

Chapter 10

Bilateral or multilateral agreements?

10.1 This chapter is a prelude to the discussion in Chapter 11 on the modelling and merit of a free trade agreement (FTA) between Australia and China. It looks at the economic and political arguments for and against signing an FTA, as opposed to negotiating an agreement within the World Trade Organization's (WTO) multilateral framework.

What is a free trade agreement?

10.2 An FTA is generally an agreement between two countries designed to eliminate all restrictions on bilateral trade in goods and services. It commits both governments to policies of non-intervention in trade between the two nations.

10.3 FTAs were originally allowed under the 1947 General Agreement on Tariffs and Trade (GATT) as a mechanism to facilitate greater economic cooperation between the recovering Western European economies. They have been an increasingly popular form of economic and diplomatic engagement. Since the WTO was established in 1995, there have been roughly 300 FTAs proposed. The Australian government has been an enthusiastic advocate of FTAs, recently establishing a website to 'help Australian businesses understand and take advantage of our FTAs'.¹

10.4 By their nature, FTAs are preferential in that they exclude all nations bar the signatories. They conflict with the WTO's 'Most Favoured Nation' (MFN) principle. The MFN principle means that every time a country lowers a trade barrier, it must do so for all its trading partners. In other words, each WTO member treats all the other members equally as 'most-favoured' trading partners.²

10.5 However, while FTAs are inconsistent with the MFN principle and are negotiated outside the multilateral framework, they are allowed under Article XXIV of the 1947 Agreement.³ This article states that the purpose of an agreement such as an FTA 'should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories'.⁴

1 Commonwealth of Australia, *Free Trade Agreements*, <http://www.fta.gov.au> (accessed 1 October 2005).

2 World Trade Organization, 'Understanding the WTO', September 2003, p. 11.

3 Since 1948, the General Agreement on Tariffs and Trade has provided the rules for the international trading system. The Agreement led to an unofficial organisation known as the GATT. It was renamed the WTO in 1995.

4 Article XXIV, General Agreement on Tariffs and Trade, 1947, http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf (accessed 6 September 2005).

10.6 This means that the WTO accepts the creation of a free-trade area (such as an FTA) provided it is not more restrictive on the signatories than under previous arrangements. In addition, a free-trade area must not lead to higher restrictions on trade with third parties.⁵

10.7 FTAs are generally consistent with the WTO's 'national treatment' principle. This principle states that all foreign goods must be treated equally once they have entered the domestic market.⁶ The same applies to foreign services and foreign trademarks, copyrights and patents. As discussed below, a significant example of this principle is the enforcement of intellectual property rights.

The benefits of FTAs

10.8 FTAs provide direct economic benefits for signatory nations. Particularly for small, developed nations like Australia, FTAs offer potentially unlimited access to major world markets and cheaper imports for domestic consumers and producers. They are recognised as an increasingly important part of bilateral relations, not only in terms of mutual economic benefit, but also by providing a long-term basis for peaceful diplomatic relations.

10.9 FTAs continue with the process of trade liberalisation in the absence of multilateral agreements. They have become the preferred means for liberalising trade in the fast-growing services sectors, given that WTO negotiations on services can only proceed at the speed of the slowest participant.⁷ The Australian Minister for Trade, the Hon. Mark Vaile, has argued that Australia is 'not prepared to move at the pace of the slowest common denominator. We can't afford to...and there are many other countries that take a similar attitude'.⁸ The WTO itself has acknowledged that without the constraint of the MFN principle, some regional free trade arrangements have paved the way for subsequent multilateral agreements.⁹

10.10 Dr Ashton Calvert, the then Secretary of the Department of Foreign Affairs and Trade, told an audience in August 2004 that Australia continues to push for an outcome in the WTO to address core problems relating to agricultural subsidies and market access.

But we also know that in its current state the multilateral system is not able to satisfy—within a reasonable time-frame—all our ambitions or needs as a liberal and efficient trading nation.

5 World Trade Organization, 'Understanding the WTO', September 2003, p. 11.

6 World Trade Organization, 'Understanding the WTO', September 2003, p. 11.

7 D. Robertson, 'Another Global Trade Crisis', *Policy*, Vol. 20, No. 1, 2004, p. 14.

8 C. Wallace, 'Global pacts preferred in bigger picture, Vaile insists', the *Australian*, 23 October 2003, p. 4.

9 World Trade Organization, 'Understanding the WTO', September 2003, p. 64.

Throughout the Asia–Pacific and beyond, countries, such as Australia—with a forward-looking agenda and who want to push ahead in building deeper economic and commercial relationships and mature policy linkages—are pursuing FTAs.¹⁰

10.11 Dr Calvert explained that Australia was seeking to maximise gains to the country by pursuing 'complementary opportunities at all levels—multilaterally through the WTO, bilaterally through free trade agreements, and at the regional level in APEC'.¹¹ In his view, Australia does not choose free trade agreements with an economic partner or a region at the expense of the multilateral trading system. He insisted that 'FTAs serve as a complementary vehicle for pursuing trade liberalisation within the WTO's global trade rules'.¹²

10.12 Furthermore, he noted that numerous countries were keen to have a free trade agreement with China and that, to make competitive gains, Australia needed to be aware of what these countries were doing in the Chinese market. He stated:

Australia competes directly with some of the countries involved in FTA discussions with China in areas such as dairy, forestry, citrus, table grapes, wine, copper, coal, gold and motor vehicles and parts.¹³

10.13 Dr Calvert surmised that an FTA with China would improve Australia's standing as 'a serious player in the international trade arena' and would place Australia in a favourable position for its economic future:

There is no question that concluding a high-quality FTA between Australia and China would be an important part of Australia's international trade profile.¹⁴

10.14 In addition to the impetus they can provide for trade liberalisation, FTAs also tend to be more ambitious than the WTO's multilateral agreements. They frequently cover issues of investment protection, government procurement and competition policy. The recent Australia–United States FTA was negotiated on the understanding that no major sector should be excluded from tariff elimination.¹⁵ Similarly, it was

10 A. Calvert, Secretary, Department of Foreign Affairs and Trade, Opening Speech, 'Strategic setting: Common future', Australia–China FTA Conference, Sydney, 12–13 August 2004, p. 4.

11 A. Calvert, Secretary, Department of Foreign Affairs and Trade, Opening Speech, 'Strategic setting: Common future', Australia–China FTA Conference, Sydney, 12–13 August 2004, p. 4.

12 A. Calvert, Secretary, Department of Foreign Affairs and Trade, Opening Speech, 'Strategic setting: Common future', Australia–China FTA Conference, Sydney, 12–13 August 2004, p. 4.

13 A. Calvert, Secretary, Department of Foreign Affairs and Trade, Opening Speech, 'Strategic setting: Common future', Australia–China FTA Conference, Sydney, 12–13 August 2004, p. 5.

14 A. Calvert, Secretary, Department of Foreign Affairs and Trade, Opening Speech, 'Strategic setting: Common future', Australia–China FTA Conference, Sydney, 12–13 August 2004, p. 5.

15 Senate Select Committee on the Free Trade Agreement between Australia and the United States of America, *Final Report*, p. 2, http://www.aph.gov.au/Senate/committee/freetrade_ctte/report/final/ch01.pdf

agreed that the negotiations on the Australia–China FTA will cover all sectors and will address the issue of investment flows.¹⁶ Multilateral negotiations, on the other hand, are often restricted to a particular produce or sector. Even regional trade agreements tend to have significant exemptions. For example, China's negotiations with the Association of South East Asian Nations (ASEAN) exempted 480 goods.¹⁷

10.15 Mr Andrew Stoler, the Executive Director of the Institute for International Business, Economics and Law at the University of Adelaide, has argued that trade in services is one area where the WTO negotiations have faltered. He stated:

Notwithstanding the fact that the services negotiations started at the beginning of 2000—nearly two years before the Doha Declaration was agreed—there are still only 48 initial offers on the table and their quality is poor. Some have even said that the average level of commitment reflected in the Doha offers implies a regression from the current level of commitments. As services are now by far the most significant part of the modern global economy, a lack of progress in the GATS negotiations not only bodes ill for the overall WTO negotiations but it also casts a shadow on the prospect that services liberalisation can make a significant contribution to global economic development in the years to come.¹⁸

10.16 In accepting the WTO system's limited scope and glacial pace, among other complications, Mr Stoler concluded:

In the meantime, the system itself will be responsible for dynamics that make the negotiation of additional Free Trade Agreements attractive complements to the WTO and we shouldn't worry about that.¹⁹

The pitfalls of FTAs

10.17 These arguments, and the growing use of the provisions in Article XXIV of the GATT, have been criticised on both economic and strategic grounds. Most obviously, the lesser volume of trade in a bilateral agreement than in a multilateral agreement makes the economic gains from FTAs commensurately smaller. Trade Minister Vaile has recognised that FTAs are a second-best option: 'There is no

16 C. Ryan and T. Sutherland, 'China backs 'no limits' trade deal', *Australian Financial Review*, 11 March 2005, p. 1.

17 C. Ryan and T. Sutherland, 'China backs 'no limits' trade deal', *Australian Financial Review*, 11 March 2005, p. 1. ASEAN has ten members: Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Burma, Cambodia, Laos and Vietnam.

18 A. Stoler, 'WTO Negotiations under the Doha Development Agenda and Perspectives on Current WTO Developments', Shanghai, December 2004, p. 3.

19 A. Stoler, 'WTO Negotiations under the Doha Development Agenda and Perspectives on Current WTO Developments', Shanghai, December 2004, p. 4.

question...that if we could tomorrow get a much better result out of the multilateral system, it would certainly be the best outcome'.²⁰

10.18 The more pointed argument against FTAs is their discriminatory impact. Many economists emphasise that while FTAs may increase market access for signatories, they limit the access of third parties. A 2003 Productivity Commission study found that 12 of 18 FTAs surveyed 'diverted more trade from non-members than they have created among members'.²¹

10.19 There is also an 'internal' discriminatory aspect to FTAs. The agreements are often negotiated and structured through the influence of powerful vested interests, which may lead to resentment among industries with less political clout.

10.20 Another common criticism of FTAs is their complexity. A particular difficulty has been negotiating the 'rules of origin'. These rules ensure that only the products made and value-added in the signatory nations are accorded preferential treatment. The WTO makes these rules a responsibility of the individual member nation. This means there is enormous variation among FTAs in the pattern of these rules, which often makes the negotiation process particularly difficult.²² Australia is currently renegotiating the rules of origin under the Closer Economic Relations (CER) agreement with New Zealand to conform to the rules of origin established under the US FTA.²³

10.21 FTAs also complicate the broader international trading environment. Dr David Robertson, a former Commissioner of the Australian Productivity Commission, refers to the 'hubs' and 'spokes' of current trading arrangements. The 'hubs' are the powerful trading nations, such as the United States and Japan, which negotiate FTAs with small and medium sized countries (the 'spokes'). The powerful trading nations have the negotiating power to set the scope, rules and tariff reduction schedules of the agreement. Less powerful nations are left to accept the terms. Moreover, the powerful few are in the position to negotiate a more favourable FTA with another 'spoke'.²⁴

10.22 This imbalance was apparent in the negotiation of the recent Australia–US FTA (AUSFTA). The Americans modelled the AUSFTA on the less liberalising North American Free Trade Agreement, signed in 1993. Key Australian exports, such as sugar, failed to gain unlimited access to the American market. The US was also

20 C. Wallace, 'Mandarins still segregated over bi versus multilateral deals', the *Australian*, 6 November 2003.

21 C. Wallace, 'Mandarins still segregated over bi versus multilateral deals', the *Australian*, 6 November 2003.

22 P. Lloyd and D. MacLaren, 'Gains and Losses from Regional Trading Agreements: A Survey', *The Economic Record*, vol. 80, no. 251, December 2004, p. 464.

23 'FTAs should all sing to the same song', *Australian Financial Review*, 22 April 2005, p. 82.

24 D. Robertson, 'Another Global Trade Crisis', *Policy*, vol. 20, no. 1, 2004, p. 13.

reluctant to negotiate on 'beyond the border' issues, including standards for industrial goods, food and the environment.²⁵ The contrast is with Australia's wide-ranging FTA with a similarly sized nation in Singapore.

10.23 Given all these shortcomings, and in the absence of multilateral progress, many economists claim that the best FTA is one which abolishes Australia's protection unilaterally. Professor Ross Garnaut, for example, has argued that Australia's experience of the past two decades shows that 'by far the main benefits of reducing trade barriers are received by the liberalising country'.²⁶ This prospect is unlikely, however, given the influence of sectional interests.²⁷ Moreover, market access has been keenly contested in international trade, and there are no guarantees that Australia's trading partners would reciprocate.

10.24 Even strident critics of FTAs accept the need for pragmatism over principle. Professor Garnaut has himself conceded that the best response of third nations that are excluded from FTAs may be to sign FTAs themselves:

...even if China and Australia recognise that the proliferation of FTAs is unfortunate for the multilateral system and their own trade interests, there may still be an argument for their seeking a bilateral agreement. Contemporary policy has to take into account the contemporary reality...

Within the contemporary reality, Australia, most importantly in the USFTA, now systematically discriminates against supplies from China, its most rapidly growing trading partner, and in January 2005 its largest merchandise trading partner and second largest export market...The imminent completion of the China-ASEAN FTA is set soon to expand discrimination against Australia across the whole range of agricultural and manufactured products.

It can be expected that the persistence of this discrimination on both sides of the relationship would gradually corrode the current excellent trade relations between China and Australia.

A standard FTA between Australia and China, if it were comprehensive in coverage and liberalised market access as much or as little as the two countries' other bilateral agreements, would end the discrimination that each country has introduced against the other in recent FTAs, and with it the costs of trade diversion away from Sino–Australian trade.²⁸

25 D. Uren, 'Trade agreements slammed for their lack of clear goals', the *Australian*, 10 September 2004, p. 23.

26 R. Garnaut, 'Bridging a fractured trade system', the *Australian*, 17 November 2003, p. 9.

27 Editorial, 'A multilateral trade pact is the jackpot', *Australian Financial Review*, 19 November 2004, p. 82.

28 R. Garnaut, 'Australia, US and China: Open Regionalism in an Era of Bilateral FTAs', Paper presented at a public lecture, Asialink, Melbourne, 22 March 2005, pp. 11–12, http://rspas.anu.edu.au/economics/publish/papers/garnaut/2005_Australia_US_and_China.pdf (accessed 1 November 2005).

Strategic concerns

10.25 There have also been strategic concerns about the discriminatory nature of FTAs. Signing a trade agreement with one nation may be seen as a sign of neglect by other nations.²⁹ In a submission to the Senate Select Committee on the Free Trade Agreement between Australia and the United States, Professor Peter Lloyd argued that negotiations on the agreement 'should be accompanied by diplomatic initiatives'.³⁰ Professor Lloyd claimed that the Australian government had a responsibility to:

...assure our Asian trading partners that this proposed agreement does not represent a downgrading of our relations with these economies and, furthermore, that we stand ready to negotiate parallel trading RTAs [regional trade agreements] with these countries.³¹

10.26 Professor Lloyd argued that 'particular diplomatic effort' must be accorded to nations such as Malaysia and Indonesia with whom Australia's relations have been strained. However, he does acknowledge that 'several of our [Australia's] Asian trading partners are pursuing a similar strategy of multiple RTAs [which] indicates that these countries should not logically object to us on grounds of trade discrimination'.³²

Australia and the China–ASEAN FTA

10.27 A case in point is the recent signing of the China–ASEAN FTA in traded goods. The agreement is part of a plan to work towards an ASEAN–China Free Trade Area within ten years.³³ The Secretary–General of ASEAN, His Excellency Ong Keng Yong, has argued that:

The establishment of ACFTA by 2010 looks set to enhance economic cooperation and integration between ASEAN and China. The market and purchasing power are very much enlarged by the FTA. Preliminary

29 See P. Kelly, 'Change in US sharpens our dilemma', the *Australian*, 20 December 2000.

30 P. Lloyd, *Submission to Senate Select Committee on GATS and the Australia–US Free Trade Agreement*, April 2003, http://www.aph.gov.au/Senate/committee/fadt_ctte/completed_inquiries/2002-04/gats/submissions/sub73.doc (accessed 8 November 2005)

31 P. Lloyd, 'Australia's Economic Diplomacy in Asia', *Melbourne Asia Policy Papers*, number 3, July 2003, p. 8, <http://www.asialink.unimelb.edu.au/cpp/policypapers/0801FINALLLOYDMAPP.pdf> (accessed 5 November 2005).

32 P. Lloyd, 'Australia's Economic Diplomacy in Asia', *Melbourne Asia Policy Papers*, number 3, July 2003, p. 8, <http://www.asialink.unimelb.edu.au/cpp/policypapers/0801FINALLLOYDMAPP.pdf> (accessed 5 November 2005).

33 ASEAN, *Framework Agreement on Comprehensive Economic Co-operation between the Association of South East Asian Nations and the People's Republic of China*, 4 November 2002.

estimates suggest that the ASEAN-China FTA would raise ASEAN's exports to China by 48% and China's export to ASEAN, by 51%. At the same time, the combined GDP of ASEAN would expand by at least US\$1 billion while that of China, by some US\$2.3 billion (note: assuming a 6 per cent annual growth rate in ASEAN and 7 per cent in China).³⁴

10.28 DFAT has argued that 'as a general principle, Australia welcomes initiatives that improve regional economic growth and liberalise trade'.³⁵ Similarly, Mr Steven MacMillan, a consultant for ITS Global which runs China Business Focus, told the committee that a China–ASEAN FTA would not limit Australia's capacity to negotiate or require Australia to negotiate an FTA with China more quickly. He also disputed that the benefits of lowering barriers to Australian goods into China's markets would be lost as a result of China's FTA with ASEAN.

The issue of trade diversion is probably more of a concern in areas where the barriers are very high—Australia's certainly are not and China's are decreasingly so—but that does not negate the benefits available from further liberalisation. In other words, the group's view would be that these things should go on and that Australia should continue to seek those liberalisations that are available in the FTA context.³⁶

10.29 A more closely integrated economic community in East and South East Asia means that Australia, whose economic and commercial interests are centred in this region, will have to manage these developments carefully. In their submission to the committee, Mr Reg Little and Mr James Flowers observed:

Given current trends, it is becoming imperative to base an important portion of Australia's strategic planning on the contingency that China in particular, and East Asia in general, will re-emerge at the centre of global trading, first rivalling and later overshadowing Anglo–American power. In such circumstances it is apparent that Australian policy cannot afford to be ill-informed about powerful, deep-rooted cultural qualities, largely suppressed and disguised over much of the past century, that direct behaviour among its most powerful neighbours.

This imperative will increase in importance if there is further movement towards an Asian trade and financial grouping to match European and American regional groupings. Australia will need not only to be closely in tune with developments in China but also with other key members of any such grouping so as to ensure that it can lobby effectively to optimize its negotiating positions.³⁷

34 H. E. Ong Keng Yong, Secretary–General of ASEAN, 'Prospering ASEAN–China relations', Keynote address at the Chinese Business Leaders Summit, Global Entrepolis, Singapore, 11 October 2004, <http://www.aseansec.org/16461.htm> (accessed 8 November 2005).

35 *Submission P19*, p. 18.

36 S. MacMillan, *Committee Hansard*, 27 June 2005, p. 19.

37 *Submission P26*, p. 5.

10.30 In addressing the China–ASEAN FTA, they were of the view that the arrangement is 'likely to be little more than a stepping stone to closer China-led regional cooperation, designed to protect against a repeat of the 1997 Asian financial crisis and against regional groupings in Europe and the Americas'. They stated:

It is hard to see how Australia can protect and advance its interests except by displaying a preparedness to respond constructively to developments of this nature. It is likely to best optimize its negotiating position if it is playing a pro-active, strategic role that is built on an astute understanding of regional interactions and regional sensitivities about the influence of non-regional and alien cultural norms.³⁸

Committee view

10.31 The committee believes there is an important economic and strategic role for FTAs. Although multilateral liberalisation is the preferred option, FTAs are a means to end the discriminatory practices that both nations may suffer as a result of the agreements that they both sign with third countries.³⁹ Australia, through the US FTA, systematically discriminates against supplies from China: China, through the ASEAN FTA, expands discriminatory trade practices against Australia. Given the number of FTAs that China has already signed, there is a significant opportunity cost to Australia from not signing an agreement with China.

10.32 The committee notes, therefore, that the *prima facie* case for an Australia–China FTA is to remove the existing costs of trade diversion. Moreover, given the size and centrality of China's economy in the region and its compatibility with Australia's economy, an Australia–China FTA will also be trade creating. The following chapter looks closely at these benefits.

The progress of multilateral negotiations

10.33 The committee also emphasises that an Australia–China FTA must be pursued concurrently with opportunities for multilateral trade liberalisation through the WTO. The Sixth WTO Ministerial Conference is scheduled to take place in Hong Kong from 13 to 18 December 2005.⁴⁰ It will be the third Ministerial Conference under the current 'Doha Round' of multilateral trade negotiations.

38 *Submission P26*, p. 9. This viewpoint reinforces the committee's suggestion that Australia must have available a body of knowledge and understanding to make accurate assessments about developments in the region, and formulate responses that will not disadvantage Australia. See chapter 2, paragraph 2.68 and chapter 13, paragraphs 13.33–13.46.

39 R. Garnaut, 'Australia, US and China: Open Regionalism in an Era of Bilateral FTAs', Paper presented at a public lecture, Asialink, Melbourne, 22 March 2005.

40 World Trade Organization, 'The Sixth WTO Ministerial Conference', http://www.wto.org/english/thewto_e/minist_e/min05_e/min05_e.htm (accessed 8 November 2005).

10.34 The focus of the Doha Round is to assist developing countries by cutting agricultural protection. The Australian government has strongly supported this agenda.⁴¹ However, the most recent Ministerial Conference in Cancun, Mexico, in September 2003 failed to achieve consensus on cutting protection for farm products. Some developed nations—notably the European Union (EU)—insisted that progress on reducing agricultural tariffs and subsidies should be conditional on addressing the 'Singapore issues': investment, competition, transparency in government procurement and trade facilitation. Certain developing nations opposed the inclusion of the Singapore issues, believing they were irrelevant to their interests.⁴² This impasse contributed to the failure of the Cancun negotiations.

10.35 At the time of writing, the Director-General of the WTO, Mr Pascal Lamy, warned that without a better proposal from the EU on market access for agriculture, it may be necessary to postpone the Hong Kong Ministerial Conference.⁴³ Trade Minister Vaile argued:

The US has put forward a plan to cut agricultural subsidies by 60 per cent. It goes well beyond any previous US offer. In contrast, the EU has put forward a disappointing offer. It has offered to cut tariffs by 20 to 50 per cent, which is just not enough...I don't believe the [WTO] meeting should be postponed, even if the EU does not put forward a better proposal.⁴⁴

10.36 It is estimated that Australia could benefit by as much as \$7 billion a year from the successful completion of the Doha Round.⁴⁵

Recommendation 12

10.37 The committee recommends that the Australian government continue its support for the Doha Round of multilateral trade negotiations, most immediately through the Sixth WTO Ministerial Conference in Hong Kong.

41 M. Vaile, 'Europe's hurting the poor', the *Australian*, 25 November 2005, p. 12.

42 J. Robertson, 'Cancun to Hong Kong: Prospects for the WTO', *Research Note*, Parliamentary Library, 10 October 2005, p. 1.

43 T. Sutherland, 'Trade talks hang on EU offer', *Australian Financial Review*, 28 October 2005, p. 14.

44 M. Vaile, 'Europe's hurting the poor', the *Australian*, 25 November 2005, p. 12.

45 DFAT, *Global Trade Reform 2000: Maintaining Momentum*, 1999 cited in J. Robertson, 'Cancun to Hong Kong: Prospects for the WTO', *Research Note*, Parliamentary Library, 10 October 2005, p. 1.