Submission to the Productivity Commission's Review of Trade Agreements Study

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As two Canberra-based economists with a keen longstanding professional interest in trade policy, we would like to make this brief submission to assist the Productivity Commission's study on bilateral and regional trade agreements. Our wide experience as trade economists within government and beyond make us feel well qualified to do so. The submission is also built around work we have published over the last few years which is referenced below.

The undisciplined proliferation of these agreements, deceptively called free trade agreements (FTAs) when they are really preferential trade agreements (PTAs) or even more precisely, discriminatory trade agreements (DTAs), is not only to use Professor Bhagwati's word, a "pox" on the multilateral trading system, but also a "pox" on Australian trade policy.[2] Unless some common economic sense is quickly applied to re-balance trade policy to again prioritise domestic unilateral policy processes for trade reforms based on economic efficiency, Australia's economic performance will suffer long term.

Is it coincidental that at a time when DTAs are proliferating globally, with increasingly overlapping membership, resulting in a tangled network leading to greater discrimination in trade that resembles a spaghetti/noodle bowl, the WTO multilateral system has collapsed?

The answer is no! Government trade negotiators often attribute their fascination with DTAs to despair about Doha's failure to address protectionism multilaterally. They argue that in difficult times, resort to DTAs offers scope for some progress. The real story is quite the opposite – there is nothing about DTAs that can make up for the failings of the multilateral approach, and indeed, it can be seen that DTAs are afflicted to a greater degree than multilateral processes

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[2] Jagdish Bhagwati, *The Trading System in Crisis*, paper presented at the 2008 Heinz Arndt Memorial Lecture, ANU-Toyota Public Lecture Series, ANU, Canberra.

with the obscure processes and hidden devices which vested interests utilise to secure preferred treatment at community expense. That is why, viewed comprehensively, DTAs need to be regarded more often as contributing to protectionism than containing it. They are generally trade "light" i.e. contribute little real (on-the-ground) trade liberalisation in services as distinct from "on paper", and in the case of goods cut tariffs preferentially that makes any efficiency gains ambiguous at best. The Doha Round has failed, and what we are left with is to decide whether to have its funeral or push on to finalise an agreement that is already so badly compromised through negotiations that it is worth very little, and certainly no recipe for trade liberalisation and transparency. While inherent weaknesses in the WTO system, including a far too wide an agenda and diverse membership, have no doubt contributed to this situation, there is little doubt that governments' growing pre-occupation with DTAs has been a major factor. Despite what governments say, the two approaches are inconsistent. Thinking that both can be pursued simultaneously with the same high priority is a nonsense. Governments have only finite resources, and it would seem evident that if all governments had put the same financial and human resources, as well as effort and political capital, into the Doha Round instead of DTAs we would have a far better international trading regime built on transparency and non-discrimination rather than a cumbersome, non-transparent and discriminatory system. To illustrate the magnitude of the change with reference to Australia, when the DTAs in the pipeline are implemented, over three-quarters of Australia's trade will be conducted on a non-MFN basis. This mirrors world trends and is symptomatic of the crisis facing the international trading system.

And of course responding to a weak multilateral system by negotiating "undisciplined" DTAs violates a basic economic principle of good public policy that only weakens the WTO even further. That is, any problem should be itself targeted rather than going around the problem with other measures that are likely to introduce other distortions that will worsen the problem trying to be solved. If there are weaknesses in the WTO then governments should focus on reforming these rather than rushing into DTAs with their own distortions and associated problems. And for the reasons explained below, the best policy that all governments can follow which both individually maximises national welfare and strengthens the multilateral system is to implement unilateral trade-related reforms. Unilateralism and multilateralism can at least reinforce each other by adopting non-discriminatory (MFN) liberalisation while DTAs are incompatible to both and open up new mine fields. Furthermore, the only real way out of the bind the international trading system is in with the already large number of DTAs (with many more in the pipeline) is to ensure a return of focus to unilateral/multilateral MFN liberalisation to reduce the discrimination and associated adverse effects, such as trade diversion.

Professor Bhagwati has strongly supported the multilateral system and highlighted the dangers associated with DTAs as "stumbling blocks" rather than "building blocks" to freer trade, and we recommend to the PC study team his many such publications on this issue (e.g. *Termites in the Trading System: How preferential agreements undermine free trade* (2008)). More recently, ECIPE Director, Dr Razeen Sally, has also written widely on the failings of DTAs, with a particular focus on Australia's part of the world including ASEAN and Asia more generally (e.g. *FTAs and the Prospects for Regional Integration in Asia*, ECIPE Working Paper 1, 2006, and *New Frontiers in Free Trade, Globalization's Future and Asia's Rising Role*, Cato Institute, 2008).

Is it coincidental that at a time when Australia's activity in negotiating DTAs is greatest that our unilateral trade-related reforms have stalled?

Again the answer is no, and this is even more of a concern for Australia's national welfare. This point was eloquently made by Professor Ross Garnaut in his 2003 article entitled *Requiem for ULDORAMA: A Plain But Useful Life,* which clearly highlights the shift in Australia's trade policy for the worst, associated with our drift (and now stampede) into DTAs through the "death" of **U**nilateral **L**iberalisation **D**omestically, **O**pen **R**egionalism in **A**sia, **M**ultilateralism **A**broad (ULDORAMA). We commend this paper to the Commission.[3] Australia has largely dropped the ball on unilateral reforms in recent years and it is no longer the "main game" in town, despite the fact that the Commission has always urged it should be. While there are other reasons behind this, the "fetish" of successive Australian governments' with DTAs has been an important contributory factor. In part, no doubt this reflects an economic misunderstanding among trade officials of what is in Australia's best interests. The political economy of trade policy, centred on a trade minister serviced by a Department that has self interests in promoting trade negotiations (whether multilateral, regional or bilateral) as a policy, almost ensures this outcome. In a world of unilateral reforms there is less government intervention and far less of a role for trade negotiators (and trade ministers). If we are not careful Australia will return to the period before its highly successful unilateral reforms that were strongly resisted by trade officials arguing that Australia should only liberalise as part of trade negotiations (the WTO at that time) so that "we get something in return." Indeed, these flawed mercantilist concerns prompted one well known economic consultant and businessman, David Trebeck, to suggest that "DFAT is now more the problem than the solution when it comes to trade policy effectiveness….its perspective is completely wrong, and responsibility for trade

[3] Available at: http://www.rossgarnaut.com.au/Documents/Requiem%20for%20Uldorama%20-%20CEDA%20Forum,%205%20June%202003.pdf

policy should be relocated to Treasury where the economy-wide arguments and interests would receive fuller and more rigorous assessment."[4]

Australian trade policy and the decision-making framework underlying it risks becoming an unintelligible mess. Its DTAs are proliferating, and cross-membership is becoming common. This approach is clearly inefficient and undesirable. As elsewhere in the world, there is no thought here as to how Australia's DTAs will interconnect in future, and indeed the chances of this happening would seem slim. Moreover, the chances of any of these progressing to significant integration, such as a customs union with a common external tariff, are virtually zero. Australia is therefore much more likely to be burdened by this period of DTA fascination with a non-transparent and discriminatory trade regime in which trade is going to be governed by obscure negotiated trade agreements and the many distortions that they impose, such as specific rules of origin. Rather than negotiating a multitude of DTAs with many partners, including cross-membership, it would be far better to have one agreement and to ensure it remained open to new members on existing terms. This would ensure they inter-connected immediately and avoid the dangerous discriminatory layers (or "hub-and spoke" outcomes) that are now being promoted.

PACER negotiations in the Pacific are likely to be a case in point. If Australia (and New Zealand) seriously wanted to use this as a liberalising tool to also help our Pacific neighbours, they should have simply opened up CER for new members on existing terms. Building on a single agreement, especially CER which is pretty liberal, including in movement of people and having anti-dumping handled within domestic competition policy, would make more sense economically than negotiating a multitude of different island agreements. But of course that would have been politically unacceptable because it would have extended some sensitive areas of liberalisation (including labour) to other trading partners, even though to do so would be in Australia's economic interests. Thus, Australia builds up many separate agreements to meet political ends (their basic rationale) rather than advancing Australia's liberalisation. Trade policy should be about ensuring Australia uses its resources efficiently to maximize national economic welfare, and is far too important an economic instrument to be negotiated externally and become a political pawn in meeting foreign policy goals.

In view of the substantial evidence (e.g. Sally) to show that DTAs are mostly, if not almost exclusively, trade "light", with most sensitive areas where the economic gains from liberalisation are potentially the greatest either being left off the table or made subject to long

[4] David Trebeck, *The Getting of Wisdom or Grumpy Old Policy Analysts?*, paper presented to the AGM of the Australian Agricultural and Resource Economics Society, ACT Branch, 8 July 2009.

transitional arrangements, Australia and the international community is paying a high price through systemic weakening of the multilateral system and governments' commitment to unilateral reforms and getting no liberalisation benefits in return. Instead, we are ending up with less transparent and more cumbersome and distortive trade regimes around the world, including in Australia. That is, we are replacing non-discriminatory liberalizing approaches that guarantee economic benefits to those reforming with a discriminatory approach that generates at highly ambiguous economic impacts. Our own work has also found Australian DTAs to be trade light, and two such publications are attached.[5]

Moreover, in the few cases where some liberalisation has seemingly occurred, its significance is often over-stated and needs to be tempered by the discriminatory and associated impacts. For example, in the AUSFTA, by negotiating higher FDI screening limits for US investors, we now discriminate against non-US investors, which is impossible to justify economically, and there have been no moves to unilaterally extend these concessions on an MFN basis to all other foreign investors, or even it seems to offer these in the negotiations with other major investors, such as China and Japan. One of the authors of this submission, also recalls being told publicly at a conference in Bangkok by a Ford Motor executive a few years ago that an additional reason why Ford was arguing in Australia for the Government to maintain its relatively high MFN tariffs on imported cars was to preserve its tariff preferences to Australia from Thai exports under the Thailand-Australia FTA. This illustrates how DTAs can generate business opposition to unilateral MFN liberalisation to protect preferential positions and associated rents.

In closing, we would also like to strongly support the Joint Submission to the Commission on this Study by Nineteen Australian and New Zealand Business Leaders and Economists arguing coherently that bilateral agreements are no answer for anything, and that ultimately domestic transparency and unilateral reforms remain the fundamental weapon against protectionism, both in Australia and overseas. This is where governments should be putting most of their efforts i.e. opening their own economies rather than trying to open other economies.

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[5] Bosworth, M. and R. Trewin (2008), "Domestic Dynamics of Preferential Services Liberalisation – Experience of Australia and Thailand" Chapter 18 in publication entitled *Liberalising trade in services: bilateral, regional and multilateral perspectives in the 21st century*, Marchetti and Roy (eds), WTO, February 2009; Trewin, R., M. Bosworth, D. Narjoko, A. Mukherjee, A. Stoler, J. Redden, V. Donaldson, and G. Thomson (2008), *East Asian FTAs in Services: Facilitating Free Flow of Services in ASEAN?*, Final Report, REPSF II Project No. 07/004.