

## SHOULD AUSTRALIA CONTINUE NEGOTIATING BILATERAL FREE TRADE AGREEMENTS? A PRACTICAL ANALYSIS

BRYAN MERCURIO\*

### I INTRODUCTION

In February 2004, Australia and the United States successfully concluded negotiations for the *Australia–United States Free Trade Agreement* ('AUSFTA').<sup>1</sup> The agreement resulted from 11 months of complex negotiations in which both sides were forced to compromise and withdraw from their initial positions. While the AUSFTA negotiations were barely noticed or reported in the US, where American efforts to negotiate a regional free trade agreement ('FTA')<sup>2</sup> with the 10 South American nations (commonly called the *Free Trade Agreement of the Americas* ('FTAA')) took centre stage, the AUSFTA negotiations and completion have been at the forefront of media activity in Australia.<sup>3</sup>

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\* Lecturer, University of New South Wales; Director, International Trade and Development Project, Gilbert + Tobin Centre of Public Law; Fellow, Tim Fischer Centre for Global Trade and Finance.

1 Australian Trade Minister Mark Vaile and US Trade Representative Robert Zoellick signed the AUSFTA on 18 May 2004. See Department of Foreign Affairs and Trade, *Australia–United States Free Trade Agreement* <<http://www.dfat.gov.au/trade/negotiations/us.html>> at 6 November 2004; Office of the US Trade Representative, *Australia FTA* <[http://www.ustr.gov/Trade\\_Agreements/Bilateral/Australia\\_FTA/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Australia_FTA/Section_Index.html)> at 6 November 2004.

2 A standard definition of an FTA is an agreement between two countries or amongst groups of countries aimed at a policy of non-intervention by the state in trade between their nations. Tariffs and non-tariff barriers to trade are removed or lowered, whilst each country maintains its own commercial policy towards countries that are not part of the FTA. The key feature of an FTA is its discrimination in favour of the interests of the members of the agreement resulting in businesses in the member countries securing preferred access to the markets of other members over business from non-members. Throughout the AUSFTA negotiations, the term 'free trade agreement' confused many onlookers who expressed concern about the fact that barriers on all products were not being immediately removed; however, modern FTAs rarely lower or remove barriers on all goods and services, and members can often still use protections, such as anti-dumping actions, against the other members. In contrast, a customs union is an FTA in which members apply a common external tariff on goods imported from non-member countries. However, even members of the European Union customs union can use competition policies to restrict trade from other members, and certain sectors, most notably agriculture, are excluded from its ambit.

3 An unfortunate by-product of the increased attention on the AUSFTA negotiations was the amount of misinformation stemming from the media. While literally hundreds of misleading or incorrect articles can be found, a small sampling includes: 'Free Trade Comes at a Price', *Australian Financial Review*

In fact, the amount of publicity and interest surrounding the negotiations may have forever changed the face of the international trade debate in Australia.<sup>4</sup> Adding to the publicity surrounding the AUSFTA was the fact that both major political parties insisted on making the AUSFTA a campaign issue. This can be seen, not only through the Australian Labor Party's ('ALP') initial criticisms of the agreement and the continued comments in the media from politicians from all sides of the political spectrum, but also in the two parallel parliamentary committees formed to investigate and analyse the agreement. In a highly irregular move, both the Joint Standing Committee on Treaties (with a majority of members from the Liberal Party) and the Senate Select Committee (with a majority of members from the ALP) inquired into the 'Free Trade Agreement between Australia and the United States of America'.<sup>5</sup>

Upon taking effect, the AUSFTA will immediately eliminate tariffs on 99.5 per cent of all trade between the two countries, making the agreement one of the most significant, in terms of the reduction of tariffs, ever achieved in a bilateral

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(Sydney), 22 August 2003, 71 (claiming the US was 'demanding the immediate removal of the reference wholesale pricing scheme' in the Pharmaceutical Benefits Scheme); Jeremy Calvert, 'Free Trade Deal is Bad Medicine', *Herald Sun* (Melbourne), 18 July 2003, 2 (asserting that 'drug prices could surge' without any evidence to substantiate the claim); Jane Drake-Brockman, 'The Yanks are Coming and There are Big Changes in Store', *Sydney Morning Herald* (Sydney), 10 February 2004, 13 (stating that Australia will have 'fewer Australian and more American programs to choose from over the years', even though the AUSFTA allows Australia to maintain local content rules); Gabriella Coslovich, 'Trade Fight Hangs over Film Industry's Big Night', *The Age* (Melbourne), 21 November 2003, 1 (stating that '[f]ilmmakers ... confirmed that local content regulations for TV and new media will be traded-off').

4 On the other hand, it is clear that the public is only aware of a small part of Australia's trading ambitions. According to Austrade/Newspoll, when asked about any trade issues they had heard of in the media, 49 per cent of respondents nominated trade with the US. This compares with only 4 per cent who mentioned China, while 3 per cent mentioned other Asian nations. Moreover, while 62 per cent are aware Australia has completed an FTA with the US, only 1 per cent are aware that Australia has also negotiated an FTA with Thailand or Singapore: 'Market Watch', *The Australian* (Sydney), 13 July 2004, 29.

5 Both inquiries came out in support of the agreement: see Joint Standing Committee on Treaties, Parliament of Australia, *Australia – United States, Free Trade Agreement* (2004), <<http://www.aph.gov.au/house/committee/jsct/usaftra/report.htm>> at 6 November 2004; Senate Select Committee on the Free Trade Agreement between Australia and the United States of America, Parliament of Australia, *Final Report on the Free Trade Agreement between Australia and the United States of America* (2004) <[http://www.aph.gov.au/Senate/committee/fretrade\\_ctte/report/final/report.pdf](http://www.aph.gov.au/Senate/committee/fretrade_ctte/report/final/report.pdf)> at 6 November 2004. The AUSFTA implementing legislation (*US Free Trade Agreement Implementation Act 2004* (Cth)) only passed in the House of Representatives when former leaders Kim Beazley and Simon Crean led 12 ALP colleagues across the floor while 42 other ALP members walked out of Parliament instead of supporting or opposing the legislation. Comments from Mr Beazley sum up the situation well. On the agreement, Mr Beazley enthusiastically stated, '[the agreement] allows us to more effectively penetrate the American market. In the United States they know that they are going to have some of their most treasured protections stripped away. Once we are in the door it is an Australian Trojan horse that has just marched in'. On the other hand, Mr Beazley also stated that the Government's rhetoric regarding the US alliance had made it 'damn hard for members of the ALP to support this legislation': see Michael Baume, 'Taking the Cowards' Way Out', *Australian Financial Review* (Sydney), 28 June 2004, 63. The ALP only passed the implementing legislation in the Senate after gaining concessions on local content rules for television and on the procedures by which a patent holder can enforce its rights against generic manufacturers of pharmaceutical drugs.

framework.<sup>6</sup> Economic modelling anticipates that Australia stands to gain over A\$6 billion from the AUSFTA<sup>7</sup> and the agreement has the support of every state premier, every large business association, every major industry association and most trade economists.<sup>8</sup> But the agreement has not been universally supported. Some commentators believe Australia's involvement in the AUSFTA negotiations signalled its intention to abandon the multilateral framework in favour of operating in a more fragmented bilateral world.<sup>9</sup> This article will prove

6 FTAs were once relatively straightforward and simply set out commitments to remove tariff and non-tariff barriers to trade in goods. Today they cover much more than trade in goods, with services and investment now arguably the more important part of any agreement. So while agriculture may be the key to the AUSFTA, agricultural exports represent less than 15 per cent of Australia's total trade with the US. Over time, the most substantial economic benefits of the AUSFTA are likely to come in investment and services.

7 See Centre for International Economics ('CIE'), *Economic (CIE) Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States* (2004), <[http://www.dfat.gov.au/trade/negotiations/us\\_fta/economic\\_analysis\\_report](http://www.dfat.gov.au/trade/negotiations/us_fta/economic_analysis_report)> at 6 November 2004. Australia and the US already have close economic ties. The US has recently become the number one destination for Australian foreign direct investment (receiving around twice the level of Australian investment as the UK). Australian companies own over A\$61 billion in assets in the US, making Australia the eighth largest foreign asset-holder in the US: American–Australian Free Trade Agreement Coalition, *Partnership for a Stronger Future: US–Australia Free Trade Agreement* (2003) 16, <<http://www.aaftac.org/Partnership.pdf>> at 6 November 2004; Australian Asia-Pacific Economic Co-operation Study Centre, *An Australian–US Free Trade Agreement: Issues and Implications* (2001) 9, <<http://www.apec.org.au/docs/usfta.pdf>> at 6 November 2004. Australian investment employs over 84 000 Americans. Spread throughout many industries, Australian investment is particularly high in the areas of broadcasting, mining, minerals, building materials, steel manufacturing and real estate: see Australian Asia-Pacific Economic Co-operation Study Centre at 16. Australian investment accounts for 1.7 per cent of total foreign direct investment in the US: Australian Asia-Pacific Economic Co-operation Study Centre at 16. The US is also the largest foreign investor in Australia, with investments of over US\$110 billion directly responsible for the employment of nearly 300 000 Australians: American–Australian Free Trade Agreement Coalition at 18. Australia is also a large importer of American products and services. In fact, Australia purchases more goods from the US than from any other country. American exports accounted for 18.2 per cent of total Australian imports in 2001. In 2002, the US exported US\$12.3 billion worth of goods to Australia, making Australia the 12<sup>th</sup> largest US export market: American–Australian Free Trade Agreement Coalition at 5. The US has a large trade surplus with Australia (exceeding US\$3.5 billion every year since 1989) – the surplus, including investment, reached US\$5.9 billion in 2002. In absolute terms, the US surplus with Australia is ranked only second to the Netherlands: American–Australian Free Trade Agreement Coalition at 5.

8 See, eg, Steve Bracks, 'Forging Stronger Links with the US: It's a Fair Trade', *Australian Financial Review* (Sydney), 30 July 2004, 87; Peter Beattie, 'Blueprint for Boosting Profits and Jobs', *Australian Financial Review* (Sydney), 28 July 2004, 55; Hugh Morgan, 'FTA: The Change We Have to Have', *Australian Financial Review* (Sydney), 28 July 2004, 55; Mark Davis, 'ALP Urged to Sign Trade Deal', *Australian Financial Review* (Sydney), 27 July 2004, 4; Steve Lewis, 'Business Urges PM to Buckle to Latham's Trade Demands', *The Australian* (Sydney), 28 July 2004, 55. An example of the gains to be made from the AUSFTA can be seen in the case of Dairy Australia. Chris Phillips, General Manager for International Trade and Development, stated that the FTA allowed for significant and immediate expansion in Australian dairy access and improved trading arrangements on existing quota sales to the US. He further stated that farmers with an average herd size of 200 milkers could expect a rise in their gross income of between A\$2000–\$3000 per season and that key benefits would also include new product sales valued at more than A\$60 million per annum (potential premiums from US market sales relative to alternative market outlets were estimated to be A\$18–25 million per year and rising over time) and wider product coverage which would enable a broad cross section of Australian milk producers to participate: Paul Jarvis, 'Dairy Australia Pushes for FTA', *The Countryman* (Perth), 24 June 2004, 12.

9 See, eg, Jagdish Bagwati and Ross Garnaut, 'Say No to This Free Trade Deal', *The Australian* (Sydney), 11 July 2003, 11.

that such an assertion lacks credible foundation by demonstrating, not only Australia's continued commitment to the multilateral agenda, but also that the two frameworks can operate together; that is, they are not mutually exclusive. In addition, the article will assert that, if Australia wishes to maintain its place in the world, it has no choice but to negotiate bilateral agreements. The article does, however, caution that FTAs should not be negotiated without regard to their effect on the multilateral system and warns that too rapid an explosion of FTAs has the potential to destabilise the entire foundation of the multilateral trading system.

Part II will briefly explain the origin of the multilateral trading system and the compatibility of FTAs with that system, before detailing how vast differences of opinion between WTO Member States have stalled progress in the multilateral trading system and how, because of the current situation, many Members have begun negotiating FTAs to protect their own interests and further liberalise trade. The section will also highlight Australia's efforts to restart multilateral negotiations as well as otherwise evidence its commitment to the multilateral framework. Part III analyses why nations are moving toward bilateral FTAs and demonstrates that they are doing so in order to further the agenda beyond that which can be accomplished multilaterally (whether it be in the form of increased trade liberalisation, market access, environmental protection, etc) and, perhaps more importantly, to avoid their exports being outpriced and effectively excluded from many markets. This section also explains that Australia's failure to negotiate FTAs with key trading partners is both risking its export markets, and costing consumers. Part IV investigates FTA possibilities for Australia and finds that substantial benefits could result from FTAs with several Asian nations. Part V explores several potential drawbacks of FTAs, including their effect on the multilateral system, the risk of trade diversion, and the difficulty of gaining substantial trade liberalisation from FTAs. Part VI concludes that while the Australian government should negotiate more FTAs in order to drive the multilateral agenda and to prevent Australian exporters from being excluded from markets, it should also continue to fully participate in the multilateral process and take account of the effects of its FTAs on the multilateral system.

## II THE MULTILATERAL TRADING SYSTEM

### A The Origins of the Multilateral Trading System

In the aftermath of World War II, Western leaders did not want a repeat of the economic isolationism that characterised the pre-war years and played a large part in deepening the Great Depression and leading to the start of the war.<sup>10</sup>

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<sup>10</sup> It is well recognised that the *Smoot-Hawley Tariff Act of 1930*, by increasing US tariff levels to the 'highest tariff levels in US history', led to retaliation by America's trading partners, thus transforming a normal economic downturn into major world depression: see Richard N Cooper, 'Trade Policy and Foreign Policy' in Robert Stern (ed), *US Policies in a Changing World Economy* (1987) 291, 291–2; Harold Hongju Koh, 'The Legal Markets of International Trade: A Perspective on the Proposed United States–Canada Free Trade Agreement' (1987) 12 *Yale Journal of International Law* 193, 201–2. After

Attempting to create new world political and economic institutions necessary to promote and maintain peaceful international relations, world leaders united in 1944 to negotiate the *Bretton Woods Agreement*, which established the charters for the International Monetary Fund and the International Bank for Reconstruction and Development.<sup>11</sup> A year later, the US proposed the creation of a world trade system in the form of the International Trade Organization ('ITO').

The proposed Charter for the ITO included specific provisions on trade, development, commodity agreements and other economic issues. It also mandated consultation, arbitration and referral to the International Court of Justice ('ICJ') as part of dispute settlement. On 21 November 1947, 57 nations met in Cuba to finalise drafting of the proposal, which would become the Havana Charter.<sup>12</sup>

During that time, 25 of those nations agreed on a trade agreement known as the *General Agreement on Tariffs and Trade*<sup>13</sup> ('GATT'). Seeking to liberalise international trade and reduce internationally negotiated tariffs, the Contracting Parties intended the GATT to be a temporary measure until absorbed by the ITO. The US Congress, however, in a move reminding some of the Treaty of Versailles and the League of Nations, refused to ratify the ITO and the organisation never materialised.<sup>14</sup>

Consequently, eight signatories agreed to provisionally apply the GATT as of 1 January 1948.<sup>15</sup> The terms of the Protocol of Provisional Application ('PPA') allowed for full application of Parts I and III of the GATT<sup>16</sup> and applied Part II

World War II, the Allies were gravely concerned with avoiding a depression like the one that had followed World War I. Thus, they wanted to put in place a regime that promoted free trade and ended protectionism: John Jackson, William Davey and Alan Sykes, *Legal Problems of International Economic Relations* (2002) 37–41, 211–16. In fact, it has been said that the primary international goal for the US following World War II was to build national security through international free trade: see generally Cooper. See also Elizabeth E Kruis, 'The United States Trade Embargo on Mexican Tuna: A Necessary Conservationist Measure or an Unfair Trade Barrier?' (1992) 14 *Loyola of Los Angeles International and Comparative Law Review* 903, 910 (detailing the purpose behind the creation of the GATT).

11 See generally World Trade Organization, *Guide to GATT Law and Practice* (1995) 3–6.

12 See *Havana Conference Final Act and Related Documents*, 158–9, UN Doc ICITO/I/4 (1948). See also Terence P Stewart, *The GATT Uruguay Round: A Negotiating History* (1993) 2671–2.

13 Opened for signature 30 October 1947, 55 UNTS 187 (entered into force 1 January 1948). Negotiated during 1946–48, the GATT is a multilateral treaty, with norms that bind members and the ability to create law and develop custom. The GATT, however, lacks many of the provisions of the ITO Charter and does not include rule-oriented language or recourse to arbitration or the ICJ, meaning the GATT is not self-autonomous and Members must drive for organisational change: see Jalil Kasto, *The Function and Future of the WTO* (1996) 4; John Jackson, *World Trade and the Law of GATT* (1969) 40.

14 In hindsight, the ITO was probably too ambitious a proposal for the times. The ITO required significant changes in the law (such as requiring implementation and governed compliance with rules regarding trade barriers, restrictive trade practices, international commodity arrangements and international labour policies) and many signatories were not ready to abandon domestic laws in favour of implementing ITO consistent language: see Stewart, above n 12, 2670.

15 This group consisted of Australia, Belgium, Canada, France, Luxembourg, the Netherlands, the United Kingdom and the US.

16 Parts I and III set basic policy for trade liberalisation based on (i) preference for tariffs over other forms of protection (such as quotas or quantitative restrictions); (ii) abolition of quotas; (iii) application of quotas only under exceptional circumstances and with multilateral permission; (iv) most favoured nation status to all GATT parties (with narrow exceptions); and (v) national treatment to all products of GATT parties that lawfully clear customs.

only 'to the fullest extent not inconsistent with existing legislation'.<sup>17</sup> This clause became known as 'grandfather rights', allowing parties with these rights to continue applying measures inconsistent with the GATT obligations.

Article XXIX:2 of the GATT indicates just how fleeting the PPA was designed to be, providing: 'Part II of this Agreement shall be suspended on the day on which the Havana Charter comes into force'. As the Havana Charter was expected to come into force rather quickly, GATT inconsistent legislation was not supposed to be tolerated for long. But the Havana Charter never came into force and the GATT survived for 47 years on a 'provisional' basis. Thus the GATT alone, without a constitutional or institutional foundation, was left to function as the world forum for international trade matters. The result of this unanticipated scheme was an organisation ill-equipped to regulate the broad issues presented in world trade. Consequently, the Contracting Parties continuously sought revisions, codifications and improvements to the system, leading to constant improvisation and uncertainty.

The eighth round of multilateral trade negotiations, the Uruguay Round, aimed to resolve the textual and procedural shortcomings uncovered in the GATT and reach an agreement as to the solutions. Formally concluding on 15 December 1993 in Marrakech, Morocco, the Uruguay Round substantially expanded upon the coverage and procedures of the GATT and created the World Trade Organization ('WTO') as the new international trading system.<sup>18</sup>

Coming into force on 1 January 1995, the WTO replaced the GATT as the authority on world trade relations, negotiations and dispute resolutions. Essentially functioning exactly as the ITO was supposed to in the late 1940s, the WTO serves as the legal and institutional foundation of the international trading system. However, as the WTO implements the rules negotiated in the Uruguay Round, it is guided by past GATT decisions, procedures and practices. A condition of entry to the WTO is that nations must accept the entire package of substantive agreements; a nation cannot 'pick and choose which rules to follow and which to ignore'.<sup>19</sup> This requirement is a substantial improvement on the voluntary nature of the GATT.

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17 Part II contains the substantive portion of the GATT, consisting of arts III–XXIII. The provisions, which provide the necessary market access complement to Part I, include topics such as national treatment, anti-dumping and countervailing duties, custom valuation, origins, quotas and limitations, balance of payment restrictions, subsidies, emergency action and exceptions to the GATT (including exceptions necessary to protect human, plant and animal life, health and safety and national security).

18 *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) ('WTO Agreement'). The first 13 agreements of the WTO incorporated the GATT 1994. The topics for negotiation included tariffs, non-tariff measures, tropical products, natural resource-based products, textiles and clothing, agriculture, GATT articles, safeguards, most favoured nation agreements and arrangements, subsidies and countervailing measures, dispute settlement, trade-related aspects of intellectual property ('TRIPs') and trade-related investment measures ('TRIMs'). See *Ministerial Declaration on the Uruguay Round*, 5–8, GATT Doc No MIN(86)/6 (1986).

19 William Scanlan, 'A Test Case for the New World Trade Organization's Dispute Settlement Understanding: The Japan–USA Auto Parts Dispute' (1996) 45 *University of Kansas Law Review* 591, 598.

The Uruguay Round intended that the WTO serve five main functions: (i) facilitate the implementation, administration and operation, and further the objectives of the agreement; (ii) provide a forum for negotiations among its members concerning matters addressed under the agreement; (iii) administer the Understanding on Rules and Procedures Governing the Settlement of Disputes; (iv) administer the Trade Policy Review Mechanism; and (v) cooperate with the International Monetary Fund, International Bank and related agencies for reconstruction and development with a view towards achieving greater coherence in global economic policy.<sup>20</sup>

### B The Compatibility of FTAs with WTO Obligations

The foundation article of the GATT requires all imported 'like-products' to be treated equally.<sup>21</sup> To explain simply, while a nation must levy the same tariff rate against particular 'like-products' from every country from which it imports the product, the level of tariff protection that the nation places on the product is solely the choice of the importing country.<sup>22</sup> The purpose of the WTO is to allow nations to negotiate with each other to lower the maximum rates that each country places on imported products (through what is referred to as 'tariff bindings').<sup>23</sup> FTAs can, however, help countries legally to effectuate discriminatory policies as long as the two conditions of art XXIV are satisfied: (i) that FTA reduces or removes barriers on 'substantially all trade'; and (ii) that non-members of the particular FTA do not find trade more restrictive than before the FTA came into force.<sup>24</sup>

20 See *WTO Agreement*, opened for signature 15 April 1994, 1867 UNTS 3, art II, paras 1–5 (entered into force 1 January 1995).

21 See GATT, opened for signature 30 October 1947, 55 UNTS 187, art I (entered into force 1 January 1948). This principle is referred to as 'Most Favoured Nation' ('MFN'). For a detailed discussion of the MFN, see William J Davey and Joost Pauwelyn, 'MFN Unconditionality: A Legal Analysis of the Concept in View of its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product"' in Thomas Cottier and Petros Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (2000) 13, 38–41. The principle of 'National Treatment' (art III) also reflects the principle of treating 'like-products' similarly. For a discussion of national treatment, see Robert Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (1998) 32 *International Lawyer* 3.

22 If a nation's tariff rate is bound, it must not raise above the bound rate: see GATT, opened for signature 30 October 1947, 55 UNTS 187, art II (entered into force 1 January 1948). For instance, if Australia bound its tariff rate for semiconductors at 20 per cent, it would be free to tariff imported semiconductors at a rate between zero and 20 per cent, but could not charge a rate higher than 20 per cent. For a detailed discussion of tariff binding, see Thomas Cottier and Krista Schefer, 'Good Faith and the Protection of Legitimate Expectations in the WTO' in Marco Bronckers and Reinhart Quick (eds), *New Directions in International Economic Law* (2000) 47.

23 Cottier and Schefer, above n 22. As a nation that lowers its tariffs must charge the same rate to all other Member States, the system must contend with a considerable free-rider problem.

24 See GATT, opened for signature 30 October 1947, 55 UNTS 187, art XXIV (entered into force 1 January 1948). Article V of the *General Agreement on Trade in Services*, opened for signature 15 April 1994, 13 ILM 1167 (entered into force 1 January 1995) allows for FTAs in parallel terms to that of art XXIV of the GATT. It must be noted that Part IV (1965) and the Enabling Clause (1979) permit partial FTAs in the form of preferences from developed countries to developing countries (in what is called the Generalised System of Preferences ('GSP')) and also permit developing countries to exchange preferences: see Thomas Graham, 'The US Generalized System of Preferences for Developing Countries: International

On its face, art XXIV seems to prohibit partial FTAs, that is, agreements which do not substantially lower all barriers to trade within the union. However, the provisions of art XXIV have not been challenged in a dispute settlement proceeding and countless FTAs have been formed and are continuing to be formed that technically do not meet the threshold set out in the provision.<sup>25</sup> The WTO Appellate Body in *Turkey – Textiles*, however, attempted to provide some helpful guidance on the correct interpretation of art XXIV when it stated:

Sub-paragraph 8(a)(i) of Article XXIV establishes the standard for the *internal trade* between constituent members in order to satisfy the definition of a ‘customs union’. It requires the constituent members of a customs union to eliminate ‘duties and other restrictive regulations of commerce’ with respect to ‘substantially all the trade’ between them. Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term ‘substantially’ in this provision. It is clear, though, that ‘substantially all the trade’ is not the same as *all* the trade, and also that ‘substantially all the trade’ is something considerably more than merely *some* of the trade. We note also that the terms of sub-paragraph 8(a)(i) provide that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are otherwise permitted under Articles XI through XV and under Article XX of the GATT 1994. Thus, we agree with the Panel that the terms of sub-paragraph 8(a)(i) offer ‘some flexibility’ to the constituent members of a customs union when liberalizing their internal trade in accordance with this sub-paragraph. Yet we caution that the degree of ‘flexibility’ that sub-paragraph 8(a)(i) allows is limited by the requirement that ‘duties and other restrictive regulations of commerce’ be ‘eliminated with respect to substantially all’ internal trade.<sup>26</sup>

Until the 1980s, FTAs were only used in Western Europe (through the European Community (‘EC’) (now the European Union (‘EU’)) and the European Free Trade Area), among a handful of developing countries, and as preferences granted from developed to developing countries. In fact, at the same time as the EC was deepening its ties within the community and negotiating a common external tariff, the US was strongly committed to the multilateral process and even arguing against FTAs. Perhaps with the strife caused by protectionism and fractured trading arrangements throughout the Great Depression and World War II still engrained in its psyche, the US had been

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Innovation and the Art of the Possible’ (1978) 72 *American Journal of International Law* 513. However, the European Union’s GSP has recently been subject to challenge from India in dispute settlement: see *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) (Report of the Appellate Body). See also Robert Howse, ‘Appellate Body Ruling Saves the GSP, at Least for Now’ (2004) 8(2) *Bridges Monthly Review* 5, 5–6. It can be argued that partial FTAs among developing nations, such as those involving Southern Cone Common Market (‘MERCOSUR’) and Asian Free Trade Area (‘AFTA’), are formed under the Enabling Clause and not subject to the stricter standards of art XXIV of the GATT.

25 The term ‘substantially all trade’ has never been defined and has been interpreted differently by various commentators. For a critical review of art XXIV, see WTO, *Regional Trading Arrangements and the World Trading System* (1995). Australia has participated in attempts to define the term: see Department of Foreign Affairs and Trade, *Submission on Regional Trade Agreements by Australia*, WTO Doc TN/RL/W/15 (2002). Australia has also proposed tightening the rules of FTAs: see Department of Foreign Affairs and Trade, *Communication from Australia, Negotiations On Regional Trade Agreements: Key Issues For Consideration*, WTO Doc TN/RL/W/2 (2002).

26 *Turkey – Restrictions on Imports of Textile and Clothing Products*, WTO Doc WT/DS34/AB/R, AB-1999-5 (1999) [48] (Report of the Appellate Body) (emphasis in original).

referred to as the undeniable ‘champion of a nondiscriminatory global trade regime, grounded firmly in the MFN [Most Favoured Nation] principle’.<sup>27</sup>

The American aversion to bilateralism began to waiver in 1982 as the EU resisted American efforts to start the eighth round of multilateral trade negotiations (which eventually became the Uruguay Round). At that point, the US felt that FTAs were the only way to further liberalise international trade and abandoned its steadfast opposition to preferential agreements. The US eventually completed two FTAs in the 1980s, one with Israel (1985) and one with Canada (1989). The agreement with Canada was expanded to include Mexico in 1992 (becoming the *North American Free Trade Agreement* (‘NAFTA’)). At the same time, the EU continued its expansion, adding six new members during the 1980s and 1990s.<sup>28</sup> In addition, the EU negotiated FTAs with the Western European countries not in the EU, several Eastern and Central European countries and with the Baltic Republics. Moreover, negotiations began for FTAs between other regional markets at this time, including smaller nations in Africa, Central and South America, South and Central Asia, Central and Eastern Europe, Oceania, and the Baltics. In fact, during this period, the only region not to negotiate any FTAs was East Asia.

The rise of FTAs, with their inherent discriminatory qualities, led many to question whether they may undermine the multilateral trading system. This growing discontent led to the formation of the WTO Committee on Regional Trade Agreements, which examined the issue of whether FTAs are compatible with multilateralism. At the same time, the WTO’s Singapore Ministerial Declaration stated:

We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number, scope and coverage. Such initiatives can promote further liberalisation and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and extent of regional trade agreements make it important to analyse whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules. In this regard, we welcome the establishment and endorse the work of the new Committee on Regional Trade Agreements. We shall continue to work through progressive liberalisation in the WTO as we are committed in the WTO Agreement and Decisions adopted at Marrakesh, and in so doing facilitate mutually supportive processes of global and regional trade liberalisation.<sup>29</sup>

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27 Arvind Panagariya, ‘The Regionalism Debate: An Overview’ (Working Paper, University of Maryland, Faculty of Economics, 1998) 6. Even as early as 1945, the US expressed its dissatisfaction with FTAs. The sentiments of Howard Ellis explain: ‘There are good reasons for believing that no device portends more restrictions of international trade in the post-war setting than bilateral arrangements’: at 10.

28 The EU added Greece in 1981, Portugal and Spain in 1986 and Austria, Finland and Sweden in 1995.

29 Singapore Ministerial Conference, *Singapore Ministerial Declaration*, (1996) [7], <[http://www.wto.org/english/thewto\\_e/minist\\_e/min96\\_e/wtodec\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm)> at 6 November 2004.

Thus, the Committee believed that FTAs are compatible with multilateralism and can be used to promote liberalism and development.<sup>30</sup>

### C The Resurgence of FTAs

There is little doubt that multilateral agreements negotiated in the WTO should be the preferred instruments for liberalising international trade. Such agreements ensure a non-discriminatory approach with mutual benefits for all Member States, reduce trade distortions worldwide and simplify the administration of international business transactions. The eight rounds of multilateral trade negotiations under the GATT, from 1947–95, contributed greatly to unprecedented economic growth and worldwide higher living standards.<sup>31</sup> The creation of the WTO built upon the success of the GATT and added significant improvements, including the full inclusion of agriculture, textiles and services in the multilateral trade regime, the expansion of coverage to include services and intellectual property, the abolition of most of the GATT's plurilateral codes and a more formalised and stable system of dispute settlement.<sup>32</sup>

The Fourth Ministerial Conference of the WTO held in Doha, Qatar in November 2001, launched the ninth round of multilateral negotiations ('Doha Round' or 'Doha Development Agenda') in the form of a highly ambitious programme in which Members agreed to negotiate such diverse topics as services, investment, intellectual property and agriculture, all as part of a 'single undertaking'. This means that the series of agreements covering all negotiated topics must be signed as a package. The format does not allow Members to 'pick and choose' which agreements to follow and which to ignore, and essentially means that if there is not agreement on every topic, there is no agreement on any

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30 The effects of regionalism have also been studied by the Organisation of Economic Co-operation and Development and by the World Bank: see Serge Devos, *Regional Integration and the Multilateral Trading System: Synergy and Divergence* (1995) (which found that regionalism does not preclude multilateral progress); Australia–United States Free Trade Agreement Business Group, 'New Critiques? Old Arguments' *FTA Analyst*, Issue 9, 27 May 2003 <<http://www.austa.net/analyst/analyst9.html>> at 6 November 2004 (which concluded that FTAs do not weaken the global trading system). Several academics have likewise studied the effects of FTAs on member and non-member countries and have disagreed in their conclusions: see, eg, Arvind Panagariya, 'The Regionalism Debate: An Overview' (1999) 22 *World Economy* 477; Anne Krueger, 'Are Preferential Trading Arrangements Trade-Liberalizing or Protectionist?' (1999) 13(4) *Journal of Economic Perspectives* 105; John Gilbert, Robert Scollay and Bijit Bora, *New Regional Trading Arrangements in the Asia-Pacific: Implications for East Asia* (2002).

31 See WTO, *In Brief* (1999), <<http://depts.washington.edu/wtohist/Research/documents/WTOinbrief.pdf>> at 6 November 2004 (stating that merchandise growth has been at 6 per cent over the last 50 years, that total trade in 1997 was 14 times larger than in 1950 and that a 'strong and prosperous trading system' contributed to this level of 'unprecedented growth').

32 See generally Judith H Bello and Mary E Footer, 'Symposium: Uruguay Round – GATT/WTO' (1995) 29 *International Lawyer* 335, 340.

of the topics.<sup>33</sup> Significant progress towards consensus on the Doha Round was expected at the Fifth Ministerial Conference, held in Cancun, Mexico ('Cancun Ministerial'), but the September 2003 meetings collapsed due to irreconcilable differences between the needs and problems of the developed and developing world. The failure of the Cancun Ministerial to progress the Doha Development Agenda sent major shockwaves through the international trading community. While an analysis of the specifics leading to the breakdown is beyond the scope of this paper, it is sufficient to say that the substantial majority in the trading community believe the WTO negotiations have reached a significant impasse.<sup>34</sup> Fortunately, Members did not allow the failure of the Cancun meetings to permanently derail the Doha Development Agenda and, by working diligently both within and outside of formal processes, serious negotiations were restarted in early 2004. These efforts produced positive results and a 'framework' agreement was reached in late July 2004 that sets out the scope for negotiating the completion of the Round.<sup>35</sup> However, much work still remains before the Doha Round can be successfully completed and it is universally regarded that the Round will not meet its original completion deadline. In fact, a poll conducted shortly after the completion of the 'framework' agreement shows that many still believe that the conclusion of the Doha Round remains a long way off.<sup>36</sup>

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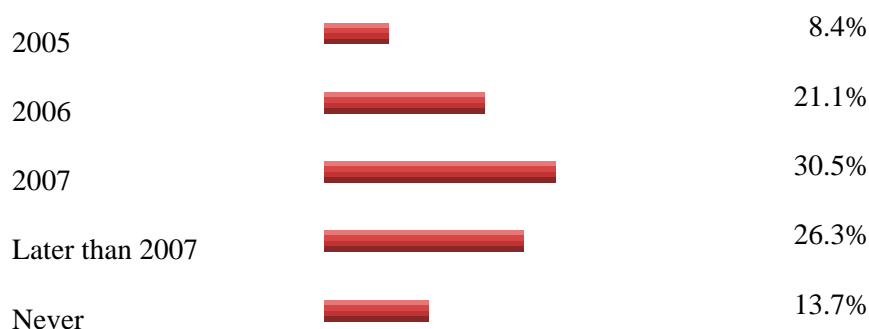
33 As a result of the new-found spirit of co-operation following the terrorist attacks of September 11, ministers shifted the focus of the Round from investment and market access issues to focus instead on the concerns raised by developing countries. The agreement produced at Doha, the Doha Declaration, contained a number of concessions to developing countries, such as rollbacks or extinguishment of a number of obligations negotiated during the Uruguay Round. In addition, new interpretations and clarifications on rules and obligations were promulgated directly favouring developing countries. See Peter M Gerhart, 'Slow Transformations: The WTO as a Distributive Organization' (2002) 17 *American University International Law Review* 1045, 1074. See also Inaamul Haque, 'Doha Development Agenda: Recapturing the Momentum of Multilateralism and Developing Countries' (2002) 17 *American University International Law Review* 1097. It has been suggested that developed countries have taken less interest in the progress made by the developing countries post-Doha than was originally expected: see Xin Chang, 'Implementation of the WTO Agreements: Framework and Reform' (2003) 23 *Northwestern Journal of International Law and Business* 388.

34 While substantial differences between the positions of Members caused the collapse of the Cancun meeting, unprecedented participation from non-governmental organisations has also been blamed for the failure. The level of NGO participation has led to what some commentators call the 'UN-isation' of the process, whereby grandstanding and showmanship commonly seen in the United Nations replaced useful bargaining: see Razeen Sally, *The WTO in 2003: The Rocky Road to Cancun*, London School of Economics <<http://www.lse.ac.uk/collections/globalDimensions/tradepolicy/papers/wto2003.htm>> at 6 November 2004.

35 *Doha Work Programme*, WTO Doc WT/GC/W/535 (2004) A-1 (Draft General Council Decision of 31 July 2004). The 'Framework for Establishing Modalities in Agriculture' is included as Annex A.

36 The poll was conducted at World Trade Law <<http://www.worldtradelaw.net>> at 13 November 2004.

### When will the Doha Round negotiations conclude?



Source: [www.worldtradelaw.net](http://www.worldtradelaw.net), poll results as of 20 August 2004.

In addition, following the collapse of the Cancun Ministerial, a number of developed and high-income developing countries realised that protectionist elements in many countries were slowing the multilateral liberalisation process and that, in the current climate, their interests would be better served by bypassing the multilateral negotiations and instead focussing their attention on and pursuing their own initiatives in bilateral FTAs.<sup>37</sup> The reasoning behind this decision is not to dismantle the multilateral system. Instead, the reason is more pragmatic, as nations realised that FTAs will shield them against future protectionist incursions into their particular trading relations, even if their trading partners later succumb to the growing protectionism.<sup>38</sup> This line of reasoning is particularly persuasive for developing countries, as such arrangements guarantee access to large markets and protect the smaller nation against any future protectionist action of the larger nation seeking to reverse liberalisation.<sup>39</sup>

So the question inevitably becomes: is the world trading system moving away from non-discriminatory multilateralism towards a more fractured, bilateralism? From what is emerging, the short-term answer is a resounding 'yes'. The shift towards bilateralism has unquestionably been promoted by the US, which has completed FTAs or started negotiations with countries from every continent (bar Antarctica). The fact that the US is leading the world into expanded bilateral frameworks is significant, not simply because the US is the world's only superpower and possesses the largest and most dynamic economy in the world; far more important is the policy shift from the traditional American view of

37 These agreements, like the vast majority of agreements concluded post-1997, include a number of features which were not in the earlier FTAs, such as the following: (i) countries that had not previously been in any free trade area are now included; (ii) countries are now in several FTAs or regional agreements; (iii) agreements now frequently cross regions; and (iv) many of the post-1997 agreements only have two members in the union: see Peter Lloyd, 'New Regionalism and New Bilateralism in the Asia-Pacific' (Paper presented at the Pacific Economic Co-operation Council Trade Forum, Lima, 17–19 May 2002) 4.

38 For instance, Canada has stated its motivation for negotiating FTAs is to secure access for its goods in the face of growing protectionism: *ibid* 6.

39 See Panagariya, Working Paper, above n 27, 18–19. The cost, therefore, of opening one's own market to the larger nation is seen as insurance against possible loss of market access to the larger nation: at 18–19.

world trade. Since the formation of the GATT in 1947, the US has only pursued multilateral negotiations and, for the most part, avoided bilateral agreements. The only exceptions to this policy have been close neighbours and friends such as Canada, Mexico and various Caribbean states. However, following the failed Cancun Ministerial, the US has unquestionably encouraged and promoted the proliferation of FTAs. This shift caused many in the trade community to initially question whether the US felt it had given all it could to the multilateral process and would abandon multilateral negotiations.<sup>40</sup> Fortunately for the multilateral trading system, subsequent American leadership in the continued Doha Round negotiations has answered that question in the negative.<sup>41</sup>

But while the US may have started the trend, bilateral FTAs are being promulgated by many countries around the world. In fact, nearly every Central and South America country, many Middle Eastern states and a large part of Africa have recently signed or are negotiating multiple FTAs.<sup>42</sup> Even East Asian countries, which have traditionally shied away from bilateral trade agreements, are vigorously pursuing FTAs.<sup>43</sup> This movement is being led by the 10 members of the Association of Southeast Asian Nations ('ASEAN'), who are not only crafting their own regional customs union, but also signing FTAs with countries both within and outside the region.<sup>44</sup> But the move to abandon seeking only multilateral solutions to trade arrangements was started by regional powers Japan and South Korea, who began negotiating an FTA in 1998. While those efforts failed to cement an agreement, countries within the region continued negotiating

40 See David Spector, 'Trade Treaty Threats and Sub-national Sovereignty: Multilateral Trade Treaties and Their Negligible Impact on the State Laws' (2004) 27 *Hastings International and Comparative Law Review* 391.

41 One example of continued US leadership can be seen in the recent agriculture negotiations. See below nn 57–59 and accompanying text. In addition, US Trade Representative Robert Zoellick has met over 40 of his counterparts to discuss how best to get the Doha negotiations back on track. Even more, the US is the only country in the world to propose the elimination of all tariffs worldwide on consumer and industrial goods by 2015, substantial cuts in farm tariffs and trade distorting subsidies, and broad opening of services markets: see Office of the US Trade Representative, *2004 Trade Policy Agenda and 2003 Annual Report* (2004), <[http://www.ustr.gov/Document\\_Library/Reports\\_Publications/2004/2004\\_Trade\\_Policy\\_Agenda/Section\\_Index.html](http://www.ustr.gov/Document_Library/Reports_Publications/2004/2004_Trade_Policy_Agenda/Section_Index.html)> at 6 November 2004. Moreover, the US is a frequent user of the dispute settlement mechanism: see *WTO Dispute Settlement Tables and Statistics*, World Trade Law <<http://www.worldtradelaw.net/dsc/stats.htm>> at 13 November 2004. The US is also a key participant in the Review of the Dispute Settlement Understanding ('DSU Review'): see generally Bryan Mercurio, 'Improving Dispute Settlement in The WTO: The DSU Review – Making It Work?' (2004) 38 *Journal of World Trade* 795.

42 For instance, at its meeting in March 2002, the members of the Organisation for African Unity agreed to negotiate an 'African Union' to be loosely modelled on the EU: Lloyd, 'New Regionalism and New Bilateralism in the Asia-Pacific', above n 37, 15. Democracy itself is fragile in many of these nations, but even they can see that multilateralism is not embracing free market values at a quick enough pace and, thus, have become some of the foremost champions for open markets and liberalised trade while embracing bilateral FTAs.

43 The longstanding regional consensus was that, if any activity happened outside of the WTO, the Asia-Pacific Economic Co-operation would serve to further liberalise the region. Correspondingly, early proposals for a regional trading bloc, such as the 1993 proposal for an East Asian Economic Grouping, failed to gain acceptance: see Robert Scollay, 'RTA Developments in the Asia Pacific Region: State of Play' (Paper presented at the Pacific Asian Co-operation Council Trade Forum, Phuket, 25 May 2003) 2.

44 Many speculate on the reasons why East Asia abandoned its opposition to FTAs: see, eg, Fred Bergsten, 'America's Two-Front Economic Conflict' (2001) 80(2) *Foreign Affairs* 16.

FTAs, with the first agreement occurring in 2002 between Japan and Singapore.<sup>45</sup> Since that time, FTAs have flourished in the region and over 30 proposals including Asian-Pacific countries have recently been discussed.<sup>46</sup> Moreover, Japan and Korea have signed FTAs with several countries, and China, looming to be the region's economic power, is fielding calls from a number of countries queuing about negotiating economic ties with the budding giant.<sup>47</sup>

Even Australia, which up until last year had only one operational FTA (the *Australia–New Zealand Closer Economic Relations Agreement* ('CER')),<sup>48</sup> has begun negotiating FTAs on a more widespread basis. In 2003, Australia signed an FTA with Singapore<sup>49</sup> and, in addition to the much publicised agreement with the US, Australia has also recently signed an FTA with Thailand.<sup>50</sup> Moreover, Australia is investigating the possibility of future FTAs with China, South Korea, Japan and several Middle Eastern states.<sup>51</sup>

However, it cannot be said that Australia's newly formed desire to integrate on a bilateral basis has come at the expense of its participation in the multilateral process. In fact, the opposite is true. Australia's participation in multilateral trade is longstanding, with the nation of 20 million citizens playing a large part in the development of the modern world trading system. From the mid-1940s, Australia was one of 25 nations which originally negotiated and agreed on the GATT. Considering that Australia, with only the 14<sup>th</sup> largest economy, is a relatively small player in the world trade scene, the nation has done well to situate itself in a position of relative power.<sup>52</sup> A substantial part of Australia's status as a world player is derived from its active participation in developing the rules of

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45 *Japan–Singapore Economic Partnership Agreement*, 31 October 2002 (entered into force 30 November 2002), <<http://www.mofa.go.jp/region/asia-paci/singapore/jsepa.html>> at 10 August 2004.

46 Proposals have included an 'ASEAN Plus 3', including China, Japan and Korea along with the 10 Member Nations of ASEAN: see Scollay, 'RTA Developments in the Asia Pacific Region', above n 43, 3. See also Robert Scollay, 'The Changing Outlook for Asia-Pacific Regionalism' (2001) 24 *World Economy* 1135.

47 *The Economist* recently wrote: 'If [Asian nations] are to have any hope of luring foreign businessmen these days, these countries need to trumpet their growing economic ties with Asia's next giant': 'Everybody's Doing It: Why Asian Countries are Racing to Sign Bilateral Trade Deals with Each Other', *The Economist* (London), 28 February 2004, 2.

48 *Australia–New Zealand Closer Economic Relations Agreement*, 28 March 1983 [1983] ATS 2 (entered into force 1 January 1983).

49 *Singapore–Australia Free Trade Agreement*, 17 February 2003 [2003] ATS 16 (entered into force 28 July 2003).

50 *Australia–Thailand Free Trade Agreement*, 5 July 2004 (enters into force 1 January 2005 pending parliamentary approval in both countries). The agreement will immediately eliminate up to 75 per cent of Thai tariffs on Australian goods and will eliminate the substantial majority of the remaining tariffs within five years. (Sensitive agricultural products will retain tariffs until 2025.) Investment and the services sectors should also increase, as Australian companies will be permitted to become up to 60 per cent majority owners in Thai-based businesses (instead of the current 49 per cent).

51 On Australian bilateral negotiations, see generally Department of Foreign Affairs and Trade, *Trade Policy* <<http://www.dfat.gov.au/trade>> at 13 November 2004.

52 For more detailed economic information on Australia, see *Australia: Economic Data* (2004) *The Economist* <<http://www.economist.com/countries/Australia/profile.cfm?folder=Profile-Economic%20Structure>> at 6 November 2004.

international trade through its leadership in such activities as the Cairns Group,<sup>53</sup> as well as its participation in other multilateral organisations and agreements.<sup>54</sup>

Australia has greatly benefited from the freer market access stemming from WTO membership, with Australian exports rising from A\$93 billion to over A\$154 billion since the WTO's inception.<sup>55</sup> The sharp increase in trade has also significantly contributed to over 250 000 jobs created in Australia during that short timeframe.<sup>56</sup> It would be economically unwise for Australia to turn its back on the multilateral trading regime.

One example of Australia's continued commitment to multilateralism is the role it recently played in negotiating the 'framework' agreement of July 2004.<sup>57</sup> Australia was one of five nations invited to a series of March 2004 mini-ministerial meetings attempting to bridge the vast differences between WTO Member States on the sensitive issue of agriculture liberalisation. These meetings involved ministers and representatives of leading agricultural nations and included only the EC, US, Brazil, India and Australia. These same countries met again in Brazil in June 2004 to further negotiate an acceptable agricultural framework. It is quite clear that Australia's invitation to these negotiating sessions was a direct result, not only of Australia's continued leadership in the Cairns Group, but also of its action in putting forward proposals in an attempt to resolve the deadlock. The final agreement reflected an agreement reached on 28 July 2004 by Australia and the four other countries invited to the March 2004 meetings on all three substantial pillars of the framework agreement (market access, domestic support and export competition).<sup>58</sup> While the manner in which the final text was concluded drew the ire of other Members,<sup>59</sup> Australia's inclusion shows not only what an important player it is in the agricultural market but also its continued commitment to multilateralism.

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53 The Cairns Group is an Australian-led coalition of 17 agricultural exporting countries. The Cairns Group accounts for one third of all agriculture trade and the strength-by-numbers approach has succeeded in putting agriculture on the multilateral trade agenda and generally reforming trade in agriculture.

54 Australia's active participation in the international arena has led to it being generally regarded as a 'good international citizen', a designation which plays a part in its current reputation and status. As a 'middle power', Australia is large enough to have credibility and influence on the world stage but not large enough to be seen as a dominant player. Historically, Australia has accepted its role as a 'middle power' and embraced its role as a 'good international citizen', thereby gaining credibility within both the developed and the developing worlds.

55 Department of Foreign Affairs and Trade, 'Push to Highlight Importance of the WTO to Australia' (Press Release, 8 November 2002), <[http://www.trademinister.gov.au/releases/2002/mvt145\\_02.html](http://www.trademinister.gov.au/releases/2002/mvt145_02.html)> at 6 November 2004. The Australian government recognises the important role that the WTO plays in protecting and advancing Australia's interests, with Minister Vaile stating: 'Australia has benefited significantly from the WTO system, including winning better access for beef exports to Korea and regaining access for prawns and lamb exports to the United States'.

56 Ibid.

57 For an overview of Australia's participation throughout the Doha Round, see Department of Foreign Affairs and Trade, *WTO Doha Round Negotiations* <<http://www.dfat.gov.au/trade/negotiations>> at 6 November 2004.

58 'Doha Framework Likely to Offer More General Agriculture Text', *Inside US Trade*, 30 July 2004 <<http://www.insidetrade.com>> at 13 November 2004. Moreover, Australia and the other four countries then spent much of 29 July 2004 briefing other delegations on the agreement in order to gain support from the countries that were excluded from the negotiating process.

59 Ibid.

Moreover, Australia continues to show its commitment to the multilateral system by being an active player in the dispute settlement system and using the WTO Dispute Settlement Understanding ('DSU')<sup>60</sup> where it has deemed it necessary and appropriate to realise its negotiated benefits. Since the inception of the WTO, Australia has been involved in over 30 disputes as a complainant, respondent or third party.<sup>61</sup> Australia has successfully litigated five WTO complaints to date, with two of those disputes being resolved without having to resort to the full process of the DSU.<sup>62</sup> The other three disputes, *Korea – Beef*,<sup>63</sup> *US – Lamb*<sup>64</sup> and *US – Offset Act*,<sup>65</sup> required Australia to use the full extent of the dispute settlement process in order to resolve the complaint. Moreover, Australia has two cases pending against the EU.<sup>66</sup>

Australia has also been the respondent in five disputes,<sup>67</sup> with two of the disputes, *Australia – Salmon*<sup>68</sup> and *Australia – Leather*,<sup>69</sup> reaching the panel

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60 *WTO Agreement*, opened for signature 15 April 1994, 1867 UNTS 3, Annex 2 (entered into force 1 January 1995).

61 For an up-to-date listing of all cases involving Australia, see Department of Foreign Affairs and Trade, *Australia and WTO Dispute Settlement* <[http://www.dfat.gov.au/trade/negotiations/wto\\_disputes.html](http://www.dfat.gov.au/trade/negotiations/wto_disputes.html)> at 6 November 2004.

62 The two disputes not requiring full recourse to the DSU are: *India – Quantitative Restrictions on Agricultural, Textiles and Industrial Products*, WTO Doc WT/DS91 (1997) (during consultations dated March 1998, India committed to removing quantitative restrictions on a range of products according to an agreed timetable); *Hungary – Export Subsidies in respect of Agricultural Products*, WTO Doc WT/DS35 (1996) (in March 1996, Australia and five other complainants sought consultations with Hungary; a mutually agreed solution involving a time-limited waiver was reached after some of the complainants requested the establishment of a panel).

63 *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WTO Doc WT/DS161/R, WT/DS169/R (2000) (Report of the Panel); WTO Doc WT/DS161/AB/R, WT/DS169/AB/R, AB-2000-8 (2000) (Report of the Appellate Body).

64 *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WTO Doc WT/DS177/R, WT/DS178/R (2000) (Report of the Panel); WTO Doc WT/DS177/AB/R, WT/DS178/AB/R, AB-2001-1 (2001) (Report of the Appellate Body).

65 *United States – Continued Dumping and Subsidy Offset Act of 2000*, WTO Doc WT/DS217/R, WT/DS234/R (2002) (Report of the Panel).

66 See *European Communities – Export Subsidies on Sugar*, WTO Doc WT/DS/265 (2002) (complaint by Australia); *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*, WTO Doc WT/DS/290 (2003) (complaint by Australia).

67 Australia has also recently been complained against in three additional disputes: *Australia – Subsidies on Sugar*, WTO Doc WT/DS265/1 (2002) (complaint by the EC); *Australia – Certain Measures Affecting the Importation of Fresh Fruit and Vegetables*, WTO Doc WT/DS270/1 (2002) (complaint by the Philippines); *Australia – Certain Measures Affecting the Importation of Fresh Pineapple*, WTO Doc WT/DS271/1 (2002) (complaint by the Philippines).

68 *Australia – Measures Affecting Importation of Salmon*, WTO Doc WT/DS18/R (1998) (Report of the Panel); WTO Doc WT/DS18/AB/R, AB-1998-5 (1998) (Report of the Appellate Body); WTO Doc WT/DS18/9 (1999) (Arbitration under art 21.3(c)); *Australia – Measures Affecting Importation of Salmon*, WTO Doc WT/DS18/RW (2000) (Recourse to art 21.5 of the DSU by Canada).

69 *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WTO Doc WT/DS126/R (1999) (Report of the Panel); WTO Doc WT/DS126/RW (2000) (Recourse to art 21.5 of the DSU by the United States – Report of the Panel).

stage.<sup>70</sup> In both of those disputes, the complaining countries litigated to the full extent of the DSU. In both cases, Australia was found to have acted inconsistently with its obligations under the WTO Agreements. While Australia postponed compliance in both disputes, neither dispute resulted in countervailing duties or retaliation being sanctioned against Australia.

Australia has also appeared as a third party in at least 23 disputes. While appearing as a third party does not give full complainant rights or rights of retaliation, it does provide access to the system and allows for a Member to voice its opinion on the matter.<sup>71</sup> In appearing as a third party, Australia has effectively influenced the legal reasoning and interpretation of WTO obligations in a number of important disputes.<sup>72</sup>

Australia's use of the DSU is a perfect example of a smaller-sized nation using the multilateral system to achieve fairness and equality in its trading relationships. It has always been a player in the international trading environment, but until the WTO was formed, it had trouble winning concessions from larger Members or influencing systemic change under the GATT. Since the inception of the WTO, Australia has been able to benefit from the DSU in a number of ways. Not only has the WTO allowed Australia to benefit directly from the system, such as gaining increased market opportunities in *Korea – Beef* and *Hungary – Agricultural Subsidies*, but, due to the WTO's system of MFN, Australia has also benefited where it participated only as a third party (*US – Shrimp* and *Canada – Dairy*) or where it had no direct participation in the dispute (*EC – Poultry*).

Moreover, Australia's use of the DSU has influenced the jurisprudence of the Dispute Settlement Body in a way that far exceeds its market size or wealth. In every dispute in which Australia has appeared, the important principles and key systemic finding have emerged to significantly shape WTO jurisprudence and, correspondingly, the direction of dispute settlement in the WTO.<sup>73</sup> These disputes illustrate the importance of active participation in the organisation and prove that

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70 The three cases settled before reaching the panel stage are: *Australia – Anti-Dumping Measures on Coated Woodfree Paper Sheets*, WTO Doc WT/DS119 (1998) (In 1998, Switzerland sought consultations over anti-dumping measures taken by Australia. The case concluded at the consultation stage after the provisional anti-dumping measures at issue were terminated in the course of routine domestic anti-dumping processes); *Australia – Measures Concerning the Importation of Salmonids*, WTO Doc WT/DS21 (1995) (In November 1995, the US sought consultations regarding Australia's salmon import restrictions. A panel was established on 16 June 1999, but the US requested its suspension pending the outcome of the case brought by Canada (*Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, above n 69). The dispute was resolved on 27 October 2000, when the US accepted Australia's revised measures as consistent with WTO obligations); *Australia – Textile, Clothing and Footwear Import Credit Scheme*, WTO Doc WT/DS57 (1996) (In 1996, the US complained against subsidies that Australia maintained on leather products. The parties reached a settlement soon after the panel request).

71 See *WTO Agreement*, opened for signature 15 April 1994, 1867 UNTS 3, Annex 2 (DSU), art 10 (entered into force 1 January 1995) (on third parties and the protection of their interests).

72 See, eg, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R, AB-1998-4 (1998) (Report of the Appellate Body).

73 For an analysis of Australia's role in shaping the WTO through its participation in its dispute settlement mechanism, see Bryan Mercurio, 'The Australian Contribution to the Dispute Settlement System' (2005) forthcoming *Currents: International Trade Law Journal* (copy on file with author).

one Member can influence the future of dispute settlement in the WTO simply by using the system as it is designed. Such a positive outcome could not have been possible under the GATT and would not be possible in any other international forum.

Another example of Australia's commitment to the multilateral system can be seen by its actions and efforts to reform the rules governing and regulating the dispute settlement mechanism, the DSU. As part of the Review of the DSU,<sup>74</sup> Australia has taken an active leadership role as a middle power, proposed numerous amendments, built coalitions of like-minded nations and compromised when necessary in order to achieve consensus.<sup>75</sup>

It is clear from Australia's continued actions in and in furtherance of the WTO that it has not abandoned the multilateral system. On the contrary, Australia's actions prove that the two negotiating frameworks are not mutually exclusive and that a nation can successfully navigate between the two. With a mid-sized, export-oriented economy, Australia relies on the rules of the WTO to increase market access for its products and any attempts to discard 50 years of multilateral progress and liberalisation would not be in its interests.

### III WHY BILATERAL?

#### A Bilateralism as a Building Block for Multilateral Trade

While multilateral negotiations reducing trade-distorting barriers across all Member States of the WTO are preferred, the decision-making process of the WTO is one of consensus, meaning that essentially all Members must agree to each and every amendment.<sup>76</sup> Therefore, if even one Member baulks, the situation stalls. In terms of trade liberalisation, this means that one nation adopting a protectionist mentality can block progress, opportunity, and increased competition for all other Member States.

Unsurprisingly, it is difficult to get the 147 Member States of the WTO to agree on anything, much less the complex issues comprising a WTO negotiating round. The Uruguay Round creating the WTO took over eight years to negotiate,

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74 The *WTO Agreement* mandated a comprehensive DSU Review be conducted and completed by October 1998. While Members initially worked hard to complete their mandate, consensus could not be reached and the deadline was extended until 31 July 1999. Regrettably, the Seattle Ministerial Conference ended without agreement on the matter and while Members informally continued to prepare draft proposals, strong differences of opinion on several key issues continued to prevent the DSU Review from being completed. The DSU Review was then seemingly removed from the agenda, or 'permanently suspended', until the Doha Round revived the Review with the aim of concluding an agreement by May 2003. While progress has been made, the May 2003 deadline passed without agreement and was extended until May 2004. Attempts to complete the mandate have thus far proved unsuccessful and the May 2004 deadline has recently passed. As of yet, a new deadline for the completion of the DSU Review has not been set. See Mercurio, 'Improving Dispute Settlement in The WTO', above n 41.

75 Ibid.

76 See Jackson, Davey and Sykes, above n 10, 223–6. See generally Mary Footer, 'The Role of Consensus in GATT/WTO Decision-Making' (1996–97) 17 *Northwestern Journal of International Law and Business* 653, 661.

and even then it was a marvel that all nations agreed to the text.<sup>77</sup> It is unrealistic to expect multilateral negotiations to be concluded with ease or in a short time period, and especially not within a week at a Mexican resort.<sup>78</sup> Moreover, even when change occurs in the multilateral setting, the consensus rule can drive the standard down to a lowest common denominator, sometimes leaving us with weak standards (see intellectual property) and toothless rules (see agriculture).<sup>79</sup> So what should one nation do if another nation or a group of nations blocks progress by refusing to agree to systemic reform?<sup>80</sup>

In such a scenario, it may be necessary to drive the agenda by negotiating bilateral agreements. Deeper economic integration accomplished through bilateral FTAs can bring faster results than the multilateral process, can enable parties to liberalise beyond the levels achievable through multilateral consensus, and may be able to address specific issues that do not even register on the multilateral menu.<sup>81</sup> In this regard, the resulting achievements in trade liberalisation substantially complement the WTO and can be an important building block for future multilateral liberalisation.

For example, if the US succeeds in including environmental and labour standards in its FTAs with both developed and developing countries, such provisions may become commonplace and eventually be eased into the

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77 As an organisation comprised of 147 Members with conflicting interests and varying levels of economic development, political stability and democratic governance, the WTO is rife with internal conflicts and philosophical debate. For general discussion on some aspects of conflict, see 'Symposium: The United States, the Doha Round and the WTO – Where Do We Go from Here?' (2003) 37 *International Lawyer* 651.

78 For an example of the time periods involved in building consensus, see the complicated process of completing the DSU Review, described above n 74.

79 See, eg, Ian Sturgess, 'The Liberalisation Process in International Agricultural Trade: Market Access and Export Subsidies' in Sanoussi Bilal and Pavlos Pezaros (eds), *Negotiating the Future of Agricultural Policies: Agricultural Trade and the Millennium WTO Round* (2000) 135, 139; Christopher Stevens et al, *The WTO Agreement on Agriculture and Food Security* (2000) 41; Dale McNeil, 'Agricultural Trade Symposium: Furthering the Reforms of Agricultural Policies in the Millennium Round' (2000) 9 *Minnesota Journal of Global Trade* 41, 56–7.

80 This does not imply that nations should agree to reforms if it is not in the best interest of the multilateral system. What is meant is that nations should look beyond their own short-term interests for the long-term interests of the system. For example, in the course of the agriculture negotiations, the G-10 group of net-agriculture importing nations (including Japan, Norway and Switzerland) refused to liberalise all agriculture sectors and also refused to agree to significant tariff cuts. While such actions may protect their respective domestic industries, it also keeps developing country products from those marketplaces. On the other hand, the US and EU eventually agreed to open all areas and reduce tariffs on all products, not because it was particularly good for their own farmers, but in order to aid the farmers in the developing world and so that the negotiations could successfully conclude: see 'Framework for Establishing Modalities in Agriculture', above n 35.

81 See Razeen Sally, *Multilateral Versus Bilateral Trade Liberalisation: East Asia and the New Regionalism* (2002) London School of Economics <<http://www.lse.ac.uk/collections/globalDimensions/research/multilateralVersusBilateralTrade>> at 6 November 2004. The famous work of Kemp and Wan argues that incentive exists for every nation to join a customs union until they cover the globe. This would make negotiations smoother and further liberalisation more likely: see Murray Kemp and Henry Wan, 'An Elementary Proposition Concerning the Formation of Customs Union' (1976) 6 *Journal of International Economics* 95, 95–7. This work has been extended to FTAs by several economists: see, eg, Arvind Panagariya and Pravin Krishna, 'On the Existence of Necessarily Welfare-Enhancing Free Trade Areas' (Working Paper No 32, Department of Economics, University of Maryland, 1997).

multilateral agreements. As it currently stands, strong developing-country opposition is blocking the inclusion of any environmental or labour standards into the WTO agreements.<sup>82</sup> But, if enough developing countries agree to abide by environmental and labour standards negotiated in FTAs with the US or other developed countries, those developing countries no longer have any reason to oppose their inclusion in the WTO. In fact, those countries have incentive to encourage their inclusion into the multilateral agreements for the simple reason that if they now have to abide by the stringent rules, and other developing countries (that is, competitors) do not, they lose any competitive advantage that they may have had over those countries and are effectively disadvantaged.<sup>83</sup>

Given the new dimensions of globalisation, WTO Members need to demonstrate that trade rules can adapt to meet evolving needs and circumstances. In this sense, because multilateralism is stalled, the momentum created by FTAs is now needed to underpin the multilateral environment.<sup>84</sup> In this regard, bilateral negotiations are not mutually exclusive of the multilateral negotiations and can be used to influence positively the multilateral agenda by going beyond what is achievable at the present time. Put simply, bilateral agreements have the ability to establish prototypes for liberalisation in a wide range of trading areas, including services, e-commerce, intellectual property, transparency in government regulation, and better enforcement of labour and environmental protections that

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82 See, eg, Donald McRae, 'Trade and the Environment: Competition, Cooperation or Confusion?' (2003) 41 *Alberta Law Review* 745; Jagdish Bhagwati, 'Boundaries of the WTO: Afterword: The Question of Linkage' (2002) 96 *American Journal of International Law* 126.

83 For arguments against the inclusion of environmental and labour standards into FTAs, see Jagdish Bhagwati, 'Preferential Trade Agreements: The Wrong Road' (1996) 27 *Law and Policy in International Business* 865–6; Jagdish Bhagwati and Arvind Panagariya, 'Bilateral Trade Treaties are a Sham!', *Financial Times* (London), 14 July 2003, 17.

84 For instance, during the NAFTA negotiations in the early 1990s, the US made it clear that it would not agree to the NAFTA without the inclusion of meaningful intellectual property protection provisions in the agreement. As Canada already adequately protected intellectual property rights, Mexico was forced to decide if improving intellectual property protection was a price it was willing to pay for liberalised trade with the US and Canada. It decided the question in the affirmative. Subsequently, the Uruguay Round included intellectual property as a negotiating topic in the creation of the WTO. For more on negotiating intellectual property protection into international trade agreements, see generally Daniel Gervais, *The TRIPS Agreement: Drafting History and Analysis* (2003); Bryan Mercurio 'TRIPs, Patents and Access to Life-Saving Drugs in the Developing World' (2004) 8 *Marquette Intellectual Property Law Review* 211. Mexico also agreed to the environmental and labour standards annexed to the NAFTA. Ever since, the US has sought to include such provisions into its FTAs. For instance, lobbyists pressured the Clinton Administration to incorporate meaningful provisions into the *US–Jordan Free Trade Agreement* and the Bush Administration has similarly been under pressure from labour and environmental lobbies during its FTAA and *Central America Free Trade Agreement* negotiations. Moreover, the US has recently negotiated for the insertion of a provision banning the use of capital controls in its FTAs with Chile and Singapore (with parties agreeing to a dispute settlement and compensation mechanism in situations where controls are used). It appears the US has created another FTA precedent with this use. However, the wisdom of such capital controls has been questioned: see Joseph Stiglitz, 'New Trade Pacts Betray the Poorest Partners', *New York Times* (New York), 10 July 2004, 17.

are simply not possible on the multilateral stage.<sup>85</sup> At the same time, bilateral FTAs are helping developing countries gain from regional integration and stronger economic ties to developed countries, improving both the trading regimes and rule of law in those countries.<sup>86</sup>

### B Become Advantaged, Not Disadvantaged

An arguably more important reason for Australia to negotiate bilateral FTAs is so that it does not get left behind and become disadvantaged in the world trading system. Australia is, and will always be, an active participant in multilateral trade,<sup>87</sup> but there are currently over 200 FTAs in effect, with many more under negotiation, and Australia's participation in these agreements is minimal. In fact, while many Members belong to several FTAs and only three Members of the WTO do not belong to any regional FTA (Macau, Taiwan and Mongolia),<sup>88</sup> Australia is part of only two operational agreements, one with New Zealand and one with Singapore.<sup>89</sup> Australia has also recently signed FTAs with the US and Thailand.<sup>90</sup>

As a result of inactivity on the bilateral front, Australia is currently facing actual discrimination in many key markets. To illustrate with a hypothetical fact pattern: say India has a bound tariff rate of 100 per cent on wheat products but negotiates an FTA with the US to lower that rate to 10 per cent. This means that American wheat will now enter the country at a 10 per cent rate, but all other imported wheat (including Australian) is tariffed at 100 per cent. This FTA would be compatible with the WTO. First, the reduction in a barrier to trade, in this instance the tariff, is substantial and (we will assume) part of a larger, more comprehensive trade agreement. Second, non-members are not put in a worse situation than before the agreement came into force, meaning they still pay only the 100 per cent tariff on wheat products. But even though Australia and the others are not in a worse position (they still only pay 100 per cent), those nations

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85 See generally Ramkishan Rajan, Rahul Sen and Reza Siregar, *Singapore and Free Trade Agreements* (2001) ch 2. Former Singaporean Prime Minister Goh explicitly stated his intention of using FTAs as a building block to regional liberalisation by stating Singapore's 'intention to spin a web of interlocking free trade agreements between Asia-Pacific Economic Co-operation members, which could help to move the organisation toward achieving free trade in the Asia Pacific': see Lloyd, 'New Regionalism and New Bilateralism in the Asia-Pacific', above n 37, 12.

86 See Devos, above n 30. Not everyone believes that negotiations with substantially poorer nations result in balanced agreements: see Stiglitz, above n 84.

87 Australian Bureau of Statistics show Australia's import and export trade relies on foreign investors to keep the economy going. In 2002–03, 49 per cent of the value of exports from Australian-based companies was ultimately controlled by offshore interests. Likewise, 65 per cent of the value of imports by companies based in Australia was controlled by off-shore interests: see Australian Bureau of Statistics, *Foreign Ownership of Australian Exporters and Importers*, Cat No 5496.0.55.001 (2004).

88 Of these countries, only Mongolia is not currently involved in any FTA negotiations: Avinash Celestine, 'More Hype Than Hope? For India it Won't be All Smooth Sailing in the FTA Waters', *Business World* (Kolkata, India), 26 April 2004, <<http://www.businessworldindia.com/apr2604/coverstory03.asp>> at 6 November 2004.

89 See above nn 48, 49.

90 See above n 50.

suffer as the US gets the benefits of the lower tariff and will likely be able to corner the imported wheat market.

To illustrate further using an actual example, Japan and Mexico recently agreed to a bilateral FTA which will see, among other things, Japan increasing Mexican imports of pork, oranges and other agricultural products, while Mexico will import more steel, automobiles and other industrial products from Japan.<sup>91</sup> Negotiating this agreement was difficult for Japan, as the powerful Japanese agriculture lobby worried about cheap agricultural imports flooding the Japanese market.<sup>92</sup> But Japan realised that its lack of bilateral activity was disadvantaging its exports, as Mexico already has FTAs with the US and the EU, thus rendering Japanese industries non-competitive in the market.<sup>93</sup> As a result of the agreement, existing Mexican tariffs, ranging between 18 per cent and 30 per cent on Japanese games, motorcycles, computer peripherals, photocopiers, telecommunications equipment, CD players and musical instruments, will be lifted, as will the duty-free export quota for cars.<sup>94</sup> This means that Japanese products will enter Mexico on an equal footing with products originating in the US and EU.<sup>95</sup>

This agreement has ramifications for Australia, as food products make up a large amount of Australian exports to Japan, many of which are directly competitive with food products from Mexico. As a result, Australian exports to Japan are now disadvantaged vis-à-vis Mexican products. Thus, Australian agriculture and food exports to Japan are likely to see slower than expected, or even negative, growth in the coming years. This scenario is not unique or even rare, but is commonplace in the world trading system. In a number of key markets, Australian exports are becoming disadvantaged and facing high tariffs

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91 See 'Japan, Mexico Reach Broad Agreement on FTA', *The Japan Times* (Tokyo), 11 March 2004 <<http://www.japantimes.com/cgi-bin/getarticle.pl5?nn20040311a2.htm>> 6 November 2004; Mayumi Negishi, 'With Mexico FTA Set, Japan Turns Toward Asia', *The Japan Times* (Tokyo), 12 March 2004 <<http://yaleglobal.yale.edu/display.article?id=3512>> at 6 November 2004.

92 See 'Japan, Mexico Reach Broad Agreement on FTA', above n 91; Negishi, above n 91. Japan already imports almost all its avocados, tequila and salsa from Mexico, as well as limited volumes of pork, poultry, meat, tuna, juice and pumpkins (the FTA increases the quotas for the restricted products). Mexico anticipates the FTA to create annual growth of 10.6 percent in Mexican exports to Japan: Negishi, above n 91.

93 See 'Free Trade with Mexico: Bilateral Pact Doesn't Mean Giving Up on WTO', *Asahi Shimbun* (Japan), 12 March 2004.

94 Negishi, above n 91. Japan also anticipates that the cost of food products (Japan pays an estimated ¥3.8 trillion to import 60 per cent of its total food consumption) will decrease. Mexico claims that the FTA will encourage Japanese investment worth an average US\$1.3 billion a year, or \$12.7 billion over 10 years. Mexico currently receives only 1.3 per cent of Japan's foreign direct investment: Negishi, above n 91.

95 Industrial tariffs were very detrimental to Japanese manufacturers, a point illustrated by Canon Inc, NEC Corp and Sanyo Electric Co, who all recently withdrew from Mexico due to the high price of machine parts imported from Japan: Negishi, above n 91.

while Australia's competitors are securing preferential treatment via bilateral FTAs.<sup>96</sup>

In fact, it is clear that the prospect of Australia becoming disadvantaged worldwide is not just distant speculation but is apparent in a number of markets. Even more, the number of FTAs is rapidly increasing. During the GATT years (1948–94), 124 bilateral and regional FTAs were negotiated and signed, but since the implementation of the WTO in 1995, over 130 bilateral and regional FTAs have been negotiated and signed.<sup>97</sup> In addition, every major world trading nation, and certainly every major trading partner of Australia, is negotiating FTAs with multiple countries. In fact, between 100 and 200 FTAs are scheduled to be concluded by the end of 2005.<sup>98</sup>

So while some argue that Australia should be an example to the world and adhere to the principle of multilateral negotiations, it is highly doubtful that an Australian stand against bilateral FTAs would do anything to cease the momentum behind the global bilateral drive. Theoretically, Australia could seek to build a coalition of like-minded countries to oppose the trend towards bilateralism, but even finding one willing partner could be problematic; every major trading nation is actively involved in bilateral agreements, including every member of the Cairns Group of agricultural exporting nations committed to multilateral liberalisation. In 1999, and thus before the explosion of FTAs which resulted following the failure of the Cancun Ministerial, the WTO estimated that 57 per cent of world trade in goods was covered by FTAs; therefore, less than half of all trade in goods is covered by the principle of multilateralism.<sup>99</sup> As a result, any possible stand Australia would take would be as a stand-alone nation and would have virtually no chance of slowing the pace of bilateralism; there are simply too many FTAs in existence or in the pipeline, and such a stand would only serve severely to harm Australian interests. Some economists believe that this exclusion from markets, or disadvantage as against competitor nations, is the main reason driving the growth of FTAs.<sup>100</sup> Just a few examples of current bilateral or regional negotiations include:

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96 While all Australian businesses are disadvantaged, the negative consequences disproportionately affect small and medium sized businesses. For that reason, these businesses strongly support Australian involvement in FTAs: see Mark Fenton-Jones, 'Asian Opportunities Beckon', *Australian Financial Review* (Sydney), 29 June 2004, 49.

97 As of December 2002, 250 FTAs have been notified to the GATT/WTO, of which 130 were notified after January 1995. See WTO, *Regional Trade Agreements* <[http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm)> at 6 November 2004.

98 Ibid. See also United Nations Economic and Social Commission for Asia and the Pacific ('UNESCAP'), 'The Cancun Aftermath: From Bali to Bangkok to ...', *Regional Rapid Response Trade Bulletin*, Flier Number 1, <<http://www.unescap.org/tid/news/flier1.pdf>> at 6 November 2004.

99 See WTO, *Mapping of Regional Trade Arrangements*, WTO Doc WT/REG/W/41 (2000). Intra-EC trade accounts for 25 per cent of this total.

100 See, eg, Lloyd, 'New Regionalism and New Bilateralism in the Asia-Pacific', above n 37, 7. This reasoning is commonly called the 'domino effect', where the more nations that join FTAs, the greater is the need for non-members to negotiate FTAs, just to keep their goods on competitive terms. The domino effect is strongest when a trading partner has negotiated multiple FTAs. For more on the domino effect, see Richard Baldwin, 'A Domino Theory of Regionalism' in Richard Baldwin, Pertti Haaparnata and Jaakko Kiander (eds), *Expanding Membership of the European Union* (1995) 25.

- The US, since April 2004, has signed FTAs or Trade and Investment Framework Agreements with Morocco, Peru, Ecuador, Columbia, Malaysia, Uruguay, Chile, Bahrain, Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan) and Australia, and has signed the *Central American Free Trade Agreement* (Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua). The US has also concluded, but not yet signed, an FTA with Thailand, is negotiating the FTAA with 10 South American countries, and is negotiating FTAs with several Middle Eastern states, Taiwan, Singapore and the Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland).<sup>101</sup>
- India recently concluded FTAs with Sri Lanka, Bangladesh and Afghanistan, signed a framework agreement with Brazil, and is negotiating with ASEAN, Thailand, Singapore and South Africa.<sup>102</sup>
- Thailand recently concluded FTAs with Australia and the US, and is negotiating FTAs with China, Bahrain and India.<sup>103</sup>
- Korea recently signed an FTA with Chile and will soon be launching formal FTA negotiations with Japan, Singapore, Mexico, the US and China.<sup>104</sup>
- ASEAN (Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand and Vietnam) agreed to a customs union

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101 See Office of the US Trade Representative, *Bilateral Trade Agreements* <[http://www.ustr.gov/Trade\\_Agreements/Bilateral/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html)> at 6 November 2004. See also 'Dominican Republic Becomes Sixth Member of CAFTA' (2004) 17(5) *World Trade* 16. The US, by negotiating so many FTAs, is clearly attempting to establish itself at the centre of its new bilateral trading regime. Economist Ronald Wannacott calls this process 'hub and spokes', where one nation negotiates several FTAs and therefore has preferential access to all the 'spokes', but the 'spokes' do not enjoy similar widespread preferential access and only get the preferences with the 'hub'. The EU is the undisputed champion of this model, as it has negotiated no less than 25 FTAs, but with its recent actions, the US is forming its own 'wheel'. For more on 'hub and spokes', see Ronald Wannacott, 'Trade and Investment in a Hub-and-Spoke System Versus a Free Trade Area' (1996) 19 *The World Economy* 237.

102 See 'Indian Trade Fair in Colombo to Focus on Bilateral Trade', *Business Line* (Chennai, India), 20 June 2004, 3; 'Brazil Building Ties With the Subcontinent' (2004) 37(5) *NACLA Report on the Americas*, 5; Seema Gaur, 'Framework Agreement on Comprehensive Economic Co-operation between India and ASEAN: First Step Towards Economic Integration' (2003) 20 *ASEAN Economic Bulletin*, 283; Louie Divinagracia, 'The View from Taft: More Regional Trade Accords in Asia?' *Business World* (Philippines), 2 October 2003, 4.

103 See M Ramesh, 'Free Trade with Thailand Likely to Begin from July', *The Hindu Business Line* (Chennai, India), 27 February 2004 <<http://www.thehindubusinessline.com/2004/02/27/stories/2004022700960400.htm>> at 6 November 2004. Two-way trade between India and Thailand is expected to double from the current level of A\$1.5 billion in the first year of the agreement.

104 See, eg, 'Trade Volume with Chile Surge 56% after FTA', *Korea Times* (Seoul), 3 May 2003; 'Singapore, S Korea Hope to Sign Free Trade Pact by End of 2004', *Asia in Focus*, 19 July 2004. For more on Korea's trading ambitions, see generally Republic of Korea Ministry of Foreign Affairs and Trade <<http://www.mofat.go.kr/en/index.mof>> at 13 November 2004.

among the group,<sup>105</sup> has an agreement to negotiate an FTA with China, is negotiating with India and Japan, and recently launched preliminary negotiations with Australia and New Zealand (collectively as members of the CER).<sup>106</sup>

- Singapore is a member of ASEAN, has signed FTAs with New Zealand, Japan, Australia, the US and the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland), and is negotiating FTAs with Mexico, Canada, India and South Korea.<sup>107</sup>
- China signed an FTA with Hong Kong, is negotiating with ASEAN, Thailand, the Gulf Co-operation Council (United Arab Emirates, Bahrain, Kuwait, Oman, Qatar and Saudi Arabia), Chile, Namibia and South Africa, and expressed interest in launching negotiations with Australia, New Zealand and South Korea.<sup>108</sup>
- Japan recently concluded agreements with Singapore and Mexico, and is negotiating with Malaysia, the Philippines, Thailand and South Korea.<sup>109</sup>
- Argentina is a member of the Southern Cone Common Market ('MERCOSUR') trade bloc (with Brazil, Paraguay, Uruguay, Peru, Chile,

105 The ASEAN members signed the *Declaration of ASEAN Concord II ('Bali Concord II')* (7 October 2003) providing that '[a]n ASEAN Community shall be established comprising three pillars, namely political and security cooperation, economic cooperation and socio-political cooperation that are closely intertwined and mutually reinforcing for the purpose of ensuring durable peace, stability and shared prosperity in the region'. ASEAN has a population of 500 million and an annual foreign trade of US\$700 million. The group plans to achieve a single production base and market by 2020 with a free flow of goods, services and investments in the region: see Denis Hew and Hadi Soesastro, 'Realizing the ASEAN Economic Community by 2020: ISEAS and ASEAN-ISIS Approaches' (2003) 20 *ASEAN Economic Bulletin*, 292.

106 For more on ASEAN's FTA negotiations, see generally ASEAN <<http://www.aseansec.org/4920.htm>> at 13 November 2004. See UNESCAP, above n 98; Andrew Burrell, 'Asean Puts Out Welcome Mat on Trade', *Australian Financial Review* (Sydney), 28 June 2004, 5; John Wong and Sarah Chan, 'China ASEAN Free Trade Agreement' (2003) 43 *Asian Survey* 507; Allesandra Fabro, 'Singapore Joins Trade Push', *Australian Financial Review* (Sydney), 14 July 2004, 9.

107 For more on Singapore's FTAs, see Ministry of Trade and Industry, *Free Trade Agreements* <[http://www.mti.gov.sg/public/FTA/frm\\_FTA\\_Default.asp?sid=12](http://www.mti.gov.sg/public/FTA/frm_FTA_Default.asp?sid=12)> at 13 November 2004. See also Rahul Sen, *Free Trade Agreements in Southeast Asia*, Southeast Asia Background Series No 1, Institute of Southeast Asian Studies (2004); Rahul Sen, Ramkishan Rajan and Reza Siregar, *Singapore and Free Trade Agreements: Economic Relations with Japan and the United States* (2001); Teofilo C Daquila and Le Huu Huy, 'Singapore and ASEAN in the Global Economy' (1993) 43 *Asian Survey* 909. For more information on the US-Singapore Free Trade Agreement, see Sean Murphy, 'US-Singapore Free Trade Agreement' (2003) 97 *American Journal of International Law* 699.

108 See 'China to Hold Talks on Trade Pact with the Middle East', *The Australian* (Sydney), 8 July 2004, 27; Kevin C Gai, 'The ASEAN-China Free Trade Agreement and East Asian Regional Grouping' (2003) 25 *Contemporary Southeast Asia* 387; Rowan Callick, 'Change of Heart' (2004) 167(8) *Far Eastern Economic Review*, 44. For more information on China's trading ambitions, see generally Ministry of Commerce of the People's Republic of China <<http://english.mofcom.gov.cn>> at 13 November 2004.

109 On the bilateral activities of Japan, see generally Japan Ministry of Foreign Affairs, *Free Trade Agreement and Economic Partnership Agreement* <<http://www.mofa.go.jp/policy/economy/fta>> at 13 November 2004. See also Negishi, above n 91; 'Free Trade with Mexico', above n 93; 'Japan, Malaysia Resume Free Trade Talks' *Agence France Presse*, 19 July 2004. Several powerful lobby groups in Japan have also recently proposed the creation of a strategy panel to promote bilateral FTAs: see 'Key Business Lobby Floats FTA Panel', *The Japan Times* (Tokyo), 13 March 2004 <<http://202.221.217.59/print/business/nb03-2004/nb20040313a2.htm>> at 6 November 2004.

Bolivia and Venezuela) and is negotiating seven FTAs (including the FTAA) as part of an export renaissance following its 2002 economic implosion.<sup>110</sup>

- Mexico has signed 32 FTAs (including the recently agreed FTAs with Japan and South Korea) and is negotiating an FTA with MERCOSUR.<sup>111</sup>

These agreements provide for preferential access and lower tariff rates among members. Thus, if Australia fails to negotiate similar preferential agreements, it will be left behind and its exports and standard of living may eventually decline. Fortunately, the government is negotiating deals, having recently signed a deal with Singapore (to add to the CER), concluded FTAs with the US and Thailand and announced plans to study the possibility of a deal with China and several other countries.<sup>112</sup> The FTA with Thailand will be particularly beneficial to Australian exporters, as it will enable Australia to be one of the first Western nations to reach a comprehensive agreement with East Asia's second-largest and fastest growing economy. And while Thai tariffs currently average 15 per cent, tariffs on some products of particular interest to Australian exporters are as high as 200 per cent.<sup>113</sup> As a result, certain Australian goods have been locked out of the Thai market. Fortunately, the Agreement's immediate reduction or elimination of tariffs on a majority of Australian imports presents an 'unprecedented window of opportunity' for Australian exporters. Austrade's senior trade commissioner in Bangkok, Sean Riley, predicts that Australian products would have a significant advantage over international competitors for a short period of time.<sup>114</sup> Mr Riley warned, however, that this advantage would not last forever: 'The Thai Government is currently in FTA negotiations with China, Chile and the United States ... I would estimate Australian companies have about two years to get themselves established while they have this advantage'.<sup>115</sup>

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110 See Jane Bussey, 'Free Trade Area Focus of 2003 Americas Conference in Coral Gables, Fla' *Knight Ridder Tribune Business News*, 29 October 2003. See also Robert Dunn, 'The Routes to Crisis Contagion: International Crisis', *Challenge*, November–December 2001 <[http://www.findarticles.com/p/articles/mi\\_m1093/is\\_6\\_44/ai\\_80747790](http://www.findarticles.com/p/articles/mi_m1093/is_6_44/ai_80747790)> at 13 November 2004 (detailing Argentina's economic rise and fall, from an economic darling of the emerging markets to economic disaster, and explaining how the best-intentioned market reforms can sometimes go astray). For more on Argentina's bilateral trading ambitions, see *Argentina*, SICE: Foreign Trade Information System <[http://www.sice.oas.org/Trade/arg\\_e.ASP](http://www.sice.oas.org/Trade/arg_e.ASP)> at 6 November 2004.

111 See Negishi, above n 91; Oscar Serrat, 'Venezuela Joins Mercosur Trade Bloc' *Associated Press*, 8 July 2004. For more on Mexico's bilateral trading ambitions, see *Mexico*, SICE: Foreign Trade Information System <[http://www.sice.oas.org/Trade/mex\\_e.ASP](http://www.sice.oas.org/Trade/mex_e.ASP)> at 6 November 2004.

112 See generally Department of Foreign Affairs and Trade, *Australia–China Free Trade Agreement Feasibility Study* <<http://www.dfat.gov.au/geo/china/fta>> at 13 November 2004.

113 Graham Cooke, 'Thai Free-Trade Agreement a Window of Opportunity', *Canberra Times* (Canberra), 13 July 2004, 16.

114 *Ibid.*

115 *Ibid.* The CIE estimates that the deal will be worth US\$2.4 billion (A\$4 billion) in the first 20 years of its existence: CIE, *The Australia–Thailand Free Trade Agreement: Economic Effects* (2004) 26, <[http://www.dfat.gov.au/trade/negotiations/aust-thai/tafta\\_eco\\_effects\\_cie.pdf](http://www.dfat.gov.au/trade/negotiations/aust-thai/tafta_eco_effects_cie.pdf)> at 6 November 2004.

The AUSFTA will also benefit Australians immensely, as it alone is expected to boost Australia's national income by up to an annual A\$359 million.<sup>116</sup> But these agreements may not be enough to protect Australian interests. The world trading system moves at a rapid pace and if Australia wants to keep its place in the world and improve the standard of living for its citizens, it must take a more active approach to bilateral trade agreements.<sup>117</sup>

#### IV POTENTIAL FOR AUSTRALIAN FTA NEGOTIATIONS

Throughout the AUSFTA negotiations, some critics argued that by negotiating with the US, Australia risked alienating 'Asia'.<sup>118</sup> This criticism is odd, to say the least, as Australia has recently agreed to FTAs with Singapore and Thailand, not to mention the fact that Australian exports to China are booming; that Australia is the leading source for Chinese direct foreign investment; and that China recently approached Australia, during President Hu's visit last year, about the possibilities of a deal.<sup>119</sup> Moreover, on 21 April 2004, ASEAN invited both Australia and New Zealand (together as members of the CER) to launch talks with the aim of forming a large regional free trading conglomerate. Furthermore, Malaysia has approached Australia about the possibilities of beginning FTA negotiations.<sup>120</sup> Not that the point needs further belabouring, but the fact that these same Asian countries are also negotiating deals with the US, and the fact that Asian countries

116 CIE, *Economic (CIE) Analysis of AUSFTA*, above n 7, 83. A more pessimistic analysis concluded that the annual national income gain would be A\$53 million: see Philippa Dee, *The Australia-US Free Trade Agreement: An Assessment* (2004), <[http://www.aph.gov.au/Senate/committee/freetrade\\_ctte/report/DeeftaReport.pdf](http://www.aph.gov.au/Senate/committee/freetrade_ctte/report/DeeftaReport.pdf)> at 6 November 2004.

117 An example of this would be the impending competition Australia's wheat industry will soon face in the key Middle Eastern market from a rejuvenated Russia. While Russia's agriculture sector remains inefficient by world standards, its emergence as a major exporter could depress global wheat prices by 2.8 per cent and coarse grain prices by 2.6 per cent: see John Breusch, 'Russians to Emerge as Wheat Rivals', *Australian Financial Review* (Sydney), 28 June 2004, 6. Russia's agriculture industry will get an even greater boost when it completes its accession to the WTO.

118 See, eg, Ross Garnaut, 'An Australia-United States Free Trade Agreement' (2002) 56 *Australian Journal of International Affairs*, 134-6; Rob Burton, 'Australian Opposition Mounts to Free Trade Deal with the United States', *Inter Press Service*, 23 July 2003 <<http://www.ips.org/asiaamerica/briefingroom/trade/australia1.html>> at 13 November 2004 (citing academic Ross Garnaut as stating the negotiations could 'sour relations within the Asia-Pacific region').

119 China desperately needs raw materials and energy in order to keep up its booming growth. The importance of Australia as a trading partner to China is evidenced by the fact that Australia was the second nation President Hu visited after gaining power.

120 For more information on the AFTA-CER *Closer Economic Partnership*, see Department of Foreign Affairs and Trade, *AFTA-CER* <[http://www.dfat.gov.au/cer\\_afta](http://www.dfat.gov.au/cer_afta)> at 6 November 2004. It is thought that the ASEAN invitation reflects its rethinking of the role that Australia and New Zealand can play in balancing the burgeoning economic power of China and India: see Burrell, above n 106. Indonesian Foreign Ministry official, Marty Natalegawa, stated that the AFTA-CER meetings 'provide a reaffirmation of Australia's important place within the regional setting': Burrell, above n 106, 5. See Michael Bachelard, 'Malaysia Keen on Trade Pact', *The Australian* (Sydney), 27 July 2004, 1.

view close economic ties to the US as a strength, not a weakness, also puts paid to the theory that the AUSFTA negotiations risked alienating 'Asia'.<sup>121</sup>

Importantly, most Asian countries have begun to realise that they cannot compete with the low-cost labour and cheap inputs of China and India in the production of low-cost manufactured and textile goods. Those same countries further realise that they need Australian capital, education standards and research potential in order to increase their own skills and technical knowledge in order to produce and export sophisticated products. Thus, instead of Australia courting Asia, as happened during the Keating years, Asia has begun courting Australia. So, in sum, it is abundantly clear that the AUSFTA has not threatened Australia's ties with its Asian neighbours.

As noted earlier, many East Asian countries have shed their apprehension and aversion to FTAs and are now among the leading proponents of bilateralism.<sup>122</sup> And while a number of the agreements are with other Asian countries, many are also negotiating with Europe, several South American countries and the US. The time is ripe for Australia to begin negotiations with these same countries, not only to capture preferential deals for its exports, but also out of necessity. If the Asian countries negotiate FTAs with Australia's trading competitors and at the same time Australia fails to negotiate more bilateral agreements, Australia's access to overseas markets (both in Asia and elsewhere) will be cut, prices non-competitive and markets effectively reduced (as is now the case with Japan as a result of their FTA with Mexico).

This is not to say that negotiating an FTA with Japan, South Korea or China (to name but a few) will be easy.<sup>123</sup> Asian countries are historically protectionist and lack transparency. Correspondingly, both Japan and South Korea have more

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121 In fact, a 'very senior' Chinese official is quoted as saying the AUSFTA is 'a sign of Australia's great economic strength': Tim Harcourt, 'Balancing Pros and Cons of Trade Deal', *The Australian* (Sydney), 21 June 2004, T5. Trade statistics confirm that Australia maintains a trading system diversified in product and in regions, meaning it is not tied to the US or Asia and can benefit from trading with both. In addition, Minister Vaile has indicated that FTA negotiations with Japan and South Korea could be forthcoming: see 'Trade Deals Eyed' *PNG Post Courier* (Port Moresby, Papua New Guinea), 19 July 2004, 39.

122 One reason that many Asian nations are negotiating FTAs is that China's burgeoning role as a trade and investment giant following its entry into the WTO has so affected the competitiveness in exporting and foreign direct investment in the region that nations feel the need to form closer economic integration with their trading partners in order to maintain existing markets: see Seema Gaur, 'Framework Agreement on Comprehensive Economic Co-operation between India and ASEAN: First Step towards Economic Integration' (2003) 20 *ASEAN Economic Bulletin* <[http://www.findarticles.com/p/articles/mi\\_hb020/is\\_200312/ai\\_n5710205](http://www.findarticles.com/p/articles/mi_hb020/is_200312/ai_n5710205)> at 13 November 2004. See also 'Brazil Eyes Shift in Trade Dominance, Foreign Minister Builds Coalition, Courts Chinese', *Boston Globe* (Boston), 23 May 2004, A13.

123 Another market Australia should seek to exploit is India, where rapid growth has created a middle class of 285 million consumers. Currently, only 1500 Australian businesses invest in India: see Fenton-Jones, above n 96.

non-market features than one would like to see,<sup>124</sup> and China remains a non-market economy.<sup>125</sup> So while negotiating an agreement with the US was hard, at least Australia knew what the Americans were putting on the table and what they were holding back. This may not be the case in negotiations with the East Asian nations. Not only will negotiating an agreement with these countries be trying, but actually realising the negotiated benefits and, if necessary, enforcing the negotiated rights will be even more challenging.<sup>126</sup>

But the rewards of being one of the first Western nations to agree to a bilateral FTA with the Asian nations will be great. Japan is already Australia's largest export source and second largest trading partner, South Korea is a significant export source and China is a growing source of import, export and investment potential.<sup>127</sup> An FTA with any of these three countries would mean that Australia would get a head start on competitors in terms of both goods and services and, perhaps more importantly, in terms of investment.

Obviously, an FTA with China would be the most intriguing, if not also the most difficult to negotiate. Over 3100 Australian companies currently export to China and an FTA with the looming power would make it considerably easier for Australian companies to do business there. The result would mean that Australian raw materials and energy exports would boom and the removal of tariffs on equipment exports would give Australian companies an advantage over competitors. This was confirmed by Ou Jang Ju of Austrade's Beijing office, who, speaking of Australian exports of mining equipment, stated 'there will be real competitive advantage for Australian suppliers with the removal of the [6 per

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124 For instance, the Japanese agricultural industry is highly protected, with tariffs upwards of 200 per cent on sugar and other products: see, eg, '... While Sugar Producers Call for Cuts in Japanese Tariffs', *Business World* (Philippines), 19 July 2004, 2. See generally Paul Krugman, *Currencies and Crises* (1998) (discussing international monetary economics in the context of the past 20 years); Joseph Stiglitz and Shahid Yusuf (eds), *Rethinking the East Asian Miracle* (2001) (detailing and offering potential remedies on key facets of the Asian economies including weaknesses in the financial sector, corporate governance, exchange rates, trade policies, and regulatory capability).

125 The US and EU have recently rejected Chinese requests officially to deem the country a 'market economy', with both finding that the Chinese economy suffered from too much state interference, poor corporate governance and weak rule of law: see Colleen Ryan, 'EU Set to Deny Beijing Market Status', *Australian Financial Review* (Sydney), 29 June 2004, 12. The Chinese believe its designation as a non-market economy unfairly harms China in trade relations, particularly in anti-dumping actions. As a condition of entrance into the WTO, Member States can treat China as a non-market economy for up to 15 years. While New Zealand, Singapore and Malaysia have granted China market-economy status, the vast majority of China's total external trading partners have refused to extend the same preferences.

126 On market uncertainties in Asia, see generally Barry Herman, *Global Financial Turmoil and Reform: A United Nations Perspective* (1999) (summarising Asia's financial crisis and recommending actions to strengthen the capacity of developing and transitional economies and to reduce risks posed by the current international financial system); Paul Krugman, *The Return of Depression Economics* (1999) (discussing six Asian economies following the financial crisis of the late 1990s); K S Jomo, *Malaysian Eclipse: Economic Crisis and Recovery* (2001) (examining the Malaysian economic crisis of 1997-98); Alison Harwood, Robert E Litan and Michael Pomerleano, *Financial Markets and Development: The Crisis in Emerging Markets* (1999) (explaining that many Asian countries that suffered during the financial crisis failed to substantially deregulate local financial sectors).

127 In fact, China has recently overtaken the US as Australia's second-largest export market: see Victoria Batchelor, 'Australian Exports Hit Highest Level in 16 Months' *New Zealand Herald* (Auckland), 30 June 2004, C06.

cent tariff] duty – especially given Australia’s high quality, relative to our US and German competitors’.<sup>128</sup> Moreover, the cost of importing manufactured goods from China would decrease which would, in turn, increase the wealth of the Australian consumer. The financial services sector would also greatly benefit from such a deal as Australian companies would be some of the first Western companies to gain a foothold in China.

Making matters more complicated, however, is that China has the dubious distinction of leading the world in anti-dumping claims initiated against it.<sup>129</sup> In addition, China is also failing to live up to its WTO commitments. The US claims that China has failed adequately to implement structural changes mandated upon entry to the WTO and recently warned that China’s unfettered access to the US market will be jeopardised unless it reciprocates by opening its markets and honouring its WTO commitments.<sup>130</sup> The US and China recently resolved the first dispute filed in the WTO against China but both the US and the EU have publicly stated their intentions to investigate several other Chinese practices with a view to establishing future cases in the WTO.<sup>131</sup>

This article is certainly not advocating that Australia abandon prudent caution and negotiate FTAs with the East Asian nations at all cost, but it does advocate investigating the possibilities that its Asian neighbours have to offer. This article also views the opportunity to advance Australian economic growth and development at the same time as advancing the rule of law in China and providing stability to the region as an opportunity too good not to fully explore.

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128 Fenton-Jones, above n 96, 49. Christine Gibbs Stewart, Australian Business Ltd International Trade General-Manager, added that Australia has specific competitive advantages in terms of technology, quality and manufacturing know-how that China requires.

129 A recent WTO study confirmed this information, showing 12 claims against China in the last six months, down from 21 the previous six month period: see WTO, *Report (2003) of the Committee on Anti-Dumping Practices*, WTO Doc G/L/653 (2003). Korea and India took second and third place respectively, with eight and six anti-dumping studies made on their exports. During the six month period, 18 WTO Members initiated 79 inquiries into anti-dumping compared with 149 investigations launched by 17 Member States in the first half of 2002. The US launched the highest number of probes on its imports (16) followed by India (12). Both figures were a decline from a year earlier at 22 and 25 respectively.

130 In July 2003, China surpassed Mexico to become the US’s second largest trading partner. Since 2001, China has also been the fastest-growing export market for the US. The current trade disparity between the US and China is the main reason for friction in the US–China trading relationship. China exports more than five times as much as it imports from the US and the US trade deficit is estimated at US\$130 billion: see Don Evans, ‘America Plays Fair: Does China?’, *The Wall Street Journal* (New York), 5 November 2003, A20. See also Chris Buckley, ‘The US’s Blunt Message to China’, *International Herald Tribune* (Paris), 29 October 2003, 14.

131 See *China – Value-Added Tax on Integrated Circuits*, WTO Doc G/L/675, S/L/160, WT/DS309/1 (2004) (Request for Consultations by the US). The EC, Japan, Mexico and Taiwan requested third party status before the US and China reached a mutually agreed solution to the dispute: see *China – Value-Added Tax on Integrated Circuits*, WTO Doc G/L/675/add.1, S/L/160/add.1, WT/DS309/7 (2004) (Joint Communication from China and the United States).

## V THE DRAWBACKS OF FTAs

It is well recognised that bilateral FTAs benefit the participants of such agreements.<sup>132</sup> But this article would be incomplete without pointing out that bilateral agreements are subject to legitimate criticisms.<sup>133</sup>

The most powerful economic argument against bilateral trade agreements is that they reward inefficiencies by diverting trade to the bilateral partner due to lower tariff rates and/or increased access at the expense of a more efficient producer in a non-member country.<sup>134</sup> In such an instance, the more efficient producer/seller in a non-member country is harmed, as the preferential tariff rates negotiated in the bilateral FTA could effectively raise the price of the efficient producer to a level higher than the inefficient producer in the FTA-member country. As a result, the buyer purchases goods from the less efficient (but now cheaper) producer. This is not an efficient economic outcome.

However, trade diversion is only harmful to member nations when the trade diversion created by the FTA exceeds the trade creation (benefits) resulting from the agreement.<sup>135</sup> While the benefits and burdens of each FTA must be studied individually, it is generally presumed that trade diversion can be problematic in two instances: first, when an FTA is reached between two nations who are not already significant trading partners; and second, when one is reached between nations that have significant tariff barriers to trade. Thus, if two nations that have an insignificant trading relationship and high external barriers to trade agree to an

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132 See, eg, Keith Head and John Ries, 'Rationalization of Tariff Reductions' (1999) 47 *Journal of International Economics* 295 (observing that in the years following the 1988 US–Canada FTA, Canadian manufacturing industries (during the period 1988–94) increased output by 34 per cent while the number of plants declined by 21 per cent; this was caused by lower Canadian tariffs to offset the scale increase of 10 per cent as a result of the US tariff cuts).

133 The article will, however, ignore the blatantly incorrect arguments some have put forward as reasons to oppose FTAs. Examples of these include the 'economic' claims that Australia should not have negotiated with the US because it already has a trade deficit with the US (which misunderstands economic theory, where one should look to the economy's overall current account balance) and that Australia should not have negotiated with the US because Australia has more liberalised agriculture and manufacturing sectors (which goes against centuries of economic theory that asserts that a nation should always liberalise, regardless of what its trading partners do). Both of these claims not only fundamentally misunderstand economic theory but also fail to comprehend why a nation engages in international trade. Both arguments seem to believe that exports are a 'necessary evil', where the reality is that exports are needed to pay for imports and other worldly goods/services that a nation cannot produce itself: see Panagariya, 'The Regionalism Debate', above n 30, 455–76. See also Mark Thirlwell, *The Good, The Bad and the Ugly: Assessing Criticism of the Australia–United States Free Trade Agreement* (2004) 5–7. The article will also ignore the blatantly flawed argument that the disparity in size between the countries should have precluded negotiations. This argument ignores the economic performance of Canada post-NAFTA, Ireland post-EU accession and New Zealand's post-CER growth, to name but a few.

134 Diversion allows nations to protect inefficient, but politically key, sectors such as agriculture: see Murray Hiebert, 'The Perils of Bilateral Deals' (2003) 166(51) *Far Eastern Economic Review* 19.

135 For more on the trade creation and diversion effects, see the seminal work of Jacob Viner, *The Custom Union Issue* (1950).

FTA, trade diversion is likely to occur.<sup>136</sup> Conversely, when an FTA is reached between 'natural trading partners', that is, nations that already have a significant amount of bilateral trade flowing between two countries that have low barriers to trade, diversion is not thought to be a considerable problem.<sup>137</sup> This is the case with the AUSFTA, as the amount of bilateral trade between the participants is significant (the US is Australia's largest trading partner) and both countries have low tariff barriers to trade (measured by international standards). Thus, it can safely be assumed that the trade created by the AUSFTA will outweigh the diversion that it creates.<sup>138</sup>

Another potential downfall of bilateral agreements is the complexity resulting from multiple bilateral or regional FTAs. Each bilateral or regional FTA contains different conditions and obligations which can sometimes lead to confusing or even conflicting obligations. The differing standards and rules can create obstacles to trade facilitation by increasing administrative complexity at customs and creating a 'web' of differing rules. This is a major source of concern for the international trading community.

One specific example of the complexities that are a by-product of bilateral FTAs is the proliferation of different preferential rules of origin – a prominent source of trade costs and complexity in today's global marketplace where companies depend on the rapid delivery of products and components from multiple overseas sources.<sup>139</sup> Rules of origin are designed to prevent a product being exported from a non-member country to a member country before being re-exported to, and gaining the reduced tariff rate in, another member country. To guard against such abuse, FTAs contain some form of a 'rules of origin' requirement. This requires that a minimum level of value-added creation must occur in a member country to the FTA before the preferential tariffs or access is granted.<sup>140</sup> The problem is that the standard differs between FTAs and the

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136 Diversion of this nature has been shown to occur as a result of the MERCOSUR: see Alexander Yeats, 'Does Mercosur's Trade Performance Justify Concerns about the Effects of Regional Trade Arrangements?' (1998) 12 *The World Bank Economic Review* 1. Expansion of the EU, where some countries had disproportionately large tariffs before entry, has also resulted in diversion: see Shang-Jin Wei and Jeffrey Frankel, 'Open Regionalism in a World of Continental Trade Blocs' (Paper presented at the American Economic Association Meetings, Washington, 3–6 January 1997).

137 See Lawrence Summers, 'Regionalism and the World Trading System', *Federal Reserve Bank of Kansas City – Proceedings* (1991) 295. For a critical analysis of this work, see Panagariya, Working Paper, above n 27; Jagdish Bhagwati, 'US Trade Policy: The Infatuation with Free Trade Areas' in Jagdish Bhagwati and Anne O Krueger (eds), *The Dangerous Drift to Preferential Trade Agreements* (1995) 9.

138 The CIE analysis recognises that some diversion will occur. For instance, the CIE estimates that Australian exports to the US will increase by approximately A\$3.35 billion but the total increase in Australian exports will only be A\$2.77 billion. Thus, approximately A\$582 million of the increased exports to the US will be diverted from other markets. Likewise, the CIE expects American exports to Australia to increase by A\$6.52 billion, but total Australian exports are expected to increase by only A\$2.82 billion. Thus, A\$3.7 billion of the American total will be diverted from other import sources. Therefore, trade diversion will be substantial, but the CIE estimates that the overall effect of the FTA will be trade creation in the amount of A\$5.58 billion: CIE, *Economic (CIE) Analysis of AUSFTA*, above n 7, 91.

139 For instance, the NAFTA contains over 200 pages dealing with rules of origin requirements.

140 Under the AUSFTA, a number of Australian textile and clothing exports will not meet the standards and will not receive preferential access: see CIE, *Economic (CIE) Analysis of AUSFTA*, above n 7, 52–3.

sometimes arbitrary definitions of which product comes from where, and what constitutes local added value. This results in a multiplicity of tariffs depending on the source, which are extra business costs and detrimental to FTAs.<sup>141</sup>

For example, take one specific good, a computer. If a country's import regime imposes different tariff rates for the same computer, depending on the country of origin (and how much value was added (some FTAs require 'substantial transformation') in each of the several countries the product passed through whilst being assembled), it is common for international traders to apply for a preferential rate honestly believing that their product qualifies for the rate but only to find out later (as a result of a customs audit) that the product did not meet the complex rules of origin standard set in the bilateral FTA. This innocent mistake can, and often does, result in millions of dollars of back-payments owed on top of the significant fines and penalties which the customs service will also impose. With the number of bilateral agreements rapidly increasing, the already bad situation could worsen dramatically.<sup>142</sup>

In addition, the overlapping jurisdiction of FTAs can cause further distortions and confusion. For instance, if Chile were to become a member of NAFTA and MERCOSUR, it may have to buy goods from Brazil in order to satisfy the rules of origin requirements of MERCOSUR and from Canada to exploit the preferences of the NAFTA.<sup>143</sup> Such rules are not congruent. Harmonisation of standards and rules, through cohesive negotiations or international intervention, and simplification of preferential rules could alleviate some of these obstacles, but the process of harmonising schemes is slow and certainly will not be completed in the next decade.

Another criticism of FTAs is that while some issues can easily be negotiated bilaterally – industrial tariffs, for example – many problems cannot be solved between two countries, particularly the 'hard core' issues that have survived more than 50 years of multilateral trade negotiations.<sup>144</sup> For instance, inefficient agricultural policies, discriminatory sanitary and phyto-sanitary measures, technical barriers to trade, and biased trade remedy rules remain despite pressure from almost all of the trading nations in the previous eight rounds of intense multilateral trade negotiations and transparent information flowing between all the parties. It may be unrealistic to expect that two nations of unequal economic

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141 One commentator states that rules of origin requirements have an 'unambiguously harmful effect': Panagariya, Working Paper, above n 27, 16. For more on the effects of rules of origin, see Anne Krueger, 'Free Trade Agreements as Protectionist Devices: Rules of Origin' (Working Paper No 4352, National Bureau of Economic Research, 1993).

142 In addition, the rules relating to 'special and differential treatment' of products originating from certain developing and least-developing countries, and the protective trading rules given to certain 'infant' industries, are also difficult to define in a bilateral context. Further, where standards are included in an agreement between countries of unequal economic strength, the stability and enforceability of rights based on a bilateral agreement are uncertain at best.

143 See Panagariya, Working Paper, above n 27, 17.

144 In this regard, FTAs have the ability to set 'bad precedent' as well as the 'good precedent' detailed earlier. One example of 'bad precedent' is the exclusion of some key agricultural products from the Japan–Singapore FTA (which excludes cut flowers and ornamental fish, Singapore's key agricultural exports to Japan, from the FTA). Similarly, the exclusion of sugar in the AUSFTA re-enforces the idea that exclusions can be part of full-scale FTAs.

levels will have the same bargaining knowledge and power on sensitive issues and therefore highly unlikely that a middle-tier trading nation such as Australia will be able to convince a larger nation to change its agricultural subsidies scheme or modify anti-dumping rules in a bilateral framework.<sup>145</sup>

Along those same lines, cutting export subsidies preferentially for one's FTA partners, though technically possible, is out of the question politically because such a move would turn the political logic of preferential trade deals on its head. Reducing tariffs for members of an FTA lowers the competitiveness of non-members, which continue to face tariffs when they sell into FTA markets. That provides a strong incentive to sign FTAs. But if FTA members cut their export subsidies, the competitiveness of non-members that maintain their subsidies instead increases in both FTA and non-FTA markets. Therefore, for both practical and political reasons, one cannot expect that a nation will agree to cut export subsidies in a bilateral framework.

Another criticism of bilateral trade agreements is that the preferential agreements ultimately undermine the multilateral system because of their discriminatory nature.<sup>146</sup> The GATT/WTO was built on the premise of equal trade opportunities for all Member States, but if the number of FTAs multiply by too great a number, critics argue that the entire foundation of the multilateral system could be weakened.<sup>147</sup> Indeed, the line dividing the positives of FTAs (such as using them to spur multilateral progress) and the negatives (such as hampering multilateral progress) is sometimes unclear.<sup>148</sup>

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145 For reference, Australia's economy is US\$11 billion (roughly equivalent to the economy of the US state of Pennsylvania) and the US economy measures US\$510 billion. The Australian economy is therefore less than 5 per cent of the US gross domestic product. This may mean that the US has bargaining strength, but it also means that Australia stands to benefit much more than the US in relative economic terms from the AUSFTA. Using NAFTA as a guide, it has been shown that the longest phase-out periods in FTAs are in the sectors in which import-competing lobby groups are the strongest: see Carsten Kowalczyk and Donald Davis, 'Tariff Phase Outs: Theory and Evidence from GATT and NAFTA' in Jeffrey Frankel (ed), *Regionalization of the World Economy* (1996) 227.

146 To limit this effect, it has been suggested that (i) multilateral agreements should remain the priority of national legislatures; (ii) regional agreements should prevent parties from excluding whole sectors from the agreement; and (iii) nations should commit to keeping free trade agreements open for other countries to join: see Claude Barfield et al, 'The Multilateral System and Free Trade Agreements: What's the Strategy?' (2003) 37 *International Lawyer* 805.

147 One advantage of larger, multilateral agreements is that they have the capacity to accept new members, fewer negative repercussions and comparatively larger positive net welfare effects on the region as a whole, and on the world, whereas bilateral FTAs have the dynamic effect of encouraging other bilateral FTAs in the adjoining regions: see Peter Lloyd, 'New Bilateralism in the Asia Pacific' (2002) 25 *The World Economy* 1294.

148 Numerous economists debate this point: see, eg, Summers, above n 137 (advancing the proposition that multilateral negotiations will progress faster if bloc formations develop); Jagdish Bhagwati, 'Regionalism and Multilateralism: An Overview' in Jamie de Melo and Arvind Panagariya (eds), *New Dimensions in Regional Integration* (1996) 22; Arvind Panagariya and Pravin Krishna, 'On Necessarily Welfare-Enhancing Free Trade Areas' (2002) 57 *Journal of International Economics* 353; Pravin Krishna, 'Regionalism and Multilateralism: A Political Economy Approach' (1998) 113 *Quarterly Journal of Economics* 227.

It is clear that bilateralism cannot replace the multilateral trading system.<sup>149</sup> Unfortunately, in the short-term it appears to be the only option to liberalise economies and drive the multilateral agenda.

## VI CONCLUSION

The agreements negotiated with Singapore and Thailand signalled Australia's intention to enter the bilateral age and help Australian enterprises become competitive in the world market again. The agreement with the US is a major step in reducing the discriminatory effect Australian exporters currently face in most markets. Successfully negotiating agreements with some of our larger Asian neighbours will, for the first time, give Australia an advantage over other nations. The benefits of such agreements will be great, both economically and politically.

This is not to say that the government should jump blindly into bilateral agreements just because our trading partners are doing so. Obviously, the government must only sign agreements that will be of overall benefit to the Australian business community as well as the Australian consumer.<sup>150</sup> In addition, bilateral agreements should not be used to impede the resurrection of the multilateral process. The 50 years of the GATT/WTO have led to tremendous gains, not only for Australia, but also for all Members (both developed and developing) who have embraced liberalised trade.<sup>151</sup> The multilateral trading system has increased trade through lower tariff rates, increased transparency and non-discriminatory trading rules. It is well recognised that the protectionist values of the early 1900s worsened the Great Depression and contributed to the

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149 Jagdish Bhagwati calls FTAs 'a pox on the world trading system' because, in his opinion: (i) such agreements are often trade diverting, not trade creating – and hence projected gains are often illusory; (ii) FTAs adversely affect multilateral trade negotiations by draining the energy of trade negotiators and producing a 'spaghetti bowl' of agreements to be covered (overlapping and intersecting FTAs in which the provisions of individual agreements may be inconsistent with provisions of another); and (iii) FTAs hurt poor nations because these countries are the least equipped to conduct successfully bilateral negotiations: Jagdish Bhagwati, *Free Trade Today* (2002). All of these criticisms have been addressed in this article.

150 Australia actively seeks public opinion and consultations regarding potential FTAs. For a list of current consultations, see Department of Foreign Affairs and Trade, *Trade Policy* <<http://www.dfat.gov.au/trade>> at 6 November 2004. Of course, in order to reach an agreement and meet the interests of all concerned parties, the government must compromise on certain issues. Australian businesses will profit in industries in which they have a comparative advantage, but weaker sectors of the country may suffer as a result of freer trade. This is especially the case with inefficient or structurally deficient industries. Those relatively weaker sectors should attempt to improve their competitive edge by improving their efficiency or structure.

151 For instance, in 1967 the per capita gross national product of Korea was US\$550 and the per capita gross national product of Ghana was US\$800. Since that time, Korea joined the GATT and has pursued an open economy and good management, while Ghana has maintained a closed economy and poor overall management, causing Korea's 1997 per capita GNP to rise to \$US10 360 and Ghana's 1997 per capita GNP to fall to \$US370: Raj Bhala and Lucienne Attard, 'Austin's Ghost and DSU Reforms' (2003) 37 *International Lawyer* 651, 676 (citing Robert Zoellick, Office of the US Trade Representative, 'The WTO and New Global Trade Negotiations: What's at Stake' (Speech delivered at the Council of Foreign Relations, Washington, 30 October 2001)).

start of World War II. Fractured trade, protectionist beliefs and xenophobic trading regimes should not be allowed to flourish again. Too rapid an expansion of FTAs has the potential to bring about such a situation.

Instead, the Australian government should use the bilateral process to secure market access for its products and raise the standard of living for its citizens, while at the same time driving the multilateral agenda to enhance its chances of success, both in the present and in the future. But whatever course of action Australia chooses it cannot choose to stand on the sidelines and watch others act. The current state of the WTO negotiations does not allow for bystander status as an option. For these reasons, Australia should look to negotiate more bilateral agreements that positively contribute to Australian interests while also contributing to the further development of the multilateral trading system.