Comments on the Productivity Commission's Draft Research Report on Bilateral and Regional Trade Agreements

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In general I found this Draft well-reasoned, sound and comprehensive. Consequently, I comment only on a few areas which could, in my opinion, be strengthened. These are addressed under a series of headings.

Draft Recommendations

I support all of the draft recommendations with the sole exception of Draft Recommendation 2, first dot point.

Draft recommendation 2, first dot point, raises some complex issues. The main arguments for and against comprehensiveness are listed. The advocacy of sector-specific agreements by the Australian Services Roundtable is understandable in the case of the EU. However, consideration needs to be given to the weight of individual arguments.

First, it is true that the WTO law does not stipulate that agreements must address both services and in a single undertaking, as noted on page 13.6 of the Draft. This is, however, an artefact of the way in which the WTO law relating to goods and that relating to services evolved separately. The first was incorporated in Article XXIV of the original GATT 1947 and the second in the GATS Agreement Article V from the Uruguay Round. The spirit of both GATT Article XXIV and GATS Article V is that of comprehensiveness. Taken together, they imply logically (but not legally) that comprehensiveness across both sectors is desirable.

At this stage, we should seek guidance from economic theory. The theory of discriminatory trade agreements indicates that trade agreements which are restricted to sectors may be beneficial to the Member countries (see the recent work of Ohyama, 2007). This is not surprising.

However, practical considerations relating to the effects of sector-limited agreements could override this result. In particular, the signing by Australia of a bilateral or regional trade agreement restricted to one sector would signal to all possible future negotiating parties that Australia might be willing to exclude sensitive sectors from future negotiations. This would be a very undesirable outcome. In particular, potential trade partners with highly restrictive barriers to exports of Australian agricultural goods would seek to have these sectors excluded from the outset of the negotiations.

More emphasis on export benefits

More emphasis in the reports should be placed on the benefits from bilateral and regional agreements through achieving improved access to the export markets. This is not withstanding the results of the Productivity Commission's own modelling that are reported in Table 12.1. This table purports to show that Australia's unilateral movement to free trade (in terms of tariffs only) would achieve more than half of the gains to be had if the whole world moved to free trade (tariffs only). I find this implausible. Australia has one of the lowest average tariff rates in the world, and in addition, it has low peak rates. As our tariff barriers have been lowered, the importance of barriers to trade arising from other countries' restrictions on our potential exports has increased. As a reductio ad absurdum argument, if Australia's own barriers were reduce to zero across-the-board, all gains must then arise on the export side. In my view, most of the benefits of future bilateral and regional agreements must come from improved access to partner countries.

Indeed, the main justification for our seeking any new agreements lies in regionalism as a strategy for preventing the worsening of our export market access. As other second countries with which we have not signed an agreement, particularly those which are major export markets for us, sign preferential agreements with other third countries, our market access worsens. This is, of course, the domino effect at work.

This applies too if we have already negotiated a preferential agreement with the second country. It is another form of preference erosion which arises because of overlapping agreements in hub countries.

MFN Clauses

MFN clauses would preserve equal treatment in the event that a second country with which we had signed an agreement later signs an agreement with a third country or countries giving better treatment on some item(s) that were incorporated in our earlier agreement.

At first sight these clauses seem like a good idea. For our exporters, they would guarantee equal treatment when the second country's later agreement gave better market access to some third country or countries. However, we need to recognise the reciprocal nature of this commitment. We too would have to extend equal treatment to the exporters of other countries with which we had signed an agreement containing an MFN clause.

The importance of this commitment depends on all market access provisions of all of our bilateral and regional agreements. In the case of Australia, we have a bilateral agreement with New Zealand under which all tariff barriers and almost all non-tariff barriers have been reduced to zero for all tariff items. We would, therefore, be committed, under this provision, to granting any country with which we signed an agreement free access to our markets for any tariff item included in the agreement, and irrespective of whether the preferential rates on these items were themselves zero. The pattern of trade liberalisation would be haphazard. We would end up giving improved market access without equal reciprocity.

The standard arguments in favour of free trade for a small price-taking country indicate that this would be a benefit. However, our negotiating partners might not accept what would be a reduction in the market access they might get from reciprocal bilateral negotiations. It is no accident that these provisions are rarely, if ever, observed in goods trade where bilateral and regional negotiations are based on the principle of reciprocity.

Minor misstatements and omissions

I would like to note a small number of minor misstatements or omissions. These are listed as dot points:

- In chapter 9.2 and elsewhere there is discussion of the AUSFTA investment provision that resulted in the lowering of the FIRB thresholds which apply to foreign direct investment inflows from the US. It should be noted that this introduced, for the very first time, country discrimination into our FDI regulations. This is a very bad precedent. It should also be noted that the discrimination could, and in my view should, be removed by extending immediately the US thresholds to all countries.
- In chapter 8.1 and elsewhere the impact of discriminatory trade barrier reductions is posed in terms of the offsetting of trade creation and trade diversion. This is wrong. The theory of trade discrimination indicates that there are many other (static) effects of reducing tariffs and other barriers in a discriminatory way, as I noted in my submission.
- On page 4.6, it is stated that "In July 2008, agreement [in the Doha Round] was reached on a number of topics…" This is misleading. The sentence appears to refer to the Chairpersons' draft modalities for Agriculture and NAMA that were concluded at that time. These were not, however, agreements among the Members of the WTO. They were the Chairpersons' judgements of what Members might be able to agree upon after further negotiations.
- On page 6.22, it is stated that "Production and export subsidies remain outside the scope of BRTAs…" This is not correct. All subsidies that would distort trans-Tasman trade are excluded under ANZCERTA, as specified in the 1988 Agreed Minute on Industry Assistance.

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Reference

Ohyama, M. (2007), “Partial Free Trade Agreements and Economic Welfare: Reconsidering GATT Article 24”, *Review of Development Economics*, 11, 621-628.