Chapter 5

Conclusion and recommendations

5.1 While the committee's inquiry focused on Australia's trade agreement with Korea, a number of broader issues regarding Australia's trade agreements have also been highlighted through the inquiry process. In particular, these relate to ISDS mechanisms, intellectual property provisions in trade agreements, utilisation by Australian exporters of the opportunities created by trade agreements, labour market testing, certificates of origin processes and the treaty making process.

ISDS mechanisms

5.2 Despite the 'safeguards' and exceptions contained in the provisions, the committee remains concerned about the potentially broad scope of application of the ISDS provisions in KAFTA as well as the broader procedural issues regarding the arbitral tribunal processes used to determine ISDS claims. In some 'rare' circumstances it appears that any regulatory action undertaken for legitimate public welfare objectives by the Australian Government could potentially be considered to constitute an indirect expropriation of an investment which would fall within the ISDS mechanism of KAFTA.

5.3 The committee recognises that the ISDS mechanism within KAFTA appears to have been a requirement of the Korean government for the agreement to be concluded. In this case, the Australian Government has made the decision to include an ISDS mechanism within the agreement. In order to take full advantage of tariff reductions achieved by KAFTA it would be preferable for the treaty to be ratified this year. Any major renegotiation of KAFTA is not consistent with meeting this deadline.

5.4 Delaying the implementation of KAFTA in order to negotiate amendments to the ISDS mechanism would not be productive. The committee recognises that Australia is already a party to many other trade agreements which include ISDS provisions. In this context, the risk of investors 'forum shopping' in order to bring a case against Australia (which was articulated by witnesses in relation to the Philip Morris case) will not be substantially increased by ratifying KAFTA at this point in time.

5.5 However, subsequent negotiations to limit the scope of the KAFTA ISDS mechanism as well as the prompt establishment of an appellant body are in Australia's interest. For example, the negotiation of a subsequent side letter with Korea could be undertaken after the commencement of the agreement. In the view of the committee, such a side letter should be negotiated with the Korean government as soon as possible with the objective of narrowing the scope of application and strengthening the safeguards. Obviously, such a side letter would depend on the agreement of the Korean government. However, the committee notes that the Korean government

would also benefit from any additional safeguards or changes agreed to the ISDS mechanism in KAFTA.

5.6 A key objective of such a negotiation should be a clarification of the shared understanding of the term 'expropriation'. The committee notes that other free trade agreements, such as the Canada Korea FTA, have used narrower definitions of where the term expropriation applies. In the view of the committee, a narrower definition of 'expropriation' which limits the scope of potential liability would provide additional predictability and certainty for investors and governments.

5.7 Additionally, the committee does not agree with the argument that it is preferable to have an ill-defined phrase 'legitimate public welfare objectives' within one of the key safeguard provisions. Australian interests could be more effectively protected through a definition of 'legitimate public welfare objectives' which included a non-exhaustive list of public policy areas covered by this term. This definition would clarify some of the uncertainty about potential liability and decrease the chance that the ISDS mechanism in KAFTA will have a 'chilling effect' on the Australian Government's willingness to institute appropriate reforms in the national interest. The important issues raised by Chief Justice French regarding the possible effects of ISDS mechanisms on the authority and finality of decisions of Australian domestic courts should also be addressed as part of any negotiation.

Recommendation 1

5.8 The committee recommends that the Australia Government initiate discussions with Korea to omit or, in the absence of agreement, narrow the scope of the investor state dispute settlement provisions within the treaty, to be formalised by a subsequent side letter. Discussions on narrowing the provisions should include consideration of:

- **a narrower definition of 'expropriation';**
- **a non-exhaustive list of public policy areas covered by the term 'legitimate public welfare objective';**
- **limitations as suggested by French CJ, or as subsequently formally recommended by the Council of Chief Justices; and**
- **that the parties promptly establish a bilateral appealant mechanism as envisaged in Annex 11-E of the agreement.**

5.9 The evidence for the benefits of ISDS mechanisms in terms of increasing foreign investment appears questionable. This reflects the finding of the Productivity Commission in 2010:

> There does not appear to be an underlying economic problem that necessitates the inclusion of ISDS provisions within agreements. Available

> evidence does not suggest that ISDS provisions have a significant impact on investment flows.[1]

5.10 Further, the committee notes that investors often have alternative means of protecting their investments in foreign jurisdictions including legal proceedings and insurance risk products. Reputational incentives also exist to discourage national governments from inappropriately taking action which may result in the expropriation of an investment.

5.11 Despite the history of ISDS mechanisms in trade agreements, the broader community has only recently become aware of the full implications for Australia. The committee acknowledges the community concerns about the potentially negative influence of ISDS mechanisms on Australia's public policy. This strong sentiment has been consistently reflected in submissions to this inquiry, to the JSCOT inquiry and to the recent inquiry into the Trade and Foreign Investment (Protecting the Public Interest) Bill 2014.

5.12 The committee notes that Australia's international trade negotiations are entering an important period with a bilateral trade agreement with China expected to be concluded before the end of the year and the discussions for the Trans-Pacific Partnership continuing. It is important that future trade agreements, such as these, are concluded on terms which are in Australia's long term national interest.

5.13 In this context, it is worthwhile restating the recommendation of the Productivity Commission on ISDS that the Australian Government should seek to avoid the inclusion of investor-state dispute settlement provisions in [bilateral and regional trade agreements] that grant investors in Australia substantive or procedural rights greater than those enjoyed by Australian investors'. Broadly, this position reflects the view of the committee. In particular, unless the fundamental procedural flaws in ISDS mechanisms identified by Dr Kyla Tienhaara and the potential impacts on Australia's justice system highlighted by Chief Justice French are resolved, the Australian Government should not agree to include an ISDS mechanism in future trade agreements.

5.14 However the committee recognises that the Australian Government has indicated that it will consider including ISDS mechanisms in future trade agreements on a 'case by case' basis. In light of this position, the committee considers it is vital the Australian Government ensure there are sufficient safeguards within these future ISDS mechanisms to protect the ability of future Australian Governments to conduct its ordinary processes without the apprehension that investors may instigate compensation claims if their investments are negatively affected.

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1 Productivity Commission, *Bilateral and Regional Trade Agreements*, November 2010, p. 271.

Recommendation 2

5.15 The committee recommends that the Australian Government should not agree to include investor state dispute settlement mechanisms in future trade agreements.

Copyright and other intellectual property

5.16 The intellectual property (IP) chapter in KAFTA was negotiated 'a few years ago' and does not appear to have been substantially reconsidered since. It does not appear that this chapter was checked or updated close to the time of finalisation of the entire agreement. This is a matter of concern, given the apparent lack of consultation on IP issues and the relatively fast moving pace of technology in this area.

5.17 The justifications made during the inquiry that the IP obligations of the treaty text merely replicate existing domestic Australian law or existing treaty obligations raise the question of the rationale for their inclusion. It is not clear on the evidence available to the committee why the IP provisions were considered a necessary part of KAFTA.

5.18 IP protection provides an incentive for creativity, but can also operate to hamper innovation and cause economic harm. KAFTA includes IP provisions which DFAT has acknowledged, in many cases, are 'differently worded' but maintains these IP provisions are 'consistent with current Australian law, and outcomes negotiated in other FTAs'.[2] This position was disputed during the inquiry. The view of the committee is that the provisions in KAFTA appear to have incrementally expanded some of Australia's treaty obligations in relation to IP protection.

5.19 The Productivity Commission has discussed the complexity of IP rights and interactions with domestic and international law. In relation to global frameworks, the Productivity Commission has noted:

> There has been a progressive increase in the coordination and harmonisation of IP law and its application through global frameworks, as well as bilateral and regional agreements. Frameworks influencing Australian IP law, and trade and commerce in IP both within Australia and internationally, include:
>
> - the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS);
> - treaties administered by the World Intellectual Property Organization (WIPO);
> - other dedicated IP agreements falling outside of the WIPO framework; and IP provisions included as part of bilateral and regional trade agreements.

2 DFAT, responses to questions on notice – intellectual property questions, p. 1.

- Other international treaties and agreements, such as the United Nations Framework Convention on Climate Change and the Kyoto Protocol contain provisions relating to the transfer.[3]

5.20 The interaction between the plurality of international IP agreements with existing domestic law is complex and changing, both with new agreements and with new technologies. The committee believes that this complexity should not be amplified by detailed intellectual property chapters in bilateral trade agreements. References to complying with existing international commitments (as is done in the labour and environmental chapters in KAFTA) would in most cases be sufficient. The community and Parliament should be fully engaged in robust and transparent debate on any proposed changes to the domestic balance of rights in intellectual property. The committee notes that the Productivity Commission and others have recommended a full independent economic assessment as part of the consideration of any such changes.[4]

5.21 The committee broadly agrees with the Productivity Commission's assessment that Australia should not generally include IP provisions in bilateral or regional trade agreements and such provisions should only be considered after a robust economic assessment of the impacts, including on consumers, in Australia and partner countries.[5] An assessment of the potential impact of the IP provisions in KAFTA does not appear to have been undertaken.

5.22 The committee is also concerned that a disputed interpretation of Australia's treaty obligations in relation to online copyright infringement was included in the National Interest Analysis for KAFTA. While some industry submissions supported this aspect of KAFTA, it appears to the committee to be a domestic issue rather than a matter that should be pursued through a bilateral trade agreement. The committee notes that, while assurances were given during the inquiry that Australia's bilateral IP treaty obligations are 'flexible and high-level', the NIA's statement that the *Copyright Act 1968* required amendment due to a court decision was detailed and specific.

Recommendation 3

5.23 The committee recommends that the Australian Government:

- **provide clarity on proposed changes to copyright and assurance that any proposed changes as a result of the Korea-Australia Free Trade Agreement will not create adverse impacts for intellectual property owners or users;**

3 Productivity Commission, *Trade and Assistance Review 2011-12*, 2013, p. 78; also see Competition Policy Review, *Draft Report*, September 2014, p. 87.

4 Productivity Commission, *Bilateral and Regional Trade Agreements*, November 2010, p. 285; Competition Policy Review, *Draft Report*, September 2014, p. 88.

5 Productivity Commission, *Bilateral and Regional Trade Agreements*, November 2010 p. 264.

- **retain harmony in future trade agreements by limiting intellectual property provisions to Australia's obligations under specific intellectual property related multilateral agreements only and retain policy space to make changes to Australia's domestic intellectual property laws in the future; and**
- **ensures that the potential impact of intellectual property provisions in trade agreements is properly assessed and, in particular, give consideration to the recommendations of the Productivity Commission.**

Labour market testing and labour standards

5.24 The committee acknowledges the concerns raised by various community and industry groups and unions relating to the removal of the right to use labour market testing and the lack of enforceability of the labour chapter.

5.25 Labour market testing underpins a rationale that citizens should have the primary right to jobs in their country. If there are genuine labour shortages, then temporary migration can play, and has played, an important role in Australia's economic growth. Supply and demand of labour in different sectors changes over time and with different projects. The committee is concerned that KAFTA appears to have traded away Australia's policy space to apply labour market testing over time. It is also concerned that this is an asymmetrical position, with Korea retaining such policy space.

Recommendation 4

5.26 The committee recommends the Australian Government:

- **seeks to renegotiate with Korea to preserve the right to labour market testing, noting that Korea retains this right;**
- **put in place measures to more accurately track visa entrants based on free trade agreement provisions, including to monitor and record the levels of contractual service providers granted 457 visas without labour market testing;**
- **reserves policy space in future free trade agreements to regulate labour market entry and better promote labour standards;**
- **actively monitors Korea's adherence to the general principles and labour standards outlined in Chapter 17 of the KAFTA, particularly with reference to goods exported from the special processing zones on the Korean Peninsula pursuant to Annex 3-B of Chapter 3; and actively upholds these standards in various committees and consultation with Korea under the agreement.**

Certificates of origin

5.27 For trade agreements to be beneficial and effective, there must be clear, consistent and readily available rules or origin procedures as well as quick

commercially responsive dispute resolution procedures for exporters and importers. The committee acknowledges the concerns raised by the ACCI regarding ensuring the integrity of the certificate of origin processes for transactions which will be affected by KAFTA. The committee also acknowledges the responses of DFAT and other agencies which outlined a commercially-focused approach in allowing businesses a flexible choice of a certificate of origin completed by the exporter or producer or a certificate of origin issued by an authorised body. However, this aspect of the agreement should not be seen as 'settled' and work should continue in consultation with Australian industry to streamline and improve certificate of origin processes.

Recommendation 5

5.28 The committee recommends that the Australian Government addresses business concerns regarding complex rule of origin processes in KAFTA, and the lack of harmonisation with other preferential trade agreements.

Utilisation of FTAs

5.29 Evidence of low levels of utilisation by exporters of the opportunities available under Australia's trade agreements concerned the committee. The benefits of FTAs are wasted if Australian exporters are unaware of opportunities or find them too difficult to access. In the view of the committee, there is a clear role for the Australian Government to do more in this area, in partnership with peak export and trade facilitation organisations.

Recommendation 6

5.30 The committee recommends that the Australian Government provide additional resources to Austrade and peak export organisations to monitor and improve the awareness within the Australian export industry of the opportunities provided under trade agreements, as well as assistance to new exporters on how to efficiently navigate Australia's complex network of free trade agreements.

Transparency

5.31 The committee notes DFAT's statement that, in general, the Australian government was 'very open to having a high degree of transparency on the implementation going forward'. In order to assist to remove a perception of secrecy surrounding FTAs and to advance the understanding and accessibility of FTAs for industries, businesses and the community, the committee supports the procedural recommendation made by Dr Rebecca LaForgia to make an interpretive declaration relating to the public nature of KAFTA committee proceedings and documents.

Recommendation 7

5.32 The committee recommends that the Australian Government makes an interpretive declaration along the following lines in order to clarify its practice under article 21.4(4) and elsewhere in KAFTA:

This declaration is made to clarify Australia's interpretation that Committee reports will be made public under article 21.4(4). This is made also as an undertaking to the Australian public of Australia's interpretation of KAFTA as an open agreement. As a general approach at points of ambiguity in the text or where the text is silent on the matter, as in article 21.4(4), Australia will favour an interpretation that supports open and public provision of information.

Treaty making processes

5.33 In Australia, responsibility for negotiating trade agreements rests with the executive government. Following the Senate Legal and Constitutional Affairs References Committee's report *Trick or Treaty?* in 1995, the Joint Standing Committee on Treaties (JSCOT) was established as part of reforms to improve the openness and transparency of the treaty making process.[6] This process includes that all treaty actions proposed are tabled in Parliament for a period of at least 15 (or in some cases, 20) sitting days before action is taken that will bind Australia. The JSCOT report on the Anti-Counterfeiting Trade Agreement, in 2011, highlighted the important accountability role it plays in reviewing Australia's trade agreements. However, despite these reforms, there continues to be a level of dissatisfaction with the treaty making process.

5.34 A further component of the treaty making process is that major treaty actions are accompanied by a National Interest Analysis (NIA) prepared by DFAT which provides an explanation of why the Australian Government considers it appropriate to enter into the treaty.[7] It is important that the NIA contains a comprehensive analysis of the costs and benefits of any proposed treaty to allow appropriate parliamentary consideration. In the view of the committee, there is room for improvement in this area. In particular, there is merit in the ACCI's proposal that there should be greater stakeholder input and consultation in the preparation of the NIA. Further, there may be benefit in the NIA, or parts of the NIA, being prepared by an independent body such as the Productivity Commission rather than DFAT. Reforms in relation to this issue should be examined by the Australian Government.

Recommendation 8

5.35 The committee recommends that the Australian Government examine reforms to increase stakeholder consultation in the preparation of National Interest Analysis documents and that the viability of National Interest Analysis documents, or parts of these documents, being prepared by an independent body.

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6 Senate Legal and Constitutional References Committee, *Trick or Treaty? Commonwealth Power to Make and Implement Treaties*, 1995, Recommendation 9.

7 JSCOT, 'Role of the Committee', available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Treaties/Role_of_the_Committee (accessed 19 September 2014).

Conclusion

5.36 The committee recognises that bilateral trade and investment treaties are negotiated outcomes. Every trade agreement is likely to involve both benefits and some costs for Australia. The key question for the committee during the inquiry, having regard to the JSCOT report, was whether the balance of measures agreed under KAFTA was in Australia's national interest.

5.37 It is clear that some specific sectors of the Australian economy will benefit from increased access to the Korean market through reduced tariffs. However, as JSCOT found, the predicted benefits to the Australian economy 'appear minimal in statistical terms'.[8] The economic modelling of KAFTA contained in the RIS is limited to the production and flow of goods between Australia and Korea arising from changes in tariff rates and quota arrangements. The modelling undertaken did not consider the impact of services or investment liberalisation. Further, KAFTA includes an ISDS mechanism with a broad scope of potential liability for the Australian Government. This state of ambiguity in relation to the merits of a major trade agreement with an important strategic partner at such a late stage in the treaty making process is of concern.

5.38 Despite misgivings regarding several aspects of KAFTA, in particular the drafting of the ISDS provisions, the committee judges that, on balance, KAFTA should be ratified. A number of industry bodies and individual companies, such as Teys Australia and Blackmores, have highlighted the benefits of the agreement for them. The ABARES analysis in relation to beef and cheese suggests there will be significant export opportunities under KAFTA for those sectors.[9] There is evidence these specific export opportunities will have positive flow-on benefits for the Australian economy.

5.39 In making this decision, the committee takes into account the external factors surrounding KAFTA, in particular the trade agreements signed (or likely to be signed) by our major export competitors. The committee hopes that KAFTA will be an important step in Australia's trade relationship with Korea with a view to developing further opportunities in the future.

8 JSCOT, *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea*, Report 142, 2014, p. 45.

9 ABARES, *Agricultural commodities*, Vol. 4, No. 2, June 2014, pp 33-36.

Recommendation 9

5.40 The committee recommends that prompt binding treaty action be taken in relation to the *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea*.

Senator Alex Gallacher
Chair