Australian Government

Rural Industries Research and Development Corporation

Level 2, 15 National Circuit, Barton, ACT 2600
PO Box 4776, Kingston, ACT 2604
phone 02 6271 4100 | fax 02 6271 4199
email rirdc@rirdc.gov.au | www.rirdc.gov.au
abn 25 203 754 319

Ref: R10/203

1 March 2010

The Commissioners
Review of Bilateral and Regional Trade Agreements
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

By Fax: 02 6240 3311 / By Email: tradeagreements@pc.gov.au

Dear Commissioners

Review of Bilateral and Regional Trade Agreements

Ongoing trade liberalisation is an important component of the future performance of Australian agriculture as well as the wider Australian economy. Trade liberalisation, whether multilateral or bilateral is also important to the development of Australia's trading partners and has a role to play in ensuring future food security for importing nations around the world.

A significant challenge facing Australia's policy makers responsible for designing Australia's trade and investment liberalisation policies is having a comprehensive understanding of the best means of achieving positive trade liberalisation outcomes.

This submission to the Productivity Commission's inquiry into Bilateral and Regional Trade Agreements aims to contribute to this challenge by drawing together the key findings of research conducted under RIRDC's Global Challenges Program.

The Centre for International Economics (CIE) has assisted the Rural Industries Research and Development Corporation (RIRDC) in the preparation of this submission. RIRDC and CIE welcome the opportunity to provide more information/data to the Commission if required.

The submission addresses specific questions/issues raised in the Issues Paper; and has used a 'question and answer' type format. Following a brief overview of RIRDC's Global Challenges Program and the importance of the agricultural sectors to the Australian economy, our submission largely follows the structure of the Issues Paper.

Yours sincerely

Peter O'Brien
Managing Director

Australian Government

Rural Industries Research and Development Corporation

Review of Bilateral and Regional Trade Agreements

Rural Industries Research and Development Corporation submission to The Productivity Commission

1 March 2010

Abbreviations

AANZFTA	ASEAN-Australian-New Zealand Free Trade Agreement
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
AUSFTA	Australian-US Free trade agreement
CER	Closer Economic Relations
CIE	Centre for International Economics
CU	Customs Union
DFAT	Department of Foreign affairs and Trade
EIA	Economic Integration Agreement
FDI	Foreign direct investment
FTA	Free trade agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
MFN	Most favoured nation
NAFTA	North American Free Trade Agreement
NTB	Non-tariff barrier
PTA	Preferential trade agreement
RIRDC	Rural Industries Research and Development Corporation
SPS	Sanitary and phytosanitary
TCF	Textiles, clothing and footwear
TRIPS	Trade related intellectual property rights
TRIMs	Trade related investment measures
WTO	World Trade Organization

Contents

Tables, charts and boxes

1. RIRDC's Global Challenges Program and the importance of agriculture

RIRDC is a statutory authority established by the government to work with industry to invest in research and development for a more profitable and sustainable rural economy. This object is pursued through R&D investment in new rural industries, specific established rural industries and national rural issues.

The National Rural Issues portfolio has two main program areas, Global Challenges and Resilient Communities. Through the Global Challenges Program,[1] RIRDC attempts to address emerging and current issues through R&D, including global competitiveness, market access and trade barriers, productivity and climate change. Under this program RIRDC undertakes research aimed at improving international trade policy. RIRDC's long standing commitment to the promotion of trade liberalisation motivates the preparation of this submission.

Through numerous publications on trade policy related issues RIRDC has been able to infuse the debate with the perspective of the agricultural sector. A list of publications produced by RIRDC's Global Competitiveness Program can be found in appendix A.

The agricultural export markets are the most protected and distorted by overseas government policies of all goods traded. This makes it difficult for Australian exports to gain overseas market access, through which Australia stands to benefit $4 billion per year (net of adjustment costs and other costs on the economy) from the removal of all world restrictions on agricultural trade.[2]

Agriculture is an important sector in the Australian economy and to exports. Its contribution to real GDP and as a source of employment has remained very stable throughout the challenging environment of the past decade (see chart 1.1); the agriculture and processed food sector was first hit by one of longest and most severe droughts, which was followed by a mining boom and then a global economic slowdown (the Global Financial Crisis of 2007–08).

1.1 Agriculture's contribution to the Australian economy

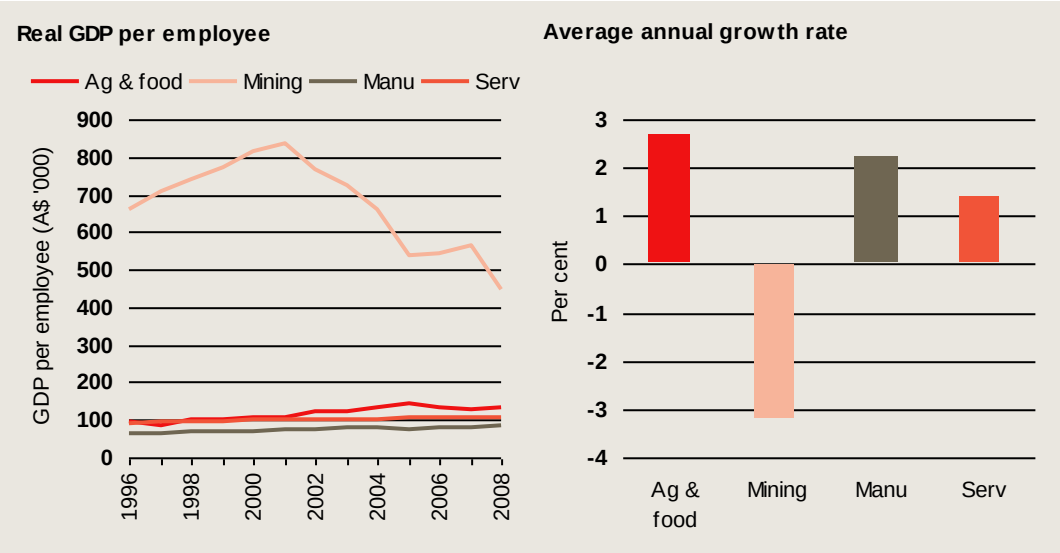
1 Previously known as the Global Competitiveness Program and now forms part of the Global Challenges Program.

2 RIRDC (2008), *Submission to the Review of Export Policies and Programs*, Canberra.

Data sources: ABS (5206.0, table 6); COMTRADE; the ABS's Labour Force Survey and CIE calculations.

While the relative share of the agricultural sector's contribution to exports has decreased, this reflects not the poor performance of the agriculture sector, but rather the expansion of the mining sector under the recent mining boom. In fact, the agriculture and processed food sector is second only to mining in the measure of GDP per employee. And the average annual growth rate in real GDP per employee in agriculture and food is the highest of the sectors (see chart 1.2). Annual growth in labour productivity in the agriculture and food sector of nearly 2.7 per cent since 1996 is a remarkable achievement. Such productivity growth is one reason why the Australian agricultural sector has performed above expectations in incredibly challenging conditions.

1.2 Performance of the agricultural and food sectors over time



Data sources: ABS (5206.0, table 6), the ABS's Labour Force Survey and CIE calculations.

Another source of growth has been trade liberalisation achieved under various preferential trade agreements (PTAs).

But the benefit of trade liberalisation — and a message repeated throughout RIRDC's numerous publications on trade policy — is that it is mutually beneficial to all parties. Australian agricultural exporters will gain by securing greater market access for their products, but importing countries too will benefit from less expensive Australian agricultural imports.

2. Background

What are the prospects for further multilateral liberalisation through the Doha round? How broad or deep is such liberalisation likely to be?

What factors have lead to the growth of trade agreements? Is ongoing growth of trade agreements inevitable?

The answers to these two sets of questions are closely intertwined. Indeed, the proposition could be made that the lack of timely trade liberalisation under the WTO's Doha Round is one reason for the recent proliferation of trade agreements.

Multilateral liberalisation under the auspices of the Doha Round will likely be realised; but at this point in time it is hard to say what the scope and pace of liberalisation will be. However, RIRDC sees the issue as not so much whether multilateral liberalisation will be realised, but when. And from the agricultural sector's perspective, faster paced liberalisation is better than slow liberalisation.

At the time, the GATT believed the Uruguay Round to be the 'largest trade negotiation ever, and most probably the largest negotiation of any kind in history'. The Uruguay Round commenced in September 1986, with a negotiating agenda that

> …covered virtually every outstanding trade policy issue. The talks were going to extend the trading system into several new areas, notably trade in services and intellectual property, and to reform trade in the sensitive sectors of agriculture and textiles. All the original GATT articles were up for review. It was the biggest negotiating mandate on trade ever agreed, and the ministers gave themselves four years to complete it.'3

Whilst allowing themselves four years, the Uruguay Round actually took seven and a half years to negotiate (hence roughly twice the original schedule).

The current round of WTO negotiations — the Doha Round (or Doha Development Agenda) — started in November 2001. The Doha Round identifies around 20 subjects for negotiation, spanning areas such as agriculture, SPS, textiles and clothing, market access for non-agricultural products, services, technical barriers to trade (or NTBs), customs valuations, rules of origin, subsidies and countervailing measures, and trade related intellectual property (TRIPS) and investment (TRIMs) issues. The Doha Round also addresses issues arising from the implementation of the existing agreements.

The original aim was to reach agreement on almost all subjects in the negotiation by 1 January 2005 (hence giving themselves around four years to negotiate — the same time period as the initially allocated to the Uruguay Round negotiations). This deadline was missed and some eight years later the negotiations are still ongoing.

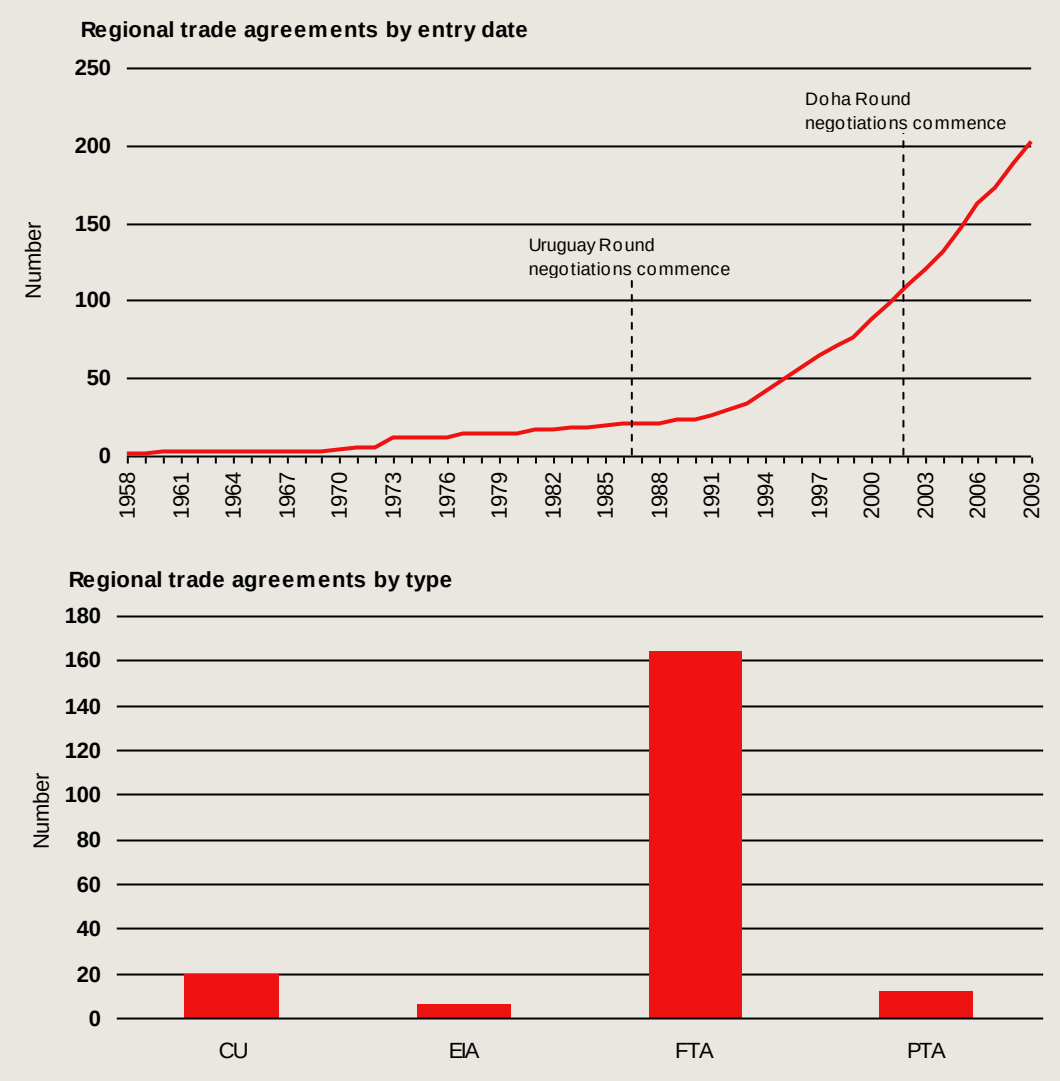
Hence if we compare Uruguay Round negotiations — which took over seven years to negotiate and which were the 'largest trade negotiations ever' (in the WTO's words) — to the Doha Round — whose negotiations are still ongoing after eight years — there must be some significant differences in members' opinions across the 20 subjects for negotiation. Will these negotiating challenges/differences be overcome? Probably yes. When will they be overcome? Who knows?

---

3 WTO Secretariat, Understanding the WTO: The Uruguay Round, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm, accessed 3 February 2010.

The slow progress of the Doha Round is probably one (of several) driving factors in the proliferation of preferential trade agreements. As can be seen from chart 2.1, trade agreements, and especially free trade agreements, have proliferated since the early 1990s. Indeed, the WTO reports that Mongolia was the only WTO Member in 2005 not party to a regional trade agreement; and by 2010 there could be 400 trade agreements in force.[4] (Although given chart 2.1, this looks unlikely by the end of 2010.). FTAs have dramatically increased in number as multilateral trade reform under the auspices of the WTO has slowed.

2.1 Regional trade agreements[a]



[a] Note that due to the way in which GATT/WTO provisions allow for trade agreements, it is possible that the one agreement could be recorded twice by the WTO (with entries for both of merchandise trade and services trade). Also note that the WTO classifies some trade agreements as being, for example, both a Free Trade Agreement and Economic Integration Agreement, or a Customs Union and Economic Integration Agreement etc. In such instances, the agreement has been assigned to the first mentioned type.

Data source: The World Trade Organization's Regional Trade Agreements Information System (online database).

---

4 See WTO 'Regionalism: friends or rivals', http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm, accessed 16 April 2007; and Lamy, P. (2007), *Multilateral or bilateral trade agreements: which way to go?*, speech to the Confederation of Indian Industries, Bangalore, 17 January 2007, World Trade Organization.

Over the last decade there has been increasing debate about whether preferential trade agreements (PTAs) help to move international trading arrangements towards global free trade, or whether they actually retard trade. In effect, there is a continuing debate about whether PTAs are 'building blocks' or 'stumbling blocks' towards global free trade.[5]

There are likely to be numerous reasons why countries are pursuing (typically) bilateral PTAs (such as free trade agreements). Reasons often cited include:

- slow progress in the Doha Round of WTO talks and the multilateral trading system generally;
- PTAs can be (relatively) quick to negotiate, and negotiations can be entered into with only those countries that are strategically important geopolitically and/or trading partners;
- PTAs can enter into new areas (such as investment, competition policy, technical standards etc) where there is no consensus among WTO members; and
- PTAs can set up a political dynamic for decreasing domestic political opposition to future multilateral liberalisation.[6]

Those debating the merit of PTAs typically counter:

- there is little consistency between negotiated PTAs, resulting in a complicated set of liberalisation profiles, procedure, and differing rules of origin requirements (termed the 'spaghetti bowl' effect);[7]
- those with preferential access under a PTA can argue against global trade liberalisation as that preferential access would be lost;
- some important trade barriers, such as production subsidies, cannot be addressed at the bilateral level; and
- PTAs divert scare resources from the wider goal of global free trade.

Opponents and supporters of PTAs have argued these points extensively.

In response to such criticisms, RIRDC would contend that as the number and nature of PTAs has evolved over time, consistency amongst agreements is improving. For example, APEC has release best practice guidelines for PTAs[8] and Australia's most recent PTAs tend to use the less administratively burdensome/onerous change in tariff classification approach to rules of origin. It should also be appreciated that even before the proliferation of PTAs, Australia had numerous tariff schedules (and accompanying rules of origin). For example, Australia has an MFN tariff schedule for developed countries; two MFN schedules for developing countries, and a schedule for less developed countries. Hence Australia's MFN tariff schedule(s) already have preferential elements.

---

5 Griswold, D.T. 2003, 'Free-trade agreements: stepping stones to a more open world', *Cato Institute Trade Briefing Paper,* no. 18.

6 Hoekman, B.M. and Kostecki, M.M. 1995, *The Political Economy of the World Trading System: From GATT to WTO*, Oxford University Press.

7 Bhagwati, J. 2002, 'Spaghetti Bowl: A Systemic Problem' *Free Trade Today*, pp. 112–18, Princeton University Press.

8 APEC 2005, *Negotiating Free Trade Agreements: A guide*, APEC Branch, Department of Foreign Affairs and Trade.

The argument against global trade liberalisation, made on the basis of countries' losing preferential access conferred under a PTA, does not appear to hold weight in reality. For example, Australia appears to be a willing participant of the Trans Pacific Partnership (TPP), which if brought to fruition, would see Australia's preferential access to the US being lost as New Zealand (plus numerous other countries) exporters received duty free access to the US market. Australia appreciates that a NZ-US FTA (via the TPP) would be of large benefit to the New Zealand economy, which, due to Australia's strong economic ties to the New Zealand economy, would also be of benefit to the Australian economy. That is, Australia stands to benefit from a richer New Zealand.

A key weakness of PTAs is that some of the most trade distorting interventions, such as production subsidies, cannot be addressed at the bilateral level. Such distortions can only be addressed unilaterally or multilaterally.

Finally, the claim that PTAs divert scarce (government) resources from the wider goal of global free trade may be true for some of Australia's Pacific island neighbours — and even then, PTA capacity building is available from organisations such as the WTO or via development aid. For a country such as Australia, such claims are baseless. Indeed, in a speech to the Foreign Correspondents' Association, the Australian Minister for Trade, the Hon Simon Crean MP, noted:

> Multilateral agreements such as Doha are the pinnacle of trade agreements. Nothing can match the global benefits of completing a Round. We saw that with the completion of the Uruguay Round in 1994… But the Australian Government is not putting all its eggs in the Doha basket. We are developing trade relationships on many fronts and that is the way it should be. There is a complementary relationship between multilateral, regional and bilateral Free Trade Agreements, which I call the cascade effect. (Hon Simon Crean MP, Sydney 16 February 2010)

From RIRDC's perspective, global unilateral liberalisation or multilateral trade liberalisation (on an MFN basis) is the ultimate objective. If realised, such liberalisation would obviously deliver far greater gains than a single PTA. Hence PTAs reflect a 'second best' policy choice. This is because a PTA infers preferential access for the parties involved in the agreement, disadvantaging those outside the agreement. In RIRDC's *Preferential trade and developing countries: Bad aid, bad trade*, publication case studies are presented to illustrate the 'kiss of death' that preferences can become; in providing preferential access for particular goods (sugar and bananas are the most common examples cited) while other, potentially more efficient, suppliers are excluded.[9] This practice of preferential access undermines the MFN principle, and is one of the arguments against PTAs generally.

However, it should be appreciated that as a country's PTAs increase in number, the liberalisation there under will eventually approach multilateral liberalisation. For example, Australia's existing (and main) PTAs, with ASEAN, Chile, New Zealand and the US, sees 30 per cent of Australia's total (import and export) merchandise and service trade in 2008 being subject to preferential trade liberalisation. If Australia concluded PTA negotiations with China, Japan and South Korea then a further 32 per cent of total trade would be covered by PTAs. Hence these seven PTAs could see some 62 per cent of total Australian trade being subjected to preferential trade liberalisation; well on the way to achieving multilateral liberalisation.

The proliferation of PTAs is more likely a symptom of a slowing multilateral trading system and not a cause of the slowing. Countries wishing to undertake trade liberalisation do not want to be tied to the 'slowest ship', as is the case with multilateral liberalisation, and the recent troubles with the Doha Round of WTO talks has increased the incentive for pro-trade countries to look elsewhere for new

---

9 Furthermore, the protection offered by the preferential treatment locks the incumbent into production of a good which they may not be most efficient, diverting resources away from other goods and services which they will have a comparative advantage in.

trading opportunities. Since WTO member governments agreed in November 2001 in Doha to launch a new Round of multilateral trade negotiations, 104 regional trade agreements have entered into force.

And while a 'second best' policy choice, the speed at which PTAs can be negotiated and the breadth of coverage means that pro-trade countries, such as Australia, can quickly access the gains that (preferential) trade liberalisation can bring.

Whether the ongoing growth in PTAs in inevitable is largely contingent on progress on the multilateral front. If the Doha Round continues to progress slowly and/or only limited trade liberalisation is achieved, then a natural consequence is the continued proliferation of PTAs.

What developments within our trading partners' economies or the regional and global economic architecture, more broadly, have implications for Australia's approach to trade agreements?

Unilateral global or multilateral trade liberalisation should be the ultimate objective of all countries. However, individual countries, especially small and medium economic powers such as Australia, are likely to be unable to stop the movement towards PTAs as multilateral forums such as the WTO flounder. Therefore, from an individual country perspective, it is necessary to decide whether, given the proliferation of PTAs, that country wants to be included or excluded from the 'game'. It is not an option for Australia to say that PTAs should not be proliferating. Whether Australia is involved or not, trade agreements will likely continue to multiply in number.

Hence if the net impact of a preferential trade agreement is viewed as being economically and/or geopolitically beneficial for participants, then in essence, the decision facing countries concerns whether they should get those gains now, or wait for progress on the multilateral front.

And as noted above, RIRDC and the wider agricultural sector believe that faster paced liberalisation is better than slow liberalisation, even if that liberalisation is on a preferential rather than multilateral basis.

3. Impacts on trade and investment barriers

What liberalisation of trade in goods can be attributed to countries' involvement in trade agreements? How has this varied across products or sectors?

When analysing the merchandise trade liberalisation negotiated under a PTA, there are two elements to consider:

- the magnitude of any (for example) tariff reduction
- the pace at which liberalisation is undertaken.

To allow the liberalisation undertaken under different PTAs to be quantitatively assessed (or ranked), the CIE developed an index — the PTA Liberalisation Index — to provide a single measure of the magnitude and pace of liberalisation undertaken in various negotiated PTAs. Further details on how the Index is calculated can be found in appendix B.

PTA Liberalisation Index scores for Australia's most recent PTA —AANZFTA — and the most 'debated' PTA — AUSFTA — are reported in table 3.1. Note that the index ranges between 0–100, with 0 being no liberalisation (of value today) being undertaken, and 100 being total liberalisation overnight. Also note that a country may receive a low index score due to undertaking only limited tariff liberalisation, or delaying any liberalisation until a future time.

As can be seen from table 3.1, Australia typically receives higher PTA Liberalisation Index scores, meaning Australia typically liberalises faster and/or more extensively than the PTA partners. The various PTAs considered have also resulted in significant liberalisation of tariff barriers.

(Note that when considering the index scores for Australia, it should be appreciated that the index scores may be artificially inflated due to Australia's unilateral liberalisation of PMV and TCF products in 2005 (date AUSFTA entered into force) and 2010 (when AANZFTA entered into force). Hence irrespective of AUSFTA and AANZFTA entering into force, Australia would still have undertaken some trade liberalisation, which in turn would have registered as a positive index score. This may see too much liberalisation having been attributed to the various PTAs.)

3.1 PTA Liberalisation Index scores

FTA partner country	*ASEAN-Australia-New Zealand FTA*	*Australia-United States FTA*
	Index score (0–100)	Index score (0–100)
Brunei	74.9	Na
Cambodia	59.7	Na
Indonesia	75.7	Na
Lao PDR	52.5	Na
Malaysia	81.9	Na
Myanmar	52.0	Na
Philippines	82.9	Na
Singapore	100.0	Na
Thailand	88.4	Na
Viet Nam	65.0	Na
ASEAN	89.0	Na
Australia	93.6	92.1
New Zealand	89.1	Na
United States	Na	89.9

Source: CIE calculations based on negotiated tariff liberalisation schedules.

The PTA Liberalisation Index can also be applied at the product level. Table 3.2 provides index scores at the product level for members of AUSFTA and the larger economies in AANZFTA (for convenience, the products identified are the same as that used in GTAP database).

When looking at table 3.2, it is important to remember that a country could record an index score of zero due to either undertaking no liberalisation or already having no tariffs (and hence no liberalisation was possible). An example of the former situation is the ASEAN members' failure to lower tariffs on rice imports under AANZFTA. An example of the later situation is Australia (and New Zealand) already allowing the duty free importation of rice prior to AANZFTA, hence there was no tariff liberalisation possible.

Under AANZFTA, Australia (and New Zealand) clearly undertook more substantial trade liberalisation than the ASEAN members (with the exception of Singapore, which was largely free trade already). This may reflect a conscious decision by Australia (and New Zealand) to allow the developing ASEAN members a longer period of time to implement the trade liberalisation, akin to the approach taken with developing countries in the WTO.

Liberalisation of Australian agricultural and food imports exceeded that undertaken in the manufacturing sectors, potentially reflecting beliefs about where Australia's areas of competitive/comparative advantage lie. Of concern to Australian agricultural exporters is the fact that Australia's liberalisation of manufacturing imports was in the same ballpark as the liberalisation undertaken by ASEAN members; yet the same did not occur for Australian agricultural exports. That is, there are some substantial differences between the PTA Liberalisation Index scores for Australia and ASEAN members in agricultural and food products.

Almost exactly the same points, although to a lesser extent, could be made about the tariff liberalisation negotiated under AUSFTA. That is, US and Australian tariff liberalisation is pretty much on-par in manufacturing products, close in agricultural products, with the largest differences being in processed foods. Typically, though not always, Australia undertook more tariff liberalisation than the US.

The conclusion to reach is that Australia's involvement in PTAs has seen a substantial lowering of Australian tariff barriers, albeit on a preferential basis.

3.2 PTA Liberalisation Index scores by sector

GTAP products	*AANZFTA (select economies)*[a]						*AUSFTA*	
	Indon	***Malay***	***Phil***	***Thai***	***Aus***	***NZ***	***Aus***	***US***
	Index	Index	Index	Index	Index	Index	Index	Index
Paddy rice	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Wheat	95.2	0.0	91.0	0.0	0.0	0.0	0.0	100.0
Cereal grains nec	83.3	0.0	56.7	13.9	0.0	0.0	0.0	100.0
Vegetables, fruit, nuts	70.7	69.1	73.5	90.7	100.0	100.0	100.0	85.0
Oil seeds	85.2	92.5	89.0	84.5	100.0	0.0	100.0	100.0
Sugar cane, beet	95.2	96.3	89.1	94.4	0.0	0.0	0.0	0.0
Plant-based fibers	95.2	0.0	90.7	91.9	0.0	0.0	0.0	0.0
Crops nec	85.1	17.2	89.6	62.9	100.0	96.9	100.0	98.0
Bovine cattle, sheep	71.3	0.0	77.9	100.0	0.0	0.0	0.0	95.8
Other animal prods	93.7	100.0	87.5	95.0	100.0	100.0	100.0	98.3
Raw milk	14.9	88.1	62.7	0.0	0.0	0.0	0.0	0.0
Wool, silk	95.2	0.0	90.7	98.3	0.0	0.0	100.0	87.6
Forestry	93.5	88.8	90.3	95.6	100.0	100.0	100.0	97.6
Fishing	84.6	90.3	88.8	92.3	100.0	100.0	100.0	100.0
Coal	95.2	0.0	74.3	100.0	0.0	0.0	0.0	0.0
Oil	0.0	92.5	90.7	0.0	0.0	0.0	0.0	100.0
Gas	95.2	0.0	71.5	100.0	0.0	0.0	0.0	0.0
Minerals nec	92.2	86.5	87.0	96.9	100.0	100.0	100.0	94.4
Bovine meat products	71.0	91.5	83.1	75.9	0.0	0.0	0.0	99.3
Meat products nec	89.2	81.5	58.9	89.3	100.0	100.0	100.0	95.4
Vegetable oils, fats	93.4	90.2	87.9	77.0	100.0	89.4	100.0	89.9
Dairy products	71.8	99.3	78.4	63.3	100.0	100.0	100.0	62.8
Processed rice	0.0	0.0	0.0	0.0	0.0	0.0	0.0	94.9
Sugar	7.1	0.0	6.6	24.4	100.0	0.0	100.0	91.6
Food products nec	66.7	92.6	86.1	87.3	99.4	98.1	100.0	86.8
Beverage, tobacco	1.2	10.1	88.1	90.1	100.0	99.6	100.0	80.5
Textiles	91.9	89.3	87.9	86.2	92.4	81.2	84.7	84.1
Wearing apparel	84.6	88.7	88.1	76.4	79.3	76.2	81.9	79.9
Leather products	88.0	89.6	84.0	95.1	97.1	79.7	96.6	96.0
Wood products	92.5	89.4	87.9	92.1	97.6	89.8	100.0	99.5
Paper, publishing	94.8	89.0	87.6	95.4	98.9	88.0	99.6	100.0
Petroleum products	51.5	92.5	80.2	99.2	0.0	99.5	0.0	100.0
Chem, rubber, plastic	87.4	80.8	70.4	96.8	97.4	94.9	99.8	99.9
Mineral products nec	92.5	84.6	75.9	95.7	98.9	95.1	99.3	93.1
Ferrous metals	75.1	65.8	59.5	86.1	97.4	87.5	100.0	99.5
Metals nec	93.5	88.2	90.5	98.8	98.4	97.6	100.0	100.0
Metal products	85.4	89.4	81.0	94.4	99.1	95.6	100.0	99.1
Motor vehicles, parts	64.0	86.1	92.8	88.6	94.8	95.2	97.3	100.0
Transport equipment	90.4	85.5	90.7	97.4	99.1	98.9	100.0	100.0
Electronic equipment	89.9	90.0	88.5	95.4	96.9	95.6	100.0	97.4
Machinery nec	90.3	82.5	88.9	96.7	98.9	97.8	99.9	99.3
Manufactures nec	90.7	90.0	88.7	95.1	98.8	94.0	99.7	99.9

a Only index scores for products in the larger economies are reported. Product index scores for all AANZFTA members can be provided to the Commission on request. Note that Singapore was already a virtually duty free export destination prior to AANZFTA, and hence has been excluded from the table.

Source: CIE calculations based on negotiated tariff liberalisation schedules.

Where there has been liberalisation of trade in goods, has it involved preferential arrangements or has it been non-discriminatory?

The above analysis relates to solely preferential arrangements, hence most of Australia's recent trade liberalisation has been under the auspices of PTAs.

However, and most recently, Australia also undertook unilateral tariff reductions on PMV and TCF imports in 2005 and 2010.

As part of APEC, Australia, and other developed APEC economies, have a (voluntary) commitment under the Bogor Declaration to lower all tariff barriers to zero by 2010. Developing APEC economies have until 2020 to be tariff free. The Bogor Declaration represents an agreement by member economies to eliminate their tariff barriers with respect to all trading partners (even those outside of APEC), and hence is non-discriminatory in nature.

As Australia still has tariff barriers in place today (February 2010), Australia is clearly not going to be meeting its commitment to the Bogor Declaration. Singapore appears to be the only developed APEC country that has (virtually) met its Bogor commitment.

Have trade agreements encouraged further unilateral liberalisation or have they perversely discouraged such reform, so as, for example, to maintain 'negotiating coin' for future trade agreement negotiations?

The Department of Foreign Affairs and Trade is probably best placed to speak on the relationship between unilateral reform and PTAs. However, RIRDC would like to make a few observations.

- PTAs by their very nature arise because countries would like to receive something (i.e. greater market access for their exports) from providing greater market access to imports. But whether or not this infers that PTAs discourage unilateral reform is unclear, with arguments for both sides.

- This question formed the basis of a section in RIRDC's *'Free' Trade Agreements: Making them Better*, which is summarised below:

  – PTAs can help to dilute the power of special interested groups opposing trade. By exposing protected industries to small increases in competition, a PTA might allow an industry to partially adjust and therefore reduce its opposition to further trade reform.

  – An example of this is the Closer Economic (CER) agreement. Bilateral liberalisation generated through this agreement was one of adjustment for the Australian dairy industry. As the Australian dairy industry became more competitive it became easier to shift towards unilateral liberalisation.

  – The growing number of PTAs may result in a positive cycle of bidding wars. For countries that are already party to a PTA each additional PTA results in less trade diversion and so increases the likelihood of a positive impact upon welfare. This increases the incentive to join additional PTAs creating a 'race towards free trade' as countries out-bid each other in offering more and more liberalisation.

- On the negative side, the growth of PTAs could create several large and potentially hostile trading blocs.

The willingness of Australia to undertake unilateral liberalisation is probably more influenced by political considerations than economic. This is evidenced by the fact that Australia already has low applied tariff rates, which indicates that it's the not the economic benefits of greater market access that attract countries to form PTAs with Australia.

Australia's (simple) average applied MFN tariff barrier in 2010 is under 3 per cent. Note that Australia applies lower than (applied) MFN tariff rates to developing countries. Tariff concessions are in the order of 1–5 percentage points lower than the standard MFN rate and are granted on 13 per cent of tariff lines. It is typically manufacture products — chemicals, metal and metal products, other mineral products, wood and paper products, machinery etc — that receive the tariff concessions. The notable exceptions are imports of textiles, apparel and motor vehicles and parts, for which developing countries receive little in the way of tariff concessions.

Hence Australia's applied tariff rate is already very low, and even lower on imports from developing countries. Of course, an average masks some variation in tariff peaks. In 2010, the maximum Australian tariff is 10 per cent, levied on certain TCF imports. Despite the 10 per cent tariff peak levied on around 300 tariff lines, there is not much 'negotiating coin' left in the Australian tariff schedule — over 3200 tariff lines at the HS8 digit level (some 52 per cent of all lines) are already duty free. Further unilateral tariff liberalisation is therefore unlikely to reduce Australia's ability to negotiate new PTAs, which are focusing more on service and investment liberalisation, and geopolitical considerations.

Of course, the magnitude of negotiating coin lies in whether Australia liberalises its bound or applied tariff. Australia has bound nearly 97 per cent of its tariff lines with the WTO, with the average bound rate being 10 per cent.[10] With a bound versus applied tariff gap over 7 percentage points, Australia could potentially raise its applied tariffs by a substantial margin. This could act as a source of uncertainty with respect to the applied tariff. While liberalisation of tariffs under the auspices of the WTO pertains to bound tariffs, Australia's unilateral liberalisation and that conducted under PTAs (so far) has been based around applied tariffs.

We are aware of one instance where liberalisation under a PTA has been applied unilaterally. Australia is the only major industrialised country that is not a signatory to the plurilateral WTO Agreement of Government Procurement (GPA). As such, Australia is not bound by the GPA's rules on open and non discriminatory policies in government procurement. However value for money is the core principle underpinning Australia's procurement policy.[11] This is achieved by encouraging competition and ensuring non-discrimination in procurement, which means foreign competitors have the same opportunity to compete for government business as domestic businesses.

However, there were (or are if states have been slow to act) some restrictions imposed on foreign businesses when competing for state/territory procurement opportunities. For example, NSW Government policy required all NSW agencies and departments to place a 20 per cent margin on the price of all non Australian and New Zealand companies tendering for the supply of manufactured goods. This is effectively a 20 per cent 'tariff' on government procurement for these types of businesses. However, under the Australia-United States Free Trade Agreement all such barriers to US competitors should have been removed by the start of 2008; and Australia has decided to apply the government procurement rules agreed under AUSFTA to suppliers from all countries.[12] Hence in this example achievements in a PTA have been applied unilaterally.

Using existing barriers to trade can be an effective method of obtaining greater market access for our exports. It is true that this process of negotiating greater market access generates an incorrect belief that imports are bad and exports are good. But while PTAs perpetuate this, they can also provide a path through which public support for trade and trade liberalisation can be garnered. PTAs provide a

---

10 WTO Secretariat 2007, *2007 Trade Policy Review of Australia*, WTO, pp. 31 and 33.

11 Department of Finance and Administration 2005, *Commonwealth Procurement Guidelines 2005*, Financial Management Guidance no. 1.

12 WTO Secretariat 2007, *2007 Trade Policy Review of Australia*, WTO, page 24.

much easier sell to the public than unilateral reform, even if that reform is in Australia's own best interest. The well cited problem of trade reform — concentrated negative impacts, dispersed benefits — can make unilateral liberalisation politically difficult; whereas at least under a PTA Australian exporters get improve market access elsewhere.

It could be contended that unilateral reform is hindered more by an ill-informed wider public and political considerations than Australia wishing to maintain some negotiating coin for future PTAs. Keeping (average) tariffs at 3 per cent so that their removal can be used as a bargaining chip in later PTA negotiations is a questionable assertion.

From RIRDC's perspective, its main concern with using PTAs as a path to unilateral/multilateral trade liberalisation is that it continues to propagate an incorrect perception that imports are bad and exports are good. And in doing so, never effectively engage and persuade the broader community to the benefits of free trade.

RIRDC has examined the benefits of trade liberalisation through numerous publications. Publications were widely distributed at Cairns Group Ministerial Meetings as well as at meetings of the International Federation of Agricultural Producers. The reports were distributed in a number of countries, including the US, Europe and Latin America. They were also used in the context of WTO meetings in the course of the Doha Round of multilateral trade negotiations. Several of these key publications include:

- *'Free' Trade Agreements: Making them Better* provides an evaluation of bilateral trade agreements as a route to more liberal trade, highlighting key characteristics of preferential trade agreements and providing recommendations for the design of a 'good' PTA.

- *Agricultural Trade Policy Made Easy* provides a accessible summary of the economics of free trade, and introduction to the process of trade liberalisation under the WTO and some of the issues associated with Doha negotiations.

- *Preferential Trade and Developing Countries: Bad aid, Bad trade* provides an in-depth discussion of the positive and negative role that preferences play in bilateral and multilateral trade negotiations.

4. Economic impacts

What has happened to trade flows — both in goods and services — and investment flows between Australia and partner countries with which it has entered trade agreements?

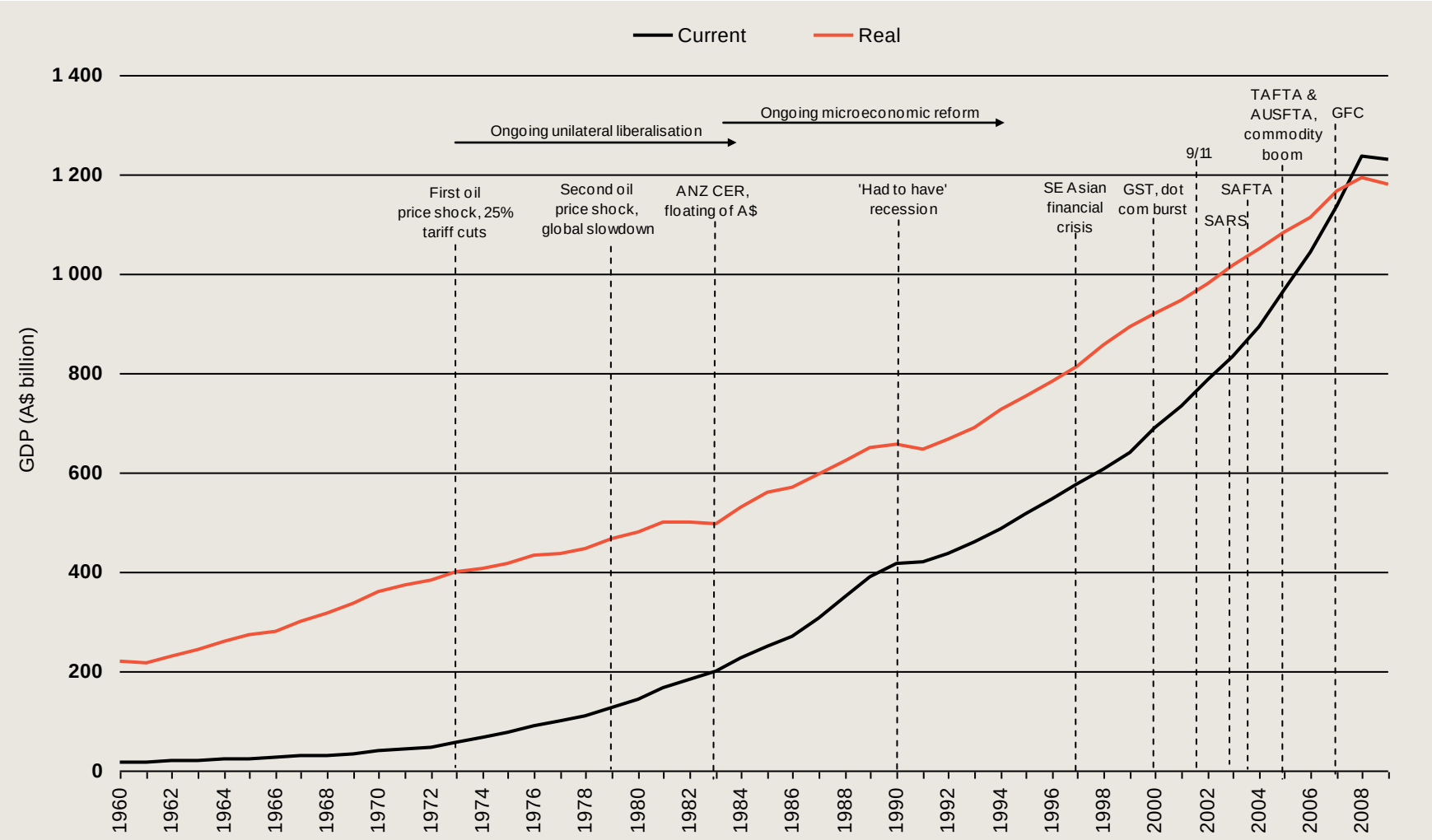
In the absence of a rigorous econometric exercise, this is an extremely hard question to unambiguously answer. Quite simply, there is too much policy 'noise' and exogenous global shocks to be able to look at trade flows between Australia and Thailand, Singapore and the US and say that changes in trade flows are the result of the PTA. Chart 4.1 shows Australia's real (chain volume) and current GDP since 1960, and notable policy reforms and exogenous global shocks. As can be seen, there is substantial noise around the time the PTAs with Singapore (July 2003), Thailand (January 2005) and the US (also January 2005) were entered into force.

To say how has the various PTAs influenced trade and investment flows, this policy noise would need to be accounted for. As already noted, this is a challenging econometric exercise (and we are not aware of such a study having been undertaken for Australia as yet). Indeed, we are aware of only one econometric paper of sufficiently high quality that has investigated the impacts of a PTA — see Treflar (2004), 'The Long and the Short of the Canada–US Free trade Agreement', *American Economic Review*, vol. 94, no. 4, pp. 870–95. Findings of this paper are discussed further below.

A further difficulty concerns by what measure are trade and investment flows measured — in absolute levels (values), or as a share of total exports, imports and inward and outward FDI positions? Views on the success of PTAs in promoting trade can differ markedly depending on which indicator is used.

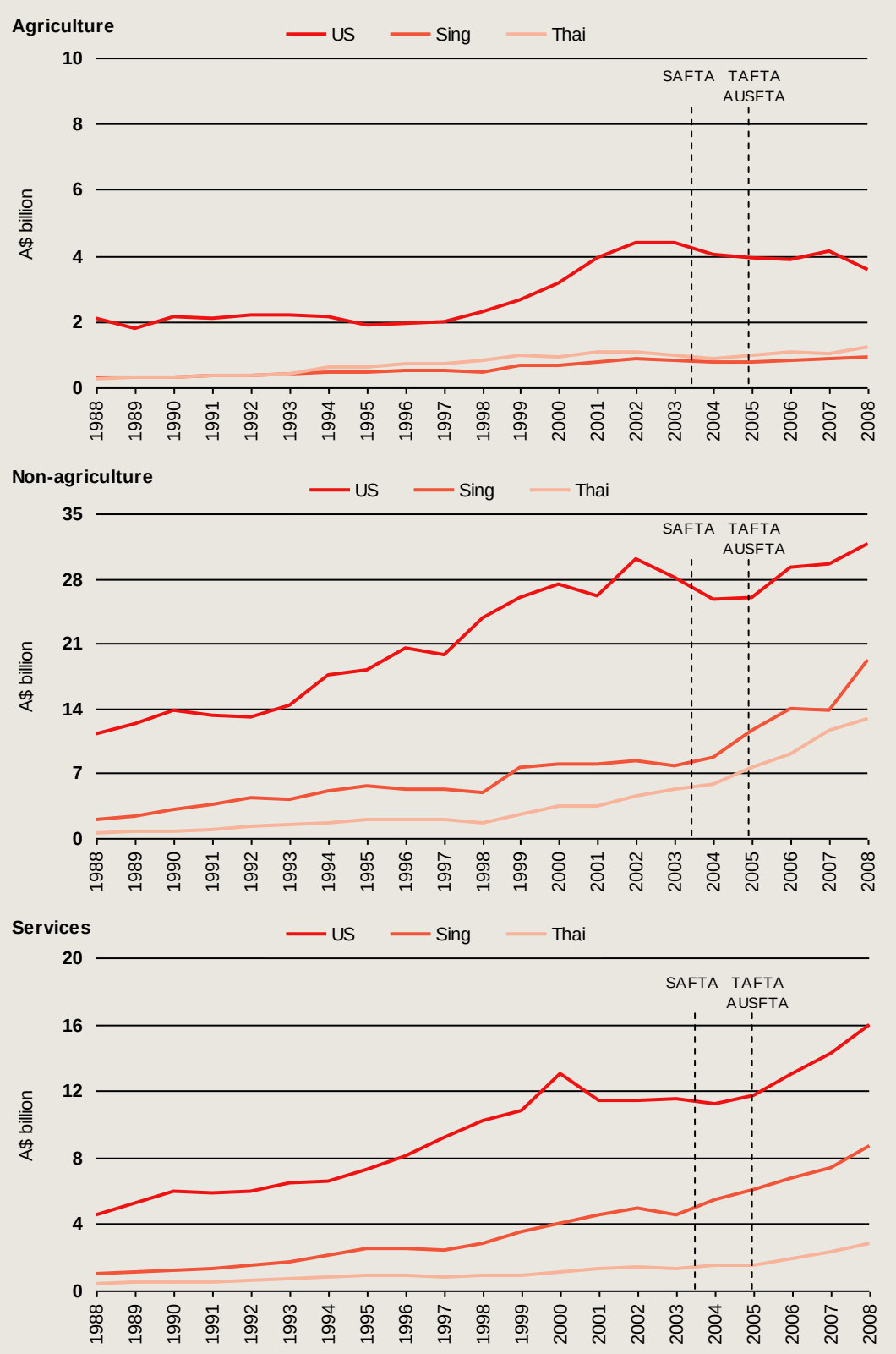
By way of example, consider chart set 4.2, which shows a time series of Australian merchandise and service trade (exports and imports) with the PTA partner countries of Singapore, Thailand and the US. As can be seen, the change in trade (exports plus imports) seems to be moving in the right direction following the PTA entering into force — trade is typically higher following liberalisation. The exception from this general rule is Australian agricultural trade with the US, which was marginally lower in 2008 than in 2004. This may reflect worsening climatic conditions in Australia, and the composition of agricultural trade with the US (vis-à-vis that with Singapore and Thailand).

4.1 Australia's economic performance



Source: ABS (5206.0, table 1).

4.2 Australian trade with PTA partners



Note: Agriculture is defined as HS chapters 1–24, 41 and 50–53 (inclusive).

Data source: United Nation's COMTRADE online database and Department of Foreign Affairs and Trade Statistical Section (personal correspondence).

Furthermore, and as can be seen from table 4.3, the average annual growth rate in trade is typically higher post PTA than pre PTA (noting that there are only a few data points post PTA for Thailand and the US). Some general observations to take from table 4.3 include:

- Thailand has larger tariff barriers than Singapore and the US, hence it could be expected that trade with Thailand would experience the largest changes in pre and post PTA growth rates (and was observed);

- changes in non-agriculture growth rates are larger than that for agriculture, reflecting the largely already free trade in agricultural products (in Australia, Singapore and the US).

But while the value of trade and the growth in trade is typically higher post PTA than pre PTA, what we do not know (unambiguously) is the contribution liberalisation carried out under the PTA has made to the trade flows. Further econometric research is needed to establish/quantify the relationship between trade flows and PTA liberalisation.

4.3 Trade growth rates

	Pre PTA	***Post PTA***
	Average annual growth rate (%)	Average annual growth rate (%)
Australian trade with Singapore		
Agriculture	7.1	2.9
Non-agriculture	10.8	19.7
Services	12.2	13.7
Australian trade with Thailand		
Agriculture	8.3	8.9
Non-agriculture	16.0	18.8
Services	9.1	21.4
Australian trade with US		
Agriculture	4.1	-3.1
Non-agriculture	5.3	7.0
Services	5.7	10.7

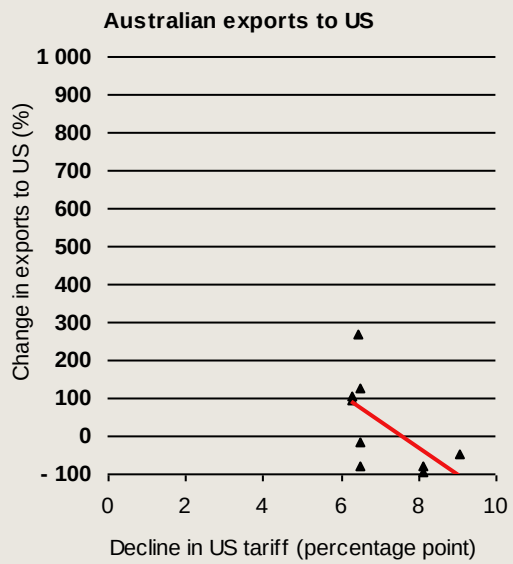
Sources: United Nation's COMTRADE online database, Department of Foreign Affairs and Trade Statistical Section (personal correspondence), and CIE calculations.

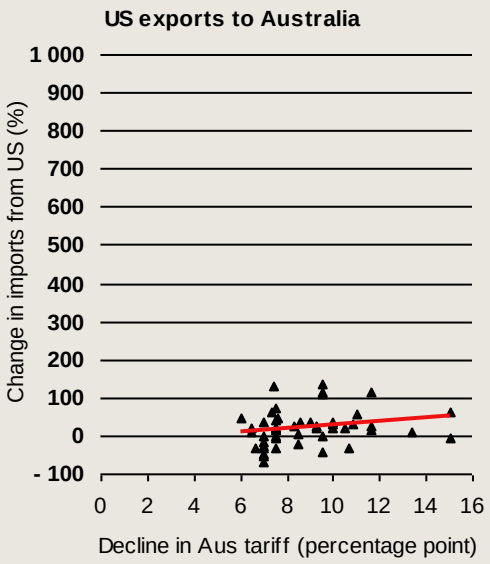
Australia, Singapore and the US already had very low (average) tariff barriers pre PTA; and hence the percentage point reduction in tariffs under the PTAs is also small. Given this, it is likely that other (microeconomic) policy reforms, productivity advancements, changing technology and tastes, exogenous shocks (global growth, exchange rate movements) etc will dominate the trade inducing effects of liberalisation carried out under the various PTAs.

By way of example, consider Australia's bilateral trade with the US in 2004 and 2008. The change in value of trade, at the HS4 digit level between in the pre (2004) and post (2008) PTA years was calculated, and then graphed against the change in tariff at the same HS4 digit level. As can be seen from chart 4.4, there (typically) appears to be a positive relationship between the change in tariff and the change in trade, but the relationship is not strong and there is substantial 'noise' occurring (as can be seen from the bottom two charts depicting no change in tariff but substantial changes in trade flows).

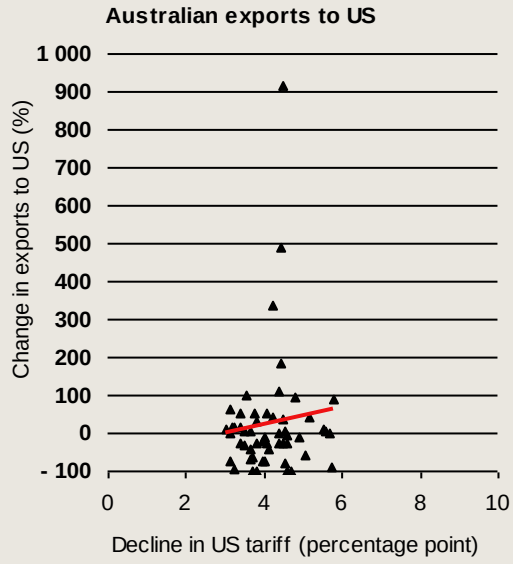
4.4 Change in Australian trade with the US by tariff reduction

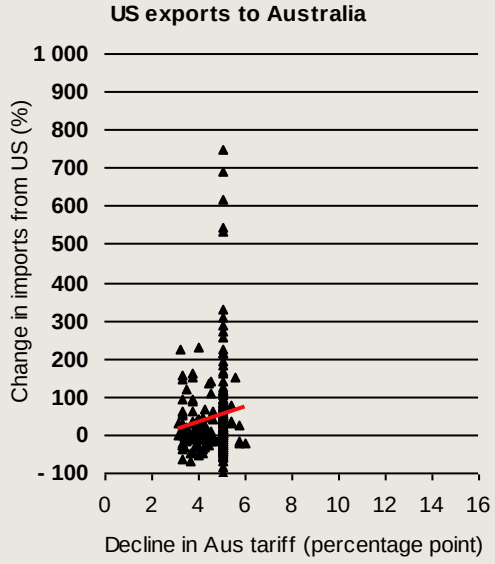
Large change in tariffs (>6 percentage points)





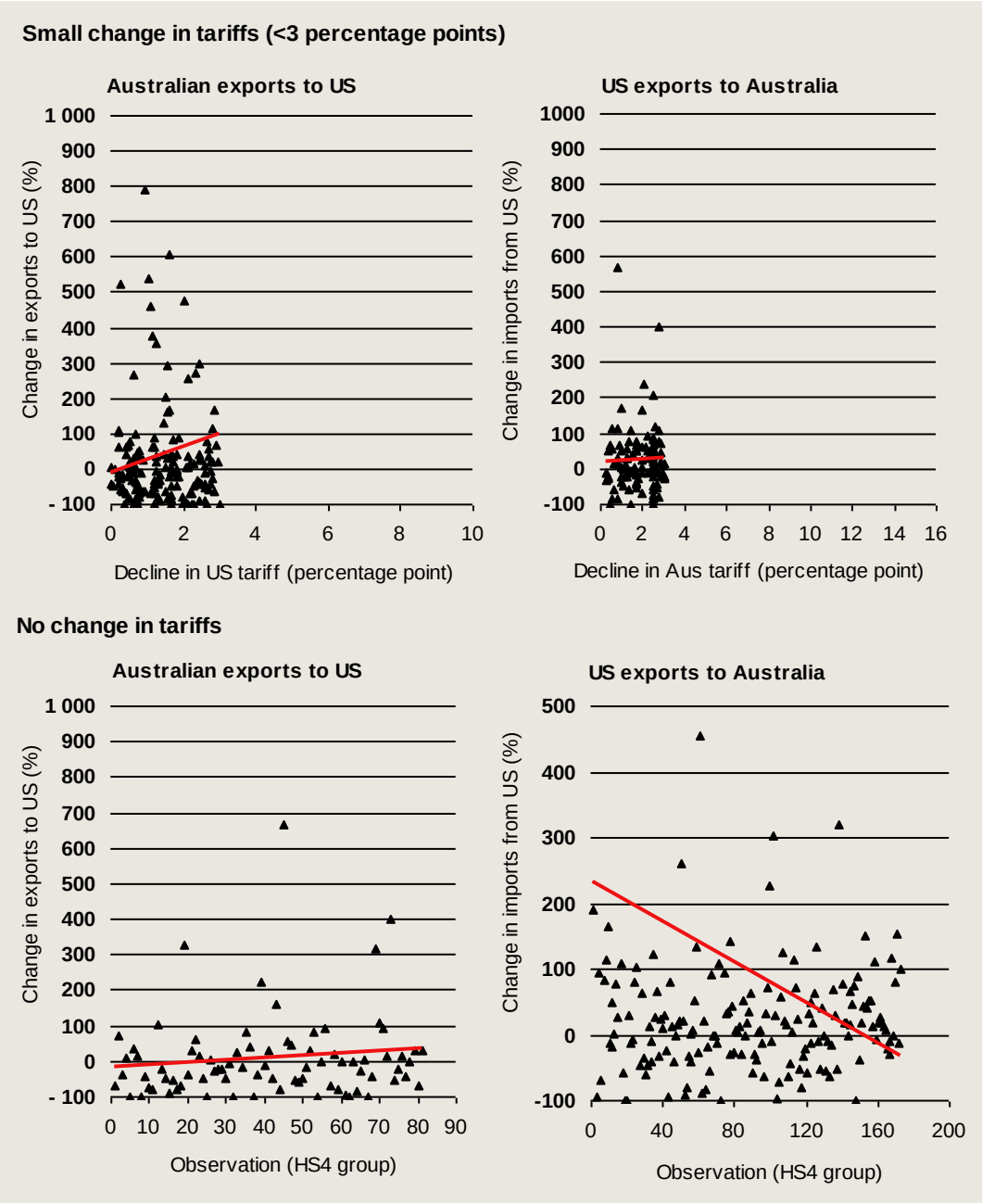
Medium change in tariffs (3-6 percentage points)





(Continued on next page)

4.4 Change in Australian trade with the US by tariff reduction (continued)



Note: HS4 categories with trade values of less than A$1 million in 2004 have been removed so as to avoid 'low base' problems.

Data sources: GTIS World Trade Atlas (online database), Australian and US AUSFTA tariff schedules and CIE calculations.

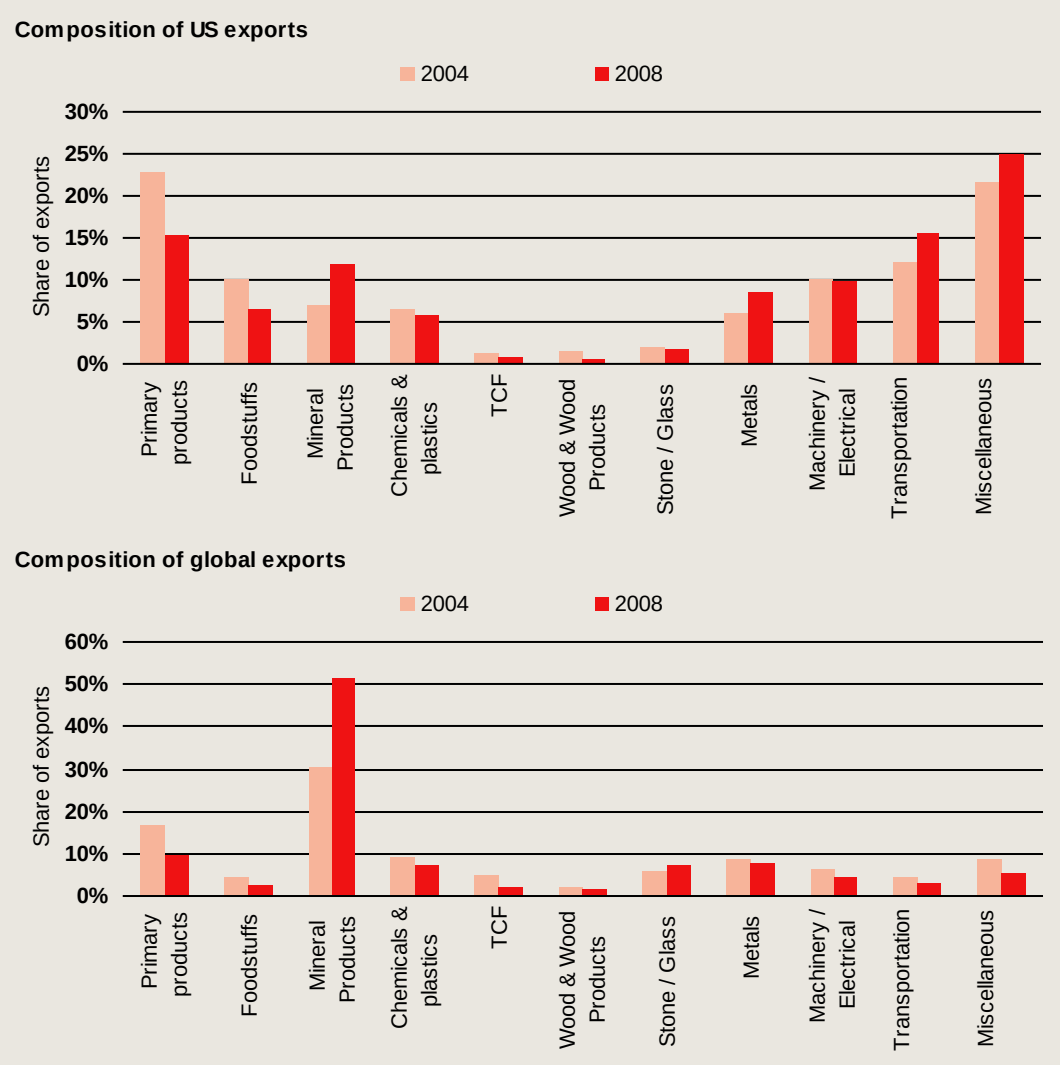
Of course, the value of trade between Australia and the US could be expected to increase over time, due to general economic growth etc. It may be more pertinent to look at the share of (merchandise) trade accounted for by the US pre and post the FTA entering into force. In 2004 the US was the destination for some 8.1 per cent of Australian merchandise exports. In 2008, the US was the destination for a lower 5.5 per cent of Australian merchandise exports. The obvious question being if a PTA promoted trade, then surely the share of exports accounted for by the US should be higher in the post FTA year (2008) than in the pre FTA year (2004).

The answer to this apparent inconsistency demonstrates the difficulty in trying to determine what it is that is driving the observed trade statistics — account needs to be taken of many factors. The US situation is explained by the pattern/composition of Australia's trade with the US, and the recent

commodity boom. In 2004 mineral products only accounted for 7 per cent of Australia's merchandise exports to the US, versus over 30 per cent in the case of exports to the world. The commodity boom saw the value of mineral exports increasing dramatically, but as a smaller share of Australian exports to the US experienced this price boom, the commodity boom led increase in Australian exports to the US was crowded out by the increase in value of mineral exports to the global economy. For example, Australian merchandise exports to Japan went from A$31.9 billion in 2007 to A$50.6 billion in 2008, largely on the back of rising coal prices. Hence in terms of exports to the US, the exports experiencing the largest increases in value were subject to a low base problem. And when measuring exports (to the US) as a share of total global exports, the importance of the US as an export market subsequently declined.

Chart 4.5 shows the composition of Australian exports to the US and global economy in 2004 and 2008.

4.5 Composition of Australian merchandise exports to US and globally



Data sources: GTIS World Trade Atlas (online database) and CIE calculations.

In summary, it is likely that liberalisation conducted under PTAs increases bilateral trade — the trade figures seem to be moving in the right direction to support economic theory in that trade liberalisation increases/promotes trade. However, and without further rigorous econometric research, we cannot definitively say what the relationship is between bilateral trade liberalisation and trade flows. Exactly the same arguments can be made for FDI.

What impact have trade agreements had on competition in affected markets?

Trade liberalisation should see the price of imports falling (assuming there is a sufficient degree of competition amongst importers). Faced with increasing import competition, domestic producers will either respond by improving productivity and remaining competitive, or exiting the industry (and as the less productive domestic producers leave the industry, average productivity rises). Hence productivity gains could be used as an indicator of/proxy for increased competition.

RIRDC are not aware of any papers that have examined the impact of PTAs on competition (and hence productivity) in the Australian context. Indeed, we are aware of only one econometric paper (of sufficiently high quality) that looked into the impacts of a PTA — the Canada–US FTA — on productivity. The paper (by Treflar) found for Canada:

- employment:
  - one in eight jobs lost in low end and heavily protected manufacturing sectors;
  - five per cent of manufacturing jobs lost;
  - no long run impact on employment rate;
- productivity:
  - 14 per cent gain in most heavily impacted export orientated industries;
  - 15 per cent gain in most heavily impacted import orientated industries (with around half of the gain coming from exit of low productivity firms);
  - six per cent gain for manufacturing as a whole;
- the FTA created more trade than it diverted, possible lowered import prices, likely raised aggregate welfare;
- short run adjustment costs borne by displaced workers and stakeholders of closed plants; and
- consumers and stakeholders of efficient plants accrue the long run gains.

Such findings are consistent with standard trade theory.

What contribution can the various models and tools (including computable general equilibrium models, ex post econometric studies, and restrictiveness indexes) make and what are their limitations?

Global computable general equilibrium (CGE) models are currently considered to be the best framework with which to quantify the potential impacts of a PTA (or unilateral or multilateral liberalisation), as a global CGE model:

- takes into account capacity constraints (land, labour and capital);
- takes into account general equilibrium linkages between sectors and trade and investment linkages with other countries, and as such can take account of any trade diversion effects;
- if the model is dynamic, a baseline can be constructed that incorporates policy initiatives that will happen irrespective of the PTA, this in turn allows the impacts of the PTA to be better estimated as account is taken of other policy reforms that may impact on trade and investment flows etc; and

- provides a framework with which to order thinking and allow for analysis to be undertaken in a rigorous, systematic and consistent way.

However, there seems to be substantial confusion about the role CGE models can play when assessing the potential economic impacts of trade liberalisation (whether that liberalisation is unilateral, multilateral of preferential in nature).

While CIEG-Cubed — the CIE's in-house CGE model of the global economy — is a highly respected economic model, it must be appreciated that the CIEG-Cubed model, like all computable general equilibrium models, is not perfect. By definition, economic models are a simplification of reality and rely on numerous assumptions about economic parameters, behaviour and relationships. As such, modelling results should only be used to infer the outcome of trade liberalisation (positive or negative) and the magnitude of such impacts (small or large). It would be inappropriate to, for example, report modelling results to the 2nd decimal point and claim that as the unambiguous impact of any trade reforms. That is, only broad messages and trends should be taken from the modelling results. This seems to be overlooked by some commentators.

Qualitative and geopolitical considerations will therefore also be important in deciding whether or not a country should enter into a PTA.

It should also be appreciated that modelling a PTA that sees quick removal of tariff, NTB, service and investment barriers to bilateral trade and investment represents a significant change to policy. As such, and over the short term, the economic impacts thereof may be quite large and fluctuate. However, when gauging the impact of the trade liberalisation, it is perhaps more prudent to focus on the impacts over the longer term (say 10–15 years post liberalisation). That way the policy changes will have worked their way through the economy and any changes to GDP (etc) will have settled down to a constant deviation from baseline.

5. Best practice PTAs

Recognising the difficulties of multilateral trade reform, APEC has released guidelines for best practice PTAs (that can also support the achievement of the APEC Bogor Declaration goal of complete unilateral trade liberalisation by 2010 for developed country members and by 2020 for developing members). Guidelines promote/encourage:

- consistency with APEC principles and goals
- consistency with the WTO
- go beyond WTO commitments
- comprehensiveness
- transparency
- trade facilitation
- mechanisms for consultation and dispute settlement
- simple rules of origin that facilitate trade
- cooperation
- sustainable development
- accession of third parties
- provision for periodic review.

Similarly, the WTO imposes three conditions for regional agreements to be WTO consistent, these being:

- an obligation not to raise trade barriers to third parties
- a free trade agreement cannot lead to higher trade barriers for members of that agreement
- tariffs and other restrictive regulations to commerce must be phased out on substantially all trade.

How useful are these benchmarks/guidelines, or other 'template' approaches, when considering the potential trade agreement partners and the design/content of prospective agreements? Could such approaches unduly restrict negotiating flexibility?

Are there alternative or additional strategies and design principles that should be adopted to ensure that any future trade agreements deliver the maximum economic and other benefits for the Australian community?

RIRDC is of the view that preferential trade agreements are a second best option for pursuing trade liberalisation behind multilateral/unilateral trade liberalisation. However, RIRDC recognises that preferential trade agreements are a permanent fixture in the trade liberalisation area, and that effort should be made to maximise the benefits and minimise the costs. To this end, guiding principles provide an important tool.

RIRDC, in their publication *'Free' Trade Agreements: Making them Better* set out 10 features of a 'good' PTA, these being:

1. ensure that prices are reduced — the greater the price reduction, the greater the probability that the agreement will facilitate trade creation rather than trade diversion;

2. don't exclude 'problem' industries — while typically sensitive, reform in these industries can also be the most beneficial; PTAs provide a good opportunity to gently expose sensitive industries to international competition, as well as those sensitive industries delivering some of the greatest price reductions from trade liberalisation;

3. make PTAs comprehensive — no industry or sectors should be exempted from an agreement, since this creates distortions and entrenches protection and special treatment;

4. make rules of origin simple and consistent — inherent to the formation of a PTA are rules of origin which can restrict trade and increase compliance costs. RoO should be minimised and simplified to minimise this cost;

5. maximise certainty — this is achieved through consistency of rules and when trade and investment restrictions are low;

6. investment liberalisation — by including this area in PTAs, the potential benefits from the agreement are improved. Furthermore, investment liberalisation is key to services trade liberalisation;

7. avoid 'new protectionism' — there is some shift towards including issues such as intellectual property, competition laws, labour market regulations and the environment into PTAS. However since there is disagreement about how these issues should be managed it is best not to let these issues cloud the more important ones of trade and investment liberalisation;

8. transparent process, consultation and detailed analysis — transparency is important at every stage to ensure that the political motivations do not hijack the negotiations of a PTA;

9. continue commitment to WTO — PTAs should be structured such that they compliment WTO negotiations through either a sunset clause or the winding back of preferences; and

10. pursue evolutionary PTAs — to facilitate the shift of preferential agreements to free trade, PTAs should be designed to be able to include more and more economies over time.

Like those developed by APEC and WTO, these guidelines for developing a good PTA are non prescriptive but provide constructive advice on developing PTAs. PTAs have the capacity to change attitudes towards trade liberalisation more generally. For example the experience of NAFTA has spawned anti-trade attitudes among many Latin Americans, due in part from the overselling of it. In influencing the general attitude towards trade, agreements may indeed make easier, or more difficult, the ability to build support for unilateral trade liberalisation. Particularly given the well cited problem of trade reform — concentrated negative impacts, dispersed benefits — can make unilateral liberalisation politically difficult; whereas at least under a PTA Australian exporters get improve market access elsewhere.

Consequently, in recognising that PTAs are the future of trade liberalisation, steps are taken to ensuring that they achieve as much as they can, at as little cost.

How could rules of origin, or other regulations intended to enforce preferences under agreements, be changed so as to increase the benefits of trade agreements?

As discussed in '*Free' Trade Agreements: Making Them Better*, rules of origin restrict trade two ways: Firstly, because production is becoming increasingly globalised, it is becoming more difficult for products to meet the RoO requirements. Furthermore, complying with RoO increases compliance and administration costs, discouraging trade.

To decrease the costs associated with RoO, negotiating countries should strive to make them as simple and consistent as possible. A study by Estevadeordal and Suominen, found that the more restrictive product-specific RoO are, the greater the adverse impact upon aggregate trade.[13]

[13] Estevadeordal, A. and Suominen, K. 2004, Rules of Origin: A World Map and Trade Effects in *The Origin of Goods: Rues of Origin in Preferential Trade Agreements*, eds. Estevadeordal, A., Cadot, O., Suwa-Eisenmann, A. and Verdier, T., DC: Inter-American Development Bank.

Appendix A: Publications produced by RIRDC's Global Challenges Program

Within the trade policy area of RIRDC's Global Challenges Program, 22 publications have been commissioned. These are listed in alphabetical order below.

Agricultural Trade Policy Made Easy

Agricultural Export Measures in WTO Negotiations

Food Aid and Agricultural Trade Reform

Free Trade Agreements: Making them Better

Green Farm Subsidies – The Next Step in Removing Perverse Farm Subsidies

Improving Japanese Agricultural Trade Policies

Intellectual Property in Agricultural Trade

Liberalising World Trade in Agriculture – Strategies for Cairns Group Countries in the WTO

Market Access under the DOHA Round

Opening Agricultural Markets through Tariff cuts in the WTO

Opportunity of a Century to Liberalise Farm Trade

Policy Transparency – Why does it Work? Who does it best?

Preferential Trade and Developing Countries – Bad Aid, Bad Trade

Reason versus Emotion – Requirements for a successful WTO round

Reforming World Agricultural Trade Policies

Solving the Problem – A Look at the Political Economy of Agricultural Reform

Technical Issues Affecting Trade in Agricultural Products

Termites in the Basement – To Free up Trade, Fix the WTO's Foundation

Trade Liberalisation and Structural Change – Agricultural liberalisation within the European Union

Trade Policy and Developing Countries: Where to Now?

Trojan Horse or More Horsepower? Foreign Investment and the Australian Rural Economy

Why Market Access Reforms Matter

Copies of all RIRDC publications can be found at https://rirdc.infoservices.com.au/

Appendix B: Calculating tariff reductions under PTAs

PTAs involve tariff reductions that can be staged in over many years and involve different tariff reductions for different products. In order to get a complete measure of the tariff reduction an index has been developed — the PTA Liberalisation Index — that allows aggregation of this information into a single measure.

For each country, the pre-PTA tariff is taken directly from the tariff schedule at the most disaggregated tariff level possible (typically, the HS8 digit level).

The post-PTA tariff for each country is calculated for each year (at the HS8 digit level) following entry into force of the PTA and using the commitments set out in the PTA.

Commitments made sooner are more valuable than commitments made in the future, if countries are assumed to have a time preference. To account for this time preference, tariff levels in the future are discounted back to the date of the PTA entering into force, using a discount rate of 5 per cent.

The aggregate post-FTA tariff (τ) for each tariff line is then calculated using the tariff for each time period t (τ_t) following entry into force of the PTA as below.

$$\tau = \frac{\sum_{t=1}^{\infty} \frac{\tau_t}{1.05^{t-1}}}{\sum_{t=1}^{\infty} \frac{1}{1.05^{t-1}}}$$

This calculation sees us having a pre PTA tariff and a (discounted) post PTA annual tariff for each tariff line in a country's tariff schedule. A simple average is then taken across the pre and post PTA tariffs for all tariff lines to arrive at a single pre and post PTA tariff measure.

The amount of tariff reduction is then the change in pre-PTA to aggregate post-FTA tariff, divided by the pre-FTA tariff. Hence the index ranges between 0–100, with 0 being no liberalisation (of value today) being undertaken, and 100 being total liberalisation overnight.

Under this method, an agreement that liberalised tariffs by nothing for five years and then 100 per cent thereafter would receive a score of 77 per cent. The 100 per cent reduction into the future is worth a weight of only 15 of today's years (rather than infinity) due to the discounting that is applied. The method also places higher weight on those tariff lines that have high tariffs to begin with (rather than, for example, placing equal weight on a 10 per cent reduction in tariffs for each country regardless of whether the tariff was originally 100 per cent or 1 per cent).