

# Trade Opportunities for Australian legal services in Australia's North Asian FTAs<sup>1</sup>

Kristen Bondiotti, Principal Trade Consultant, ITS Global [www.itsglobal.net](http://www.itsglobal.net)

## 1. What FTAs do

### *More than just tariffs*

Australia's recent FTAs, including those with Korea, Japan and China cover more than just tariffs. They now encompass a wide range of economic activity, including not only tariff reductions for goods, but commitments to reduce investment barriers, some liberalization of services and provisions addressing intellectual property, e-commerce, and temporary movement of labour.

#### **Australia's FTAs with Korea, Japan and China**

##### **Korea Australia Free Trade Agreement (KAFTA)**

KAFTA is one of our most comprehensive FTAs. It covers goods, services, investment, data processing, temporary movement, etc. KAFTA is modelled on the Australia/United States Free Trade Agreement (AUSFTA) and the (on hold) Trans Pacific Partnership Agreement (TPP). It entered into force in December 2014.

##### **Japan Australia Economic Partnership Agreement (JAEPA)**

JAEPA is the most comprehensive and significant bilateral agreement Japan has negotiated to date. JAEPA delivers improvements in access for Australian services providers which is equivalent to or better than that Japan's previous FTAs. It adopts a similar content and structure to KAFTA. It began in January 2015.

##### **China Australia Free Trade Agreement (ChAFTA)**

ChAFTA is China's first comprehensive agreement with developed economy and the first covering trade in services. It became operational in December 2015. ChAFTA provides Australian services providers with improved access to the China market (second only to China's agreements with Hong Kong and Macau). For the moment, competitors from other advanced economies such as the United States, Europe or Japan cannot match this access.

### *Regulation of services and investment*

**Regulation of services and investment in FTAs involves legal commitments for regulation.** Services businesses and investors 'use' FTAs differently to traders of goods; rather than choosing to receive the benefit of tariff preferences, services providers benefit from FTAs as recipients of changes to laws and regulations arising from legal commitments.

FTAs are treaty agreements between governments. They do not set rules for private market activities, though these are affected by government regulation.

FTAs do not grant 'free trade' or guarantee a completely open market. Commitments to remove 'barriers' can be conditional or subject to exceptions. The degree of liberalisation accorded varies among economies, by sector and by agreement. It depends on what has been agreed.

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<sup>1</sup> Material prepared for Briefing for Australian APEC Study Centre, RMIT University, 21 September 2017.

## 2. Why FTAs matter

### *Legal services support trade*

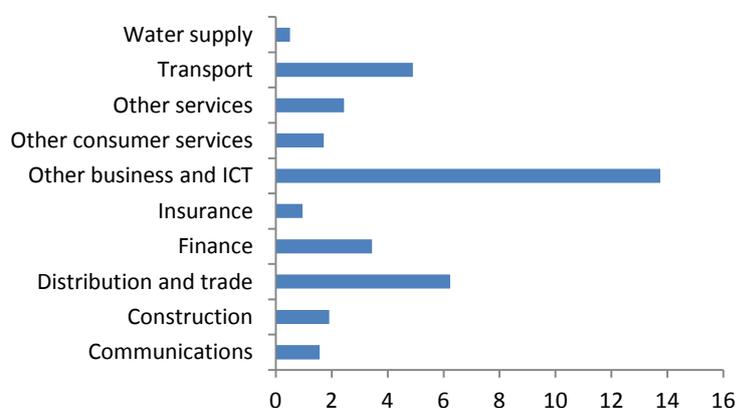
**The industry is a significant exporter.** In 2016, Australia's legal services exports were \$598m. However, this figure highly understates the significance of the legal industry to trade. It does not account for services delivered abroad to non-residents through a foreign branch or subsidiary (for example, services rendered to an Asian company by a branch office of an Australian legal firm in Shanghai). Around two-thirds of Australian services provided to the world are delivered this way, not via direct export.

There is little statistical information on the value of this trade. A study on the Australian legal services markets conducted by the Law Council of Australia for 2011 found that Australia's provision of legal services to the world was valued at \$784.5 million, including \$140.7 million of services exported to the world via a foreign affiliate (commercial presence).

**Legal services are also an important contributor to other goods and services exports.** Legal services are not only traded directly, but are also used as inputs (or 'embodied') into products and other services that are subsequently exported.

Australia's domestic services industries contribute over 40 per cent of the value of our exports overall when their value-added contribution is considered.<sup>2</sup> Other business services (including legal services) and ICT contribute more to value-added than any other service sector, accounting for 13.75% of the value of all Australian exports (2011).

**Value added contribution to Australian exports, by services sector (%) 2011**



Source: World Bank, WITS, World Integrated Trade Solution

When you add the value created by Australia's legal services in facilitating other Australian exports and the activities of foreign affiliates of Australian companies, Australia's business services exports could be worth almost double what is reported in official trade statistics.<sup>3</sup>

<sup>2</sup> OECD TiVA database 2011

<sup>3</sup> Asialink Business (2016), *Growing Knowledge Economies Insights for Australian Professional Services in Asia*.

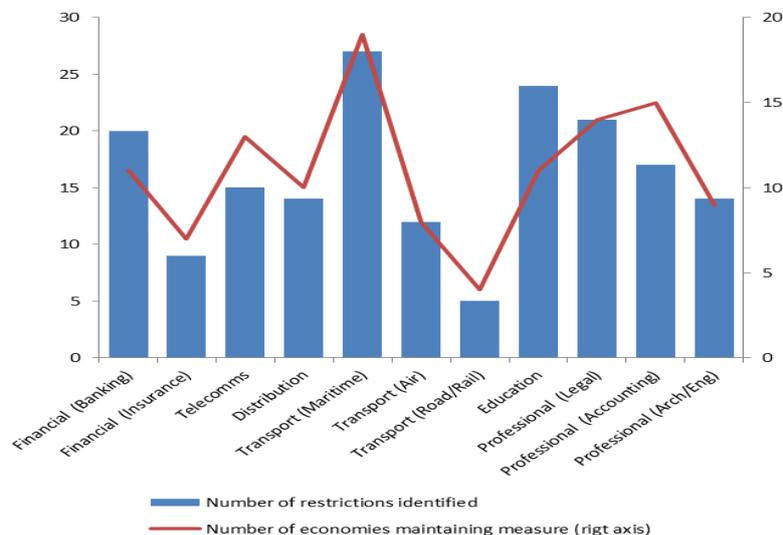
## Open services and investment matter

**Services and investment will be the next driver of growth in the Asian Pacific region.** Services play a critical role in economic performance at the national level and in international market. This is mainly due to the extensive role that they play as inputs into all other economic activities. Services now represent fully half of world trade when measured on a value-added basis.<sup>4</sup> While services now generate the vast share of GDP in most developed economies (70% - 80%), in developing and some Asian economies it is much lower (40% - 60%).

**Investment is driving greater economic activity.** Global FDI flows are generally growing at a faster rate than trade. Businesses are establishing operations in foreign markets rather than exporting. Equally, Australia depends on foreign investment to expand its services sectors.

**But barriers to services and investment are still high,** especially in developing countries. Costs for trade in services across APEC economies are estimated to be two or even three times as high (in ad valorem terms) as the trade costs of goods due to these barriers. Work by the OECD assessing the restrictiveness of policy on foreign direct investment shows that investment restrictions are higher on services (than on goods) and in many cases by a very significant amount.<sup>5</sup> Barriers to services were cited as the top impediment to ability to trade in the Asia-Pacific, and as one of the top priorities for APEC to address, by respondents to the PECC State of Trade in the Region Report for 2015.<sup>6</sup> Most FTAs of Asian economies have few commitments which advance liberalisation of services and investment.

### Restrictions on the scope of services in APEC, by sector and number of economies



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI)

Legal services remain impacted by range of barriers in North Asian markets. Controls are product and country specific. Some examples are noted in the Box below.

<sup>4</sup> See Stephenson, 'Benefits of Services Trade Liberalisation in the Asia-Pacific Region', Australian APEC Study Centre Currents Newsletter 2017 accessed at <https://www.rmit.edu.au/news/all-news/2017/local-news/benefits-of-services-trade-liberalisation>

<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

### Barriers to legal services in North Asia – examples

The regulations governing the practice of law in **Korea** are quite restrictive and therefore a key challenge. Australian lawyers can only provide advisory services or assist local lawyers in international matters for the law in which they are qualified. Eg: Australian-registered lawyers are restricted to Australian legal matters.<sup>7</sup>

Establishing a commercial presence in **Japan** is ‘an administratively intensive process’ with the numerous regulatory bodies associated with becoming a ‘Registered Foreign Lawyer.’ Registration to practise Japanese law is quite extensive. Expansion of Australian firms is restricted to one office.<sup>8</sup>

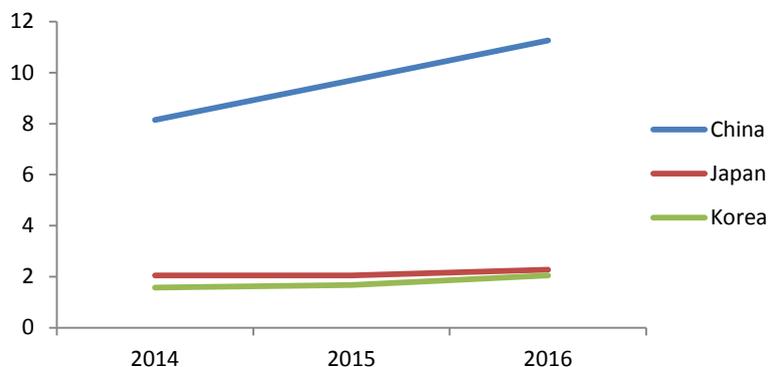
Various controls restrict Australian participation in **China**. These include limited licensing rules for the practise of foreign and international law; minimum residency and post-admission experience requirements; lengthy prior establishment of offices in China; visa rules for entry and stay of lawyers and non-lawyers with specialist skills; and citizenship requirements for qualification in China as a Chinese legal practitioner.<sup>9</sup>

### North Asia is a key trading partner

**China, Japan and Korea are significant services export markets for Australia.** China was our top export destination for services in 2016 (valued at \$11.2billion and followed closely by the US at \$8.2b). Exports to Japan and Korea were also substantial, each valued at over \$2billion. Together the three markets take over 50% of Australia’s legal services exports.

Korea is our fastest growing services export destination (22.3% growth 2015-16). Growth in services exports to China (16%) and to Japan (11%) is also well above the average growth rate across all services markets (9.2%).

#### Australia’s services exports to China, Korea and Japan 2014 - 2016 (AUD billions)



Source: DFAT (2017) *Trade in Services*

**Asian investment is driving trade activity.** Outbound investment flows to Australia from North Asia, particularly from Japan and Korea, are of increasingly importance to the Australian legal industry. Levels of investment from North Asia into Australia are rising, and there is a growing trend toward intra-Asia investment, including investment flows within the ASEAN region.

Many firms maintain a presence in North Asian markets to leverage investments in Australia and the region, and for servicing of cross border transactions and disputes. For example, Australian firms in

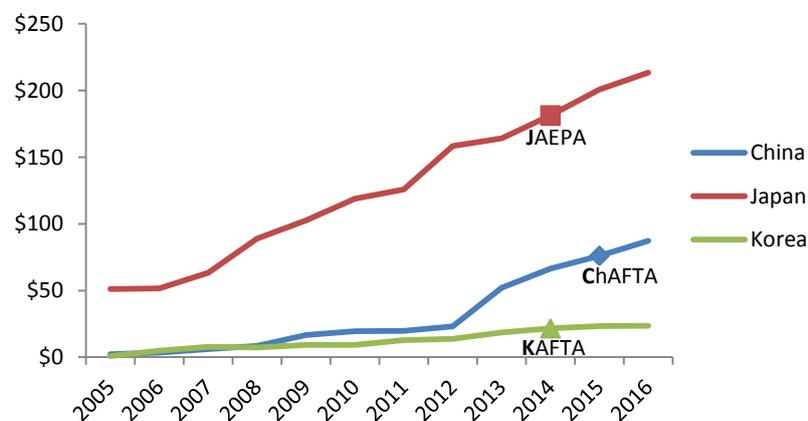
<sup>7</sup> Asialink Business (2016), *Growing Knowledge Economies Insights for Australian Professional Services in Asia*.

<sup>8</sup> *Ibid.*

<sup>9</sup> See Law Council of Australia, *ChAFTA, Submission to Joint Standing Committee on Treaties*, July 2015, and *Discussion Paper, The Proposed China-Australia Free Trade Agreement: Key Issues Regarding Legal Practice in China for Australian Lawyers*, Submission to DFAT, October 2013. Accessed at <https://www.lawcouncil.asn.au/tags/submissions>

Korea tend to act for Korean companies who are active in resources projects in Australia, rather than servicing of Australian companies exporting to Korea, for which the market is small.<sup>10</sup>

Stock of investment in Australia from China, Japan, Korea, 2005-2016 (AUD million)



Source: ABS database

### Policy agendas create growth opportunities

**China, Japan and Korea all understand their economies need reform.** The Trans Pacific Partnership (TPP) Agreement and bilateral FTAs have provided justification for domestic reform. China has triggered review of an APEC wide FTA. China's domestic policy is also focused on reorienting the economy away from its reliance on infrastructure and manufacturing toward domestic consumption, services and technology. All of these factors present opportunities for more open services markets, and increased business activity in future.

## 3. Opportunities for business – FTAs with Korea, Japan and China

### i. FTAs deliver commercial opportunities to expand trade

**Some business will benefit directly from greater market access.** FTAs deliver new rights for Australian firms to establish and deliver legal services in FTA markets. They deliver commitments which widen the scope of practice. At a minimum they 'guarantee' existing levels of access through binding treaty commitments. See Annex for examples.

These regulatory changes do not remove all constraints to operate or practise in the market. While they represent an improvement in the pre-FTA environment, numerous 'barriers' remain. Not all businesses will benefit directly. Concessions are sector and service specific.

**There are indirect benefits from expanded trade.** FTAs can be beneficial to Australian services providers in facilitating trade and investment flows that create demand for more services activity. Businesses are leveraging FTAs to create new opportunities to help expand services offered in the region for traders and investors. This is most notable for providers of services which are embodied in goods and services exports (legal services, financial services, ICT services).

<sup>10 10</sup> Asialink Business (2016), *Growing Knowledge Economies Insights for Australian Professional Services in Asia*.

FTAs can also help strengthen commercial associations and increase the visibility of Australian services providers. This is particularly so in Korea where the trade relationship is not longstanding.

**There is evidence of expanded trade.** Although services trade with North Asian partners is still small in value terms compared to that with the US (\$22 billion in 2016, 15% of services trade) it is growing faster. FTAs have coincided with rising cross border services exports to North Asian markets, particularly to China and Korea. Services trade with China is growing rapidly at a rate of 12.7% (5 year trend), more over the last year (14.2% over 2015- 16). There has also been significant recent growth in services trade with Korea (12.2% over 2015-16, compared to 3.3% on average across all countries).

### *ii. Improve the business operating environment*

**FTAs can positively alter the regulatory landscape and improve business to business links.** All agreements include provisions to support transparency in regulation and decision making. They include general provisions to support and encourage mutual recognition of professional registration/qualification/ licensing requirements but no binding commitments.

**They can ease movement of people and skills across borders.** All agreements provide temporary entry for business and qualified personnel to FTA markets. There are specific access commitments for qualified professionals, including legal service suppliers. ChAFTA and JAEPA have built in ‘cooperation agendas’ to promote greater bilateral movement of lawyers and legal services providers. See Annex for examples.

### *iii. Expand investments*

**FTAs can help expand investments in FTA markets.** Enforceable legal protections strengthen the security of Australian investments offshore (e.g.: protection from expropriation). In KAFTA, private investors can enforce these rights through international arbitration under the investor state dispute settlement mechanism (ISDS). There is no ISDS available in JAEPA. Australia and Japan have agreed to consider its inclusion in the future.

**They can also encourage foreign investment in Australia.** Direct investment opportunities in Australia from North Asia will become more attractive. The FTAs quadruple the Foreign Investment Review Board’s screening threshold for investments from Korea, Japan and China in non-sensitive sectors (from AUD252 million to AUD 1,094 million.)<sup>11</sup> This is equivalent to treatment given to the US, New Zealand and now Singapore under previous trade agreements.

**FTAs also enhance perceptions of Australia as an investment destination –‘head turn’ effect.** There is some evidence to suggest that FTAs have raised the profile of Australia and Australian companies in FTA markets. This is particularly so for Korea, where the investment and services trade relationship is not longstanding. This can support greater investment in Australia.

### *iv. Promote economic reform in FTA markets*

**FTAs set ‘standards’ for more open services markets.** Over the longer term, the creation of binding legal commitments for liberalisation will help set ‘standards’ to support more competitive services in the region. It is important in current times of increased protectionism and uncertainty in global trade.

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<sup>11</sup> The FIRB will continue to screen all direct investments, new business proposals and acquisitions of interests in land (including agricultural land), by Chinese state-owned enterprises, regardless of transaction size. ChAFTA does not change these arrangements.

## 4. Securing opportunities

While it is governments that negotiate FTAs, it is business that trades and invests. FTAs can provide commercial opportunities, but the benefits must be realised by business.

### The impact of FTAs is limited. Why?

- It takes time for the impacts of regulatory changes to be factored into business decisions. The North Asian FTAs are relatively new – in many cases it is too early to gauge significant impacts.
- Second, the ‘benefits’ are difficult to measure. Gains from services trade are particularly complex, not readily quantifiable and tend to be ‘dynamic’ throughout the economy.
- Furthermore, other issues which are beyond the scope of FTAs do and will continue to impact on business (e.g.: competition in the market, cultural and language barriers, business connections).

**What can FTAs do? FTAs should be considered as ‘living agreements.’** They can:

- **Improve outcomes for business over time.** FTAs have built in mechanisms to facilitate improvements in market access over time. This is occurring with the Australia/Singapore Free Trade Agreement (SAFTA) - recent amendments to SAFTA ease establishment controls on legal firms and improve recognition of Australian law degrees. ChAFTA includes a commitment to review services and investment chapters. Both governments have recently (March 2017) agreed to begin this process. In this respect, ChAFTA provides a starting point for a new process of services liberalisation with China.
- **Establish a platform to address and reduce barriers.** Various committees are set up by the agreements which are tasked with bringing regulators together to monitor implementation of the agreement and discuss any trade concerns. The agreements also set out various areas for future cooperation. ChAFTA for example includes a mechanism in a side letter to promote cooperative practice of registered lawyers and commercial law firms and improve the delivery transnational legal services.
- **Spread the benefits of liberalisation.** The Japan and Korea FTAs include a Most Favoured Nation (MFN) clause which means that Australia will receive the benefit of any future liberalisation commitments Korea or Japan makes in subsequent FTAs.

**But domestic policy is a stronger driver of regulatory reform than FTAs.** The majority of the potential gains to be derived from liberalisation of services will be realized from unilateral action and domestic structural reform efforts rather than FTAs. For all APEC economies, more than 60 percent of the gains derive from their own reforms rather than those of others.<sup>12</sup>

**And realisation of FTA opportunities requires more than legal commitments.** A sound business strategy, a good understanding of the market and a supportive policy environment are vital.

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<sup>12</sup> See Philippa Dee, *Priorities and Pathways in Services Reform*, Part I: Quantitative Studies, Singapore: World Scientific Publishing Company, 2013, extracted in Stephenson, ‘Benefits of Services Trade Liberalisation in the Asia-Pacific Region’, Australian APEC Study Centre Currents Newsletter 2017 accessed at <https://www.rmit.edu.au/news/all-news/2017/local-news/benefits-of-services-trade-liberalisation>.

## Annex. What FTAs do - opportunities for legal services in Australia's North Asian FTAs

Opportunity	Example
Improve market access	<p><b>New rights to establish in FTA markets.</b> ChAFTA allows Australian law firms to establish associations with Chinese firms in the Shanghai Free Trade Zone (SFTZ). The commitment includes: the right to work in association with Chinese lawyers to provide legal services from the one source covering both Chinese and foreign law; the right to provide those services to clients within and outside the PFTZ; and the capacity to maintain a level of independence between the Australian and local firms, particularly in the use of firm names and the flow of liabilities.<sup>13</sup></p> <p>KAFTA permits Australian law firms to engage in cooperative agreements with local firms. In 2019 Australian firms will be able to enter into joint ventures and hire local lawyers.</p> <p><b>Wider scope of practice.</b> Within commercial associations in the SHFTZ, ChAFTA permits Australian lawyers to practice Australian and international law where qualified. Chinese qualified lawyers practice Chinese and international law without suspension of their Chinese practicing certificates.</p> <p><b>Guaranteed levels of access.</b> JAEPA guarantees (but does not change) foreign legal rights in Japan, including the right for Australian law firms to form Legal Professional Corporations under Japanese law.</p>
Positively alter the regulatory landscape	<p><b>Facilitation of MRAs.</b> All FTAs include general provisions to facilitate mutual recognition, but no binding commitments. JAEPA has a cooperation agenda focused on improving recognition of lawyers in Australia and Japan and for strengthening cooperation on provision of trans-national legal services.</p> <p><b>Transparency of licensing and registration.</b> There is a general commitment across the FTAs to ensure licensing and criteria for services providers are based on transparent and objective criteria. JAEPA includes a commitment to expedite temporary entry, work permit and registration procedures for Australian lawyers residing in Japan to provide Australian and international legal services in Japan.</p>
Ease movement of people and skills across borders	<p><b>Commitments for improved access.</b> JAEPA provides for specific access for (qualified) legal services suppliers (including for spouses and dependents) A visa category is open for contractual service suppliers with advanced knowledge (including jurisprudence, economics, business management and accounting).</p> <p><b>Cooperation to promote access.</b> As part of ChAFTA, China and Australia agreed to facilitate professional secondments between law firms in Australia and China, and through cooperation between the peak legal bodies. There is a cooperation agenda on legal services in JAEPA which covers efforts to promote greater movement of lawyers and legal services providers between the two countries.</p>
Improve access outcomes over time	<p><b>Review mechanisms.</b> ChAFTA has a built in review mechanism to improve on liberalisation outcomes for trade in services There is also a work program for future liberalisation of investment.</p>
Establish a platform to address barriers	<p><b>Industry cooperation.</b> A side letter to ChAFTA provides a mechanism to promote cooperative practice of registered lawyers and law firms. This provides a platform for the Law Council to engage with the All China Lawyers Association to address barriers and promote mobility of lawyers.</p> <p><b>Regulatory Committees.</b> The professional services committee in the KAFTA provides a mechanism through which Australia can address barriers to legal services in Korea and implementation of treaty commitments.</p>

<sup>13</sup> This right is subject to controls. These include minimum residency and post-admission experience requirements, and lengthy prior establishment of offices in China as a pre-requisite to qualify for the establishment of a 'commercial association' office in the PFTZ. See <https://www.lawcouncil.asn.au/tags/submissions>