2

Overview and analysis

Trade agreements

2.1 The General Agreement on Tariffs and Trade (GATT) was developed and implemented to aid economic recovery after the Second World War. The objective was to break down trade barriers and liberalise world trade. GATT was formed in 1947 and came into effect on 1 January 1948, establishing a set of rules and principles for participating countries to follow. However, the accompanying proposed institutional arrangements for the establishment of an International Trading Organisation (ITO) did not eventuate. GATT remained a negotiating forum for tariff reductions and dispute resolution.

2.2 GATT transitioned to the World Trade Organisation (WTO) in 1995 after members adopted the Marrakesh Declaration in April 1994.[1] GATT had provided a multilateral trading agreement for merchandise trade. Under the WTO the General Agreement on Trade in Services (GATS) and the Trade Related Aspects of Intellectual Property Rights (TRIPS) extended the multilateral trading agreements to services and intellectual property rights respectively.[2]

2.3 As negotiations on the WTO multilateral trade agreements slowed during the 1990s, bilateral, plurilateral and regional trade agreements increased.[3] These agreements are often referred to as 'free trade agreements' but are

1 World Trade Organization (WTO), 'Marrakesh Declaration of 15 April 1994', http://www.wto.org/english/docs_e/legal_e/marrakesh_decl_e.htm, accessed 24 July 2014.

2 For more detail on the history of GATT and the WTO see: http://www.wto.org/index.htm.

3 As at June 2014 the WTO had been notified of 585 regional trade agreements. WTO, 'Regional trade agreements', http://www.wto.org/english/tratop_e/region_e/region_e.htm, accessed 25 July 2014.

more correctly termed 'preferential trade agreements'. Such agreements are signed between two or more countries providing them with favourable market access conditions by reducing tariff and non-tariff barriers.

2.4 As at July 2014, Australia has seven free trade agreements in place, eight under negotiation and two signed but not yet in force.[4]

Benefits of free trade agreements

2.5 Advocates for free trade agreements (FTAs) suggest that FTAs have provided a way forward since the WTO process stalled during the 1990s, encouraging trade liberalisation, opening up market access and strengthening bilateral relationships. The WTO gives conditional support for free trade agreements, allowing for them under GATT's Article 24, providing they meet WTO rules. The WTO indicates that such agreements can go beyond what may be available in a multilateral agreement at a given time.[5] It is often quicker and easier to achieve an outcome for an FTA where negotiations are taking place between a limited number of parties.[6]

2.6 As well as tariff reduction or elimination, free trade agreements often cover a range of non-tariff barriers and increasingly cover such matters as investment protection, intellectual property rights, trade facilitation, government procurement, and labour and environment standards. Many of these impediments to free trade are 'not within the scope in the WTO setting' and FTAs open up an avenue to pursue such matters.[7] The outcome in these non-tariff areas frequently lays the foundation for rules and issues that are subsequently incorporated into multilateral agreements.[8]

4 Department of Foreign Affairs and Trade (DFAT), 'Australia's Free Trade Agreements', <http://www.dfat.gov.au/fta/>, accessed 25 July 2014.

5 World Trade Organization, 'Understanding the WTO', p. 64, <http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf>, accessed 25 August 2014.

6 The Australian APEC Study Centre, Monash University, *An Australian–USA Free Trade Agreement: Issues and Implications*, Department of Foreign Affairs, August 2001, p. 19, <http://www.dfat.gov.au/publications/aus_us_fta_mon/aus_us_fta_mon.pdf>, accessed 25 August 2014.

7 Productivity Commission, *Bilateral and Regional Trade Agreements*, November 2010, p. xxi.

8 World Trade Organization, 'Understanding the WTO' p. 64, <http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf>, accessed 25 August 2014.

Criticism of free trade agreements

2.7 The contribution of free trade agreements to world trade liberalisation and economic growth has been questioned. The WTO cautions that, although such agreements can complement the multilateral trading system, there are a number of concerns:

- net economic impact will depend on the architecture of the individual agreement and its internal parameters;
- they are discriminatory and advantage the signatory countries;
- distortions in resource allocation, and trade and investment diversion may minimise benefits; and
- the proliferation of agreements and consequent overlapping trade rules can hamper trade by imposing extra costs on potential participants.[9]

2.8 The Productivity Commission found that commercial benefits for Australian businesses from BRTAs were limited as the agreements did not address the non-tariff barriers that prevented market access.[10]

2.9 The Productivity Commission called for a more realistic, transparent process, including a post-negotiation analysis to identify possible adverse impacts.[11]

Korea-Australia Free Trade Agreement

2.10 The following summary of the *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea* (KAFTA) and its claimed benefits is taken from the National Interest Analysis (NIA) and the Regulation Impact Statement (RIS).

Background

2.11 Over the past decade, Republic of Korea's (ROK) economic importance to Australia has expanded significantly. Korea is now Australia's third-largest export market, fourth-largest trading partner, and a growing investment partner. It is Australia's fifth-largest market for agricultural exports, Australia's largest export market for raw sugar (estimated at $461 million in 2012–13); third-largest for beef ($703 million in 2012–13); and an important market for wheat, malt and malting barley, dairy products,

9 WTO, 'Regional Trade Agreements: Scope of RTAs', http://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm, accessed 25 July 2014.

10 Productivity Commission, *Bilateral and Regional Trade Agreements*, p. xxiv.

11 Productivity Commission, *Bilateral and Regional Trade Agreements*, p. xxxiii.

animal fodder, wine, seafood and horticulture. Korea is also an important export market for Australian ores and concentrates, crude petroleum, coal, inorganic chemical elements, pharmaceuticals and automotive parts. In services, Korea is Australia's ninth largest export market, accounting for 3.2 per cent of Australia's total service exports.[12]

2.12 Currently Australia faces various tariff and non-tariff barriers and restrictions in Korea. Korea's average tariff on imports is 16.8 per cent, with an average tariff on agricultural goods of 53.6 per cent, with tariff peaks of over 500 per cent. (See Table 2 in the RIS for a summary of selected tariff restrictions faced by Australian exporters).[13]

2.13 According to the RIS, Australian exporters to Korea are coming under increasing competitive pressure which threatens Australia's existing market share as competitor countries enter bilateral and regional Free Trade Agreements (FTAs) with Korea. The European Union (EU) (through the Korea-European Union Free Trade Agreement, or KOREU), the United States (US) (through the Korea-United States Free Trade Agreement, or KORUS), Association of South-East Asian Nations (ASEAN) countries and Chile, key competitors of Australia in agriculture and services, already enjoy preferential access through their FTAs with Korea. Canada and New Zealand, also key competitors with Australia, are close to concluding their own FTAs with Korea.[14]

2.14 The RIS suggests that Australia will be at a tariff disadvantage as Korea's FTA partners receive either immediate tariff elimination or phased reductions over several years for key products.[15] Compounding the issue for Australian exporters is the danger that the tariff gap between Australia and its competitors will remain at current levels or increase allowing Korea's FTA partners to gain further advantage in the long term.[16]

2.15 The RIS concludes that Australian exports to Korea can be expected to decline as they lose competitiveness. Independent modelling by the Centre for International Economics (CIE) predicts that in the absence of a bilateral FTA with Korea, Australia's total exports to this important market would decline by 5 per cent by 2030. The RIS indicates that Australian agriculture exporters would be most disadvantaged as Korean imports of Australian agricultural goods would decline by 29 per cent.

12 Regulation Impact Statement, Korea-Australia Free Trade Agreement, 4 February 2013 (hereafter referred to as 'RIS'), para 3.

13 RIS, para 4.

14 RIS, para 5.

15 RIS, para 6.

16 Mr Malcolm John Foster, Chairman, KAFTA Beef Industry Taskforce, *Committee Hansard*, Sydney, 29 July 2014, p. 17.

Mining and manufacturing exports would also decline, by 1 and 7 per cent respectively.[17]

2.16 On the other hand, the RIS states that modelling predicts that implementing a bilateral FTA with Korea could result in exports to Korea being 25 per cent higher than they otherwise would have been by 2030. Agriculture exports could be 73 per cent higher, mining exports could be 17 per cent higher and manufacturing exports could be 53 per cent higher. The RIS therefore concludes that entering into an FTA with Korea could not only avert the threat faced by erosion of Australia's competitiveness in the market but could also create new and further opportunities for Australian exporters in Korea.[18]

2.17 The NIA argues that the Agreement could deliver market gains and deeper cuts to tariffs more rapidly than current multilateral and plurilateral initiatives underway such as the WTO Doha Round, the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership Agreement (TPP) (which currently does not include Korea).[19]

Overview and national interest summary

2.18 The RIS maintains that the Agreement will deliver significant market access improvement and significant tariff liberalisation for Australia's merchandise exports to Korea through the elimination of tariffs on a wide range of Australian goods exports, including beef, wheat, sugar, dairy, wine, horticulture and seafood. Further the Agreement could create new market openings in key areas of commercial interest to Australian services providers, including legal, accounting, financial, education and other professional services.[20]

2.19 The NIA also asserts that KAFTA protects Australia's competitive position in the Korean market, where major competitors such as the US, EU, Chile and ASEAN countries are already receiving preferential access through their respective free trade agreements. The same could apply to New Zealand and Canada, both of whom are close to concluding FTA negotiations with Korea.[21]

17 RIS, para 7.

18 RIS, para 8.

19 National Interest Analysis [2014] ATNIA 8 with attachments *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea, done at Seoul, 8 April 2014,* [2014] ATNIF 4 (hereafter referred to as 'NIA'), para 5.

20 NIA, para 3.

21 NIA, para 4.

Reasons for Australia to take the proposed treaty action

2.20 A comprehensive free trade agreement with Korea is expected to further strengthen the broader bilateral relationship between Australia and Korea by supporting an already significant, complementary and growing economic relationship. Australia and Korean two-way goods and services trade reached $30.5 billion in 2012–13. Total Australian investment in Korea in 2012 was valued at $10.4 billion, while Korean investment in Australia was valued at $12 billion.[22]

2.21 The NIA claims that the Agreement will benefit Australian exporters, importers and consumers by opening markets and freeing trade and investment between Australia and Korea. With one in five Australian jobs linked to trade, KAFTA could provide an important boost to the Australian economy.[23]

2.22 The NIA suggests that the Agreement may create immediate market access opportunities for many sectors of the Australian economy. Korea's tariffs will be set at zero on 84 per cent of its imports (by value) from Australia immediately on entry into force with most other tariffs phased out quickly. After 10 years, a zero tariff would apply to 95.7 per cent of imports from Australia (by value) and on full implementation of KAFTA, 99.8 per cent of Australia's current goods trade would enter Korea duty free.[24]

2.23 The summary below sets out the key outcomes. Further details can be found in Attachment IV to the Agreement, Table 1 and 2 of the RIS and in the DFAT Fact Sheets.

Agriculture

2.24 Currently Australian exporters face high barriers with Korea imposing an average tariff of 53.6 per cent on agricultural imports and prohibitive tariffs on some products of up to 550 per cent. Under the Agreement, Korea has agreed to eliminate:

- beef tariffs over 15 years;
- tariffs immediately for raw sugar, wheat, wine and some horticulture; and
- most dairy tariffs over 3-20 years with immediate duty-free increased quotas for cheese, butter and infant formula.[25]

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22 RIS, para 95.
23 NIA, para 6.
24 NIA, para 7.
25 For further details see the RIS, paragraphs 31–43.

2.25 One hundred and seventy-one sensitive products accounting for 0.2 per cent of Australian exports to Korea receive no tariff concessions under the Agreement. The excluded products include: rice, milk powder, honey, abalone, ginger, apples, pears and walnuts. [26]

Energy, minerals and manufacturing

2.26 Energy and minerals products accounted for approximately 80 per cent of the value of Australia's merchandise exports to Korea in 2012–13. While many Australian mineral and energy exports to Korea enter duty free, it applies tariffs of up to 8 per cent on a range of priority resources products, and tariffs of up to 13 per cent on manufactured products. On entry into force of the Agreement, 88 per cent of Australia's manufactures, resources and energy exports will enter Korea duty free, with all remaining tariffs eliminated within 10 years.[27]

Services

2.27 The Agreement is expected to provide new market openings for Australian service suppliers in education, telecommunications, financial, accounting, taxation and legal services. These services currently face a range of restrictions including with respect to commercial presence, cross-border supply and licensing requirements. Under the Agreement, Korea will permit new Australian access in these sectors, providing outcomes equivalent to those in its free trade agreements with the US and the EU.[28]

Investment

2.28 The NIA states that the Agreement provides improved access and protection for Australian investors and investments in Korea as well as for Korean investors in Australia. Korea has agreed to further open several sectors to Australian investment, including the telecommunications sector and legal, accounting and taxation services, through the progressive reduction of market access barriers.[29] The monetary threshold at which investments from Korea in non-sensitive sectors are considered by the Foreign Investment Review Board (FIRB) will rise from $248 million to $1 078 million, consistent with the threshold provided to the US and New Zealand.[30] The Australian Government has reserved policy space to

26 RIS, para 22.

27 NIA, para 7. For further details see the RIS, paragraphs 44–45. For further details on the effect on manufacturing see the RIS, paragraphs 48–51.

28 NIA, para 7. For further details see the RIS, paragraphs 56–66.

29 NIA, para 7. For further details see the RIS, paragraphs 67–70.

30 RIS, para 72.

introduce its policy on screening proposals for foreign investment in agricultural land at $15 million and in agribusinesses at $53 million.[31]

2.29 The Agreement includes an investor-state dispute settlement mechanism with appropriate protections in areas such as public welfare, health, culture, environment and foreign investment screening.[32]

Other

2.30 The Agreement also includes commitments on:

- intellectual property: KAFTA will ensure that Australian innovators and Australian creative industries receive high levels of protection in Korea broadly equivalent to protections provided in Australia;[33]
- government procurement: for Australia, this will provide, subject to agreed exceptions, national treatment for Australian goods, services and suppliers in the Korean market for government procurements above agreed value thresholds;[34] and
- electronic commerce: KAFTA contains provisions that safeguard electronic commerce, prevent the imposition of customs duties on electronic transmissions and maintain best practice regulation in this field.[35]

Obligations

2.31 KAFTA consists of 23 chapters, with associated annexes and schedules, and four side letters. A detailed chapter-by-chapter summary of key obligations is provided at Attachment III (KAFTA: An Introduction to the Text of the Agreement).

2.32 Upon entry into force, or over time, each Party will eliminate specified tariffs on imports of goods from the other Party **(Chapter 2)** that meet the agreed rules of origin[36] criteria **(Chapter 3)**. The Parties schedules of tariff commitments are set out at **Annex 2-A**. Tariff rate quotas[37] (TRQs) for certain Australian agricultural exports to Korea are set out at **Appendix 2-**

31 RIS, para 73.

32 NIA, para 7. For further details see the RIS, paragraphs 67–73.

33 For further details see the RIS, paragraphs 80–82.

34 For further details see the RIS, paragraphs 78–79.

35 NIA, para 7. For further details see the RIS, para 85.

36 ‘Rules of origin’ (ROO) establish the criteria for determining whether goods will qualify for preferential tariff treatment under KAFTA (that is, whether a good ‘originates’ in Australia or Korea). (For further detail on the ROO requirements see the RIS paragraphs 52–54).

37 Under KAFTA, a ‘tariff rate quota’ (TRQ) represents the maximum quantity of a product permitted to enter duty-free in a particular year.

A-1. Most TRQs will be progressively phased out over 10–20 years, depending on the product.[38]

2.33 Each Party will grant market access and non-discriminatory treatment (known as national treatment[39] and most-favoured-nation treatment[40]) to services and investments from the other Party under the Cross-Border Trade in Services, Financial Services and Investment chapters (**Chapters 7, 8** and **11** respectively), except where specific measures or individual sectors are specifically reserved in the non-conforming measures annexures to KAFTA (**Annexes I-III**).[41]

2.34 KAFTA also contains commitments and disciplines on:

- customs procedures (**Chapter 4**);
- sanitary and phytosanitary (SPS) measures (**Chapter 5**); [42]
- telecommunications (**Chapter 9**);
- the temporary entry of skilled persons (**Chapter 10**);
- government procurement (**Chapter 12**);
- intellectual property rights (**Chapter 13**);
- competition policy (**Chapter 14**);
- electronic commerce (**Chapter 15**);
- labour (**Chapter 17**); and
- the environment (**Chapter 18**).[43]

2.35 There is a binding State-to-State dispute settlement mechanism modelled on previous free trade agreements and the WTO system (**Chapter 20**). Most substantive obligations in the Agreement will be subject to this mechanism, except those found in the Technical Barriers to Trade, SPS Measures, Competition Policy, Labour, Environment and some aspects of the Movement of Natural Persons chapters.[44]

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38 NIA, para 11.

39 'National treatment' means Australia must treat Korean investors and service providers no less favourably than it treats Australian investors and service providers of third countries in like circumstances, and vice versa.

40 'Most-favoured-nation' (MFN) treatment means Australia must treat Korean investors and service providers no less favourably than it treats investors and service providers of third countries in like circumstances, and vice versa.

41 NIA, para 12.

42 'Sanitary and phytosanitary' (SPS) are measures, such as quarantine, to protect human, animal or plant life or health from pests and diseases.

43 NIA, para 13.

44 NIA, para 13.

2.36 An Investor-State Dispute Settlement (ISDS) mechanism is included in the Investment Chapter (**Chapter 11**).[45] The RIS states that the ISDS provisions do not constrain the Government's ability to regulate or implement policy.[46]

2.37 **Chapter 22** sets out exceptions which apply to a number of chapters of the Agreement. Such exceptions ensure FTA obligations do not unreasonably restrict government action in key policy areas, including action to protect essential security interests, the environment and health. **Chapter 22** also carves out application of the Agreement to a Party's taxation measures except in certain circumstances, and provides for the protection of confidential information.[47] Procedural safeguards to deter frivolous claims and contain costs are also included.[48]

2.38 Four legally binding 'side letters' set out the Parties' agreed interpretation of particular KAFTA provisions in relation to services and investment, telecommunications, gambling and betting services and transparency in investor-state arbitration proceedings. The side letters form an integral part of the Agreement.[49]

Implementation

2.39 To implement the Agreement, amendments need to be made to the *Customs Act 1901*, the *Customs Tariff Act 1995* and relevant customs regulations such as the *Customs Regulations 1926*. New customs regulations need to be enacted for the product specific rules of origin set out in **Annex 3-A** of the Agreement. *The Foreign Acquisition and Takeovers Regulations 1989* will also require amendment to incorporate the new threshold for screening investment proposals by Korean investors at $1 078 million (subject to lower thresholds for sensitive sectors). *The Life Insurance Regulations 1995* will require amendment in order to implement the agreement reached in respect of life insurance, whereby Korean life insurers will be able to operate in Australia through branches rather than subsidiaries. Consistent with Australia's existing obligations in the Australia-US and Australia-Singapore FTAs, and to fully implement its obligations under KAFTA, the *Copyright Act 1968* will require amendment in due course to provide a legal incentive for online service providers to cooperate with copyright owners in preventing infringement due to the

45 NIA, para 13.
46 RIS, para 74.
47 NIA, para 14.
48 RIS, para 76.
49 NIA, para 15.

High Court's decision in *Roadshow Films Pty Ltd v iiNet Ltd* [50], which found that ISPs are not liable for authorising the infringements of subscribers.[51]

2.40 The remainder of Australia's obligations under the Agreement do not require any legislative or regulatory amendments. The impact of KAFTA on States and Territories is outlined at Attachment I (*Consultation*) to the NIA.[52]

Costs

2.41 Treasury modelling has estimated that the loss of tariff revenue to the Australian Government resulting from the Agreement, based on current levels of trade, will be approximately $100 million in 2014–15 and $635.9 million over the forward estimates period. This estimate assumes that the Agreement will enter into force in the second half of 2014. The costing does not include any second-round impacts arising from increased bilateral trade. Accordingly, the estimates do not take into account additional lost tariff revenue if imports from Korea displace imports from other countries. On the other hand, the estimates do not take into account the potential domestic economic growth that the Agreement could generate and any additional taxation revenue resulting from this growth. Overall, noting the economic modelling, the NIA concludes that the Agreement represents a net gain to the Australian economy.[53]

50 [2012] HCA 16 (20 April 2012).

51 NIA, para 17.

52 NIA, para 18.

53 NIA, para 19.