must play in advancing meaningful and sustainable trade-related reforms, especially in services where barriers tend to be behind the border. Section 7 examines recent developments in Australian trade policy likely to impact on PTAs in services and liberalization more generally. Section 8 concludes the Chapter.

## 2. Economics of Services Trade Liberalization

The Australian economy derived significant benefits from the trade and investment liberalization that began in the mid-1980s (Box 1).<sup>2</sup> These unilateral, comprehensive micro-economic and related structural reforms, which reduced domestic trade barriers without the need for any specific international engagement, improved substantially Australia’s economic efficiency and performance (Banks 2010a). Despite short-term structural and related adjustment costs, the longer-term economic benefits were so pronounced that both major political parties embraced liberalization, albeit with different priorities and timetables. The economy is now much more flexible and globally integrated, with international price signals transmitted domestically to more efficiently allocate resources primarily by non-interventionist market forces.

### **Box 1: Two decades of Australian reform**

The 1980s and 1990s saw the Australian economy transformed from a closed, non-competitive and inefficient economy to a relatively open and internationally competitive country. Such reforms were applied comprehensively across all sectors, including services.

*Capital markets* — floating of the \$ Australian in 1983, progressive removal of foreign exchange controls and capital rationing (through interest rate controls) from early 1980s and allowing foreign-owned banks to compete.

*Infrastructure* — airlines, coastal shipping, telecommunications and the waterfront partially deregulated and restructured from late-1980s.

Commercialization, corporatization and privatization initiatives for government business enterprises progressively implemented from late-1980s e.g. Commonwealth Bank, introduction of Optus telecommunications and partial privatization of Telstra as well as Qantas.

*Human services* — competitive tendering and contracting out, performance-based funding and user charges introduced in late-1980s, along with administrative reforms in health, education, community services from 1990s.

<sup>2</sup> These reversed Australia’s highly protectionist “inward-looking” post-war policies.

*'National Competition Policy'(NCP) reforms* — further broad-ranging reforms to essential service industries (e.g. energy and road transport), government businesses and anticompetitive regulation commenced by all Australian governments through a coordinated national program in 1995.

### **Overview of of the NCP reforms**

#### **General**

- anti-competitive conduct provisions in Trade Practices Act extended to unincorporated enterprises and government businesses.
- structural reforms to public monopolies and other government businesses, including separating regulatory from commercial functions; reviewing merits of separating natural monopoly from potentially contestable service elements; and/or separating contestable elements into smaller independent businesses.
- competitive neutrality requirements adopted for public monopolies, involving the adoption of corporatized governance structures for significant government enterprises; the imposition of similar commercial and regulatory obligations to those faced by competing private businesses; and the establishment of independent mechanisms for handling complaints that these requirements have been breached.
- creation of independent authorities to set, administer or oversee prices for monopoly service providers.
- introduction of a national regime providing third-party access on reasonable terms and conditions to essential infrastructure services with natural monopoly characteristics.
- Legislation Review Program to assess if regulatory restrictions on competition are in the public interest and, if not, what changes are required, including in areas of the professions and occupations, retail trading, transport, communications, and insurance, superannuation, child care, gambling; and planning and development services.

#### **Sector-specific**

*Electricity:* various structural, governance, regulatory and pricing reforms to introduce greater competition into generation and retailing, and establishing a National Electricity Market in the eastern states.

*Gas:* similar suite of reforms to facilitate more competitive supply arrangements and greater retail competition.

*Road transport:* heavy vehicle charges and a uniform approach to regulating heavy vehicles implemented to improve efficiency of the road freight sector, enhance road safety and reduce the transactions costs of regulation.

*Water:* various reforms to achieve a more efficient and sustainable water sector including institutional, pricing and investment measures, and arrangements implemented to allow for permanent trading of water allocations.

#### **Estimated economic benefits**

Major elements of NCP have potentially generated a net benefit equivalent to 5.5% of GDP, and the observed productivity and price changes in key infrastructure sectors in the 1990s — to which NCP and related reforms have directly contributed — have increased Australia's GDP by 2.5%, or \$20 billion (excluding any 'dynamic' efficiency gains from more competitive markets).

Source: Banks (2010a), and PC (2005).

While the unilateral domestic reforms remain incomplete and require more comprehensive efforts, the Australian economy is now far more open. It still has major trade and investment obstacles and other areas in need of structural reform. One major concern is that the traditionally successful unilateral reform program has largely stalled and is under threat, including from recent trade policy developments that have placed too much emphasis on achieving negotiated liberalization, either in Geneva or more especially in regional capitals. The decline in unilateral reform focus started from 2000 has been well documented by the PC and others (PC 2010). This policy reversal reflected a misconception, also held by the Department of Foreign Affairs and Trade (DFAT), that Australia had gone far enough on the domestic trade liberalization agenda and should not liberalize too much ahead of its APEC trading partners, but rather wait until their voluntary reforms caught up. The new belief seemed to be that it was more beneficial to re-direct Australian trade policy towards negotiating PTAs as a means of opening up foreign markets. Australia's demonstrably successful approach of **Unilateral Liberalization Domestically, Open Regionalism in Asia, Multilateralism Abroad (ULDORAMA)** was "dead" (Garnaut 2003).

Australia no longer relies primarily on unilateral reforms and instead has regressed by embracing the PTA “frenzy”. Due to the revival in flawed mercantilist thinking linked to negotiated forms of liberalization, especially through discriminatory bilateral/regional trade agreements, to focus trade policy on its external rather than the domestic dimensions, DFAT has adopted completely the wrong perspective and now become more the problem than the solution in achieving effective trade policy (Trebeck 2009).<sup>3</sup>

The potential gains to national welfare in Australia and elsewhere from non-preferentially reforming barriers to services trade via increased competition encouraging firms to reduce costs and expand output in competitive areas using resources most efficiently are well known, including from quantitative studies with and without dynamic productivity gains (Box 2).

#### **Box 2: Potential gains from services trade liberalization**

Services liberalization covers barriers affecting all four modes of supply that are used to trade services, namely cross-border trade (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3) and temporary movement of people (Mode 4). Studies have estimated the potential gains from (non-preferential) reductions in services barriers to be:

*Allocative efficiency:* removing distortions in the use and movement of resources allows them to shift to the most productive areas, thus increasing welfare.

*Changes in the return to capital endowments:* increasing the return on capital from freer FDI movements raises real world gross product.

*Increases in product variety:* consumers benefit from greater choice.

Global services liberalization is estimated to raise services activity in Asian economies, especially China (by 33%), while services sectors would decline slightly in relative terms in a number of other countries (e.g. Australia, Canada, New Zealand, and the United States), due partly to their low trade barriers and the expected services expansion in the newly opened Asian countries (Dee and Hanslow 2000).

Another study estimated that complete liberalization (i.e. removal of national treatment restrictions and market access barriers in financial services and telecommunications) would raise world real GNP by about 0.1% for each sector (Verikios and Zhang 2001). Most of the telecommunications gain came from removing restrictions on market access, while the opposite was the case in financial services.

A recent DFAT-commissioned study projected that world production (in dollar terms) would rise by 0.4% above the baseline after 15 years (i.e. by 2025); 0.20% and 0.90% in developed and developing countries, respectively, if all trade barriers in services delivered cross border and by commercial presence (estimated to supply some 85% of international services trade) were liberalized overnight (CIE 2010). Australian GDP was projected to rise above the global average (0.81%). The study included dynamic productivity gains from services trade liberalization via greater import competition, learning-by-doing in export markets, and FDI-related technology transfers. Most gains were found to come from removing barriers to commercial presence.

*Source:* PC (2010)

## **2.1 Unilateralism Matters Most**

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<sup>3</sup> Trebeck suggests relocating trade policy responsibility to Treasury to enable the economy-wide arguments and interests to receive fuller and more rigorous assessment.

A country benefits most from its own trade-related liberalization, not from trading partners reducing their trade barriers. Reducing barriers to trade and investment benefits countries by improving resource allocation and efficiency from access to lower import prices and increased availability of capital, labor and knowledge, thus enhancing competitiveness and productivity (PC 2010, p. 196).

In terms of liberalization and economic benefits to Australia, the PC resoundingly rejected PTAs in favor of unilateralism supported to the extent possible by multilateralism (PC 2010). The potential advantages of unilateralism are especially apparent in services given that they are typically protected by complex behind-the-border regulatory measures (e.g. regulations and institutional arrangements restricting competition) that generally cannot be liberalized by PTAs. Expecting governments to significantly liberalize measures in PTAs (and multilaterally) is wishful thinking, that also fails to appreciate how essential unilateralism is to implementing sound reforms. Trade policy is not trade negotiations and nor are policy measures something best determined by negotiations. Thus, trade negotiators generally do not negotiate actual policy measures, and play a minor role in liberalization, a preferable result given the non-economic outcomes such negotiations would in all likelihood deliver.<sup>4</sup> Growth-promoting policies do not depend upon trade negotiations, but rather on governments adopting sound unilateral outcomes as part of their on-going micro-economic reform programs.

Most gains from trade liberalization are better achieved through unilateral reforms (PC 2010). Substantive trade liberalization generally involves tackling domestic constraints that can only be effectively achieved unilaterally. Most trade liberalization, including in services, has and is occurring unilaterally, in recognition that the reforming country benefits most.<sup>5</sup> Providing preferential access may on occasions be welfare enhancing but it will almost always be welfare limiting (if not welfare-reducing) compared to unilateral MFN liberalization. Strengthening these domestic outcomes offers the best prospects of advancing services liberalization, which must form an essential part of improving any economy's competitiveness and productivity.

Unilateral reforms, correctly implemented using sound and transparent economic analysis, also has the advantages of empowering all governments, no matter how small or weak, to control their trade-related economic policies without having to involve other countries, including world powers.<sup>6</sup> The basis of autonomous liberalization is domestic transparency, generally the exact opposite of what PTA negotiations involve, at least in Australia where they undergo relatively little public scrutiny and only when they have been concluded.

## **2.2 Rent-creating versus cost-increasing barriers**

Trade costs in services largely relate to regulatory measures that either create entry barriers or increase the cost burdens facing firms, in addition to geographical, cultural, and institutional differences (Miroudot, Sauvage and Shepherd 2010). Some services barriers primarily increase

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<sup>4</sup> The main exception is outside services, namely tariffs whereby PTAs negotiate applied discriminatory rates unlike in the WTO where MFN bindings are negotiated.

<sup>5</sup> Well over two-thirds of actual global tariff reductions in the past few decades came from unilateral reforms.

<sup>6</sup> While in the field of international diplomacy the term unilateralism often conjures up negative outcomes, in the trade area it is synonymous with autonomous liberalization, which will invariably be in the country's own best economic interests. Members unilaterally liberalizing on a non-discriminatory basis also offer the best means of reducing the proliferation of PTAs and strengthening the multilateral system as well as global integration.



costs of suppliers by raising the real resource cost of producing a given quantity of output (i.e. reduce price-cost margins). Many of these barriers arise from broad competition policy settings that non-discriminate in a trade sense whereas others may discriminate, such as foreign businesses and professionals having to incur retraining and accreditation costs to operate across borders. Other barriers to services trade (e.g. quantitative restrictions) artificially restrict supply and primarily create rents (i.e. raise price-cost margins). Lowering these barriers, whether preferentially or non-preferentially, may have limited economic welfare gains compared to reducing cost-raising barriers. This is because while reducing rent-creating barriers will improve allocative efficiency by re-allocating resources to more productive uses, removing cost-raising barriers effectively lifts productivity that both releases resources to other uses and also enable the affected sector to cut costs, and possibly to expand. Such measures would benefit domestic and foreign-service providers. Thus, the welfare gains from removing measures that generate real costs are likely to greatly exceed those from abolishing measures that generate rents to domestic agents (Francois et al 2010, Dee 2009).

Identifying which services trade barriers are rent-creating or cost-raising is difficult, largely due to them operating “behind-the-border” and embedded in complex domestic regulatory legislation, often aimed at meeting legitimate social and economic objectives but also open to misuse as protectionist measures. For example, prudential controls help maintain an efficient and well-functioning financial sector, regulation of natural monopolies constrain market power abuse, and licensing or accreditation requirements on standards protect consumers by overcoming asymmetric information. Service barriers can have both rent-creating and cost-raising impacts (e.g. non-discriminatory market access barriers that create a domestic monopoly by prohibiting both domestic and foreign entrants). Hence, assessing the impact of trade restrictions on services trade and ensuring those offering the greatest economic benefits are reformed first are so complex that such reform should not be relegated to the whimsical outcomes of trade negotiations (even assuming they are capable of delivering actual reforms).

### **3. Australia’s PTA Policy Relative to Other Trade Liberalization Approaches**

Australia’s past unilateral trade-related reforms have secured the greatest economic gains irrespective of the actions of other countries (Box 3). It liberalized trade in goods independently of the WTO, and while claiming credit for its autonomous reforms, has still not removed ceiling bindings to fully “lock” in tariff reductions.<sup>7</sup> This unilateral liberalization approach from the 1980s was strongly resisted by many vested interests, including the then Trade Department and Minister, arguing that Australia should only liberalize as part of the multilateral negotiations to ensure it received reciprocal market access abroad and got something in return for making “concessions”. The Department’s traditional trade policy advice was that since the GATT excluded agriculture, the multilateral system inadequately addressed Australian trade interests in obtaining market access abroad in these products, it should make minimal commitments in Geneva. This policy opposition was a major obstacle to the success of Australia’s unilateral

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<sup>7</sup> This last aspect most likely reflects the preference of trade negotiators to maintain “negotiating coin” for future multilateral rounds that base reductions on bound rather than applied tariff levels, as well as governments wishing to maintain policy space to raise tariffs. As argued in this paper and the PC (2010), this “negotiating coin” argument for keeping protection, either multilaterally or bilaterally/regionally, is economically flawed.

reforms, and their successful adoption and subsequent opening was in spite of, and not because of, WTO membership and the Trade Department.

### **Box 3: Economic Gains to Australia from Unilateral Trade-Related Reforms**

The economic reforms of the 1980s and 1990s included floating of the currency, financial market deregulation, public enterprise reform, introduction of competition policy and reduction of trade barriers and industry protection. They greatly enhanced Australian economy's resilience and flexibility by exposing it to international competition, and thus helped insulate the country from regional economic downturns (e.g. the 1990s Asian Financial Crisis, and more recently the Global Financial Crisis). Trade liberalization, an integral part, alone increased GDP by an estimated 2.5 to 3.5%, and drove wider economic reform (CIE 2009). Opening the economy to trade by reducing tariff and non-tariff barriers is estimated to have made Australian households better off in real terms by on average A\$3,900 annually. While reform imposed painful adjustments in some manufacturing activities, almost all were better off in the long run, along with the economy in terms of lower unemployment, low inflation, rising incomes, higher wealth levels, and greater stability.

The above estimates exclude benefits from services liberalization. However, the potential economic gains to all countries, including Australia, are thought to be even greater. It has been estimated, for example, that comprehensive overnight liberalization of Mode 1 and Mode 3 barriers would generate global cumulative GDP gains of over A\$5.3 trillion from 2011-25 (in present value terms)(CIE 2010). While both developed and developing countries would benefit, the latter would gain most with average GDP growth of 0.9 % versus 0.2% in 2025, respectively. The Study suggested that Mode 3 services liberalization potentially delivered greater economic gains than Mode 1 liberalization: the phased liberalization by developing countries of Mode 3 equity barriers would raise global cumulative GDP gains from 2011-25 by A\$1.2 trillion (in present value terms).

While the study did not quantify the gains to Australia from unilaterally liberalizing its services barriers (a major oversight), these are expected to be significant. For example, while the real Australian prices of previously highly protected goods have fallen substantially (e.g. by as much as 50% for clothing, footwear and motor vehicles) since 1985 following trade liberalization and greater competition, they have risen by 15% for haircuts, 17% for house rents, and by a staggering 68% for dental care (DFAT 2011).

Australia's unilateralism, based on domestic transparency, greatly diminished the relevance of multilateral bindings to prevent policy backsliding. By domestically exposing protectionism as poor public policy and changing public perceptions on the economic costs of protection, Australia's on-going commitment to transparent unilateralism became the best means of preventing policy reversal. After all, if reductions in protection are seen as good policy to improve economic efficiency, raising import barriers is likely to be also viewed as bad and economically costly policy.

Services liberalization largely extended this unilateral approach. As goods markets were opened to import competition, manufacturers increasingly saw the need to access efficient services at world prices to compete. Similarly, technology improvements made many traditionally non-traded services internationally traded.<sup>8</sup> Thus, economists and politicians began shifting attention to services as inputs, not only to improve the competitiveness of manufacturers but also services. This growing interest in services culminated in the GATS being negotiated in the WTO and the subsequent proliferation of PTAs as so-called "new-age" or "third wave" agreements.

### **3.1 Australia's PTAs**

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<sup>8</sup> Services only began being highlighted in the international trade policy agenda in the 1980s (Francois et al 2010).



While Australia initially resisted PTAs, favouring instead multilateralism as a distant second-best alternative to unilateralism, it joined the global preferential fray by negotiating its first PTA in 2003 with Singapore (apart from the longstanding agreement with New Zealand (ANZCERTA) that formalized many expanding economic connections as both countries unilaterally reformed). Further PTAs followed. The need to liberalize services internationally was seen as a major policy driver for PTAs, even though it was generally acknowledged that successfully liberalizing services trade required substantial doses of unilateralism to tackle domestic regulations, as was being highlighted in the shallow outcomes of the GATS negotiations of the Uruguay Round and the offers in the Doha Round.<sup>9</sup>

The shift towards PTAs coincided with a more subtle and negative development in Australian trade policy. As the practical emphasis veered back towards negotiated, especially preferential, forms of liberalization, Australian trade policy began to focus more on these avenues at the expense of unilateralism. Its move to PTAs reflected a breakdown in Australia's commitment to open and transparent processes that supported unilateralism, and corrupted domestic policy setting and processes (Garnaut 2010a and 2010b).<sup>10</sup> Reversing the associated domestic deterioration in the climate of opinion about the benefits of trade liberalization requires challenging these enhanced legitimacy of conceptions of narrowly defined reciprocity, and re-establishing the role of independent, transparent policy analysis (Garnaut 2003).

Australia's PTAs follow the international convention of being deceptively called Free Trade Agreements (FTAs). In addition to an FTA with Singapore (SAFTA), Australia has FTAs with ASEAN (with New Zealand, AANZFTA), Chile (ACFTA), Thailand (TAFTA) and the United States (AUSFTA). It is negotiating PTAs with China, GCC, Indonesia, Japan, Korea, Malaysia, Pacific Islands (PACER), India, and the Trans-Pacific countries of Brunei, Chile, Malaysia, New Zealand, Singapore, Peru, the United States and Vietnam (TPPA). While Australia has no service-specific PTAs, all PTAs include services, using either a positive or negative list approach (Box 4). Key common provisions on services in these "third wave" PTAs cover national treatment; mutual recognition of selected professional qualifications; relaxed restrictions on commercial presence by foreign-service providers; and to varying degrees attempts to harmonize regulatory frameworks (PC 2010).

**Box 4: Australia's PTAs**

*SAFTA*: provisions on market access, national treatment and transparency, negative list approach (substantially more exemptions than ANZCERTA); key Australian outcomes professional residency requirements, removal of some

<sup>9</sup> It is widely accepted that the GATS negotiations of the Uruguay Round resulted in no actual significant liberalization, and that this outcome would not be changed by the Doha offers (Gootiiz and Mattoo . The current multilateral and regional approach to services trade liberalization is not working; services offers on the table in the Doha Round contain "not one iota" of genuine liberalization in the form of new market access, and some members are still unprepared to bind current levels of liberalization (PECC 2011). Thus, the frequent claim that GATS is an effective "standstill" agreement is exaggerated.

<sup>10</sup> The stalling of Australia's unilateral trade liberalization was compounded by the ascendancy of narrow conceptions of "reciprocity" with trading partners, and by the policy-making processes behind the Cabinet decision in December 2000 to seek an FTA with the United States; no public service assessment or preferably independent transparent analysis was conducted on its economic effects, and it was subsequently justified by highly constrained consultancies (Garnaut 2003)..

quantitative restrictions (e.g. number of wholesale bank licenses in Singapore for Australian banks), and framework for developing MRAs; air transport carved out; range of investor protections (e.g. national treatment, transparency, expropriation and nationalization, compensation for losses and transfer of investors' funds), including investor-state dispute settlement.

*AUSFTA*: national treatment to each other, no local presence requirements, market access provisions, MFN treatment, negative list (substantially more exemptions than ANCERTA but less than SAFTA); framework for developing MRAs (including Working Group on Professional Services); in investment, provides for national treatment, MFN treatment and a minimum standard of treatment in accordance with customary international law, no investor-state dispute settlement, higher screening thresholds for US investors.

*TAFTA*: positive list (less comprehensive commitments than SAFTA or AUSFTA), further negotiations within 3 years (not yet held); Australia granted very limited Mode 4 concessions for Thai chefs and masseurs, largely as trade-off for Thai agricultural concessions (Bosworth and Trewin 2008); in investment, provides for national treatment, MFN treatment, expropriation, compensation for losses and transfers, and investor-state dispute settlement; Australia allowed majority ownership — up to 60%, or in some cases 100%, up from 49.9% — for various business types (e.g. mining and construction).

*ACFTA*: provisions on market access, national treatment, local presence, MFN treatment, negative list with ratchet mechanism; in investment, provides for national treatment, MFN treatment, minimum standard of treatment in accordance with customary international law, and transfers, treatment in case of strife and expropriation; investor-state dispute settlement.

*AANZFTA*: positive list and no automatic MFN provision, but scope for consultation of more favorable treatment is extended to another party; reviewed within 3 years to progressively extend commitments; in investment, covers post establishment elements and investor protection though national treatment, fair and equitable treatment and full protection and security (in line with customary international law), non-discriminatory treatment for investors who suffer losses due to armed conflict, civil strife or states of emergency, free transfer of funds, and compensation for expropriation or nationalization and transparency; investor-state dispute settlement, except between Australia and New Zealand; work program aimed at including pre-establishment market access issues (e.g. foreign equity limits) within five years.

*Source*: PC 2010.

Australian policy has been to seek comprehensive PTAs. In services trade and investment, PTAs appear mainly motivated to limit foreign discrimination against Australian exporters rather than to gain preferential access; to include arrangements for developing mutual recognition of standards and professional qualifications; and to provide for the temporary movement of employees and business people to work in partner countries (DFAT 2010a). However, the distinction between limiting foreign discrimination rather than gaining preferential access is operationally unclear since negotiating former outcomes in a particular market also provides Australian exporters preferential access over non-preferential world suppliers.<sup>11</sup> Australia's key negotiating objectives have indeed in practice been to obtain, and to the extent possible retain, preference margins for Australian exporters, and to use services trade and investment liberalization as vehicles for achieving priority business objectives regarding behind-the-border regulatory barriers (ASR 2008). However, to the extent that Australian PTAs in practice do not engage in actual liberalization at home or in its trading partners but rather focus on negotiating only "on paper" commitments, they fail to achieve this objective, and instead end up becoming more "gloss" than substance.

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<sup>11</sup> Such an objective would imply only negotiating in PTAs what Australia has committed to multilaterally in the GATS. However, this would make PTA negotiations redundant and is clearly not the case.

Australia has sought a number of goals in pursuing PTAs, including on services (DFAT 2010a):

- bind existing market access levels (e.g. ANZCERTA, SAFTA, AUSFTA, ACI-FTA, and AANZFTA (restricted));
- negotiate new market access in sectors of priority commercial interest (e.g. ANZCERTA and ACFTA);
- embed MFN commitments to ensure benefits are offered to future PTA partners (e.g. ANZCERTA, AUSFTA, and ACFTA);
- improve regulatory transparency;
- promote the adoption of good-governance disciplines on domestic regulation (standards, licensing, recognition of qualifications);
- seek commitments to treat service investors at least equal to investors in goods;
- include separate chapters on sectors of particular interest (e.g. telecommunications, financial services, education, and movement of natural persons); and
- adopt a ratchet mechanism to lock in future autonomous liberalization by partners (e.g. ACFTA).

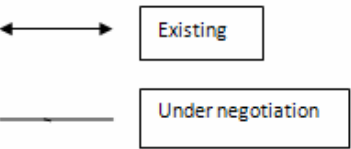
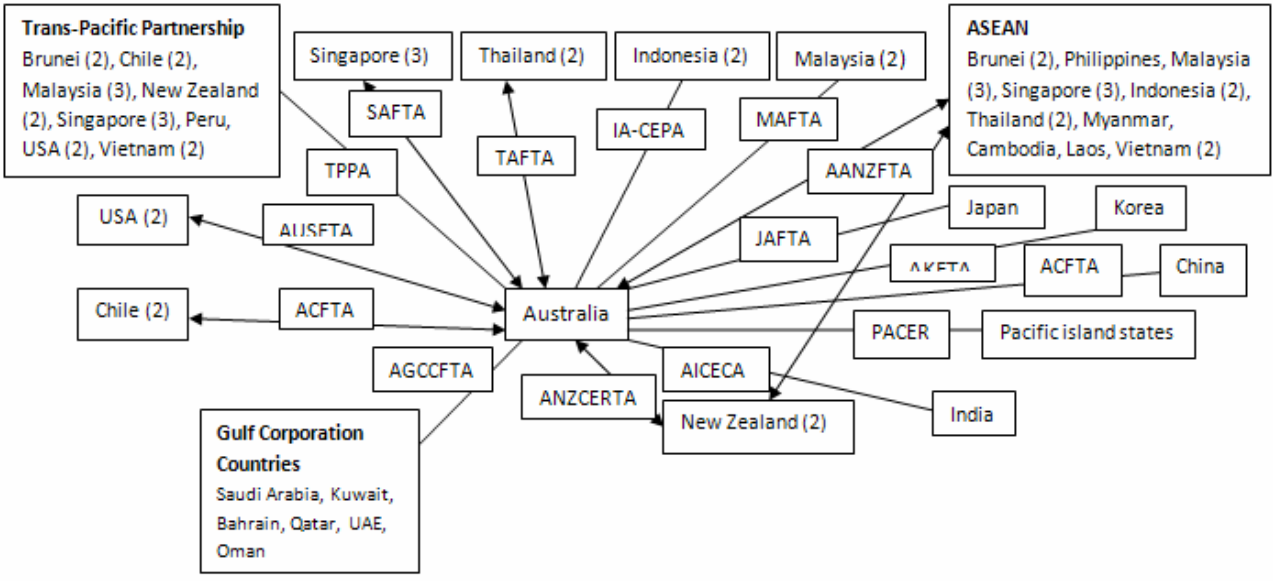
Australia's PTA patchwork already shows the signs of potentially inefficient and trade damaging overlapping agreements (the so-called "spaghetti" or "noodle" bowl effect). Australia's six PTAs cover 13 trading partners, with multiple memberships. Singapore, Thailand and Indonesia are covered by two PTAs. Nine PTAs are currently being negotiated, covering some 20 trading partners plus the Pacific Island economies (e.g. Papua New Guinea and Fiji).<sup>12</sup> When negotiated, New Zealand and Singapore will each be members of three Australian PTAs while Malaysia, Brunei, Chile, US and Vietnam will each be members of two Australian PTAs (Chart 1).<sup>13</sup> There are no signs that Australia is attempting to rationalize its PTAs and/or to remove duplication; indeed the opposite.

**Chart 1: Australia's Overlapping PTAs in Services**

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<sup>12</sup> The only PTA currently being negotiated by Australia not mentioned in the Government's Trade Policy Statement was PACER, suggesting it could have an uncertain future.

<sup>13</sup> This already growing complex network of Australian PTAs is only a small subset of the Asian Pacific "noodle bowl" which would of course include "third party" agreements.



(number) Refers to the number of separate PTAs Australia has or will have with that country e.g. Singapore (3) means Australia has or will have three separate PTAs with Singapore, namely SAFTA, AANZFETA and TPP

Such a complex web of PTAs is arguably likely to be an inefficient and cumbersome trading outcome for Australia. It contradicts the Government's longstanding goal, reaffirmed in its recent Trade Policy Statement, of establishing a transparent, predictable trading regime free of government intervention that would generate welfare-enhancing trade for Australia. The private sector's very mixed views on the desirability and usefulness of PTAs reflects mainly individual business vested interests, when it is the economy-wide or national interest that is relevant. Australia's peak services group, the Australian Services Roundtable (ASR), believes Australia's inefficient bilateral PTAs must be significantly redesigned (Box 5).

**Box 5: ASR Critical of Australian PTAs in Services and Welcomes Recent Unilateral Trade Policy Re-focus**

Services have played a prominent role in Australia's PTAs. However, in PTAs with developing country partners, services and investment liberalization are not proving much easier to negotiate one-on-one than they are in the multilateral context. In every PTA, services and investment aspects have been exceedingly difficult. This is because services markets typically have very high levels of government intervention, thus making trade and investment liberalization highly politically sensitive; most developing country governments are not displaying the will to undertake the necessary regulatory reforms.

The most constructive aspect of PTA negotiations with developing countries has been that it enables Australia to undertake a much deeper policy dialogue on services-related matters, including what constitutes regulatory best practice, than is otherwise possible with non-OECD trading partners (e.g. dialogue to facilitate regulatory cooperation and harmonization), carrying the promise of deeper economic and business integration over the medium term. Unfortunately, in the context of formal trade negotiation, this has not been Australia's apparent intention. The negotiating intention has been to obtain, and to the extent possible retain, a margin of preference for existing Australian exporting firms. Australia's negotiating mandates have been too narrowly focused on achieving small wins on market access, rather than on achieving deeper microeconomic reforms. Domestic regulatory issues have been largely off the agenda and not part and parcel of bilateral PTAs.

Consequently, Australia's PTA agenda has been of limited actual value in improving trade and investment in services. The most constructive outcomes have been to establish ongoing working groups and committees to examine possible regulatory harmonization or mutual recognition over time. To be effective, however, such panels/committees must have teeth. The value of PTAs lies simply in establishing a vehicle, which possibly of limited utility in itself, can nevertheless provide a platform to chip away at behind-the-border barriers, bring the domestic constituency on board over time, and hopefully in time facilitate a staged approach to regulatory reform.

The current suite of services trade negotiating mechanisms are unlikely to help reap the large potential economic gains to Australia from liberalizing services. To put it simply, they are not working multilaterally and, unless certain conditions apply as set out below, they are unlikely to work on a bilateral or regional basis either. WTO market access outcomes on services to date have been poor. Bilateral "WTO plus" outcomes are rare. To achieve the objective of "WTO plus" outcomes, Australia will need to drop a lot of old negotiating habits and develop a next generation tool kit. Interestingly, ASR has found a high degree of common ground on this matter with services export coalitions in our trading partners, whether they be from developed or developing economies.

There is a need to significantly redesign services trade and investment liberalization vehicles to reform behind-the-border regulatory barriers to doing business, including specifically current inefficient bilateral PTAs. ASR has little interest in pursuing them as currently constructed; a new suite of bilateral instruments is needed, focused on policy and regulatory micro-economic dialogue.

ASR believes the Government's recent Trade Policy Statement is a blueprint for needed productivity growth in Australia, and also sees trade policy is an indivisible part of overall economic policy. In particular, ASR endorses the Statement's emphasis on pursuing pro-competitive reform in its own right, especially in services. Such unilateral reform by Australia can demonstrate regional services policy leadership, particularly important as very high services barriers of many neighbors have proven difficult to lower through the WTO or PTAs.

While from a trade negotiations perspective, Australian PTAs appear to be and are politically sold as major achievements, such outcomes are more apparent than real. They are highly duplicative, including of multilateral rules and obligations, and have added little to Australian “on paper” commitments, and even less in practice to reforms in terms of actual or “on-the-ground” liberalization (Table 1). Indeed, PTAs have generally done little more than re-hash WTO commitments on all sides, and have been misleadingly portrayed as substantive. This WTO re-hash is totally unnecessary given that all parties to Australian PTAs are also WTO members. Such PTAs would be more transparent and less deceptive if they included only those differences negotiated in the PTA and leaving out each parties’ WTO commitments. In this way, seemingly substantive and comprehensive PTAs would in most cases become “wafer-thin” and more easily seen for their lack of achievement.<sup>14</sup> Moreover, many PTA provisions affecting foreign investment in services repeat, but generally fall well short of, those found in respective Bilateral Investment Treaties (BITs).<sup>15</sup> PTAs (like GATS) should also include actual measures so that the commitments can be compared with the existing situation, thereby improving transparency and indicating the extent of “binding overhang” and any areas where actual liberalization has occurred as a result.

**Table 1: Poor performance of Australian PTAs in achieving domestic services liberalization**

PTA	Improvements	Comments
AANZFTA	Virtually none	Mainly re-hash of WTO commitments; added ‘unbound’ Mode 4 in MA & NT; replaced a few ‘unbound due to non-feasibility’ entries in Mode 1 with ‘none’; added a few already liberalized sectors; made GATS-minus commitments; and slightly improved access of employer-sponsored contractual serviced suppliers (Mode 4).
AUSFTA	Virtually none	Higher screening threshold given in sensitive services to US investors, GATS-minus commitments (Adlung and Morrison 2010).
SAFTA	Virtually none	Mainly re-hash of WTO commitments in a ‘NAFTA-styled’ agreement (negative listing)
ACFTA	Virtually none	Mainly re-hash of WTO commitments in a ‘NAFTA-styled’ agreement (negative listing)
TAFTA	Minimal	Mainly re-hash of WTO commitments; slightly liberalized temporary access by Thais to labor market without market testing, including for employer-sponsored contractual serviced suppliers, especially chiefs; made some GATS-minus commitments; added a few already liberalized sectors; replaced a few ‘unbound due to non-feasibility’ entries in Mode 1 with ‘none’; CA in MA & NT allowed in several banking services (little liberalizing impact). Added insurance relating to maritime shipping and commercial aviation, space launching and freight (including satellites) covering goods being

<sup>14</sup> PTAs also duplicate many other existing provisions. For example, the minimum standard of treatment and conditions on expropriation for foreign investors included in AUSFTA are intended to reflect customary international law and partly correspond to provisions in both the Australian and US Constitutions (Mitchell and Voon 2007).

<sup>15</sup> A country’s BITs affecting trade in services as defined in the GATS (i.e. including investment), must be applied on an MFN basis unless it has taken out an MFN exemption for these treaties under GATS, which most, including Australia, have not. BITs generally cover a far wider range of sectors than scheduled under the GATS, and often contain greater obligations (e.g. compensation in the case of expropriation); nevertheless no WTO member, including Australia, has not notified its BITs to the WTO as a measure deemed to significantly affect trade in scheduled services as would be required under GATS Article III(3)(Adlung and Molinuevo 2008).



ANZCERTA	Minimal	transported, vehicles transporting the goods; and goods in international transit, and reinsurance and retrocession and the services auxiliary to insurance e.g. consultancy, actuarial, risk assessment and claim settlement services – cross-border supply as a principal, through an intermediary or as an intermediary is permitted. CA permitted. Otherwise all unbound. US higher screening threshold in sensitive sectors extended to New Zealand investors
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Source: Authors' assessments.

It is generally acknowledged that Australia negotiates PTAs more for foreign policy than economic considerations. The Government uses PTAs as instruments to secure wider foreign policy and strategic objectives often unrelated to trade and commerce; AUSFTA, which was driven by politics and not economics as demonstrated by Australia's willingness to accept such poor outcomes in major interest areas like agriculture is the most obvious contemporary example (Capling 2008). AUSFTA had at least as much to do with broader foreign policy objectives than with pure trade and investment goals (Australian Senate Select Committee 2004). Australia's assessment on PTA negotiations necessarily has regard to a broad range of considerations, including commercial and strategic (DFAT 2010a). In any event, such non-economic outcomes are usually better achieved outside PTAs; the characterization of security and strategic goals as a central justification for a PTA causes concern, as the practical value of any such contribution from a PTA is often unclear and yet seem to dominate other considerations (PC 2010). For example, a bilateral defence or security agreement would usually be superior in meeting defence-related strategic goals.

Australia pursues both negative (e.g. AUSFTA and ANZCERTA) and positive lists in its services PTAs (e.g. AANZFTA). While no compelling conceptual reason exists as to why a negative list should be more liberalizing than a positive list (other than automatically subjecting new services to liberalizing commitments), Australian PTAs with negative lists generate more commitments. However, this may reflect more the ambitions of the partners (e.g. the US) than the listing approach; positive listing seems to be associated with a more defensive or minimalist approach to commitments by partners. Notwithstanding, the US has a widespread tendency to use negative list reservations to exclude measures maintained at the sub-national level, raising scepticism of the self-proclaimed "gold standard" quality of US PTAs (Heydon and Woolcock 2009). Australian service providers have encountered instances under AUSFTA where the competent sub-national authorities have not implemented MRA mandates agreed nationally. MRA provisions promoted as trade liberalizing in AUSFTA at least, thus had little practical effect, highlighting that such arrangements must include those state governments responsible for administering them to be effective.

While in practice positive list agreements would be unlikely to be more liberalizing than those with a negative list, Australia on balance should generally follow negative lists, where possible (PC 2010, ASR 2008).

#### 4. Liberalizing Services Trade Through PTAs

The extent to which PTAs can liberalize services trade critically depends on whether they can reduce the main types of barriers impeding services trade in a way that unambiguously improves national welfare. This mainly depends on the nature of the impact of the services barrier.

Evidence suggests that the biggest gains from reforming services barriers accrue from reducing non-discriminatory market access restrictions on competition affecting both foreign and domestic suppliers (Dee and Findlay 2007a, ITS Global 2010). Discriminatory regulations that raise costs could include additional capital requirements for foreign insurance firms, or pricing regulations specifically targeting foreign insurance providers. The same rules could, however, also be non-discriminatory and raise costs for both foreign and domestic firms, thereby causing greater welfare losses. The next largest source of gains is likely to result from discriminatory market access restrictions that inhibit foreign access only. Market access barriers, especially non-discriminatory measures, are likely to exert large cost-escalation and rent-creating impacts, and should be liberalized first.<sup>16</sup> Usually entry barriers on domestic and foreign suppliers coexist, and significant barriers to foreign supply are usually associated with non-trivial barriers to domestic suppliers; it is rare to have significant barriers to foreign entry and/or operations without similar restrictions on domestic entrants (Dee 2009). Market access and regulation are interrelated, such that the key to sound policy reform is to increase market contestability by easing entry barriers for both domestic and foreign entrants.

In contrast, liberalizing national treatment measures discriminating against foreign suppliers post-establishment, offer much smaller gains. This is because they have a much lower anti-competitive or protective impact since they affect competition between suppliers rather than preventing new suppliers from entering the market. Moreover, the expressed reason for having PTAs in services is to reduce or eliminate national treatment and not market access restrictions (GATS Article V).

Poor progress in even making liberalizing commitments (let alone liberalizing actual measures) in PTAs (and the WTO) is a problem for policy makers who would like them to support their domestic programs, but it seems they will be waiting ‘till the cows come home’ (Drake-Brockman and Findlay 2011, Francois et al 2010). A far preferable course of action would be to build support for domestic unilateral reform rather than trying to side-step the fundamental problem through PTAs that focus on commitments rather than achieving actual liberalization, and can work against domestic reform by concentrating resources on trade negotiations and thereby undermining pursuit of actual on-the-ground unilateral reforms. Additionally, while it is often claimed that implementing liberalized commitments preferentially under PTAs helps pave the way for multilateralizing them in future, this is not supported by the Australian experience in those few instances where actual measures have been preferentially liberalized. Indeed, such preferential measures can be more difficult to extend on an MFN basis as certain lobby groups in both countries unite against such developments and related commitments become ripe to be used as ‘negotiating coin’ in future PTAs. For example, Australia has refrained from extending the preferential FDI screening thresholds provided US investors unilaterally on an MFN basis, which would be best outcome economically, but instead has decided to use these in PTA negotiations, having recently extended them to New Zealand.

Even in terms of commitments, it is important not to automatically conclude that a PTA with commitments that go “beyond the WTO” in “new” areas such as services trade and investment is

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<sup>16</sup> For example, empirical studies indicate that the gains to the ASEAN region from unilaterally reforming non-discriminatory restrictions on competition in services in a group of East Asian economies exceeded those from forming an East Asian PTA and from a successful Doha Round by almost sixfold and threefold (Dee 2010).

necessarily a good outcome; precisely the opposite could well be the case (Drake-Brockman 2003). Exceeding WTO rules obviously does not necessarily mean progress or even greater trade openness (Mitchell and Voon 2009). PTAs are inefficient and largely inappropriate mechanisms for services and investment trade liberalization because they do not focus sufficiently on barriers to trade which are located behind-the-border (ASR, Box 4). History shows that few market opening reforms come from trade negotiations, which primarily arise within a domestic productivity agenda (ASR, Box 4). While there have been many new PTAs with improved services commitments, trade liberalization is mainly unilateral (Miroudot 2011). Significant market opening actually comes from within economies because of the associated benefits to the community (Kwan 2011). PTAs are the best excuse reform-weary governments have had for not doing what really matter, and for distracting reform-ready governments with limited regulatory reform capacity from the main game (Dee 2007).

#### **4.1 PTA limitations in liberalizing services trade**

Because of the nature of trade barriers to services, PTAs (and the WTO) are unlikely to be effective in reducing many non-discriminatory or even some discriminatory market access barriers. PTA negotiations tend to focus on the removal of national treatment barriers that explicitly discriminate against foreign suppliers. This is hardly surprising given that only provisions that discriminate against and between foreigners can be readily liberalized preferentially (Dee and Findlay 2007a, Dee 2009).<sup>17</sup> Discriminatory market access barriers are also likely to be downplayed in PTAs (e.g. foreign ownership limits).<sup>18</sup> Also, since the Government's main commercial motive for negotiating PTAs is to obtain preferential access for service exporters, discriminatory national treatment barriers that can readily favor them over suppliers from other countries will be targeted, especially given the "request-and-offer" modalities used to negotiate concessions (including in the WTO). PTAs focus mainly with issues between domestic and foreign suppliers, while the real reform issues are between incumbent and other domestic suppliers.

There seems no escaping the fact that significant services liberalization of the main trade restrictions can only be successfully tackled unilaterally because of the nature of the measures (i.e. embedded in domestic legislation and the difficulties of liberalizing preferentially). PTAs (and especially the WTO) may marginally help but are no substitutes for unilateralism. The politics of services reform differs from that of goods; additional foreign market access is not required as part of a big political bargain to offset the local resistance to reform in services, being largely about FDI, and when barriers are removed local activity can actually increase (Drake-Brockman and Findlay 2011). Furthermore, in many cases the service businesses themselves push for services reform to remove unnecessary and costly regulation or rules. Also, for PTAs, it's hard to define origin in a way to support discrimination since market failures are not linked to the origins of services. If problems of asymmetric information exist, for example with

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<sup>17</sup> For measures to be preferably liberalized, they must be capable of easily being implemented in a way that can discriminate not only between domestic and foreign suppliers, but also by country of origin. Non-discriminatory market access limitations are thus poor fits for preferential liberalization, since it would require allowing domestic entry at the same time as permitting only foreign entry from preferential countries.

<sup>18</sup> Maintaining discriminatory or preferential market access restrictions, such as different foreign equity limits, is likely to be fraught with implementation problems as foreign investors respond by shifting origin to become eligible for preferential access (assuming that PTAs have liberal "denial of benefits" clauses).

professional services where clients cannot sufficiently assess quality and demand licensing or accreditation requirements for suppliers, regulations should apply uniformly to domestic and foreign providers to ensure equal recognition of similar overseas qualifications and experience.<sup>19</sup> Most services trade barriers likely to raise costs cannot be eliminated through bilateral negotiations, and for the most part can be addressed only through domestic competition policy reforms; while negotiations can hope to eliminate some particularly restrictive regulations, for example, to agree on mutual recognition of some professional qualifications, they cannot enforce complex legislative changes, such as better competition policies (Elek 2010).

Most significant policy reforms in services have been domestically driven, with PTAs offering limited scope to reform services, partly also due to a lack of domestic constituencies focusing on self-liberalization rather than mercantilism efforts concentrating on obtaining greater access abroad. Achieving domestic reform of services markets through external trade agreements, including the WTO, has proven difficult in practice (Francois and Hoekman 2010). At best, negotiated forms of liberalization, including PTAs, have resulted in commitments “on paper” without generating actual liberalization of measures, and this is certainly the case in Australia (Tables 1 and 2, Bosworth and Trewin 2008).<sup>20</sup> While the trade negotiating community claim binding such measures via “on paper” commitments to be major achievements, their value, especially in services, is largely overstated. This is especially when commitments contain significant “binding overhang” to provide substantial policy space to de-liberalize. Unfortunately, while perhaps of academic interest, much of the research documenting so-called services liberalization under PTAs (and the WTO) have overly focused on countries’ scheduled commitments, which are known to contain significant binding overhang and/or to have contributed little to actual or “on-the-ground” liberalization, and thereby been of limited policy value (Fink and Molinuevo, Roy, Marchetti and Lim 2007, Marchetti and Roy 2008, Mattoo and Sauve 2010, Sauve and Shingal 2011).<sup>21</sup> The domestic politics of trade in services may make it difficult to achieve real liberalization in PTAs (or WTO) as opposed to international codification of measures already approved domestically (Van Grassek 2011). There has also been a marked inclination among governments to dress up issues in PTAs which do not fundamentally free up markets – because eliminating the barriers needed is too hard and instead focus on issues which may please constituents but have little impact (ITS 2011).

**Table 2: Australian GATS commitments compared with SAFTA and TAFTA**

Sector/service	Comparison
<b>SAFTA</b>	
Horizontal section	Mode 4 horizontal commitments significantly improve on GATS; many of these reflected in Doha offers which is potentially nearly as liberalizing as SAFTA, certain of which (e.g. rights for permanent residents) may still be more liberalizing than Doha offers.
Business	SAFTA on legal services probably more liberalizing than Doha offer; in most other areas, it and Doha offers appear comparable.

<sup>19</sup> This is usually achieved by negotiating Mutual Recognition Agreements (MRAs), often as part of PTAs. However, when entrenched in PTAs, such MRAs can become a major source of discrimination between PTA members and non-members. MRAs would be better negotiated outside PTAs to enable any new country to more easily negotiate to join the MRA.

<sup>20</sup> Even applying the Fink and Molinuevo (2007) analysis to TAFTA found only small improvements over Australian and Thai GATS commitments, themselves second-rate (Bosworth and Trewin 2008).

<sup>21</sup> This largely reflects the ease of conducting such analysis due to the availability of PTA (and GATS) commitment databases across countries, while no such comprehensive or easily accessible databases exist on actual liberalization.

Communications	SAFTA appears slightly more liberalizing than the Doha offer.
Construction	Likely that SAFTA and Doha offer comparable, although significance of the ‘other construction services’ sector unknown.
Distribution	Additional Doha offer appears roughly comparable to SAFTA.
Financial	SAFTA, including chapter on financial services rules, seems more liberalizing than Doha offer.
Education	SAFTA reservations probably mean it does not go meaningfully beyond GATS.
Environmental	SAFTA appears more liberalizing than Doha offer.
Health & Social	No Doha offer, SAFTA same as GATS (only commitments in podiatry and chiroprody).
Tourism	SAFTA appears marginally beyond GATS (no new Doha offers).
Transportation	Although Doha offer potentially considerably more liberalizing than GATS, the same SAFTA reservations would likely apply to GATS so that SAFTA’s negative list approach likely more liberalizing overall than Doha offer.
Recreational, cultural & sporting	No Doha offer and SAFTA same as GATS.
<b>TAFTA</b>	
Horizontal section	TAFTA notable for Mode 4 provisions on temporary entry of qualified Thai Chefs and agreement to work toward similar provisions for qualified massage therapists. In nearly all other areas, access limited to senior executives and or managers/specialists.
Business	Doha Round offer potentially more generous than TAFTA (e.g. legal services).
Communications	Doha offer potentially more generous than TAFTA.
Construction	Doha offer potentially more generous than TAFTA, which has same commitments as GATS.
Distribution	Doha offer potentially more generous than TAFTA, which has same commitments as GATS.
Financial	Doha offer potentially more generous than TAFTA, in which GATS+ commitments reflect only partly Doha offer.
Education	TAFTA commitments, tied to traditional Thai specialties, more interesting than Doha offer, which is same as GATS.
Environmental	Doha Round offer essentially same as TAFTA.
Health & Social	No Doha offer, TAFTA same as GATS.
Tourism	No Doha offer, TAFTA same as GATS.
Transportation	Doha Round potentially considerably more generous than TAFTA.
Recreational, cultural & sporting	No Doha offer, TAFTA same as GATS.

*Source:* Trewin, Bosworth et al 2008.

Of real value to policy makers and the proper benchmark by which to evaluate the liberalizing impact of PTAs (and the GATS) is to assess the extent to which they actually reform measures. In this respect, the picture both in Australia and elsewhere is bleak, and the extent to which PTAs (and the GATS) “lock in” past unilateral reforms is over-stated.<sup>22</sup> Usually when a country’s PTA commitments exceed those in the WTO, it is primarily through new rather than improved existing bindings when arguably the later is more likely to imply real liberalization (Dee 2009). Similarly, comparing a country’s PTA and GATS commitments misleadingly avoids the main policy question, namely to what extent have PTAs liberalized “on-the-ground” more than GATS (Box 6).

<sup>22</sup> Working with countries’ schedule of commitments therefore creates an overly rosy picture of the extent to which PTAs (and the GATS) have actually liberalized measures, thereby potentially misleading policy makers and governments. For example, a country scheduling a new sub-sector “unbound” in its positive list is often seen as liberalizing, even though in reality nothing has changed, even in terms of bindings. Similarly, adding new service-sub sectors to the list with partial or full commitments is seen as liberalizing, even though policy measures have not changed.



### **Box 6: AUSFTA commitments**

Many parts of the agreement codify the status quo, and in some cases even the bindings are not new, with Australia already having the same promises under GATS to the US and all other WTO Members.

Because AUSFTA commitments on national treatment and market access are based on a negative list and not a positive list as for the GATS, the services chapter may potentially offer more than the status quo, particularly for sectors unlisted by one or both countries within the WTO. While in principle the same applies to chapter 13 on financial services, in practice it is primarily a status quo chapter. Similarly, since the investment chapter of AUSFTA uses a negative list for national treatment commitments compared to a positive list in GATS, it may potentially offer more than the status quo, particularly for sectors unlisted by one or both countries within the WTO.

However, importantly, AUSFTA commitments do not necessarily imply that there were significant barriers present in these areas being removed; in most cases there were not. This confirms the Government's claim that the main Australian benefit on investment and cross-border services trade were US promises not to apply new discriminatory measures (i.e. standstill provisions), rather than rolling back any existing measures. Hence, the promises will not cost either party commercially and have resulted in minimal liberalization of Australian or US measures.

#### *Intellectual property*

AUSFTA required Australia to extend copyright protection by 20 years, from the life of the author plus 50 years, to the life of the author plus 70 years. The economic benefit to Australia is the additional works created from the extra incentive to authors. However, the cost to Australia, as a net importer of copyright material, is the additional royalties that must be paid to copyright holders of existing works. The net cost to Australia is that it could eventually pay 25% more annually in net royalty payments, not just to US copyright holders, but to all copyright holders, since this provision is not preferential. This could amount to up to A\$88 million annually, or up to A\$700 million in net present value terms. This is a pure transfer overseas, and hence a pure cost to Australia.

*Source:* Dee, P. (2004).

Analysis based on commitments cannot therefore measure the extent to which PTAs achieve actual liberalization, nor assess the degree to which any liberalizing commitments would increase trade. Indeed, such analysis can badly mislead. For example, a country with open trade policies and few commitments would be found to be far less liberal than a country with substantial trade restrictions but many more scheduled commitments. Such erroneous comparisons and assessment would also apply at individual sub-sector and across-mode comparisons. It is not commitments that matter but actual policy measures. It is far better for a country to have open trade and investment regimes in reality and poor commitments than to have restricted regimes and liberal commitments. Often this fundamental distinction is lost as trade policy becomes confused with trade negotiations, and the impression often created that commitments matter as much as actual measures, and that trade negotiations are actually setting trade measures and policy.<sup>23</sup>

How much discipline PTAs impose, whether in terms of policy changes “on paper” or in terms of actual implementation, is little studied, making it difficult to argue that in practice specific agreements live up to what theory “predicts” they will achieve as a lock-in device and adding

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<sup>23</sup> Blurring this distinction seems to be often intentional, especially among trade and officials and governments. It provides them with ammunition to give the impression that they are doing a lot of trade reform when in fact reality is far different, a potentially dangerous development that can backfire and undermine genuine efforts to unilaterally reform.



reform credibility (Francois and Hoekman 2010). PTAs appear to have wider coverage than the GATS but their contribution with respect to actual policy change and implementation is difficult to assess (Drake-Brockman and Findlay 2011). Most PTAs (like the WTO) have not achieved significant additional services liberalization, and while PTAs can be useful “laboratories” for cooperation on specific sectors or policies, including mutual recognition and the adoption of common standards, most services policy reforms tend to be implemented unilaterally... there is not much compelling evidence that PTAs are going significantly beyond already applied services policies (Hoekman 2008). Even where PTAs significantly improve on GATS offers, they only “sometimes” even lead to real market liberalization (Roy, Marchetti and Lim 2006). Trade agreements do not appear to have played much of a role, if any, in generating significant policy reforms (Francois and Hoekman, 2010). This is certainly true of Australian PTAs.

An OECD study found that PTAs had reduced services trade barriers much less than for goods, primarily due to the nature of the restrictive measures; unilateral non-discriminatory policy reforms matter most in services markets, and are the effective basis for anything that happens within regional arrangements or multilaterally (Miroudot, Sauvage and Shepherd 2010). In other words, unilateralism operates effectively in liberalizing services without multilateralism or regionalism, but without unilateralism these negotiated forms of liberalization have little impact.

#### **4.2 Problems of piecemeal reforms**

At a broad level, all economic reforms tend to be piecemeal. This reflects reality – governments cannot possibly reform everything simultaneously, so that priorities and sequencing are essential. At a micro-level, however, reforms should be comprehensive as possible to minimize risks of “second-best” outcomes from piecemeal reforms that may worsen, not improve economic welfare. Comprehensive reforms also have other advantages, such as “watering down” any adverse effects on certain groups as positives help offset any negatives.

In trade, for example, it is widely accepted that the most efficient means of tariff reform is general across-the-board MFN reductions to reduce the level and disparity in rates rather than piecemeal cuts, especially since lowering tariffs on inputs without also reducing high output tariffs can worsen resource-use efficiency by raising already high effective rates of assistance.

Problems of piecemeal trade reform are accentuated in services. This is because services barriers are usually enshrined “behind-the-border” in a maze of domestic regulatory legislation that is designed to meet an uncertain mix of desirable and non-desirable (protectionist) goals. Disentangling this web is complex. The prevalence of domestic regulation complicates and constrains the use of reciprocity negotiations for services because of the difficulty in designing multilateral rules and national commitments in a way that clearly separates or distinguishes between measures that protect by preventing entry, create rents for incumbents by raising prices, or needlessly raise costs, from those having good domestic efficiency or social equity rationale relating to quality and performance; marginal *quid pro quo* changes to domestic regulatory policies may not necessarily enhance welfare (Francois and Hoekman 2010). There is no internationally-accepted best framework for regulating services, such that unique differences between countries are likely not only to exist, but to be desirable. Many PTAs, including for

example AUSFTA, are negotiated so hurriedly that it is difficult to believe that their domestic economic implications could have been properly considered.<sup>24</sup>

Intellectual property, which also affects services and investment, is a case in point. The most economic appropriate degree of intellectual property protection is far from clear, and in any event would likely differ between intellectual-property exporting and intellectual-property importing countries. Creeping strengthening of intellectual property protection, pushed hard by the US as one of the world's major exporters of intellectual property in its FTAs, risks upsetting the delicate balance between providing sufficient monopoly conditions as an incentive for innovation and creativity, and preventing anti-competitive conduct and ensuring access to new products and technologies (Mitchell and Voon 2009, Fink and Reichenmiller 2005, Mercurio 2006).<sup>25</sup> Intellectual property protection became a sensitive issue in AUSFTA, where Australia agreed to meet US requests to strengthen its intellectual property protection (e.g. extending the term of copyright protection by an additional 20 years, to bring Australia into closer conformity with the US), seemingly against Australia's national interest (Box 5).<sup>26</sup>

It is also claimed that some of the AUSFTA patent provisions that exceeded TRIPS may raise Australian drug prices and unnecessarily delay introduction of generic drugs (Drahos et al 2004, Mercurio 2005, Mitchell and Voon 2009). AUSFTA, unlike TRIPS, also banned parallel imports of patented products, thereby removing the possibility of allowing them if found to be in Australia's best economic interests.

Australia should not seek to include intellectual property provisions in PTAs as an ordinary matter of course, and should only include such provisions after an economic assessment of the impacts, including on consumers, in Australia and partner countries (PC 2010).<sup>27</sup> Moreover, intellectual property protection should arguably be outside the scope of PTAs (and the WTO) as they generally restrict competition rather than liberalizing trade (Correa 2006).

Governments, for good reason, are therefore hesitant in negotiating service barriers (either preferentially or non-preferentially) that could constrain their ability to design and implement regulatory norms that maximize national welfare; "standard" mercantilist bargaining may not do much to support significant exchange of liberalization commitments as countries are reluctant to make commitments in trade agreements or to expand on existing ones (Francois and Hoekman 2010). Indeed, negotiating "behind-the-border" regulatory services measures as the basis for setting domestic policy would be undesirable and would likely lead to sub-optimal measures, as other countries demand reforms that are not in the country's own best economic interests; such

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<sup>24</sup> For example, negotiating time for the US's PTAs between 1984 and 2005 varied between nine and 38 months (Ferrantino 2006).

<sup>25</sup> Since the WTO TRIPS Agreement has no general MFN exemption for PTAs, WTO members who provide any stronger intellectual property protection preferentially must generally extend these provisions to all (Mitchaell and Voon 2007).

<sup>26</sup> This decision reportedly involved the input of the Australian Prime Minister at the time, and reversed an earlier government decision to accept the recommendation of the Intellectual Property and Review Committee not to extend the term of copyright protection (Mitchell and Voon 2007).

<sup>27</sup> PTA provisions that are in Australia's national interest should be extended to other countries willing to settle high-quality, trade-creating agreements unlike those that are not in the national interest, such as extending the duration of foreign copyright in a PTA that does not offer obvious economic benefits to Australia (Emerson 2010).

reform is best done unilaterally away from the negotiating arena (Dee and Findlay 2007a). Since services are highly differentiated, removing all discrimination against all foreigners multilaterally may not ensure the full benefits from opening service markets will be realized as domestic service suppliers will remain “too pricey” if still penalized by domestic regulatory distortions (Dee 2009).<sup>28</sup>

One area where piecemeal trade reforms in services through PTAs can worsen members’ economic welfare relates to the scope for preference-induced trade diversion. The frequent claim that such negative effects are unlikely when liberalizing trade barriers in services since there is no foregone tariff revenue is incorrect. Preferential rent-creating measures can divert rents both overseas and between trading partners and thus have similar economic effects as the redistribution of tariff revenue (Dee and Findlay 2007b). For example, allowing foreign equity by a firm from a PTA partner in a domestic monopoly protected by non-discriminatory market access barriers would have negligible efficiency effects, and would reduce economic welfare by transferring rents overseas. Similarly, PTAs diverting investment in services from more efficient suppliers in non-PTA countries to investors in PTA partners may transfer rents between countries and reduce economic welfare of the host economy. Welfare losses from allowing preferential foreign ownership of a domestic monopolist can be on-going, especially for services with high sunk costs, where first mover advantages can be significant, such that the economic costs of preferentially attracting an inefficient supplier can be long lasting (Mattoo and Fink 2002, Bosworth and Trewin 2008). In other words, access liberalization (i.e. abolition of quotas on the number of participants) should be accompanied with equity liberalization (i.e. allowing greater foreign equity).

Preferential liberalization of services will not necessarily enhance welfare, and where it does these will be small relative to non-preferential unilateral liberalisation. Most economists and policy makers would agree that global unilateral liberalization or multilateral trade liberalization on an MFN basis is the ultimate objective, and that anything else, such as PTAs, reflect a “second best” policy choice (CIE 2010). While trade agreements are best limited to removing discriminatory policies, in practice the “benign neglect” of domestic regulation implies no assurances that liberalization will increase national welfare or raise export opportunities for firms; trade negotiators are not concerned with the adequacy of national regulation and enforcement institutions, or the need for international regulatory cooperation where there are regulatory externalities (Hoekman and Mattoo 2011).

## **5. Australia’s Experience with PTAs on Services**

The economic benefits of Australian PTAs, all of which cover services, have generally been oversold (PC 2010). They have only modestly increased Australia’s national income, with only limited impacts on reducing trade barriers and meeting other policy objectives. Australia would have been better served in sustaining strong economic performance as a multilaterally free trading economy, strongly focused on removing impediments to domestic economic efficiency,

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<sup>28</sup> These outcomes may be substantial (Dee 2007). Maintaining such regulatory impediments on domestic suppliers while opening to foreign competition may actually worsen resource allocation by causing the already too small sector to shrink further (Dee 2009, Dee, Hardin and Holmes 2000).

than by contributing to the scramble for FTAs, even in an increasingly fractured international trade environment (Garnaut 2003).

PTAs covering services have been supported in Australia for two main reasons. First, they are seen as a means for Australia to open overseas markets to advantage exporters (offensive), or to prevent them being disadvantaged by diversion to exporters in third markets with preferential access (defensive). Second, PTAs are seen as a means of liberalizing Australia's barriers to services trade and of 'locking in' domestic reforms. While domestic liberalization produces most economic gains to Australia, the first reason usually attracts most attention from trade negotiators and other PTA supporters. While appearing separate reasons, they are really inter-twinning since PTAs inadequately opening Australia's services market are also unlikely to successfully open export markets, and vice versa. This is an inevitable outcome given the mercantilism approach to trade negotiations whereby all governments negotiate by trying to gain maximum concessions from trading partners while giving as little market opening in return as possible.

Many services influencing the international competitiveness of Australian businesses are associated with significant network externalities (e.g. transport services; electricity, gas and water, postal services and telecommunications). However, as already indicated, these are the least suited to negotiated liberalization, including preferentially. PTAs are not well-suited to addressing "behind-the-border" barriers (e.g. good governance, competition policy and domestic regulations more broadly); these can be better achieved through bilateral cooperative and regional mechanisms, such as those of APEC (Treasury 2010).

## **5.1 Impact on overseas liberalization**

Australia's PTAs, which cover services, have had only limited success in reducing barriers and opening up new opportunities, and are instead more likely to bind existing levels of openness (DFAT 2010a). However, research on Australian PTAs has shown that even though they may have in some cases gone beyond other country's multilateral commitments, they have resulted in negligible actual liberalization. While it is generally acknowledged that the GATS – with few exceptions, such as in telecommunications and commitments of certain countries negotiating WTO accession — has performed little actual liberalization, ... PTAs suffer to a greater degree from the same weaknesses (Bosworth and Trewin 2008). PTA developments in the Asia-Pacific region, where unilateral liberalization abroad had benefited Australia substantially through regional growth and export demand, marked the end of unilateralism, and removed the political basis driving such reforms (Garnaut 2010). Since APEC's Bogor objectives of free and open trade and investment by 2020 (developed economies) and 2010 (developing economies) are expressed in non-discriminatory terms, the focus on PTAs of APEC economies and the associated drift away from unilateralism has threatened these goals.

The value of international legal bindings is overstated, especially in services, where substantial "binding overhang" exists and sectoral coverage of bound commitments is low. Bindings *per se* do not prevent de-liberalization but rather the best insurance against backsliding, although imperfect, are successful unilateral reforms themselves by establishing market and economic conditions that make such backsliding poor economic policy. Australia generally refrained from introducing protectionist measures in response to the Global Financial Crisis, even though it

could have under its PTA (and WTO) commitments. It did so for unilateral economic reasons, believing that to unwind, even temporarily, its successful trade and investment liberalization policies would only “shoot itself in the foot”. The nature of services barriers also make many of them politically and economically irreversible once liberalized (e.g. Mode 3 liberalization allowing foreign entities to become established domestically). According to ASR, its members place no significant value on reducing binding overhang in trade agreements, a view supported by the Global Services Coalition.<sup>29</sup>

Policy reforms based on sound domestic unilateral economic analysis are likely to be more sustainable than those introduced to simply meet international commitments.<sup>30</sup> For a start, they are self-enforcing and do not rely on other trading partners taking dispute settlement action, which they may not be in a position to do given a lack of knowledge of the measures being adopted, or may simply choose not to challenge for other, including broader political and commercial, reasons. Moreover, any such challenges can become protracted and complex, thus making dispute settlement a poor enforcer against bad, especially “temporary”, economic policies. Relying on dispute settlement challenges by trading partners to avoid policy backsliding also suffers from the fundamental weakness that good trade legal decisions (including within the WTO) are not necessarily good economic policy outcomes, and can lead a country losing such cases to implement equally bad or even worse trade policies that are legally consistent.<sup>31</sup>

Substantial “binding overhang” exists in service commitments, both multilaterally and within PTAs, especially in positive list agreements. For example, services trade in APEC economies is freer than reflected in GATS and PTA commitments (DFAT 2010b). Services commitments in the GATS and PTAs of ASEAN members are also well known to lag actual practice considerably (Stephenson and Nikomborirak 2002). Hence plenty of room exists to introduce more restrictive measures, and there is no hard evidence that “binding overhang” has been substantially reduced under PTAs.<sup>32</sup> Moreover, there is no formula approach (like for tariffs) to ensure “binding overhang” is reduced over time; indeed it may increase if countries’ commitments lag their unilateral trade liberalization measures.

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<sup>29</sup> Personal e-mail from ASR, 22 June 2011.

<sup>30</sup> If the domestic unilateral support to maintain open measures is lost then it is implausible to think that internationally bound legal commitments, either in PTAs or the GATS, will prevent policy back-sliding. At best it will only encourage governments to think imaginatively to develop restrictive measures that are consistent with international commitments, which may be more distorting and non-transparent than the inconsistent measures. Moreover, in the case of PTAs, it is also likely to encourage countries to target restrictive measures against non-preferential trading nations, thus increasing discrimination. It has been estimated, for example, that crisis import restrictions taken in response to the Global Financial Crisis significantly reduced affected trade flows by 5% from border measures and 7% from “behind-the-border” measures, such as unconventional types of protectionism like non-tariff barriers, discriminatory purchasing policies, bailouts, and domestic subsidies (Henn and McDonald 2011). Negotiated commitments, including in PTAs, do not seem to have put a brake on the re-introduction of protectionist measures, and it certainly does not follow that these commitments effectively prevented more backsliding. It seems incongruous to believe that PTAs which played a negligible role in liberalization to begin with could somehow effectively prevent de-liberalization.

<sup>31</sup> Of course, unilateralism policy making should be a major pre-requisite to any government’s decision to defend a dispute settlement case. There is little or no value in a government legally defending a trade restrictive policy if it a bad measure economically, and hence once established it would be better to unilaterally reform it.

<sup>32</sup> Even substantially reducing “binding overhang” could be largely redundant if significant binding overhang remains to allow backsliding. Some bindings are so much lower than what is applied that even large changes would have no impact.



The significant “binding overhang” is due to most services liberalization being undertaken unilaterally (Hoekman and Mattoo 2011).<sup>33</sup> The GATS bindings, on average 2.3 times more restrictive than currently applied policies, allow more than a doubling of average restrictiveness levels without breaching commitments.<sup>34</sup> While some PTAs have wider sectoral coverage of services, they do not appear, with a few exceptions, to have induced significant market opening (Hoekman and Mattoo 2011). Alarming, and surprisingly, evidence also suggests that many PTAs have less than GATS commitments (i.e. are “GATS-minus”), thus creating non-WTO compatible systems of trade agreements.<sup>35</sup> Australian PTAs contain a few of these (Table 1).<sup>36</sup> Moreover, many commitments in PTAs are no better specified than in the GATS, such that they are virtually impossible to interpret.

The PC received little specific evidence for its Study from the private sector significantly benefiting from export openings in services from PTAs, apart from the legal profession. The evidence suggested this resulted more from direct dialogue between the professions of negotiating countries driven by the need for unilateral reforms to become internationally competitive rather than MRAs within PTAs. Australia’s PTA agenda has been of limited actual value in improving the business environment for enhanced trade and investment in services (ASR, Box 4). The much used mantra that bindings on services in PTAs (and the WTO) significantly encourage FDI by reducing uncertainty and promoting investor confidence is difficult to believe, and unsupported empirically. The risks to Australia of including investor-state dispute settlement (ISDS) clauses, present in almost all of Australia’s PTAs with the notable exception of AUSFTA, were found by the PC to outweigh the possible benefits, and that such provisions granting foreign investors in Australia greater substantive or procedural rights than enjoyed by Australian investors should be excluded from PTAs (PC 2010).

Other evidence indicated that while some Australian firms had benefited from PTAs, they were: (a) generally skeptical of the extent of these benefits, and saw them as at best marginal (b) did not appear to have significantly improved market access to promoted PTA partners, even though they saw them as good places to do business when choosing markets (c) disappointed as high business expectations and optimism at the time of negotiating PTAs dissipated quickly as achievements dwindled, and (d) helped far more by “practical trade facilitation measures” (e.g. Export Market Development Grants) (PC 2010).

This limited use by business of the opportunities from Australia’s PTAs also reflected that the main factors relevant to decisions on doing businesses overseas (e.g. domestic regulations, infrastructure) were outside their scope. Other approaches were seen as more cost-effective (e.g.

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<sup>33</sup> Based on a new World Bank database on services trade barriers of 93 economies covering the five sectors of financial services (banking and insurance), telecommunications, retail distribution, transportation, and professional services.

<sup>34</sup> While Doha offers were found to improve GATS commitments by about 10%, offers still remained on average twice as restrictive as actual policies.

<sup>35</sup> Controversial OECD research of 56 PTAs in services found that some 80% had some form of GATS-minus commitments in either their horizontal or sectoral sections (Adlung and Morrison 2010).

<sup>36</sup> The motivation for negotiating “GATS-minus” commitments is unclear. It may simply be oversight and/or incompetence on the part of negotiators, facilitated by interpretation problems of relevant GATS provisions and commitments due to inadequate wording and understanding. However, it seems highly likely that in many cases it is intentional (Adlung and Morrison 2010).



separate MRAs, bilateral investment treaties, and less diversion-prone open regionalism, such as APEC, which has led to the introduction of cost-effective initiatives that facilitate trade, such as the APEC Business Travel Card). While reforms to services in PTAs may cover barriers in a range of services industries, the benefits obtained depend in large measure on the subsequent uptake of opportunities by business, which in turn will depend largely on the extent to which the services barriers addressed in the PTAs are important for facilitating commerce (PC 2010). The experience is that in PTAs with developing country partners, services and investment liberalization are not proving any easier to negotiate one-on-one than they are in the multilateral context, and it has little interest in further pursuing PTAs as currently constructed, calling instead for a new suite of bilateral instruments focused on policy and regulatory micro-economic dialogue (ASR Box 4, Drake-Brockman 2003).

MRAs in PTAs can lead to arrangements that are indeed preferential, not MFN-like (Heydon 2010). In professional services, the removal of barriers to export has been best achieved through direct negotiation with stakeholders in the relevant jurisdictions rather than through PTAs which are weak in this area, with arrangements using terms like “enhance cooperation in terms of mutual recognition (ASEAN AFAS)” (PC 2010).<sup>37</sup> Singapore, for example, imports medical skills using lists of acceptable qualifications, developed by its professional medical bodies completely outside of PTAs, and while shared standards reduce trade costs, this may be achieved by countries unilaterally adopting recognised international standards (Dee 2007). Opening is not the same as having common standards which may not make sense in some situations, for example when the PTA partners are at quite different stages of development. Substantial trade facilitation may be required before common standards and associated aspects can be meaningfully introduced. Thus unilateral reforms to implement good domestic policies are essential to services becoming internationally competitive (Bosworth and Trewin 2008).

It is frequently argued that Australia must negotiate PTAs for defensive reasons to ensure that exporters do not face exports being diverted from third markets by non-Australian exporters receiving preferential access. However, it does not automatically follow that PTAs designed to protect defensive interests should be pursued; like all trade agreements they should first be subject to an assessment of their likely national benefits to ensure that the gain from securing access for one or a few sectors are not outweighed by losses in others (PC 2010). For example, while a PTA that opens up an export market for Australia’s less efficient services benefits those exporters this would be inconsistent with Australia’s national welfare if more efficient services did not achieve the same opening. Also, the potential negative impacts upon Australia from not being involved in PTAs with major trading partners can be ameliorated by unilateral (trade and broader domestic) reforms to improve competitiveness (PC 2010). Australian unilateral trade-related reforms best safeguard export interests by permanently improving competitiveness of all exporters to all countries, including to new and emerging markets and for new services. Moreover, unilateral reforms have the added benefit of improving competitiveness of domestic firms competing with imports and of goods with embodied services.

## **5.2 Impact on domestic liberalization**

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<sup>37</sup> While PTAs may on occasion weakly direct industry groups to engage in negotiating PTAs, as indicated elsewhere in this paper, MRAs are best left out of the PTA negotiations to minimize potential discrimination.

Australia PTAs have not significantly advanced Australia's services liberalization, and in a few significant cases have resulted in Australia preferentially liberalizing measures when non-discriminatory unilateral liberalization was required (PC 2010, and Table 1). The main case was preferentially providing US investors higher investment screening thresholds under AUSFTA.<sup>38</sup> Despite being granted from 2005, these have not been either multilaterally extended in Doha offers or applied unilaterally, but have been subject to negotiations with China and Japan under PTA negotiations. Preferential thresholds make no economic sense, and risk diverting investment to less efficient US investors that detracts from Australian welfare, thus making it highly ambiguous whether these PTA developments are in Australia's economic interests. Doubt exists as to the practical significance of these higher thresholds given Australia's liberal FDI regime and that the screening thresholds have only stopped FDI projects a few times on national interest grounds, which questions why such measures were negotiated; another example of insignificant outcomes being negotiated in PTAs while meaningful policy measures (such as unilaterally increasing or preferably removing these thresholds) are put aside. Alternatively, if higher thresholds are significantly beneficial to US investors it means that the welfare-reducing risks for Australia are greater. While Australia should multilateralize these PTA preferences, in reality this has not happened as they have become "negotiating coin" in future PTAs. Australia has recently extended the higher US investment screening thresholds preferentially to New Zealand as well, in return for its investors' receiving higher thresholds.<sup>39</sup>

The need for unilateral reforms, especially in services while allowing governments to maintain sovereignty and control over policy, requires transparency in domestic policy making and its likely effects to be improved. Domestic institutions that highlight the economy-wide impacts of policy decisions would help. (PC 2010).

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

### **5.3 Joint feasibility studies on gains from PTAs found wanting**

The effects of Australia's PTAs including on investment and services were likely to have been small, and their economic benefits to Australia oversold (PC 2010). Overselling started with DFAT's commissioning of "independent" joint feasibility studies on proposed Australian PTAs to quantify the economic benefits to both countries using economic modelling. The PC criticized this broad institutional mechanism formed off PTA negotiations. Such *ex ante* studies lacked transparency and tended to highlight "outer envelope guestimates" based on complete

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<sup>38</sup> Foreigners must in advance notify if acquiring an interest of 15% or more in an Australian business valued above A\$231 million or for US investors A\$1,005 million, except in the prescribed sensitive sectors of mainly media; telecommunications; and transport (including airports, port facilities, rail infrastructure, international and domestic aviation and shipping services provided within, or to and from, Australia).

<sup>39</sup> ANZCERTA contained no investment provisions until the Investment Protocol was signed under the ANZCERTA umbrella in February 2011.

liberalization, which bore little resemblance to what was eventually negotiated. Most of these studies did not cover all the costs (many of which are hard or impossible to reliably quantify) and lacked objectivity. While done by credible “independent” economic consultants, their commissioning and oversight by DFAT compromised the consultant’s objectivity and tarnished the results. The risks are heightened given that the mere commissioning of such a study itself usually signals the trade minister’s and government’s support for the PTA. There has been no case of a proposed Australian PTA being abandoned, especially based on an *ex ante* study finding insufficient economic benefits. No study, not even those involving little trade or facing barriers that have never been or likely to be overcome in a trade agreement, have shown anything but extreme “outer” envelope positive estimates of the economic benefits.<sup>40</sup> The approach used to conduct feasibility studies for most Australian PTAs produced overly optimistic expectations of their likely economic effects, and provided an inadequate basis for assessing their merits (PC 2010).

Moreover, Australian taxpayers have had to incur the cost of “absurdly hypothetical” computable general equilibrium studies on the gains from so-called free trade agreements (Emerson 2010). These studies, commissioned by advocates of particular bilateral trade deals, will inevitably report enormous potential gains to both countries; modellers are handed the assumptions by government officials and produce the results sought in a process best described as an expensive farce designed to hoodwink the public (Emerson 2010). More independent modelling of the impact of PTAs, such as that undertaken by Dee for an Australian Senate inquiry into PTAs, have been useful in raising public concerns with the over selling of the benefits of Australian PTAs (Dee 2004).

#### **5.4 Impact on regional integration**

Apart from with Chile and the US, Australia’s PTAs are regionally focused, especially within Asia and New Zealand. However, PTAs, being discriminatory, are likely to work against regional integration, especially whenever the region is defined more broadly than the PTA, or when there are several PTAs within the region. The old adage that “who you do not invite for dinner can be just as important as who you do” suggests PTAs can work against regional integration. Empirical evidence suggests that larger regional and non-preferential agreements have had a greater trade creating impact (both for members and non-members) and thus have greater potential to contribute to broader regional integration, such as the APEC (PC, 2010). Moreover, Australia’s economic success relies on obtaining the most efficient integration, whether regional or global. There is no reason for policy to favor one over the other.

Integration differs from liberalization, and the latter should be the focus of trade policy since it is what primarily generates economic benefits to Australia. Integration is the by-product. Non-discriminatory liberalization will itself promote the most efficient degree and form of integration Australia should have with its trading partners, which will differ across products, partners and regions. Discriminatory liberalization to promote pre-determined degrees and forms of integration with certain selected trading partners, based on Government’s views, will create inefficient integration from Australia’s economic perspective. Unless regional integration is

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<sup>40</sup>A renowned Australian economist said at the time that a DFAT-commissioned modelling study quantifying the economic benefits of AUSFTA “did not even pass the laugh test” (Garnaut 2004).

defined or interpreted to mean a customs union or economic union, the term has no practical meaning for setting Australian trade policy. But Australia's PTA negotiations are not predicated as such, so that talking about integration in the context of its PTAs makes little economic sense. Moreover, the term "integration" has greater policy relevance at the global rather than the regional level since efficiency, specialization and pursuing comparative advantage are global issues requiring global supply chains. Regional integration at the expense of global integration would be a poor trade-off for Australia.

There is little compelling evidence that PTAs have helped Australia integrate regionally. Indeed, by selecting certain Asian neighbors to participate in PTAs we have explicitly ranked our relationships, such that politically we may have diverted attention away from other Asian neighbors. Just as important, there is no indication from the Asian perspective that such PTAs have fostered their regional integration, including with Australia. Trade policy in Asia is currently very unbalanced, relying too much on weak and partial FTAs which will not liberalize where it matters and thus not be a driving force for regional or global integration (Bosworth and Trewin sub. 32, Attachment 2, p. 54). With few exceptions, Asian FTAs are too 'trade-light' to change existing national practice in a liberalizing or trade-facilitating direction (e.g. in respect of professions via MRAs). Clearly, they have not proved to be a force for regional integration; nevertheless, PTA proponents argue that they are stepping-stones to wider regional-integration initiatives (Sally 2010). The barriers that exist today, and the treatment of sensitive sectors, will continue to prove a stumbling block for PTAs to yield regional integration, and it is pie-in-the-sky ("psychedelic cloud-nine politics") to expect very large group cooperation to produce a strong, clean, comprehensive PTA in Asia, at least not for a long time to come. As Sally also states, it will take Herculean policy-making to account for the many differences spread across so many bilateral and plurilateral PTAs, and fold them into a sensible regional PTA. Rather the result is likely to be a very low common denominator — another trade-light PTA, adding to (not subtracting from) an expanding noodle bowl and distracting attention from further unilateral liberalization and domestic reforms ... That will probably hinder, not help, the cause of regional economic integration with the emerging hub-and-spoke pattern of dirty PTAs threatening to contribute to regional disintegration (Sally 2008 and 2010).

## **6. Advancing Services Liberalization**

Unilateral reform is the most direct means for reducing Australia's trade and investment barriers; pursuit of PTAs can create incentives to delay unilateral reforms and entail administrative and compliance costs (PC 2010). The PC recommended Australia examine further unilaterally reductions in trade and investment barriers as a priority from pursuing liberalization through PTAs, and not delay such beneficial reforms in order to retain "negotiating coin" (PC 2010). PTAs are not a substitute for properly designed strategies for economic reform. However, they are limited in the policy changes they can drive to encourage and stimulate programs to address "behind-the-border" barrier to facilitate a more open and transparent business environment (BCA 2010).

Of particular significance since PTAs are often associated with the pursuit of non-economic objectives, such as strategic alliances, these objectives can typically be addressed more effectively by other means; PTAs are generally not the ideal means for advancing non-economic

interests in their own right (PC 2010). Governments should only use PTAs for non-economic purposes if they know alternatives to be more costly, and with a clear notion of what is an unacceptable price to pay for achieving these non-economic goals.<sup>41</sup>

Because the big gains in services are from reforming non-discriminatory, anti-competitive measures affecting both domestic and foreign suppliers, services reforms are best handled domestically where the political economy considerations principally pit incumbents against new entrants, and not domestic versus foreign (Dee and Findlay 2007a and 2007b). The main risks to reform are to focus too much on national treatment, which typically happens in both regional and multilateral trade negotiations (Dee and Findlay 2007a and 2007b). The steps in sensible unilateral reform are: (i) transparency (ii) review and evaluation, and (iii) domestic reform (Dee and Findlay 2007a and 2007b).

### **6.1 The value of domestic transparency in reforming services**

Transparency is a vital first step to any trade-related reforms. Even knowing the full array of a country's trade-related barriers, including at the state or provincial level, is a major achievement, let alone analysing their effects and disentangling these from protectionism and legitimate outcomes.

Governments should be encouraged to develop institutions which highlight the economy-wide impacts of policy decisions (ANZBLE 2010). Since protectionism results from decisions taken by governments at home, for domestic reasons, any response must therefore begin at home, and bring into public view the domestic consequences of those decisions by creating domestic transparency arrangements in individual countries to provide public information about the economy-wide costs of domestic protection to counter the powerful influence protected domestic interests exercise over national trade policies. Australia is one of very few developed countries to have substantially liberalized its industry protection regime unilaterally, outside the conventional concession-swapping milieu favored by other countries (Banks 2010b). The PC has been an important part of the institutional architecture for regulatory reform in Australia and provides a model with many features that could usefully be emulated overseas (OECD 2010).<sup>42</sup> The WTO has also noted the important contribution the PC and its predecessors have made to domestic transparency and Australian trade-related reforms (WTO 2007). Developing countries would also seem to have much to gain from greater domestic transparency in trade-related policy formulation, especially linked into the institutional policy setting framework as in Australia (independently funded think-tanks with sufficient policy formulation input may also play an effective role, especially where public institutions can be starved of funds or commissioned inquiries to avoid domestic transparency of sensitive issues). Institutions and processes within government played a crucial role in the Australian reform successes, with virtually every major reform in the past Reform Era preceded by public review processes that were commissioned by but conducted at arm's length from government (Banks 2010b). Since unilateralism is fundamental to setting trade policy, including liberalizing services, improving domestic

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<sup>41</sup> On a similar point it is also worth bearing in mind that WTO-plus PTAs are not necessarily better, such as their coverage of core labor standards and overly strict IPR protection (Heydon 2010).

<sup>42</sup> While few, if any countries, have replicated the PC, New Zealand established its own Productivity Commission in early 2011.



transparency and associated institutional arrangements is essential. Without it, review and domestic trade reform is unlikely to be complete – transparency is the key.

## 7. Australia’s “Back to the Future” Trade Policy, including on Services

In response to the PC Study, the Government released through the recently appointed Minister of Trade, a new Trade Policy Statement in April 2011, urging for a return to past successful unilateral reforms and less reliance on traditional PTAs (DFAT 2011.<sup>43</sup> Significantly, the Government accepted almost all of the PC’s recommendations (Box 7 and Appendix 1).

### **Box 7: PC Study on the Impact of Bilateral and Regional Trade Agreements (BRTAs) on Trade and Investment Barriers and Australia’s Trade and Economic performance**

The Terms of Reference required the PC to:

- examine the evidence that BRTAs have contributed to reducing trade and investment barriers, and to what extent they are suited to tackling them, including in the context of the proliferation of BRTAs between other countries;
- examine the evidence that BRTAs have safeguarded against the introduction of new barriers, and the potential for trade discrimination against Australian businesses without full engagement in the evolving network of BRTAs;
- consider the role of BRTAs in lending support to the international trading system and the WTO;
- analyze the potential for BRTAs to facilitate to global economic adjustment and to promote regional integration;
- assess the impact of BRTAs on Australia’s trade and economic performance, in particular on trade flows, unilateral reform, behind-the-border barriers, investment returns and productivity growth;
- assess the scope for Australia’s BRTAs to reduce trade and investment barriers of trading partners or to promote their structural reform and productivity growth, and consider options for doing so; and
- assess if BRTAs can evolve to deliver extra benefits, including via review provisions and built-in agendas.

The Study was made within the context that while it is widely acknowledged that the benefits of trade liberalization are greatest if it is undertaken multilaterally, the Doha Round has proven elusive with many countries seeking more quickly realizable outcomes through BRTAs. Many countries have also used them to promote broader economic integration and serve foreign policy and strategic interests. BRTAs have thus emerged as part of the global policy landscape. The WTO estimates that close to 400 free trade agreements will be in force globally by 2010. Their proliferation poses many challenges for Australia and for the global trading system, including the risk of trade diversion depending on their nature. Non-parties can be disadvantaged by preferences offered under BRTAs.

The Australian Government is committed to reinforcing the primacy of the multilateral trading system and resisting any rise in global protectionist measures. Australia has pursued BRTAs intended to support the multilateral trading system while also enhancing commercial opportunities between Australian and overseas businesses along with Australia’s broader economic, foreign and security policy interests. Australia has signed a number of BRTAs and is in the process of negotiating, or considering, several others.

Against this background, the PC was requested to advise on the effectiveness of BRTAs in responding to national and global economic and trade developments, and in contributing to efforts to boost Australia’s engagement in the region and evolving regional economic architecture.

*Source:* PC (2010).

<sup>43</sup> This followed an earlier visionary address by Trade Minister Emerson to the Lowy Institute (Emerson 2010). He was Microeconomic and Trade Policy Adviser to then Prime Minister Hawke. The Government’s Statement rejected entirely the minority opinion of the external Associate Commissioner appointed for the Study, an experienced trade lawyer and former US Trade negotiator and Deputy Director of the WTO. The minority opinion disagreed with most of the PC’s recommendations, supporting analysis and findings, and was carefully considered by the PC in reaching its conclusions and recommendations (PC 2020). The minority opinion was very sympathetic to DFAT’s support of PTAs as contained in its two submissions to the Study.



Consistent with the fundamental objective of trade policy to increase national prosperity, the Statement re-set Australian trade policy based on five guiding principles, namely unilateralism; non-discrimination; separation; transparency; and the grand unifying principle of trade policy as an indivisible part of overall economic reform (Box 8). The Statement also indicated that Australia in future would no longer seek the inclusion of investor-state dispute resolution procedures in PTAs with developing countries, and that the Government would not support PTA provisions that constrained Australia's ability to regulate legitimately on social, environmental or other similar important public policy matters.

**Box 8: Principles Guiding Australia's Trade Policy**

*Unilateralism:* Pursue pro-competitive economic reform in its own right by further opening the economy to trade and investment and avoid adopting a bargaining-chip approach of refusing to liberalize unless trade partners offer similar openings as a *quid pro quo*. In PTAs, negotiations will be assessed according to national interest, excluding considerations of how Australia had to give up, or 'pay', by way of domestic economic reform. Presumably such an assessment of national interest from PTAs will be based on what actual liberalizing impact the PTA will have both in Australia and in the trading partner, and not simply on the basis of 'on paper' commitments which may result in no economic gains.

*Non-discrimination:* Will help address the proliferation of PTAs which have MFN treatment more the exception than the rule; non-discriminatory trade agreements offer better long-run returns for Australia. Future PTAs will not insist on entrenching preferential treatment, just an opportunity to compete on level terms.

*Separation:* Clearly separate trade and foreign policies, which had deliberately become entangled since the late-1990s. This would presumably mean dispensing with so-called "economic diplomacy".<sup>44</sup> Australia will consider negotiating a PTA with any country genuinely interested in reducing its trade barriers and will only sign it if it is demonstrably in Australia's national interest. It will not allow foreign policy or geo-political considerations to dictate to parties and on the content of trade deals.

*Transparency:* Rather than possibly misleading decision makers and the public by modelling hypothetical PTAs based on assumptions of full liberalization, including on services and investment, only final or actual arrangements negotiated will be modelled, and be independently peer reviewed.<sup>45</sup>

*Indivisibility of trade policy and economic reform:* Trade policy and microeconomic policy are as one; the best trade policy is domestic economic reform – a productivity-raising, competitiveness-enhancing microeconomic reform program supported by responsible fiscal policy.

Source: DFAT 2011.

While in parts the commendable Statement is unclear, and even contradictory, it sees PTAs as a continuing priority, provided they meet the WTO benchmarks or are "high quality, truly

<sup>44</sup> Separation of political from economic diplomacy has been increasingly made more difficult by having trade and foreign affairs handled by the one department (DFAT), even though with two ministers.

<sup>45</sup> However, there is some confusion between this statement in the text of the Trade Policy Statement and the Summary of the Government's Responses to the PC Recommendations included in the Statement (Appendix 2). The Summary indicates that the Government only partly agreed with the PC's recommendations on economic modelling, stating that while an assessment of the benefits of any proposed PTA should be transparent and credible, over-reliance on highly abstract quantitative analysis can be very misleading. It also rejected the PC recommendation that the Government should commission and publish an independent and transparent assessment of the final text of the agreement at the conclusion of negotiations but before an agreement is signed, stating instead, the obvious, that quantitative analysis can be highly misleading, with modelling conclusions heavily dependent on simplifying assumptions.

liberalizing trade deals that support global trade liberalisation”, which will be offered to all of its trading partners (DFAT 2011).<sup>46</sup> However, the operational meaning of this is unknown. It should imply ensuring that any future PTAs in services are genuinely liberalizing both in Australia and overseas with respect to liberalizing actual measures restricting trade in services, and that simply achieving more commitments “on paper”, especially with substantial binding overhang would fail the test. The benchmark in deciding whether a PTA is “truly liberalizing” should not be commitments in other PTAs (or the WTO), but rather whether it is liberalizing ‘on-the-ground.’ Moreover, previous trade ministers have echoed similar views, yet in reality the PTAs concluded by Australia have fallen well short of these standards. Of greater government priority than concluding new PTAs would be to ensure that current PTAs are improved to satisfy these standards.<sup>47</sup> However, this in itself is likely to threaten additional economic risks of setting domestic policies affecting services based not on sound unilateral micro-economic outcomes but rather on negotiating expediencies.

Re-focusing Australian trade policy on unilateralism will be enormously challenging as the Government steers its negotiating agenda on a middle course of championing the multilateral system while seeking to negotiate high-quality, truly liberalising sectoral, bilateral and regional trade deals that do not detract from multilateralism. Restoring Australia’s trade reform culture and integrity of the policy setting processes based on independent transparent analysis and transparency will be essential (Garnaut 2010a and Garnaut 2010b). PTAs are arguably the most non-transparent aspect of Australian trade policy. The PC plays no role in their negotiation, evaluation or assessment, and its recent study was the first requested by the Government, some 7 years after it adopted the policy of concluding PTAs. It is unbelievable that the PC was not first consulted on this policy change, the most significant departure in Australian trade policy in the past two decades. Decisions on ratification of PTAs will continue to be made in the political arena by the Joint Standing Committee on Treaties, which is only usually after the Treaty has been signed when it is too late to make changes (Mitchell and Voon 2009).<sup>48</sup>

Australian trade departments and minister, as elsewhere, are not generally major players or advocates for unilateral reforms. Instead they tend to be pre-occupied, given their mandate and responsibilities, with the external dimensions of trade policy, namely trade negotiations in Geneva and especially regional capitals, given the proliferation of PTAs, including on services. Trade departments are paradoxically often major obstacles to liberalization in many countries, especially developing countries. Thus, an essential step in promoting unilateral reforms, especially in services, is to develop a strong domestic reform base that enables trade policy to be mainstreamed into domestic economic policy, including in services. This is unlikely to happen while trade departments, inherently mercantilist by design and nature and strong supporters of

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<sup>46</sup> Since the Trade Policy Statement was released, the Government announced the launching of FTA negotiations with India in May based on achieving a high-quality, truly-liberalising trade deal that supported the multilateral trading system (Emerson 2011).

<sup>47</sup> The Australian Treasury also recently expressed policy concerns over Australia’s growing PTA proliferation, including in services. It highlighted that PTAs were not meeting Australian needs, their proliferation had not build support for multilateralism, and that they had delivered only modest preferential market access outcomes at the cost of reduced policy reform flexibility (Treasury 2010).

<sup>48</sup> In Australia the executive branch of government negotiates and enters international treaties which the legislative branch then implements by enacting the needed legislation to “transform” the treaty provisions into domestic law.

negotiated liberalization, are left to set trade policy.<sup>49</sup> Setting trade policy to reflect domestic considerations requires strong policy input from departments responsible for domestic economic policy, such as reinvigorating Treasury's resolve to champion micro-economic, including trade-related reforms and gaining strong support from top political leaders, underpinned by domestic transparency. This is despite recent assurances from DFAT and others that Australia's PTAs are among the world's most comprehensive, being at least as comprehensive as those negotiated between other industrialized countries and, on average, much more comprehensive than those negotiated between developing countries in terms of coverage of sectors, commitments and rules (Mortimer 2008). While this may be so, they have been no more successful in promoting real liberalization.<sup>50</sup>

Steering a strong unilateral reform agenda, including in services, as called for in the Trade Policy Statement will require the Government to re-focus efforts on micro-economic impediments currently undermining productivity growth. Matching the Statement's objectives with actual policy reforms will necessitate a unilateral reform agenda being developed and implemented. However, this has not emerged yet, and so it remains very unclear as to the Government's unilateral reform priorities.

## **8. Conclusions**

Australia's pre-occupation with PTAs in the past decade has come at a substantial economic cost to the economy (PC 2010). PTAs in services have disappointed in achieving both economic and non economic objectives. They have not been truly liberalizing, either in Australia or in trading partners, being concerned with negotiating commitments "on paper" rather than policy reforms "on-the-ground". Trade policy is not trade negotiations, and these do not generally set trade measures; these are generally a "side-show" to policy formulation which can easily become the "main-show", as the case in Australia. While it is commonly suggested that PTAs may provide a useful focal point for countries to strengthen institutions and adopt legal reform, international evidence of this happening is weak. Australian PTAs have certainly not led to such outcomes, either in Australia or its partners to such agreements.

On the non-economic front (e.g. strategic alliances or other foreign policy matters), such objectives can be better met outside PTAs. In services, they have not led to better regulations, regional public goods like joint institutions or better performance such as in relation to MRAs. They have been associated with de-railing Australia's highly successful unilateral approach to trade-related reforms based on sound domestic transparency and economic analysis, led by the PC (and its predecessors) and other domestic economic reform departments, especially the Treasury. The re-ascendancy of DFAT as the main setter of trade policy has seen a strong move away from unilateralism to negotiated forms of trade liberalization, especially PTAs given the

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<sup>49</sup> Negotiated liberalization, whether preferential or multilateral, is the "bread and butter" of trade officials (and ministers) and hence is likely to be their pre-occupation rather than non-negotiated (unilateral) liberalization, which may not be seen to be in their own self-interest. Also, trade departments rarely have the economic expertise required to lead a domestic agenda based on unilateral economic trade-related reform, and hence should not be expected to play a major, but rather a facilitating, role.

<sup>50</sup> However, the generally acknowledged failure of Australia's PTAs to promote genuine liberalization, especially in services, and the PC's report, along with the Government's Policy Response, clearly indicates the emptiness, and indeed irrelevance, of such claims.

almost certain failure of the Doha multilateral negotiations. It is thus vital for Australia's productivity growth, which has suffered in recent years due largely to lack of essential micro-economic, including trade-related, reforms, , especially affecting services, to get back on track and to focus renewed attention to unilateralism. This is the only effective means of especially reforming services given their complex nature of barriers to trade that are usually embedded in domestic regulation. PTAs are even less well-equipped than the WTO in reforming the service barriers that really matter to achieving improvements in national welfare, namely market access barriers that raise costs and rents, thus also distorting resource-use efficiency as well as effectively reducing productivity, rather than discriminatory national treatment measures which are mainly the concerns of trade negotiators.

Summing up, PTAs in services have to date been a major distraction from what really matters, reforming Australia's barriers to trade in services, which as for goods is the main source of economic gains to the country, as opposed to bargaining to have other trading partners open their markets. Australian PTAs (and the GATS) have achieved little in contributing to real liberalization, which is just as well since such negotiated actual outcomes would more than likely result in inefficient measures, such as discriminatory ones, or in regulations that may not be welfare-enhancing for Australia. Because of the complexity in reforming services trade barriers, it is unrealistic (and undesirable) for such policies to be set at the negotiating table.

Australia's trade policy appears set to return to unilateralism and non-discrimination as the main reform approaches, which with probably have implications for Australia's reliance on PTAs, including in services. This unfortunately involves "re-inventing the wheel" and developing again a domestic appetite for unilaterally reforming Australia's barriers to imported services, and ensuring that negotiated forms of liberalization, especially PTAs, do not divert or delay them by holding back "negotiating coin". However, uncertainty still surrounds the role to be played by PTAs in Australian trade policy. Australia will still negotiate PTAs that are "high quality, truly liberalizing" of trade, but similar past policy objectives failed to crystallize as Australian PTAs clearly failed the test. The correct interpretation of this test should be actual liberalization of measures, and not simply so-called liberalized commitments "on paper", especially if they contain substantial binding overhang.

Trade policy in Australia, is very unbalanced, relying too much on weak and partial "trade-light" PTAs which have not liberalized where it matters. Such agreements have thus not been a driving force for regional or global integration. This is despite repeated assurances by trade officials and others with vested interests in saying so that Australia's PTAs are of world-best standard and among the most comprehensive. A return to a focus on unilateral liberalization, hopefully supported by a more active multilateral system, is required to advance trade in services liberalization and reforms. PTAs should be recognized for what they are – failures to achieve genuine liberalization and a distraction for policy makers and governments from what really counts. PTAs are not an end in themselves, nor a means to what the real end should be in all countries, namely promoting unilateral trade-related reforms as part of transparent and evidence-based micro-economic or structural policies. Based on sound economic reasoning and the Australian experience, PTAs cannot genuinely liberalize services trade. They generate outcomes that reflect mainly negotiating expediencies rather than what would be sound economic reform e.g. enhanced discrimination or non-transparent changes that may not correctly reflect the

national economic interest. At a time when Australian PTA activity is at its highest, Australia's unilateral commitment is at its lowest. Unilateralism is always likely to be undermined as long as PTAs "rule the policy roost", which is also likely to contribute to ensuring a doomed Doha outcome that is beyond rescue.

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## Appendix 1: Government's Responses to PC Report Affecting Services

Recommendation	Government response
<p><b>Recommendation 1:</b> Should only pursue bilateral and regional trade agreements (BRTAs) where they are likely to:</p> <ul style="list-style-type: none"> <li>• afford significant net economic benefits; and</li> <li>• be more cost-effective than other options for reducing trade and investment barriers, including alternative forms of bilateral and regional action.</li> </ul>	<p>Agreed – consistent with the approach articulated in the Statement.</p>
<p><b>Recommendation 2:</b> Should ensure that any BRTAs negotiated:</p> <ul style="list-style-type: none"> <li>• as far as practicable, avoids discriminatory terms and conditions in favour of arrangements based on non-discriminatory (most-favored-nation) provisions;</li> <li>• does not preclude or prejudice similar arrangements with other trading partners; and</li> <li>• does not establish treaty obligations that could inhibit or delay unilateral, plurilateral or multilateral reform.</li> </ul>	<p>Agreed - consistent with the approach articulated in the Statement.</p>
<p><b>Recommendation 3:</b> Should not include matters in BRTAs that would serve to increase barriers to trade, raise costs or affect established social policies without a comprehensive review of the implications and available options for change.</p>	<p>Agreed - consistent with approach articulated in the Statement.</p>
<p><b>Recommendation 4:</b> Should improve the scrutiny of the potential impacts of prospective trade agreements, and opportunities to reduce barriers to trade and investment more generally.</p> <p>a) Should prepare a trade policy strategy which identifies impediments to trade and investment and available opportunities for liberalization, and includes a priority list of trading partners. This trade policy strategy should be reviewed by Cabinet on an annual basis, and be prepared before the pursuit of any further BRTAs. A public version of the Cabinet determined strategy should be released.</p> <p>b) Before entering negotiations with any particular prospective partner, it should undertake a transparent analysis of the potential impacts of the options for advancing trade policy objectives with the partner. All quantitative analysis and modelling should be overseen by an independent body.</p> <p>c) It should commission and publish an independent and transparent assessment of the final text of the agreement, at the conclusion of negotiations, but before an agreement is signed.</p>	<p>Agreed in part.</p> <p>Recommendation 4(a): agreed.</p> <p>Recommendation 4(b): agreed in part – an assessment of the benefits of a proposed free trade agreement should be transparent and credible. However, over-reliance on highly abstract quantitative analysis can be very misleading.</p> <p>Rec 4(c): not agreed. Quantitative analysis can be highly misleading, with conclusions heavily dependent on simplifying assumptions used in modelling. Agreements will be presented for consideration by the Joint Standing Committee on Treaties before ratification.</p>
<p><b>Recommendation 5:</b> If it is deemed that capacity building should be part of a trade agreement development process, the Australian Government should fund and deliver capacity building programs in a manner that minimises potential (or perceived) conflicts of interest. Any such programs should not impose an obligation to negotiate a trade agreement.</p>	<p>Agreed.</p>
<p><b>Recommendation 6:</b> To enhance transparency and public accountability and enable</p>	<p>Agreed.</p>

<p>better decision making regarding the negotiation of trade agreements, the DFAT should publish estimates of the expenditure incurred in negotiating bilateral and regional trade agreements and multilateral trade agreements. These should include estimates for the costs of negotiating recent agreements.</p>	
<p><b>Recommendation 7:</b> Should examine the potential to further reduce existing Australian barriers to trade and investment through unilateral action as a priority over pursuing liberalization in the context of bilateral and regional trade agreements. The Government should not delay beneficial domestic trade liberalization and reform in order to retain 'negotiating coin'.</p>	<p>Agreed - consistent with the approach articulated in the Statement.</p>
<p><b>Recommendation 8:</b> Should support worthwhile efforts to achieve multilateral liberalization. If meaningful progress within the WTO proves elusive, the Government should weigh up with like-minded countries the feasibility of appropriate broadly based agreements to advance reform.</p>	<p>Agreed - consistent with the approach articulated in the Statement.</p>
<p><b>Recommendation 9:</b> Should lend support to initiatives directed at the establishment of domestic institutions in key trading countries to provide transparent information and advice on the community-wide impacts of trade, investment and associated policies.</p>	<p>Agreed – consistent with the approach articulated in the Statement.</p>

*Source:* DFAT 2011.