

Canberra

6 March 2010

Ms Patricia Scott  
Presiding Commissioner  
Productivity Commission study on trade agreements  
GPO Box 1428  
Canberra City ACT 2601

Dear Patricia,

This letter provides some follow up comments from the group who provided a submission to the Commission's study into trade agreements, and to which Bill Carmichael, Denis Hussey and I spoke at our meeting with you and your colleagues last Tuesday.

Our discussion focused on why the existing **international** disciplines of the multilateral system cannot deal with the domestic pressures that have stalled progress in the Doha Round, and instead need to be reinforced by the **domestic** transparency discipline we propose. Both experience and logic tell us that the gains available from liberalising through the WTO depend on the decisions governments take at home, about their own barriers. The gains they collectively take away from the negotiating table depend on what each takes to it.

Milton Friedman rather elegantly explained this relationship between the domestic and international dimensions of trade reform nearly thirty years ago, in 1982:

*"Given that we should move to free trade, how should we do so? The method we have tried to adopt is reciprocal negotiation of tariff reductions with other countries. This seems to me a wrong procedure. In the first place, it ensures a slow pace. He moves fastest who moves alone. In the second place, it fosters an erroneous view of the basic problem. It makes it appear as if tariffs help the country imposing them but hurt other countries, as if when we reduce a tariff we give up something good and should get something in return in the form of a reduction in the tariffs imposed by other countries. In truth the situation is quite different. Our tariffs hurt us as well as other countries. We would be benefited by dispensing with our tariffs even if other countries did not. We would of course be benefited more if they reduced theirs but our benefiting does not require that they reduce theirs. Self-interests coincide and do not conflict."*

He also made it clear that he was using "tariff" to cover non-tariff impediments to trade as well as tariffs.

Because our primary focus was on the government's trade policy priority--to reinforce the primacy of the multilateral system--we gave less attention to the difficulties it now faces in pursuing that objective, as a result of the bilateral agreements it has negotiated. We have therefore prepared some further comments to confirm our response to the issues raised about those agreements during the discussion.

[1] We have been unable to identify any **trade** policy objective that bilateral and regional agreements serve that could not be pursued in a much broader context, and hence more rewardingly, through a properly functioning multilateral system. Apart from the greater rewards available from reinforcing the WTO system, the opportunity our government now has to do that would also remove the mounting costs associated with administering bilateral agreements and the mine-field of compliance costs involved for business generally. These costs were described in some detail by Ross Garnaut in an attachment to our submission.

[2] We touched briefly on the fact that other policy goals--like domestic policy governance, security and strategic issues--are often included in these agreements. All of those issues are important. On the question of governance, our proposal provides a basis for dealing directly with domestic protection and trade policy governance issues, while leaving each government in full control of domestic policy. This goes to the heart of the problem now facing the multilateral system, whose authority is limited to international disciplines. The other issues clearly merit some form of agreement, but not a bilateral or regional **trade** agreement. We believe they should be dealt with separately. They are too important to be included in **trade** agreements, and their inclusion in such agreements can create the impression of progress on trade reform when there is none. For instance, APEC covers a fairly wide range of non-trade issues that require regional cooperation. Trade reform in that forum has in recent times been swamped by the other issues, and has faltered. It is significant that the WTO charter and focus is limited to trade issues--for very good reasons. We believe those reasons should be respected in all trade forums.

[3] As pointed out by Garnaut in attachment 1 of our submission, the bilateral agreements we have negotiated to date cover the easy bits, the markets of least domestic concern to each negotiating country, and therefore the easiest to 'concede'. The hard bits, which involve adjustment for protected domestic producers in each negotiating country, remain largely outside their scope. For example, in the agreement negotiated with the United States we gained no additional access for beef (in which we **are** world competitive) for eighteen years, but secured immediate and unrestricted access to the US market for our motor vehicle industry (one of our **least** competitive industries). That outcome is clearly not consistent with our paramount domestic economic objective--encouraging those industries that **can** contribute to competitive domestic development, and hence to national prosperity. The present preoccupation with bilateral agreements has taken our eye off the main game. As the Mortimer report concluded, it has fully occupied our trade policy resources. As a result, Australia has developed no coherent response that can reinforce the primacy of the multilateral system. We believe the domestic transparency response we propose is the only way to do that. Its contribution is to help governments make nationally rewarding decisions about the hard bits--and it's the hard bits that have stalled progress in the multilateral system.

[4] It is true that some Australian firms and industries have gained substantial market access through bilateral agreements. We need to be cautious about being too easily persuaded that an increase in market access for particular firms or industries is synonymous with enhanced national economic welfare. For the reasons noted in [3], each bilateral and regional agreement will open markets for **some** Australian exports. But the substantive issue in trade policy, and the basis for our submission, is this: the justification for liberalising domestic markets (whether unilaterally or through trade negotiations) is not whether it will increase markets and profitability for **some** firms or industries, but whether it will enhance **national** prosperity and **community** welfare. As noted, the bilateral agreement with the United States improved market access for our car industry, one of our least competitive industries, but our world competitive beef industry will wait eighteen years for increased access to the US market. That is the reason for a domestic transparency process that operates outside government, is independent of private interest groups, and takes an **economy-wide** view of trade policy initiatives. Its role is to provide the information governments and communities need to make informed, and nationally rewarding, choices about trade policy issues under consideration. In the absence of that underpinning, what the **community** gains from trade initiatives will remain tenuous, as will domestic support for trade liberalisation. And governments will remain under pressure to meet the demands of domestic interest groups that depend on protection.

[5] It is true that the domestic consequences of bilateral agreements, as negotiated, are routinely assessed--usually by contracting that task to private consulting firms. But the assessments that receive the greatest public exposure, and which condition our understanding and expectations, are undertaken **before** negotiations begin. These reflect the **potential** gains at issue for Australia from the subsequent negotiations, and not their outcomes. For instance, they cannot generally include the additional administrative costs or the compliance costs for business generally, identified by Garnaut. Bill Carmichael has looked at this issue in some detail and can provide examples of how these projections have raised public expectations about the gains for Australia, expectations that have not subsequently been realised in the negotiated agreements. Recognising the difference between the **potential** gains in prospect at the outset, and the **actual** gains from the agreements as negotiated, an Australian Senate committee recommended that the Productivity Commission be required to provide the analysis needed to inform public understanding of what each agreement will **actually** achieve for Australia, before each is formally ratified. That would be a good interim measure, pending the application of that same domestic process to underpin future multilateral trade negotiations.

[6] Another issue raised in our discussion is whether models can capture all the domestic consequences of trade agreements. The value of modeling is that it helps our understanding of the economy-wide effects of trade initiatives, but it cannot generally capture all the domestic consequences. For instance, we doubt it will ever include the additional administration costs associated with the bilateral agreements Australia has negotiated, or the mounting compliance costs these involve for

business generally. It may be possible to develop other ways of bringing these consequences into account. We understand that when modeling becomes an issue in Productivity Commission inquiries the Commission conducts a roundtable peer review of the relevance and quality of the modeling involved. That is a very good discipline which might be considered as part of the current study.

One final point. If the approach we propose is on the money, it suggests that Australia's Trade Ministers have to date been very poorly advised. The advice they have had to rely on has been limited to the folly identified by Friedman, as long ago as 1982. The shortcomings of the WTO system are becoming increasingly obvious, and will not go away. Fixing them will involve a change from our present preoccupation with less comprehensive agreements, and will require sustained advocacy of domestic transparency arrangements in international forums--but not in a negotiating context. This will take time, commitment, patience and sustained effort.

Yours sincerely

David Trebeck

On behalf of the 19 authors of Submission number 5 to the Commission, listed 15 February 2010