

## **AUSFTA as a “Third Wave” Trade Agreement: Beyond the WTO Envelope**

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### Introduction

Economists continue to argue about the merits of free trade agreements relative to the multilateral system of the WTO. Much of the argument centres on the potential for FTAs to result in important amounts of trade diversion as importers redirect their purchases to new preferential suppliers and away from those in other countries that may be the lowest cost producers. On top of this economic argument, certain pundits claim that FTAs are a political distraction from the WTO system and that over time, the creation of additional bilateral agreements will undermine support for the global institution. From a practical standpoint, who wins arguments like these is increasingly irrelevant as there are now more than 200 FTAs in operation around the world and about another seventy under negotiation.

The content of FTAs has evolved significantly in recent years. It has been a long time since the agreements were restricted to their initial scope of eliminating customs tariffs on trade in goods between the partners. In fact, in cases like the recently agreed Australia-USA Free Trade Agreement, tariffs were practically unimportant from the very start of the negotiations. More than half of Australia's MFN tariffs were bound at zero and the rest provided for average duties on the order of five percent or less. Notwithstanding the relative unimportance of tariffs, certain economists insisted on running computer-based models of the likely impact of the FTA on Australian welfare where what the computer program measured was largely the impact on demand of tariff elimination and consequently lower prices. Five studies produced five different results with none of the predicted outcomes likely very representative of what will really happen. In large part, this is because the models cannot yet measure the impact of the rules-based changes brought on by the FTA in non-tariff and behind-the-border regulatory areas. It is instructive to compare the number of AUSFTA chapters devoted to market access with the much greater number of chapters addressed to rules governing other aspects of the bilateral economic exchange.

The Australian Productivity Commission has called modern FTAs like the AUSFTA “Third Wave” trade agreements. The term derives from a categorization that groups FTAs dealing only with pre-1995 GATT issues as “First Wave”; FTAs with a scope similar to that of the WTO as “Second Wave”; and, agreements going beyond the current scope and coverage

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of the WTO as “Third Wave” FTAs. The focus of this paper will be on how Australia’s bilateral agreement with the United States helps to break new trade policy ground with its “third wave” provisions that go beyond the envelope of the WTO.

### Trade in Services

A good place to start in our comparison of the AUSFTA with WTO is the FTA’s provisions with respect to trade in services. Both the Australian and American economies are heavily services-oriented these days and both countries are big exporters and importers of services, so it stands to reason that this should be an important part of the FTA. It is. There are altogether four chapters that bear importantly on the issue. Two sectoral chapters deal with telecommunications and financial services, one deals with cross-border trade in services generally and services are also an important part of the investment chapter’s coverage.

The WTO General Agreement on Trade in Services (GATS) employs a positive list (“bottom up”) approach to both sectoral coverage and commitments within sectors according to their mode of delivery<sup>2</sup>. Sectors not scheduled for commitments are subject only to GATS general rules on MFN treatment and transparency. It is only through scheduling of commitments that obligations with respect to market access and national treatment are undertaken in the GATS. Naturally, the positive list approach is very limiting in its coverage and liberalisation and even where sectors are scheduled, they may still be subject to many limiting conditions. The Uruguay Round commitments on trade in services by many WTO Members often amounted to no increase in market access or roll-back in discrimination. Frequently commitments were of a standstill nature – giving traders a kind of insurance policy that the environment would not be made worse than it was at the time. And the commitments are often not very broad in terms of sectoral coverage. Some WTO Members have commitments on only one or two sectors.

AUSFTA employs a “top down” negative list approach to services coverage and market access commitments that delivers considerably more breadth and liberalisation than has so far been possible in the WTO. The only sectors or sub-sectors not liberalised fully to services suppliers of the FTA partner are those listed in a special annex of “non-conforming measures”. In the AUSFTA, both MFN and national treatment non-discrimination are guaranteed across-the-board, as is market access. Article 10:4 of AUSFTA prohibits limitations of the kind found in most GATS schedules. For example, AUSFTA parties may not impose limitations on the number of services providers, the total value of their transactions, the number of their operations in-country or the type of legal entity they can establish to provide their services. In the WTO, permission to establish a local presence has to be negotiated sector-by-sector. In AUSFTA, permission to invest for this purpose is guaranteed automatically, with minor exceptions, by the operation of AUSFTA’s Investment Chapter (Chapter 11).

Another important example of where AUSFTA goes beyond the WTO in the services area can be found in the agreement’s provisions on “recognition”. Where two countries have

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<sup>2</sup> For those not familiar with GATS scheduling techniques, commitments are scheduled according to the four modes through which services can be supplied. These are (1) cross-border supply, where the services supplier located in country A supplies services across the border to consumers in country B; (2) consumption abroad, where the consumer of the services from country B travels to country A in order to consume the services (tourism and education are good examples); (3) commercial presence, where the services supplier from country A sets up a local presence in country B in order to supply consumers in B; and (4) presence of natural persons, where persons from country A travel temporarily to country B in order to supply services to consumers in country B.

different standards and/or qualification procedures that must be satisfied before a services provider of one country can do business in the other, there are three ways to approach the problem. A first option is to pass the two different tests in both jurisdictions. But this can be costly and time-consuming. A second option would be for one government or jurisdiction to amend its procedures or standards in a way that makes them identical to those in the other jurisdiction. This is often politically impractical and in any event might not take account of differences in the country that explain the differing rules. The third and clearly the best option would be for the governments concerned to find a way of recognizing the other country's standards or qualification procedures as equivalent in effect to its own rules. From a commercial standpoint, the value of a mutual recognition agreement along these lines is obvious.

All that the GATS provides in this area is an exhortation to Members to base mutual recognition agreements (MRAs) on multilateral criteria and keep participation in MRAs open to outsiders. AUSFTA goes much further and establishes an institutional mechanism the purpose of which is to promote bilateral mutual recognition arrangements. The creation of a Professional Services Working Group with a mandate along these lines is a very significant step. This could eventually give rise to recognition in the United States of the qualifications of lawyers graduated from Australian law schools or facilitate work in Australia by U.S.-trained architects and accountants. The professional services providers have a lot to gain, but so too do the Universities and other schools engaged in providing professional services education.

As noted above, after a first start in the Uruguay Round (1986-1993), WTO's GATS Members are only now getting into what is hoped will be some real market access negotiations in the current Doha Round. But there is no guarantee of that. Even after nearly five years of negotiations (the GATS Round started in 2000), offers of additional commitments in services have been tabled by only around 50 WTO Members. AUSFTA, on the other hand, by taking the negotiations and rules beyond the WTO envelope achieves in one step an environment that would have to be seen as the final goal of the WTO – something that could probably be realised only after several additional multi-year negotiating rounds.

## Investment

Currently, the treatment of investment-related issues under WTO rules is extremely limited. Beginning with the Singapore Ministerial Conference in 1996, the European Community, Japan and others backed proposals to initiate negotiations on investment-related questions in WTO; however, the Doha Round-related decisions taken by WTO Members in July of this year have effectively removed investment from the multilateral agenda for the foreseeable future.

What treatment WTO does provide in respect of investment is found in GATT's National Treatment obligations; in the Uruguay Round Agreement on Trade-Related Investment Measures (TRIMS) and indirectly in mode 3 of the Services Agreement. None of the WTO provisions provide for a right of establishment. Post-establishment rules in the WTO's GATT Article III (National Treatment) mandate that goods of foreign origin, once on the local market, cannot be the subject of discriminatory taxes or other measures. In effect, this protects the sales of a foreign-owned but locally established subsidiary and indirectly its ability to make a fair return on investment. Also for trade in goods, the TRIMS Agreement prohibits certain discriminatory performance requirements, such as local content requirements and

trade-balancing undertakings, as well as performance requirements with the effect of a quantitative restriction – but that's as far as the goods agreements go. In the case of services, there are no *a priori* obligations on investment in the GATS; however, once a Member country schedules a commitment allowing for "mode 3" local presence with national treatment rights, then right of establishment and protection against discrimination towards the investment become binding obligations.

AUSFTA goes way beyond the limited envelope of the WTO when it comes to rules for foreign direct investment. First of all, with the exception of the limited number of instances where Australia or the United States maintain "non-conforming measures", the FTA confers an absolute, across-the-board right of establishment with investors of the FTA partner guaranteed both national treatment and MFN on an unconditional basis. In addition, AUSFTA's Article 11.9 goes considerably beyond the WTO TRIMS Agreement in terms of the kinds of performance requirements that are not permitted under the agreement.

Other important features of the FTA's investment chapter that are "WTO-Plus" for investors include the rules governing expropriation and compensation; rules setting out the protection of transfer payments relating to covered investments and the prohibition of foreign investors being required to appoint host country nationals to senior management positions, for example.

It's important to bear in mind that the pre- and post-establishment protections for investors contained in the AUSFTA apply at all levels of government in both countries – a fact that is very important in the federal systems operating in the United States and Australia.

What AUSFTA does not provide for is investor-state dispute settlement. Although investor-state dispute settlement provisions are contained in Australia's FTA with Singapore, it was pretty clear from the start of the negotiation that many parties here in Australia did not want to see such provisions in an agreement with the United States. The reasons for this are not entirely clear although in the course of the negotiations it was rumoured that the Greens and Democrats had told the Government that they would oppose the FTA in the Senate if investor-state dispute settlement was part of the deal and the Coalition felt it didn't need the extra headache. Interestingly, although the American business community lobbied USTR insisting on investor-state dispute settlement in the agreement with Australia, it was fairly clear that the U.S. Government was happy to accommodate Canberra and leave it out of the FTA. Investor-state dispute settlement in NAFTA has frequently been politically problematic and it seems that the American Government was happy to trust in the good reputation of Australian Courts.

### Competition Policy

Although the proposed negotiation in the WTO of competition policy disciplines suffered a fate similar to that of the investment proposal at the WTO's July 2004 General Council meeting, the WTO system is not completely without rules relating to the protection of a competitive environment. The GATT provisions for trade in goods are limited and basically pertain to the activities of state trading enterprises – which Members are obliged to operate consistent with the general principles applied to private traders. GATS rules for trade in services are much more significant.

First of all, GATS obliges WTO Members that permit monopolies or exclusive service suppliers to ensure that where such an entity competes outside the scope of its monopoly rights, it does not abuse its monopoly position. Secondly, GATS provides that where certain private services suppliers are believed to be engaging in practices that restrain competition, a Member of the WTO may request consultations with another Member “with a view to eliminating the practices” at issue. Perhaps the GATS’ most significant foray into competition policy is the so-called “Reference Paper” adopted by many countries as an additional commitment in the telecommunications sector and which obliges adopting members to take such measures as might be necessary to promote a competitive environment in the sector and restrain established suppliers with dominant market power from preventing the entry of competitors in the market.

The AUSFTA’s Chapter 14 builds on existing antitrust cooperation agreements between the two countries and then amplifies certain of the competition policy principles found in the WTO. For example, Article 14.4 goes beyond what the WTO provides for in terms of ensuring that state enterprises operate consistent with principles of fair competition and also specifically obliges the parties to ensure that governments at all levels do not provide competitive advantages to government businesses just because they are government-owned. In addition a range of obligations kick-in in respect of ensuring the competitive behaviour of any privately owned monopolies that might be designated by either side after the entry into force of the agreement.

Several years ago, the United States lost a high-profile WTO dispute against Japan trying to make the case that the Government of Japan had failed to ensure a competitive environment in the Japanese film market (the Kodak-Fuji dispute). Much of the American case was grounded on the premise that by virtue of being a Member of the WTO, governments somehow have undertaken an obligation to ensure a general environment of competition in their domestic economies. The WTO Panel didn’t buy the argument and in any case, if the United States had prevailed it would have been on what is know in the WTO as a non-violation claim not obliging the Japanese to pursue any particular course of action.

AUSFTA clearly goes beyond the WTO envelope in making an obligation to ensure competition in the market explicit. Article 14.2.1 provides “Each Party shall maintain or adopt measures to proscribe anticompetitive business conduct and take appropriate action with respect thereto...” This is another important area that clearly falls into the WTO Plus category, as are AUSFTA provisions on cross-border consumer protection and recognition and enforcement of monetary judgments. To work, competition policy needs to have “bite”.

### Government Procurement

Notwithstanding the fact that the GATT – WTO system has had an agreement dealing with government procurement since the end of the Tokyo Round negotiations in 1979, the utility of the agreement has always been compromised by its very limited membership. WTO Members are not obliged to join the “plurilateral” agreement and Australia has eschewed membership from the start (a policy position that has barred Australian firms from competing in the American market for government purchasing). Article XIII of the Services Agreement mandated the negotiation of government procurement provisions for services; however, despite setting a target date of 1997 for such rules, procurement has yet to be agreed as a topic disciplined by the GATS. Beginning in 1996, the United States backed the negotiation in the WTO of an agreement addressed only to transparency in government procurement (not market

access), however, this too went down in flames with WTO Members' July 2004 decision on a package of Doha Round measures. Altogether, there has been only limited progress on government procurement issues in the WTO system.

AUSFTA, by contrast, contains ambitious rules and market opening measures in the area of government procurement. A very considerable value of American and Australian government purchasing above the threshold of A\$ 81,800 will now be open to suppliers from the other country on a non-discriminatory basis. In addition to federal level procurement, substantial amounts of both countries' state-level procurement will also be opened to competition. The conditions of the market will be further improved by the ban on offsets under AUSFTA and by the FTA's explicit provisions on ensuring integrity in the procurement process.

Experience under the WTO has demonstrated that it is not easy for suppliers to get used to selling to governments in another country. However, the potential markets are enormous and the contribution that AUSFTA makes in this regard to freeing trade between the USA and Australia is not to be underestimated.

### Protection of Intellectual Property

One of the most widely-criticised chapters of AUSFTA is Chapter 17, addressed to the protection of intellectual property rights. Most of the criticism comes from those who believe the FTA goes too far in tilting the scales in favour of protection for the holders of intellectual property rights. There is a fine line between too much protection of intellectual property (such that it threatens to undermine competition and consumer welfare) and insufficient protection. Because this paper is addressed to the issue of how AUSFTA goes beyond the scope of the WTO, it will consider the AUSFTA's intellectual property provisions as "WTO Plus" from the standpoint of the rights holders.

It is not really necessary here to address in detail the specific ways in which intellectual property is protected under the WTO's Agreement on Trade-Related Intellectual Property Rights (a.k.a. the TRIPS Agreement). For the most part, the TRIPS Agreement provides protection that was state of the art in 1993 when the negotiation of the text was completed. The subject matter covered includes copyright, trademarks, geographical indicators, industrial designs, patents, layout designs and protection of undisclosed information. Obligations are generally cross-referenced to a variety of WIPO<sup>3</sup> Conventions concluded over the years on specific topics.

The problem for AUSFTA's negotiators was that the world has changed in many ways since 1993 with new products and services requiring additional and/or revised forms of intellectual property rights protection. This is particularly the case in the copyright area where digitisation of copyrighted material, the widespread use of the Internet and developments in transmission technologies has radically altered the technological and economic landscape. It was clear that the legal framework needed to catch up to the situation on the ground. To devise an agreement that reflects current commercial realities, AUSFTA negotiators had no choice but to go beyond the WTO envelope as reflected in the TRIPS Agreement. Whether the negotiators got it right or went too far is another question that will not be addressed in this paper.

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<sup>3</sup> World Intellectual Property Organization (Geneva)

Chapter 17 starts by requiring the parties to AUSFTA to observe a number of intellectual property rights treaties that have entered into force since the TRIPS Agreement was negotiated in the WTO. These include the WIPO Copyright Treaty of 1996, the WIPO Performances and Phonograms Treaty of 1996, the Hague Agreement Covering the International Registration of Industrial Designs (1999) and the Geneva Patent Law Treaty of 2000.

A considerable number of AUSFTA's TRIPS-Plus provisions relate to copyright and new technologies, such as rules for the protection of encrypted program-carrying satellite signals; liability-related provisions dealing with Internet Service Providers; and the requirement that there be criminal penalties for parties guilty of circumventing "effective technological means" that restrict unauthorized uses of copyrighted material. AUSFTA also provides for rules to govern the management and dispute resolution for domain names on the Internet. Another sign of the FTA's recognition of a changing commercial environment is the FTA partners' recognition that trademark coverage can go beyond things that are visible to the eye (for example, scents and sounds).

AUSFTA goes beyond what is found in the TRIPS Agreement in terms of its treatment of geographical indications and provides for fairly specific challenge procedures, for example, there is also a marginal expansion of the TRIPS requirement for the minimum term of trademark protection (10 years instead of the 7 years found in TRIPS).

There is little doubt, however, that the most criticised "TRIPS Plus" aspect of AUSFTA is its requirement that the general term of copyright protection be expanded from the TRIPS standard of life plus fifty years to an AUSFTA standard of life plus seventy years. We could see this coming, as it has been a standard American demand in all of the FTAs recently negotiated or under discussion. Both Singapore and Chile accepted such an extension before the Washington-based negotiators met with their counterparts from Canberra, making it politically impossible to settle for anything less from another developed country.

Whether one agrees with the contents of the AUSFTA or not, it is clear that there are many intellectual property rights obligations that go far beyond what is contained in the WTO's TRIPS Agreement.

### Labour and the Environment

There is not a great deal that needs to be noted about the AUSFTA chapters addressed to labour and the environment. The enforceable obligations are restricted to the requirement that the Parties enforce their own domestic legislation in the areas of labour standards and protection of the environment. Still, although the FTA's provisions are not very dramatic, they do break ground compared to what is found in the WTO – which is absolutely nothing. As an interesting side note, labour unions on both sides of the Pacific have criticised the labour chapter as being inadequate mainly on the grounds that the underlying national legislation governments are obligated to uphold is bad legislation.

### Dispute Settlement

A final point worthy of brief comment in this paper is the dispute settlement approach that will go into force with AUSFTA. In most respects, the system and its procedures mirror those of the WTO's Dispute Settlement Understanding, but there is a very important difference.

The WTO dispute settlement system that came into being in 1995 has been a remarkable success story – handling more than 300 government-to-government disputes over the years. Disputes that used to drag out for years under the GATT have been successfully handled in the legally prescribed time limits of the mechanism. Where the system has come in for some justifiable criticism, however, is how it operates at the very end of the dispute resolution process.

A “guilty” party in the WTO whose practices have been found to be inconsistent with its obligations has three options at the end of the process. It can of course bring its practices into conformity with its obligations under the WTO. This is clearly the best option. However, for a number of reasons, this might not be politically possible – at least in the short term. Where the government cannot conform, it has two other alternatives.

The first of these is to compensate its trading partner by “paying” for the damage with equivalent liberalising concessions in some other – hopefully related – sector. While this is trade liberalising, it suffers from the fact that “innocent parties” in the newly liberalised sector are made to pay for the wrongs brought on by those benefiting from the inconsistent practice. Another problem is that the compensation often does not directly benefit the aggrieved parties in the country that brought the complaint. Reducing tariffs on imported automobiles doesn’t put money in the pockets of a farmer who has lost his wheat market due to an illegal WTO practice.

The second alternative option is to do nothing to come into conformity or compensate and suffer retaliation against the country’s export trade. There are a lot of problems with retaliation, but probably the biggest criticism against it is that it is de-liberalising. Meeting protectionism with an equivalent level of protectionism certainly does not make for good economic management in the WTO system.

AUSFTA has the same three alternative options as the WTO, but significantly adds a fourth option. Losing parties that don’t want to comply with the rules can pay a monetary fine. Article 21.11.5 of AUSFTA allows the two parties to consult on the appropriate level of the fine but also sets a default level of an annual payment in US dollars equal to fifty percent of the level of benefits found to be compromised by the lack of conformity with the FTA’s provisions. The significance of this option as a WTO-Plus feature should not be underestimated. It is a way to keep pressure on the “guilty party” to come into conformity without at the same time negatively affecting innocents or exacerbating barriers to bilateral trade.

## Conclusions

Free Trade Agreements like AUSFTA are supposed to be more liberalising in terms of market access than the WTO. That, after all, was the expectation of the drafters of GATT and GATS rules for FTAs when they mandated elimination of trade barriers on substantially all trade and significant sectoral coverage in services as a condition for a departure for non-discriminatory treatment. So the greater degree of liberalisation, *per se*, while welcome is not a WTO Plus feature of the AUSFTA.

Where this FTA (and others like it) goes beyond the envelope of the WTO is in its rules. In some cases, these are entirely new rules, for example in the areas of antitrust cooperation or the right of establishment for investors of the other party. In other cases, the negotiators of the AUSFTA have adopted a dramatically different approach to the structure of

the agreement. A case in point is the “top down” negative list approach used for trade in services. Finally, the FTA goes beyond the WTO with its inclusion of updated rules to address issues that were not foreseen in 1993, such as the copyright protection issues for digital works.

This paper does not pretend to address each and every area where the AUSFTA goes beyond the scope of the WTO, but it probably covers the main points. Recognizing how important these third wave provisions are in this agreement is important on a number of levels. First, it makes clear that if you want an agreement with these features, there is currently no possibility of negotiating the agreement in the multilateral framework of the WTO – so it’s not a question of pursuing the liberalisation in the FTA or the WTO. Second, it helps to explain why the current approaches to economic modelling are so inadequate and not up to the task of attempting to predict the economic outcome of agreements like the AUSFTA. Finally, we should really begin to question the use of the term “Free Trade Agreement” to describe a treaty like the AUSFTA. The consequence of the AUSFTA’s “third wave” nature is that it is more than a WTO trade agreement – it is really a post-WTO economic integration agreement.

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